

Amazon.com and Overstock.com v. New York State Department of Taxation and Finance

Cases No. 33 and 34, New York, 28 March 2013

The New York Court of Appeals held that New York's 'Amazon Law' is facially constitutional, with implications for out-of-state retailers.

The New York Court of Appeals (the state's highest court) held that New York's 'Amazon Law' is facially constitutional. The law creates a presumption that a retailer is doing business in New York and must collect New York sales and use tax if the retailer contracts with New York residents who link to the retailer's website.

Background

Under New York law, 'vendors' are required to collect sales and use tax. In 2008, New York amended the definition of the term 'vendor' to create a rebuttable presumption that an out-of-state retailer is a 'vendor' if the retailer: (1) enters into an agreement with a New York resident for which the New York resident is paid a commission; (2) the New York resident links to the retailer's website; and (3) the cumulative gross receipts from such New York resident referrals exceeds \$10,000 over the prior four quarterly periods.

When this amendment was enacted, it was widely understood that it targeted Amazon, an out-of-state retailer that was not collecting New York sales and use tax and that was contracting with New York residents who operated webpages that linked to the amazon.com website.

It might be asked why the statutory amendment did not simply require that all out-of-state retailers collect New York sales and use tax. The answer is that such a statute would be unconstitutional under United States Supreme Court precedent. In 1992, the Court held that an out-of-state retailer cannot be forced to collect a sales or use tax in a state unless the retailer has a 'physical presence' (employees or property) in the state. Other United States Supreme Court opinions make clear that a salesperson's 'physical presence' in a state can be attributed to an out-

of-state retailer.

From this case law, two principles emerge. First, a retailer cannot ordinarily be forced to collect sales/use tax if it has no physical presence in a state. Second, a retailer can be forced to collect sales/use tax in a state if it has a sales representative working for it in that state.

New York's Amazon Law was designed with these two principles in mind. Its point is to create a presumption that New York resident website operators linking to retailer websites for a commission are functioning like salespeople. That presumption can be rebutted by showing that such individuals are not performing any active solicitation activities in New York on behalf of the out-of-state retailers from which they receive commissions.

Shortly after the Amazon Law was enacted both Amazon and Overstock filed complaints in New York Supreme Court challenging the facial constitutionality of the law. The complaints argue that: (1) the Amazon Law is inconsistent with United States Supreme Court case law holding that a retailer cannot be forced to collect a sales/use tax in a state unless it has a physical presence in that state; and (2) the presumption created by the Amazon Law is effectively irrebuttable and thereby produces a Due Process Clause violation.

These arguments were unsuccessful at the New York Supreme Court and Appellate Division levels. Accordingly, Amazon and Overstock appealed to New York's highest court.

The Court's Decision

In its decision, the New York Court of Appeals first noted that legislative enactments enjoy a strong presumption of constitutionality. The burden was therefore on Amazon and

Overstock to show either that there was 'no set of circumstances' under which the Amazon Law would be valid or to show that the Amazon Law lacked a 'legitimate sweep.'

The court noted that it had previously considered whether a mail order retailer could be forced to collect New York sales and use tax due to having a salesperson that solicited sales on its behalf in New York. In that case, the court concluded that the mail order retailer could be required to collect New York sales and use tax, because the 'slightest presence' in New York was enough to give rise to a sales/use tax collection responsibility, including the presence of a salesperson.

In accordance with that prior decision, the Amazon Law was ruled constitutional. 'Essentially, through these types of affiliation agreements [with in-state residents], a [retailer] is deemed to have established an in-state sales factor. Viewed in this manner the statute plainly satisfies the...nexus requirement...The bottom line is that if a [retailer] is paying New York residents to actively solicit business in this State, there is no reason why that [retailer] should not shoulder the appropriate tax burden. We will not strain to invalidate this statute...'

With respect to the Due Process Clause challenge to the presumption, the court wrote that it was 'rational' to presume that residents paid a commission for referrals would actively solicit customers. In the court's view, New Yorkers paid a commission for generating sales by linking to a website possessed an economic incentive to drive their friends and colleagues to the website; accordingly, it was rational for the Amazon Law to presume that they would function like salespeople.

That presumption, according to the court, was not irrebuttable. To

the contrary, retailers could rebut the presumption by: (1) contractually prohibiting resident website operators from engaging in solicitation activities; and (2) obtaining certification from resident website operators that no such solicitation activities had taken place. The court noted that obtaining this information may be a burden, but that burden did not render the statutory presumption unconstitutional.

A dissent was filed for the case. The dissent generally agreed with how the majority framed the issue - the dissent agreed that what needed to be resolved was whether website operators paid a commission are the equivalent of sales agents. However, unlike the majority, the dissent viewed the website operators, not as akin to salespeople, but as akin to passive advertisers. Further, the dissent thought that the statutory presumption (that all website operators are functioning like salespeople) was so strained as to be unconstitutional.

Commentary

It is important not to overstate the holding's significance. The holding does not stand for the proposition that all internet retailers must collect New York sales and use tax. The Amazon Law (and its constitutionality) is only of immediate relevance to retailers that contract with website operators that link to the retailer's website (i.e., retailers with affiliate marketing programs).

The opinion only addresses the facial constitutionality of the Amazon Law. While the statute was ruled facially constitutional, that would not bar an argument that the statute is unconstitutional as applied to a particular retailer. Additionally, any retailer, including Amazon or Overstock, could introduce evidence to rebut the

statutory presumption that the website operators are functioning like salespeople.

It would not be surprising if Amazon and Overstock were to petition the United States Supreme Court to review the case. Over the last twenty years, the Court has rarely reviewed state tax cases. However, the case's high visibility may pique the Court's interest in the case.

Several other states besides New York have enacted Amazon Law statutes (for example, Arkansas, California, Connecticut, North Carolina, Illinois, and Rhode Island). The Illinois equivalent of the New York statute was ruled unconstitutional by the Circuit Court for Cook County approximately one year ago. Accordingly, as of this writing, there is a split, with the New York statute deemed constitutional on its face and the Illinois statute deemed unconstitutional on its face.

Currently, legislation is pending in Congress that would expressly override prior United States Supreme Court decisions and would authorise the states to require that remote retailers collect sales and use tax, provided that certain requirements are met. Therefore, even if the United States Supreme Court were to deem the Amazon Law unconstitutional, Amazon and other remote retailers could still be required to collect sales and use tax if the federal legislation is enacted.

As a practical matter, Amazon is acting like it anticipates ultimately losing the war. Amazon has entered into agreements with several states whereby Amazon agrees to build a distribution centre in the state and start collecting sales and use tax as of a certain date.

The response from Overstock has generally been to cancel its affiliate

program in states that have enacted a statute similar to the New York statute. That way, the statute does not apply to Overstock and the state cannot point to the statute as a basis for requiring Overstock to collect sales and use tax.

Online taxes have led to fights between bricks and mortar retailers (who favour laws requiring that online retailers collect tax) and online retailers (who oppose such laws) with the two sides battling in the political arena and in the courts. Score the New York Court of Appeals' Amazon decision as a victory for bricks and mortar retailers.

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