

Coming Soon To A Monitor Near You: A Look at Click-Through Nexus.

Once you try to tax things that move, life quickly gets complicated.

Currently, many states are highly dependent upon sales taxes to fund their budgets. A sales tax is conceptually simple: if I buy tangible personal property at retail in a store in Pennsylvania, I will generally pay a 6% sales tax, unless I shop in Philadelphia, where the rate is 8%. Sales taxes worked very well in the brick and mortar world of the 20th Century, when people actually went shopping in stores.

Like many other things, the Internet changed shopping dramatically, and the impact upon state revenues from sales tax has been serious, as consumers stop patronizing local retailers and instead buy on-line. The problem is that a state's power to tax entities is limited under the dormant commerce clause, which has been construed to require (among other things) a sufficient nexus between a state and a transaction or taxpayer to support a tax. In the sales tax context, the Supreme Court held in *Quill v. North Dakota*, 504 U.S. 298 (1992) that this nexus requirement means that states can only impose the duty to collect sales taxes on those with a physical presence there and ruled that North Dakota could not impose that obligation on catalog retailers who lacked an in-state presence.

Most states that have a sales tax also have a use tax, which typically requires the purchaser to pay a parallel tax on goods purchased at retail if no sales tax is collected. In theory then, consumers should be paying use tax on their internet purchases, but the use tax is hard to enforce and many simply assume they are buying tax free. In an effort to stop the leakage of revenue, several states have adopted so-called Amazon laws, which attempt to impose a sales tax on out-of-state web retailers because of their relationships with affiliates based in the state. The concept, known as "click-through nexus," treats local affiliates as agents for the out-of-state retailers when customers click on a link at a local website and are directed to an out-of-state retailer's site. The "affiliate" typically is an independent contractor operating under a contract that disclaims any employment arrangement and receiving a percentage of revenue as a commission.

In Pennsylvania, the Department of Revenue issued a sales and use tax bulletin in late 2011, indicating a number of ways in which the Department believed that a remote retailer might establish nexus with Pennsylvania, including click-through technology. Currently, the General Assembly has a bill under consideration that would plainly assert that click-through affiliate programs create sufficient nexus to support a tax, House Bill No. 1043, which was referred to the Finance Committee in March.

Late last month, the New York Court of Appeals sustained New York's Amazon Law in the face of a constitutional challenge by Amazon and Overstock.com. *Overstock.com, Inc. v. New York State Dep't of Taxation and Finance*, Nos. 33, 34 (N.Y. Mar. 28, 2013). The New York statute operated by creating a rebuttable presumption that an affiliate relationship involved an out-of-state retailer making sales in the state through an agent where gross receipts exceeded ten thousand dollars over the four prior quarters. *Id.*, slip op. at 3. The New York Court of Appeals concluded that the statute was not unconstitutional on its face, ruling that the "if a vendor is paying New York residents to actively solicit business in this State, there is no reason why that vendor should not shoulder the appropriate tax burden." *Id.*, slip op. at 10. There is a solid

dissent, however, which views the affiliates' websites as advertising, an activity that is not sufficient to establish nexus.

How will all this turn out? It's too soon to tell. At some point, the Supreme Court may resolve the issue. Alternatively, Congress has proposed legislation before it; since a dormant commerce clause challenge to a state tax is premised on the notion that the tax interferes with Congressional power to regulate commerce, Congress can change the rules legislatively.

In the meantime, given the financial pressures that states face, it would be surprising if more did not adopt similar click-through nexus statutes. The problem is not just lost tax revenue; because the internet retailer can offer lower "tax-free" prices, basic economics would suggest that sales should migrate to on-line vendors to some degree. The loss of sales by local brick and mortar vendors is presumably felt not only in lower tax revenues, but in fewer jobs in the local economy.

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