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# TAX NETWORK

Newsletter of the Tax Procedure and Litigation Committee

Taxation Section of the State Bar of California

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## MESSAGE FROM THE CHAIR

Greetings to the Tax Procedure and Litigation Committee!

We are looking forward to seeing everyone at the upcoming 2011 Annual Meeting of the California Tax Bar & California Tax Policy Conference. For those of you who still have not registered, here are links for conference registration and hotel reservations:

[2011 Annual Meeting of the California Tax Bar & California Tax Policy Conference \(November 3 through November 5\)](#)

[The Fairmont San Jose](#)  
[170 South Market Street](#)  
[San Jose, CA 95113](#)  
(408)-998-1900

This conference should be another excellent event. We also hope that you are planning to attend our committee luncheon meeting, which will be held during the conference on Friday, November 4<sup>th</sup> (12:45 p.m. to 1:45 p.m., designated meeting room to be posted at the conference). We look forward to seeing everyone there.

Thank you for providing me the opportunity to serve as Chair. We thank outgoing Chair Robert Horwitz for his wonderful leadership during the past term and wish him well at his new role as member of the Executive Committee. I also want to acknowledge the current officers of the Committee, including Chair-Elect David Klasing, 1st

applicant, and the notice advises the applicant to file a claim for refund.<sup>39</sup>

Unfortunately, in practical terms, unless there is a distinct legal error, it is extremely difficult to get a reduction in value once the AAB has determined a value. For property tax matters, the superior court acts as an appeals court. The superior court gives questions of law de novo review, but reviews questions of fact using a substantial evidence standard.<sup>40</sup> Further, even if the taxpayer wins on a legal issue, the court merely remands the case to the AAB to correct the legal error. On many, if not most remands, after correcting the legal error, the AAB does not materially change the value. Thus, almost all of the taxpayer's effort should go into working with the assessor and the preparation of a compelling case to be presented before the AAB.

## Conclusion

In order to assure the best possible property tax result, taxpayers should consult with property tax practitioners that are experienced with the procedures and substantive issues of property tax law. An experienced practitioner will be able to use their expertise and knowledge to navigate the taxpayer through the administrative procedures, work with the assessor, and obtain the most favorable result possible.

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<sup>39</sup> *Id.* at §5097(a)(3)(B).

<sup>40</sup> *Kaiser Ctr., Inc. v. County of Alameda*, 189 Cal. App. 3d 978, 983 (1987).

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## FROM WEBSITE LINKS TO COLLECTIONS POINTS

*Annette Nellen, Esq., CPA*

If you have purchased goods from online vendors, such as eBay or Amazon.com, you probably noticed that your invoice doesn't always include sales tax. A likely reaction to this realization by many consumers is: "Wow, it's tax free, I'll keep shopping online!" Other consumers (likely a smaller group than the "wow" group) know they should keep record of this purchase so they can calculate and pay the use tax they are liable for on the purchase. No doubt, state sales tax collections are diminished when online buyers – both consumers and businesses – do not know of their use tax obligations, do not have sufficient records to compute it properly, or do not bother with it.

Growth in e-commerce transactions including online sales and the "cloud," challenge state sales tax systems that were designed for a different era. In California and several other states, the sales tax arose during the Great Depression as a way to generate revenue when traditional sources became less fruitful. In the 1930s, consumers primarily purchased tangible personal property and shopped at nearby stores. Today, consumers can easily purchase goods from online stores, some items such as music and books have moved to a digital form, and we spend more on services today than on tangible personal property.

The internet era has had adverse effects on state sales tax systems. Most notably:

- The sales tax base continues to shift from one where sellers are obligated to collect the sales tax to one where consumers must self assess and pay use tax. Consumers are not as compliant as sellers and administrative costs

increase with the number of filers.

- The sales tax base erodes as consumers spend more of their consumption dollars on services and digital goods rather than on tangible personal property. Lawmakers are often reluctant or challenged by voter and business opposition to broaden or modernize the sales tax base.

The first problem listed above is the focal point of this article. As states must continue to rely on a nexus standard set by the U.S. Supreme Court in 1992, and as e-commerce grows, some states have enacted legislation to try to broaden the reach of the 1992 standard. As of October 2011, eight states had enacted so-called "Amazon" affiliate nexus laws to try to get more internet vendors to collect sales tax so the states aren't left relying on non-compliant consumers to self-assess use tax.

The article explains the so-called Amazon affiliate nexus laws by providing some data on the problem that has led some states to become more aggressive, the actions taken in eight states, the legal issues of such actions, subsequent events, practical realities and alternative solutions to the collection problem.<sup>1</sup> These issues focus on the use tax, explained next.

### Focus on Use Tax

Soon after the enactment of a sales tax in 1933, California enacted a use tax to ensure that tax was collected on taxable purchases made by California buyers even if the seller was not legally obligated to collect the sales tax. The use tax was intended to put California retailers on "an equal footing with their out of state competitors" who were

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<sup>1</sup> Some states, including California, have enacted affiliate nexus laws that consider a vendor's connection with an in-state entity where there is some type of common ownership and the entities have similar names, products, trademarks or advertising. This type of affiliate nexus is not addressed in this article.

exempt from the sales tax because they were not located in California.<sup>2</sup> While the sales tax is imposed upon the retailer (although they may pass it on to the buyer), the use tax is legally imposed upon the buyer. As explained later, a seller without a physical presence in the state is not obligated to collect sales tax from buyers located in that state. All states with a sales tax also have a complementary use tax.

### Understanding State Concerns Via Data

In 1998, e-commerce represented less than 1% of total retail sales. The percentage has steadily increased to reach 4.6% of total sales in the second quarter of 2011.<sup>3</sup>

Various efforts have been made to estimate the amount of sales and use tax lost by the states by failure of buyers to self-assess and pay their use tax. Estimates vary due to challenges in measuring the use tax compliance of individuals and businesses, and identifying non-taxable transactions (such as some e-commerce sales that are not subject to sales tax). In December 2010, the California Board of Equalization ("BOE") estimated that approximately \$1.145 billion of use tax was not collected. BOE estimated that about 69% of this tax gap was attributable to individual consumers and the balance to businesses. BOE noted that this gap translates to an average of \$61 per California household and \$102 per California business annually.<sup>4</sup>

These figures illustrate why state lawmakers are focused on e-commerce sales. E-

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<sup>2</sup> Bank of America National Trust and Saving Association v. State Board of Equalization, 209 Cal App 2d 780, 26 Cal Rptr 348 (First App Dist 1963).

<sup>3</sup> Dept. of Commerce "E-stats" data including Table 5/Historical. U.S. Retail Trade Sales1 - Total and E-commerce: 1998-2009 and data for the second quarter of 2011;

<http://www.census.gov/retail/index.html#ecommerce>.

<sup>4</sup> California Board of Equalization, Bill Analysis, AB 155, 5/2/11.

commerce makes it easy for businesses to have a physical location in one or only a few states but customers in all 50 states. As will be discussed next, businesses only have sales tax obligations in states where they have a physical presence. The continuing growth of e-commerce means continued growth of the use tax gap. Given that the use tax is a tax already on the books, lawmakers would like to see it collected to address revenue needs rather than see rates on other taxes increased or other taxes enacted.

### **Basics of Sales Tax Nexus**

Sufficient nexus must exist in order for a state to subject a vendor to sales and use tax collection obligations. Nexus may be thought of as a connection between the vendor and state such that subjecting the vendor to the state's sales tax is neither unfair to the vendor nor harmful to interstate commerce. These two requirements of fairness to the vendor and no impediment to interstate commerce stem from the U.S. Constitution—respectively, from the Due Process Clause and the Commerce Clause. Both of these requirements must be satisfied before a state may impose sales and use tax collection responsibilities on a vendor.

*Due Process Clause:* "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws" (14th Amendment, clause 1). As further explained by the U.S. Supreme Court, "due process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax."<sup>5</sup>

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<sup>5</sup> *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 345 (1954).

*Commerce Clause:* "The Congress shall have power...to regulate commerce with foreign nations, and among the several States, and with the Indian tribes" (Article I, Section 8, clause 3). Courts often refer to the "dormant Commerce Clause" because the Commerce Clause does not specifically limit state activities—it just grants power to Congress to regulate commerce. In applying the dormant Commerce Clause, the courts consider the purpose served by the Commerce Clause and "whether action taken by state or local authorities unduly threatens the values the Commerce Clause was intended to serve."<sup>6</sup>

*Quill Corporation v. North Dakota:*<sup>7</sup> This case involved Quill, a seller of office equipment and supplies, a Delaware corporation, with offices and warehouses in Illinois, California, and Georgia. Quill did not have any property or employees in North Dakota. Quill sold office supplies and equipment to customers in North Dakota, reaching customers through catalogs mailed to them and ads in national magazines. Under North Dakota law, Quill was required to collect use tax on its sales made to North Dakota customers because Quill was engaged in regular solicitation of customers in the state. Quill challenged the North Dakota law as violating both the Due Process and the Commerce clauses.

The U.S. Supreme Court had previously addressed the "minimum connection" requirement of the Due Process Clause in 1967 in *National Bellas Hess v. Department of Revenue of Illinois*, 386 U.S. 753 (1967). In that case, the Court ruled that some type of minimum contact was necessary for a state to tax an out-of-state business. The necessary minimum contact existed if the out-of-state company had a sales office or sales personnel in the state.

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<sup>6</sup> *Wardair Canada v. Florida Dept. of Revenue*, 477 U.S. 1 (1986).

<sup>7</sup> *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992).

In *Quill*, North Dakota challenged the 1967 ruling as out of date with modern ways of doing business. Today, a company doesn't need a salesperson in a state to obtain a sale. Instead, a catalog and a mail-order sales system can be just as successful for a company. The taxing authority in North Dakota pointed out that \$1 million of Quill's \$200 million of sales were to 3,000 customers in North Dakota. Quill was also the sixth largest supplier of office supplies in the state. North Dakota argued that it had created an economic climate that helped Quill's sales, that it maintained a legal infrastructure to protect the market, and that it had to dispose of 24 tons of catalogs and other mail that Quill sent into the state each year. Per North Dakota, all of this created the requisite minimum connection to enable it to collect use tax from Quill without violating the due process clause of the U.S. Constitution.

North Dakota was partially successful in its argument that the *Bellas Hess* nexus standards were outdated. The Court called its earlier tests too formalistic and that for due process purposes, it would be more appropriate to not focus on physical presence, but to instead look at whether the company's contacts with the state make it reasonable for the state to require the company to collect use tax. In *Quill*, the Court stated that if an out-of-state business purposefully avails itself of the benefits of an economic market in the state, it need not have a physical presence in the state for tax collection.

Despite the Court's relaxation of the due process physical presence requirement, the Court found North Dakota's enforcement of the tax against Quill an unconstitutional burden on interstate commerce in violation of the Commerce Clause. However, the Court pointed out that because the Constitution gives Congress the right to regulate interstate commerce, Congress could provide a mechanism to allow states to collect sales and

use tax from an interstate mail-order business not physically present in the state, without violating that clause.

*Physical presence questions:* A common issue in compliance, audits and litigation is how much and what type of physical presence is needed for a business to have nexus for sales tax purposes. A discussion of this extensive case law on this issue is beyond the scope of this article. However, to get a sense of the type of issues that arise in the e-commerce realm and why the "Amazon laws" have been challenged in some states as unconstitutional, a sampling of cases is summarized below.

- *More than the slightest presence:* Quill had a few diskettes in North Dakota, but they were not viewed as a sufficient presence for tax purposes. Per the Court: "The State 'concedes that the existence in North Dakota of a few floppy diskettes to which Quill holds title seems a slender thread upon which to base nexus.'" Brief for Respondent 46. We agree. Although title to 'a few floppy diskettes' present in a State might constitute some minimal nexus, in *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 556 (1977), we expressly rejected a " 'slightest presence' standard of constitutional nexus." We therefore conclude that Quill's licensing of software in this case does not meet the "substantial nexus" requirement of the Commerce Clause."<sup>8</sup>

- *Nature of the in-state activity:* In *Tyler Pipe Industries v. Dept. of Revenue*, 483 U.S. 232 (1987), the Court stated: "'the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.'"

- *Agents and representatives:* In *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), a

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<sup>8</sup> Quill, *supra*, footnote 7.

Georgia vendor had no property or operations in Florida. The vendor did, though, have ten commissioned salespeople (contractors) in Florida. The Court held that such continuous solicitation in Florida was sufficient to constitute "substantial nexus" such that Scripto was obligated to collect Florida use tax on its sales in that state.

- *Contracts without agency status:* An unpublished opinion in California, *JS&A Group, Inc. v. BOE* (Docket No. A075021, CA Court of Appeal, 1994) involved an Illinois vendor selling via direct mail order and cable television ads. The vendor had no property or employees in California, but did have contracts with broadcasters and cable operators in California. State auditors found that such contracts were enough to establish nexus. The court disagreed. In contrasting the facts to *Scripto*, the court stated:

"We see no analogy between Scripto's relationship with a fleet of salespersons continually soliciting on its behalf within the state, taking orders and receiving commission based upon their sales and who acted as the functional equivalent of a local sales force, and JS&A's contractual relationship with broadcasters and cable operators to air advertisements. The broadcasters and cable operators did not solicit or accept orders on behalf of JS&A. Nor did they collect payments, distribute product, or receive any commission or other compensation based upon sales they made on behalf of JS&A, because they made none. Instead, as part of their own business operations, i.e., airing programming and commercial advertisements, they aired commercials for JS&A, as one of many clients, and received payment for the commercial air time. They were engaged in their business of advertising, which by its nature, has the incidental effect of informing potential customers about the products available, which may in turn lead to more business for the entities that purchase such air

time. The fact that a broadcast or cable operator contracts to air a commercial that promotes a product does not convert the broadcaster into an agent, or sales representative of the out-of-state retailer who purchases air time."

Thus, the court found that the vendor had no physical presence in California and that portions of RTC Section 6203 were unconstitutional.

- *Separate entities without agency:* *Current, Inc. v. SBE*, 24 Cal. App 4th 382 (1994), held that a remote seller could not be treated as having nexus due to the physical presence of a parent corporation where the corporations were separate and distinct entities. Per the court, the parent and subsidiary "did not have integrated operations or management," "were organized and operated as separate and distinct corporate entities," and, "neither ... was the alter ego or agent of the other for any purpose." Thus, we find Current's physical nexus with the State of California insufficient to justify the imposition of a use tax."

### **New York Takes Presumptive Action**

In April 2008, New York enacted legislation<sup>9</sup> to improve use tax collection on e-commerce sales by attempting to get some remote vendors to collect the tax. The law broadened the definition of "vendor" (Tax Law §1101(b)(8)) to presume that sellers are soliciting business and therefore required to collect use tax if, per an agreement, they compensate New York residents for directly or indirectly referring potential customers. Referrals may be made through a website or other means. The presumption only applies to vendors with over \$10,000 of sales to New York customers made via the referrals in the prior four quarters. Vendors may rebut the presumption by showing that the residents did

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<sup>9</sup> Part OO-1 of Chapter 57 of the Laws of 2008.

not solicit sales in New York for them.<sup>10</sup> Unlike later states that followed New York's lead, the New York legislation provided amnesty for those who registered due to the law change.

The legislation was estimated to generate \$50 million in 2008/2009.<sup>11</sup> Despite the positive revenue, this was not a new tax or a rate increase or base broadening. Instead, the revenue estimate represented revenue the state now hoped to collect from remote vendors that should have been remitted as use tax by New York customers, but was not so remitted.

Soon after enactment of the affiliate nexus law, the New York State Department of Taxation and Finance issued two rulings explaining how the new rule operates and how a vendor could rebut the presumption of solicitation. This guidance also provided that if affiliates are compensated on a fixed fee per click for having the vendor's link on their website (rather than a commission based on

any purchase made), the new law does not apply to the vendor.<sup>12</sup>

### **Vendors Respond to the New York Law**

Soon after enactment of the presumptive presence and solicitation law, Amazon and Overstock.com filed complaints challenging the constitutionality of the new provision.<sup>13</sup> Amazon argued it had no physical presence in New York as required for sales tax collection. In addition, Amazon argued that its "associates" (those with the Amazon links on their websites, entitled to commissions for purchases made by Amazon customers who started with the Associate's link) only performed advertising, not sales solicitation. Despite the challenge, Amazon started to collect sales tax in New York. In contrast, Overstock.com cancelled its agreements with its New York affiliates so that it was no longer subject to the broadened definition of vendor.<sup>14</sup>

The trial court opinion was issued in January 2009.<sup>15</sup> The court dismissed the claims for failure to state a cause of action in that the companies could not prevail to find the law unconstitutional. The court observed that "it is not irrational to presume that at least some of them [the affiliates] will actively solicit business for the remote seller from within the State from others within the State." The court also highlighted the importance of the rebuttable presumption. Per the court:

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<sup>10</sup> Key elements of the new language added to New York Tax Law at Section 1101(b)(8): "a person making sales of tangible personal property or services taxable under this article ("seller") 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 under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website 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. This presumption may be rebutted by proof that the resident with whom the seller has an agreement did not engage in any solicitation in the state on behalf of the seller that would satisfy the nexus requirement of the United States Constitution during the four quarterly periods in question."

<sup>11</sup> New York State Division of the Budget, 2008-09 Enacted Budget – New Initiatives; [http://www.budget.ny.gov/pubs/archive/fy0809archive/enacted0809/0809Budget\\_NewInitiatives.html](http://www.budget.ny.gov/pubs/archive/fy0809archive/enacted0809/0809Budget_NewInitiatives.html).

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<sup>12</sup> TSB-M-08(3)S (5/8/08) and TSB-M-08(3.1)S (6/20/08); [http://www.tax.ny.gov/pubs\\_and\\_bulls/memos/sales\\_memos.htm](http://www.tax.ny.gov/pubs_and_bulls/memos/sales_memos.htm) - 2008.

<sup>13</sup> Saul Hansell, "Amazon Sues Over State Law on Collection of Sales Tax," New York Times, 5/2/08; <http://www.nytimes.com/2008/05/02/nyregion/02amazon.html>.

<sup>14</sup> Anne Broache, "Amazon to collect N.Y. sales tax; Overstock drops out," CNET News, 5/15/08; [http://news.cnet.com/8301-10784\\_3-9944934-7.html](http://news.cnet.com/8301-10784_3-9944934-7.html).

<sup>15</sup> Amazon.com v. New York State Dept. of Taxation and Finance, 2009 NY Slip Op 29007 (Sup. Ct. 2009).

"Out-of-state sellers can shield themselves from a tax-collection obligation by altogether prohibiting in-state solicitation activities referring to them or encouraging sales on their behalf that would subject them to a tax-collection requirement and, as a condition of compensation, requiring that their New York contractors attest to compliance. To the extent that the exercise may be burdensome, it is a cost of doing business associated with the decision to contract with New York residents and offer them incentives for bringing them sales when such an arrangement is profitable to the vendor."

The vendors appealed and a decision was issued in November 2010.<sup>16</sup> The court noted that solicitation must exist, rather than passive advertising. The court noted that the commission arrangement for compensating affiliates encouraged solicitation. Despite finding validity in the state's approach, the court remanded the case to give the taxpayers an opportunity to "develop a record which establishes, actually, rather than theoretically, whether the in-state representatives are soliciting business or merely advertising on their behalf."

### **Copycat States**

As of October 2011, eight states have enacted so-called "Amazon" affiliate nexus laws. However, the statutory language and approach is not identical in each state. Table A on the next page provides a summary of the laws in these states, shown in order of enactment. A summary of some differences and likely issues that may result is summarized below.

- *Additional Sales Requirement:* In addition to the standard (although not

consistently adopted) \$10,000 sales threshold for in-state sales tied to affiliates, California law includes a requirement that the vendor have over \$1 million of in-state sales. This amount had been \$500,000 in the original legislation.<sup>17</sup> This additional sales threshold aims to make the broadened nexus rule applicable to larger vendors. Without this threshold, many people selling goods on eBay, a California-based company, would be subject to sales tax collection in California because they pay a commission to eBay which has the vendor's links on its website.

- *Rebuttable Presumption:* Two states, Illinois and Connecticut, did not include rebuttable presumptions in their statutes. This may prove problematic. In the New York litigation, the trial and appeals court suggested that the rebuttable presumption helped support a finding that the legislation was not unconstitutional.

- *Scope of the Affiliate In-State Activity:* The description of what the in-state affiliate does to make the statute applicable to the remote vendor varies among the states. For example, in California, RTC Section 6203(c)(5)(A), as modified provides: "Any retailer entering into an agreement or agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, *whether by an internet-based link or an internet Web site, or otherwise...*" (emphasis added).

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<sup>16</sup> Amazon.com, LLC v New York State Dept. of Taxation & Fin., 913 NYS2d 129, 2010 NY Slip Op 07823 (App Div, First Dept., 11/4/10); [http://www.nycourts.gov/reporter/3dseries/2010/2010\\_07823.htm](http://www.nycourts.gov/reporter/3dseries/2010/2010_07823.htm).

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<sup>17</sup> The first version of California's affiliate nexus law was ABX1 28 (Chapter 7). This legislation was replaced with AB 155 (Chapter 313).

Table A

	NY	NC	RI	IL	AK	CT	VT	CA
Threshold 4-quarter sales amount; other	\$10,000	\$10,000	\$5,000	\$10,000	\$10,000	\$2,000	\$10,000	\$10,000 + > \$1 million in-state sales
Solicitation presumption rebuttable?	Yes	Yes	Yes	No	Yes	No	Yes	Yes
Effective date	6/1/08	8/7/09	7/1/09	7/1/11	10/24/11	7/1/11	When 15 other states adopt	9/15/12 (1/1/13 if federal law enacted)

In contrast, the Illinois revised statute reads:<sup>18</sup> "Beginning July 1, 2011, a retailer having a contract with a person located in this State under which the person, for a commission or other consideration based upon the sale of tangible personal property by the retailer, directly or indirectly refers potential customers to the retailer *by a link on the person's internet website.*" (emphasis added)

A lawsuit filed in June 2011 by the Performance Marketing Association in the U.S. District Court for the Northern District of Illinois states, among other challenges, that the "Amazon" law in Illinois violates the internet Tax Freedom Act because it a discriminatory tax on e-commerce.

### Other Approaches

A few states have adopted alternative approaches to improve use tax collections on

e-commerce sales that also involve actions by remote vendors. Colorado took the lead on this approach by enacting legislation in 2010 that required certain remote vendors to provide use tax information to Colorado customers and information reports to certain customers, with a copy to the state tax agency. Penalties apply for non-compliance.<sup>19</sup> The Colorado Department of Revenue provided the specific on operation of this law. Basically, remote vendors with over \$100,000 of sales to Colorado customers must provide "transactional notice" for each purchase. In addition, for customer with over \$500 of annual purchases, the vendor must provide an "annual customer report."<sup>20</sup>

The Direct Marketing Association brought an action to enjoin enforcement of the Colorado law. A preliminary injunction was granted in

<sup>18</sup> Illinois Public Act 096-1544 (2011); <http://www.ilga.gov/legislation/publicacts/fulltext.asp?name=096-1544>.

<sup>19</sup> HB10-1193 (2/24/10); [http://www.leg.state.co.us/clics/clics2010a/csl.nsf/fsbillcont3/B30F574193882B4B872576A80026BE0C?Open&file=1193\\_enr.pdf](http://www.leg.state.co.us/clics/clics2010a/csl.nsf/fsbillcont3/B30F574193882B4B872576A80026BE0C?Open&file=1193_enr.pdf).

<sup>20</sup> Colorado Dept. of Revenue FYI Sales 79.

January 2011. The rationale for the court's decision included that the law was discriminatory in requiring out-of-state vendors to do something in-state vendors did not have to do. Also, alternative approaches for collecting use tax, such as having a use tax line on state income tax forms, was available. The court also observed that if the law was later found to be unconstitutional, the vendors who complied would not be able to get their compliance costs back.<sup>21</sup>

Both Oklahoma and South Dakota followed Colorado's lead, but with modifications. These two states only require the transactional notice to in-state customers and there is no penalty for failure to comply.<sup>22</sup>

### **Better Solutions to E-commerce Sales and Use Tax Collection**

The affiliate nexus approaches discussed in this article are not the answer to state efforts to improve sales and use tax collection on e-commerce sales. These laws only potentially apply to remote vendors with affiliate arrangements that do not cancel such arrangements to avoid application of the law. In addition, there are constitutional issues with the approaches.

Alternatives to improve tax collection on e-commerce sales include the following possibilities.

- Improve use tax collection efforts by educating consumers about the use tax and providing simple collection procedures. For example, states can use "look-up" tables which allow the consumer to determine their use tax liability based on their income. Alternatively, the consumer can keep records to measure their exact use tax liability.

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<sup>21</sup> The Direct Marketing Association v. Roxy Huber, Dir., CO Dept of Revenue, No. 10-cv-01545-REB-CBS (1/26/11).

<sup>22</sup> Oklahoma, HB 2359 (June 2010) and South Dakota, SB 146 (2011).

California has adopted the look-up table approach starting with 2011 returns.<sup>23</sup>

- States can also consider technology-based solutions. For example, states can make arrangements with vendors to have the customer's credit card or Paypal account charged for the sales tax at the time of sale. This approach eliminates recordkeeping and filing for both the vendor and consumer and enables the states to get their money immediately. The states would also have to pay the credit card processing fee, rather than the vendor, further reducing costs for vendors.

- State tax agencies can look for possible nexus points vendors might have in a state. Even without special affiliate nexus legislation, if an agent or representative is soliciting sales for a vendor in the state, existing state statutes are likely to be sufficient to allow the tax agency to enforce sales tax collection responsibilities on the vendor.

- States can adopt uniform sales tax laws to simplify sales tax compliance for vendors. In 2000, several states started this approach in a project known as the Streamlined Sales and Use Tax Agreement ("SSUTA"). It includes standardized definitions and administrative procedures. In addition, software and third party collector options are available. A state must modify its statute to conform to the SSUTA to become a member state. At October 2011, there were 21 member states. The SSUTA does not include a simplification that many vendors would like to see, one-rate per state. Instead, local jurisdictions can have their own rate, but not their own base.<sup>24</sup>

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<sup>23</sup> SB 86 (Chapter 14, 2011). For individual purchase of \$1,000 or more, the actual use tax must be added to the table amount. It is estimated that the look-up table will generate \$10.6 million annually. See approved 2011 look-up table in BOE news release of 7/26/11.

<sup>24</sup> Information on the SSUTA is available at <http://www.streamlinedsalestax.org/>.

Members of the SSUTA hope that Congress will enact legislation that, in effect, reverses the *Quill* decision for them, thereby allowing them to collect sales and use tax from remote vendors. Recently, the SSUTA Governing Board has started to explore challenging *Quill* on its own due to inaction by Congress.<sup>25</sup>

- Congress can reverse the *Quill* decision to allow states to collect use tax from remote vendors. This type of proposal has been proposed multiple times over the past several sessions of Congress. In the 112th Congress, H.R. 2701 and S. 1452, the Main Street Fairness Act, would allow states that have adopted the SSUTA to collect sales tax from remote vendors. Small vendors would be exempted (the proposal does not provide a dollar amount for this threshold).

A proposal by Congressman Womack is similar to H.R. 2701 and S. 1452, except that it provides for tax collection at a uniform rate throughout the state.<sup>26</sup>

### Looking Forward

Despite the reality that the so-called "Amazon" affiliate nexus laws can be avoided by cancelling affiliate arrangements, states are likely to continue to consider enacting such laws. Main street retailers and multichannel vendors continue to encourage Congress to enact legislation to enable states that have adopted the SSUTA to collect from remote vendors.

The legislative activity in California in summer of 2011, which led to postponement of the effective date of the affiliate law, also led Amazon to say it would work with Congress and the states to find a federal

solution to the problem.<sup>27</sup> While it would seem that with states, thousands of vendors, and Amazon pushing for a federal solution, we'd see one enacted, resolution will likely wait due to the complexity of the issue and a busy congressional agenda. In the meantime, states would be well-served educating their residents about the use tax.

For more information and links to information on this topic, please visit Annette's affiliate nexus website at:

[http://www.cob.sjsu.edu/nellen\\_a/affiliate\\_nexus.html](http://www.cob.sjsu.edu/nellen_a/affiliate_nexus.html).

Annette's general tax website and blog is: [www.21stcenturytaxation.com](http://www.21stcenturytaxation.com)

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## FEDERAL AND STATE TAXATION OF INTERNET GAMBLING; DEPOSIT TAX VS. GROSS GAMING REVENUE TAX

*Sanford Millar, Esq., MB*

California has been considering various approaches to legalization of Internet based gambling. The most recent efforts include two bills, SB 40 ("Correa") and SB 45 ("Wright"). The bills differ in what form of

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<sup>25</sup> "Working Group to Study Overturning *Quill*," *State Tax Notes*, 10/10/2011, Vol. 62, No. 2, page 70.

<sup>26</sup> Copy of the legislative proposal available at <http://www.taxfoundation.org/files/womack-speier.pdf>.

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<sup>27</sup> Janet Novack, " Amazon Deal To Collect California Sales Tax Passes," *Forbes*, 9/10/11; <http://www.forbes.com/sites/janetnovack/2011/09/10/amazon-deal-to-collect-caifornia-sales-tax-passed/>.