

Amazon vs. New York and its Impact on Nexus Standards

By Art Kliewer

Due to the growth of internet sales, an increasing amount of purchases are made without sales tax collected by the seller because of the seller's lack of physical presence, or "nexus," in a particular taxing jurisdiction. Examples of online retailers that fit this model include companies like Amazon and Overstock.com. Without nexus, sellers are not obligated to register, collect, and remit sales tax in the taxing jurisdiction. Instead, the consumers become responsible to remit consumer's use tax - though this is typically only done by business entities, not individual consumers.

The inability to make sales without charging sales tax creates an inherent disadvantage to "brick and mortar" sellers because they are required to collect sales tax. As a result of the tax benefit and possible online administrative efficiencies, online retailers usually maintain an advantage when it comes to overall product pricing. Consumers have responded by purchasing more and more through internet channels. State and local taxing authorities also lose in this migration as they are not receiving tax revenues otherwise due. During these tight budgetary times, this has had a crippling impact on their revenues.

To confront these concerns, New York amended its definition of a "retailer engaged in business" to include online retailers, such as Amazon, who compensate resident representatives for referrals - thus altering the types of activities and agent relationships that can create nexus for a retailer.

In order to understand this change, let's provide a bit of historical background. Nexus is a term that defines a level of connection between a taxing jurisdiction and an entity. As mentioned above, nexus is required before a taxing jurisdiction can impose its taxes on an entity.

Nexus determination is controlled by the U.S. Constitution under the Due Process Clause and the Commerce Clause. The Due Process Clause requires a definite link or minimum connection between the state and the person, property or transaction it seeks to tax. However the Commerce Clause requires a higher level or connection. The Commerce Clause requires a substantial presence in a taxing state by the entity the state desires to tax. The United States Supreme Court, along with various state level courts, has shaped the interpretation of nexus over the history of the sales tax.

Today, most states as agree that a retailer has nexus in their state if they are "maintaining, occupying, or using permanently or temporarily, directly or indirectly or through a subsidiary, an office, place of distribution, sales or sample room or place, warehouse or storage place or other place of business." The definitions also include activities by individuals, including, "having a representative, agent, salesman, canvasser, or solicitor operating in this state under the authority of the retailer or its subsidiary on a temporary or permanent basis."

In addition to the traditional approach to nexus, some states have expanded their definition to include affiliate nexus and attributional nexus. Affiliate nexus is based on common ownership between an in-state taxpayer and an out-of-state company. There are certain activities that states will look for to determine if an in-state company is creating or maintaining a market in the state for the out-of-state company. Examples include sales solicitation, accepting returns of product, advertising, and marketing. Conversely, attributional nexus is not based on common ownership. Instead, it is based on an entity's relationship with another entity doing business in the state. In this case, the state attributes the in-state entity's nexus-creating activities to the out-of-state entity as it relates to their relationship.

In April 2008, New York enacted a statutory provision that required out-of-state internet retailers with no physical presence in New York to collect New York sales and use taxes. This provision is based on the attributional nexus theory. The new statute created a rebuttable presumption that a retailer is "engaged in business" in New York if the seller meets two requirements. First, the seller must enter into a representative agreement with a New York State resident under which, for compensation, the resident directly or indirectly refers potential customers to the seller, whether by link on an internet web site or otherwise. The second requirement is that the seller's cumulative gross receipts from sales to customers in New York State as a result of referrals by all of the seller's resident representatives total more than \$10,000 during the preceding four quarterly sales tax periods.

As a result of the New York statute, Amazon filed suit against the State alleging that the provision violated the Commerce Clause because it imposes tax collection obligations on out-of-state entities that have no substantial nexus with New York. Amazon also contended that it violated the Due Process Clause because it effectively created an irrebuttable presumption of 'solicitation' and is overly broad and vague. Amazon further contended that it violated the Equal Protection Clause because it intentionally targeted Amazon.

The New York Supreme Court held that even if all of the facts alleged by Amazon were deemed to be true, there was no basis upon which Amazon could prevail. Therefore, the Court dismissed Amazon's arguments and the lawsuit for failure to state a cause of action. The State of New York stated that the "neutral" Commission Agreement simply obligates out-of-state sellers to shoulder their fair-share of the tax-collection burden when using New Yorkers to earn profit from other New Yorkers. Overstock.com filed a similar suit and was similarly dismissed. It should be

noted that both companies have appealed their respective decisions, but it is unclear as to when the appellate court will hear the cases or what the outcome will be.

In light of the New York provision and resulting Amazon and Overstock.com case dismissals, California, Colorado, Connecticut, Hawaii, Illinois, Iowa, Maryland, Minnesota, Mississippi, New Mexico, North Carolina, Rhode Island, Tennessee, Vermont, Virginia, and Washington have introduced similar legislation or regulations. Hawaii's bill was ultimately vetoed. Legislation introduced by California, Iowa, Maryland, Minnesota, Mississippi, New Mexico, Tennessee, and Virginia have either been tabled or died. North Carolina and Rhode Island's bills were passed and signed into law. Their language is identical to New York's, though Rhode Island's statute reduces the threshold to \$5,000. It is likely that the bills which were tabled or died will be heard again in future legislative sessions.

Colorado passed legislation that does not require out-of-state retailers with in-state affiliates to collect Colorado sales taxes, but does require retailers to annually notify Colorado purchasers that they are required to file a Colorado Sales and Use Tax Return and to indicate the date, amount, and taxability of each purchase. Retailers who fail to provide this notification can be penalized \$5 for each failure. Given the number of customers, this could become a sizeable penalty. The retailer must report the same information to the Colorado Department of Revenue.

Further, the Colorado law creates a rebuttable presumption that out-of-state retailers have nexus if they are part of a controlled group of corporations where at least one member has a physical presence in Colorado. This can be overcome if the out-of-state retailer proves that an in-state affiliate did not perform solicitation on its behalf. This law applies to all sales made on or after March 1, 2010.

In response to these pieces of legislation, both Amazon and Overstock.com severed ties with their affiliates in North Carolina and Rhode Island in order to ensure that nexus was not created. Overstock.com took similar measures against its affiliates in New York. Amazon, however, decided to register and begin collecting sales tax on its New York sales. No action has been taken against the Colorado law, but due to the large burden that it places on out-of-state sellers, it is likely that it will be challenged.

Without a clear judicial decision on this issue, more states are expected to introduce, and possibly enact, legislation similar to New York, North Carolina, Rhode Island, and Colorado. Until then, on-line retailers and consumers should be aware of the possible changes ahead to nexus definitions and the corresponding impact to the future sales tax landscape.

Note: *Art Kliewer is a senior manager with [Yetter Consulting Services, Inc.](#), a tax consulting firm with technology expertise that focuses exclusively on its clients'*

needs regarding transaction taxes including sales, use, VAT and miscellaneous state and local transaction taxes.