

# Taxes up the Amazon?

By Robert W. Wood

Regardless of where your clients do business, they may be struggling with California sales and use taxes. Unless they perform solely services, they may be looking over their shoulders for California tax bills. Moreover, California consumers making purchases on the Internet may be too.

The U.S. Constitution prevents states from taxing interstate commerce. No state can force an out-of-state merchant to collect or pay tax unless it has a "nexus" in the state. But like mosquitoes, Amazon taxes are swarming across many states.

The California State Board of Equalization administers the state's sales and use tax laws. Recently, it got a big boost, which the Board will inevitably exploit. California passed the newest and toughest law, requiring many online merchants to collect use tax on shipments into the state. Use tax is the flip side of sales tax. If you buy an item in a California store, you pay sales tax. If you buy it in Nevada and ship or bring it to California, it is subject to California use tax at the same rate.



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What's the only practical mechanism for collecting use tax? Having the retailer collect it. That's why California wants online retailers to collect tax on shipments to the state. Until now, if you bought over the phone or online from an out-of-state merchant, the merchant had to charge California tax only if the merchant also had a California bricks and mortar store.

But the new law goes beyond traditional notions of physical presence, prompting Steve Forbes to label ours the "Pickpocket State." See *Forbes*, "The Pickpocket State," *Forbes.com* (July 25, 2011), available at [blogs.forbes.com/steveforbes/2011/07/25/california-the-pickpocket-state/](http://blogs.forbes.com/steveforbes/2011/07/25/california-the-pickpocket-state/). A retailer must now collect tax if it designs or develops (directly or through a subsidiary) products the retailer sells, or if it has online affiliates in the state.

Some - including Amazon - argue that the new tax is unconstitutional. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the U.S. Supreme Court held that a business had to be "physically present" before any state could force it to collect use tax. A warehouse, showroom or office was enough, but merely shipping into a state was not. States like Illinois, New York and California believe technology requires a more expansive view of nexus and that online affiliation (even without a store inside the state) is enough.

Amazon is fighting New York's tax in court. Once California enacted its Amazon tax, Amazon cut its affiliate deals in the state. Amazon did the same in Illinois. But even so, California's new law could have a major impact.

Cast as a "clarification" of the law, ABx1 28 was signed by Gov. Jerry Brown on June 28, and took immediate effect. It mandates use tax registration for large out-of-state retailers, providing that a retailer engaged in business in California includes any retailer that is a member of a commonly-controlled group and is a member of a combined reporting group that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer.

The new law also includes any retailer entering into an agreement under which a person in California, for a commission or other consideration, refers potential purchasers of tangible personal property to the retailer, whether by

an Internet-based link or an Internet website, or otherwise if: The retailer's total sales of tangible personal property to California consumers that are referred pursuant to all of those agreements with a person in California in the preceding 12 months must be in excess of \$10,000; and the retailer's total sales of tangible personal property to California consumers in the preceding 12 months must be in excess of \$500,000.

If a business meets these requirements and is not registered with the Board, the business must apply for a use tax permit (Sec. Form BOE-400-CSC California Certificate of Registration - Use Tax). Of course, it is appropriate to consult a tax adviser during this process, but enforcement does appear to be on the way. The chairman of the Board has already announced enforcement steps. See Jerome Horton Press Release (July 12, 2011), available at [www.boe.ca.gov/news/2011/82-11-H.pdf](http://www.boe.ca.gov/news/2011/82-11-H.pdf).

Online retailers covered by the law must register with the Board, and must then collect the tax. Out-of-state retailers that refuse to comply are unlikely to escape. The Board expects to have its first indication of non-compliance on Oct. 31. That is the date on which California sales and use tax returns for the third quarter of 2011 are due. At that time, the Board may begin issuing estimated billings to retailers that have failed to comply.

Then, on an individual merchant scale, the battle over taxes and registration will really start. The Board has made clear it does not have the power to declare a statute unenforceable or refuse to enforce it. You need an appellate court or a referendum by voters to determine that a statute isn't enforceable.

Amazon clearly wants the voters to overturn the new law. A petition for a referendum has been filed with the state attorney general, so voters may actually get to vote on the new law. It seems inevitable that the federal Congress or the U.S. Supreme Court will need to address this mess. Sooner would clearly be better than later.

*This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.*

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