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## California Becomes Seventh State to Adopt "Amazon" Tax on Out-of-State Online Sellers

By  
*Joseph Henchman*

### Introduction

Beginning July 1, California's "Amazon" law goes into effect. Named after their most visible target, these laws deem an out-of-state company to be an in-state company for sales tax collection purposes if the company receives commissioned referrals from in-state resident "affiliates." The out-of-state company must then collect sales tax for the state. While 21 states have considered "Amazon" laws in the past three years, only seven have enacted them: Arkansas, California, Connecticut, Illinois, New York, North Carolina, and Rhode Island (see Table 1).<sup>1</sup>

[Our recent Special Report on Amazon tax laws<sup>2</sup> explains](#) why they expand state taxing authority in a manner likely to invite extended litigation, and that in every state, they have failed in their twin objectives of collecting additional revenue and creating a level playing field between brick-and-mortar and remote sellers.

### "Amazon" Tax Laws Seek to Expand State Taxing Authority

States are constitutionally barred from forcing retailers with no property or employees in the state to collect state sales and use taxes. Otherwise, the U.S. Supreme Court has held, there is a serious threat to interstate commerce as states try to impose thousands of state- and local-level sales taxes, each with different rules. States are frustrated with this limitation of their ability to tax sales made out of state to in-state residents, and have sought federal legislation to overrule it, known as the Main Street Fairness Act.

Rather than joining this effort or acquiescing to the Supreme Court's ruling, New York and other states have chosen to defy it in enacting these "Amazon" taxes. Supporters seek to build upon a series of Supreme Court cases where the Court permitted states to tax companies if their presence in the state depended on independent contractors who made sales. However, the Court described that situation as the "furthest extension" of state taxing power, and affiliates do not engage in direct solicitation nor are they crucial for Amazon.com's market in states. (In New York, for example, their referrals are only 1.5% of the company's sales.)

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*Joseph Henchman is Vice President of State & Legal Projects at the Tax Foundation.*

<sup>1</sup> Colorado has adopted a modified form that has an expanded nexus definition but relies on disclosure obligations instead of mandating collection.

<sup>2</sup> Joseph Henchman, "Amazon Tax' Laws Signal Business Unfriendliness And Will Worsen Short-Term Budget Problems," *Tax Foundation Special Report* No. 176, March 18, 2010, <http://www.taxfoundation.org/research/show/25949.html>.

The California law, for instance, expands the scope of state taxing power not only to out-of-state businesses with affiliates, but also out-of-state businesses that sell items designed by a subsidiary in the state, and gives ambiguous authority to the state Board of Equalization to extend the tax obligation to others at its determination.

In short, a state adopting these laws is using the weak link of an out-of-state retailer's relationship with an in-state referrer to claim the power to exercise its taxing authority over that out-of-state retailer. It thus claims a significant expansion of state taxing power to an extent where it likely exceeds what is constitutionally permissible.

### **“Amazon” Tax Laws Have Resulted in Extended Litigation**

Litigation over the New York law has been ongoing for three years, with no clear resolution in sight. (While the “New York Supreme Court” upheld the law, this is just New York's term for its trial-level court. The higher appellate court issued a mixed opinion, returning the case to the trial judge; the case may be appealed to New York's highest court, the Court of Appeals.)

Seeking to avoid litigation and the negative effects on in-state affiliates, Colorado passed a related law that emphasized a duty to disclose use tax liability to consumers, rather than requiring collection by out-of-state vendors. The law's disclosure requirements, however, were draconian and designed to force collection. A federal court has struck down the Colorado law as unconstitutional, and another federal court has struck down a similar North Carolina regulation as unconstitutional.

### **“Amazon” Tax Laws Have Failed to Collect Additional Revenue and Have Caught In-State Affiliates in the Crossfire**

Proponents of the California claim that the law will raise \$200 million per year in tax revenue, but no windfalls have been forthcoming in other states with identical laws. This is often because online companies respond to Amazon tax law enactments by ending their affiliate programs. In-state persons who earn income from referring potential customers lose that income source.

Rhode Island revenue-analysis office head Paul Dion stated in December 2009 that the six-month-old law had collected no revenue.<sup>3</sup> An affiliate trade group believes that Rhode Island has seen less tax revenue come in because the elimination of the affiliate program reduced income and thus income tax collections.<sup>4</sup> State Treasurer Frank Caprio echoed this, saying, “The affiliate tax has hurt Rhode Island businesses and stifled their growth, as they've been shut out of some of the world's largest marketplaces, and should be repealed immediately.”<sup>5</sup>

North Carolina has also not seen additional revenue from the law. Illinois has seen an outflow of Internet-related businesses after its law's passage. While New York is collecting revenue, it is because Amazon.com is collecting taxes under protest while the issue is litigated. If New York loses the case, it will have to refund those collections to taxpayers.

State residents are the intended beneficiaries of state services, and residents should be willing to pay for services if they are desirable. Use taxes and taxes that out-of-state companies are forced to collect may be politically desirable

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<sup>3</sup> Ted Nesi, “Amazon tax' has not generated revenue,” *Providence Business News* (Dec. 21, 2009), [http://www.pbn.com/detail.html?sub\\_id=2976531d0961&page=1](http://www.pbn.com/detail.html?sub_id=2976531d0961&page=1).

<sup>4</sup> Shawn Collins, “Advertising Tax Generates Zero Taxes in Rhode Island,” *AffiliateTip.com* (Feb. 2, 2010), <http://affiliatetip.com/news/article003119.php>.

<sup>5</sup> David Sims, “Virginia Advances Online Sales Tax Despite Track Record,” *TMCNet* (Feb. 11, 2010), <http://voice-quality.tmcnet.com/topics/phone-service/articles/75297-virginia-advances-online-sales-tax-despite-track-record.htm>.

because they create the appearance that tax burdens are being shifted away from residents, but states should instead look to other revenue sources that have a track record of being effective.

### **“Amazon” Tax Laws Do Not Create a Level Playing Field**

Tax systems should aim to treat like transactions alike, whether the seller is remote or in-state. In arguing for “Amazon” tax laws, in-state retailers make the compelling argument that they must collect sales taxes while competing against businesses that do not have that obligation. But “Amazon” tax laws do not level that playing field. Instead, they create a three-fold unequal tax structure:

- In-state brick-and-mortar businesses must collect sales tax based on where the *business* is located.
- Out-of-state online businesses must collect sales tax based on where the *in-state customer* is located.
- In-state online businesses face no additional obligation beyond collecting sales tax on in-state sales.

All out-of-state online retailers subject to the law, no matter their size, are obligated to track 8,000+ sales tax jurisdictions, which have been growing recently at the rate of several hundred per year. While software can be purchased for rate lookup, jurisdictions vary widely in what they tax and exempt, and even how they define items. Further, all these rules constantly change and (contrary to common assumptions) are not aligned with five-digit or even nine-digit zip codes. States have also been aggressive at setting low or no thresholds for the amount of sales activity that subjects a company to the collection obligation.

Some proponents concede that although these laws do not raise revenue and result in extended litigation, they are good policy because they “send a message” that something must be done about remote tax collection. The state tax academic and policymaking community is divided on this strategic question, but most believe that the issue is best resolved by Congress or the courts, not through state efforts to avoid complying with a Supreme Court ruling with which they disagree.

### **Conclusion**

“Amazon” tax laws such as the one California has enacted are poor tax policy and likely unconstitutional. Some possible amendments to obviate these flaws include:

- Require that in-state affiliates be the source of a majority of the out-of-state seller’s sales in the state for the collection obligation to be effective.
- Set a *de minimis* threshold of \$1 million or more of in-state referred sales for the law to apply to a particular out-of-state company.
- Replace the collection obligation with a requirement that the out-of-state vendor notify the customer by e-mail that a use tax obligation may exist.
- Treat out-of-state and in-state online businesses alike by forcing in-state businesses to collect each jurisdiction’s respective sales tax on all their out-of-state sales.
- Switch to an origin-based system whereby all California businesses must collect California sales tax on their sales, regardless of where the customer is, and urge other states to follow the lead.
- Exempt the in-state online sales by brick-and-mortar retailers from the state sales tax.

**Table 1: “Amazon” Tax Law Bill Introductions and Enactments**

2008	2009	2010	2011 (as of June 3)
New York (enacted)	California (passed but vetoed) Connecticut Hawaii (passed but vetoed) Maryland Minnesota New Mexico North Carolina (enacted) Rhode Island (enacted) Tennessee	Colorado (enacted in modified form, struck down by federal judge) Connecticut Illinois Iowa Maryland Mississippi New Mexico Vermont Virginia	Arizona Arkansas (enacted) California (enacted) Connecticut (enacted) Hawaii Illinois (enacted) Louisiana (passed by Legislature, pending with Governor) Massachusetts Minnesota Mississippi Missouri New Mexico Tennessee Texas (passed but vetoed) Vermont (passed by Legislature and pending with Governor; will not take effect unless 15 other states have such a law)

Source: Tax Foundation survey of state legislation.

*Note: Not included are repeal proposals in North Carolina and Rhode Island.*

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National Press Building  
529 14th Street, N.W., Suite 420  
Washington, DC 20045  
202.464.6200  
www.TaxFoundation.org

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