

# DEPARTMENT OF TAXATION

## 2010 Fiscal Impact Statement

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| <b>1. Patron</b> Emmett W. Hanger, Jr.   | <b>2. Bill Number</b> <u>SB 660</u>      |
|  | <b>House of Origin:</b>                  |
|  | <u>          </u> <b>Introduced</b>      |
|  | <u>          </u> <b>Substitute</b>      |
|  | <u>          </u> <b>Engrossed</b>       |
| <b>3. Committee</b> House Finance  |  |
| <b>4. Title</b> Retail Sales and Use Tax; Out-of-State<br>Dealers Soliciting Business through "Affiliate<br>Agreements" with Residents | <b>Second House:</b>                     |
|  | <u>      X      </u> <b>In Committee</b> |
|  | <u>          </u> <b>Substitute</b>      |
|  | <u>          </u> <b>Enrolled</b>        |

### 5. Summary/Purpose:

This bill would create a rebuttable presumption that an out-of-state dealer who enters into an agreement with a Virginia resident, under which the resident, for a commission or other consideration, refers potential customers to the dealer, is soliciting or transacting business in Virginia by independent contractors, agents, or other representatives, and is thus required to collect the Retail Sales and Use Tax pursuant to Virginia's nexus statute.

Under current law, only certain vendors who meet the definition of a dealer and who have sufficient contact with the Commonwealth are required to register and collect the Retail Sales and Use Tax.

The effective date of this bill is not specified.

### 6. Fiscal Impact Estimates are: Not available. (See Line 8.)

### 7. Budget amendment necessary: No.

### 8. Fiscal implications:

#### Administrative Costs

TAX considers implementation of this bill as "routine", and does not require additional funding.

#### Revenue Impact

The revenue impact of this bill would depend on the response to its enactment by affected online retailers. Given the response to similar legislation enacted in other states, it is unlikely that online retailers would comply with the provisions of the bill and begin to collect the Retail Sales and Use Tax.

When similar legislation was enacted in Rhode Island and North Carolina, large online retailers ended their affiliate programs. If this were to happen as a result of this bill, there

would be no additional revenue from the enactment of this bill. In fact, by ending the affiliate program with Virginia vendors, such vendors would likely lose business and remit less Retail Sales and Use Tax to Virginia. Ending affiliate agreements in Virginia would also reduce or eliminate the commissions and profit that the affiliates receive from these agreements. Although there is only very limited publicly available data, the reduction or elimination of such commissions and profits would likely have a negative impact on those businesses' profits.

Alternatively, online retailers may comply with the provisions of this bill and file suit, challenging the constitutionality of the statute, as Amazon.com and Overstock.com have done in New York. While New York raised \$53 million in state and local sales and use taxes during the three quarters that their statute was in effect in Fiscal Year 2008, and while they expect to raise \$70 million in revenue for the current fiscal year, this amount will be reduced by the costs of litigation that New York incurs to defend its legislation. Similarly, if online retailers choose to take this approach in Virginia, any potential revenue gain from enactment of this bill would be offset by the costs to litigate this issue.

Assuming, however, that the online retailers comply with the provisions of the bill and begin to collect the Retail Sales and Use Tax, this bill would result in an unknown revenue increase for Virginia. Based on the revenue received by New York as a result of enacting its statute, adjusted for the differences in population and tax rates between the states, Virginia could realize as much as an additional \$17 million in state and local revenue.

**9. Specific agency or political subdivisions affected:**

TAX

**10. Technical amendment necessary: No.**

**11. Other comments:**

Constitutional Nexus

The Commerce Clause of the U.S. Constitution reserves to Congress the power to regulate commerce among the states and with foreign nations. The U.S. Supreme Court has established a four-prong test to be used in determining whether a state tax on an out-of-state corporation's activities in interstate commerce violates the Commerce Clause. A state may require an entity engaged in interstate commerce to collect taxes on its behalf provided the tax is 1) applied to an activity with a substantial nexus with the taxing State; 2) is fairly apportioned; 3) does not discriminate against interstate commerce; and 4) is fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The U.S. Supreme Court has also determined, in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) that the Commerce Clause barred a state from requiring an out-of-state mail-order company to collect use tax on goods sold to customers located within the state when the company had no outlets, sales representatives, or significant property in the state. In this case, the Court determined that only Congress has the authority to require out-of-state vendors, without a physical presence in a state, to register and collect that state's tax.

Virginia law specifically sets out the standards for requiring out-of-state dealers to collect the Virginia Retail Sales and Use Tax on sales into the Commonwealth. The law provides that a dealer is deemed to have sufficient activity within the Commonwealth to require that dealer to register to collect the Virginia Retail Sales and Use Tax if the dealer:

- Maintains an office, warehouse, or place of business in the Commonwealth;
- Solicits business in the Commonwealth, by employees, independent contractors, agents or other representatives;
- Advertises in Commonwealth publications, on billboards or posters located in the Commonwealth, or through materials distributed in the Commonwealth;
- Regularly makes deliveries into the Commonwealth by means other than common carrier;
- Continuously, regularly, seasonally, or systematically solicits business in the Commonwealth through broadcast advertising;
- Solicits business in the Commonwealth by mail, provided the solicitations are continuous, regular, seasonal, or systematic and the dealer benefits from any banking, financing, debt collection, or marketing activities occurring in the Commonwealth;
- Is owned or controlled by the same interests which own or control a business located within this Commonwealth;
- Has a franchisee or licensee operating under the same trade name in the Commonwealth, if the franchisee or licensee is required to obtain a certificate of registration; or
- Owns tangible personal property that is rented or leased to a consumer in the Commonwealth, or offers tangible personal property, on approval, to consumers in the Commonwealth.

Restricted by the United States Constitution and the Supreme Court's decision in *Quill*, many states have similar nexus statutes that restrict their ability to require remote sellers to collect taxes on sales made into Virginia. With growing retail sales on the Internet and declining tax receipts, some state tax collectors have turned their attention to the revenue being lost from sales by out-of-state retailers to the residents of their states. Although individuals who purchase goods from out-of-state firms via the Internet or mail order owe their states of residence use tax on their purchases in lieu of sales tax, states find it difficult to enforce this obligation. As a result, many states lose out on substantial revenue.

Two proposals have developed from the difficulty among states in collecting sales and use taxes on remote purchases. Some states have become involved with the Streamlined Sales Tax Project, which is an effort among states to simplify and unify state and local sales taxes in order to encourage Congress to overturn *Quill*. Other states have enacted "Amazon statutes," which impose a Retail Sales and Use Tax collection requirement on out-of-state online retailers that have affiliate agreements with residents, provided certain requirements are met.

## Streamlined Sales Tax Agreement

The Streamlined Sales Tax Project ("SSTP") was founded in March, 2000, with the purpose of developing measures to simplify and unify state and local sales taxes. Streamlining is primarily an effort by states to enhance sales tax collection on mail order, catalog, Internet, and other remote sales. In reaction to the *Quill* decision and in an attempt to create a level playing field, whereby out-of-state vendors and in-state vendors are both operating under the same tax rules, 40 states and the District of Columbia came together through the SSTP and endorsed the concepts embodied in the Streamlined Sales and Use Tax Agreement ("SSUTA"). States expect that out-of-state businesses without a requirement to collect sales tax will voluntarily collect tax when the states adequately streamline their sales tax.

The SSUTA seeks to improve the sales and use tax administration systems used by the states through:

- State level administration of sales and use tax collections.
- Uniformity in the state and local tax bases.
- Uniformity of major tax base definitions.
- Central, electronic registration system for all member states.
- Simplification of state and local tax rates.
- Uniform sourcing rules for all taxable transactions.
- Simplified administration of exemptions.
- Simplified tax returns.
- Simplification of tax remittances.
- Protection of consumer privacy.

Currently, there are 20 full member states and 3 associate member states that make up the Streamlined Sales Tax Governing Board. Since 2002, Virginia has been an active member of the Streamlined Project, but is not a member of the Governing Board.

## New York's "Amazon Statute"

Amazon.com operates a retail Internet business with in-state affiliates that are authorized to maintain links to Amazon.com on their own websites and are compensated for any referrals that lead to a sale. Several other retailers, such as Overstock.com, have similar business structures. On April 23, 2008, the state of New York enacted a statute identical to this bill (N.Y. Tax. Law § 1101(b)(8)(vi), which required the collection of New York sales taxes by out-of-state sellers that contractually agree to pay commissions to New York residents for referring potential customers to them, provided that more than \$10,000 was generated from such New York referrals during the preceding four quarterly periods. On April 25, 2008, Amazon.com brought suit against the New York State Department of Taxation, alleging that the Commission Agreement Statute violated the U.S. Constitution's Commerce Clause, Due Process Clause, and Equal Protection Clause. The Supreme Court of the State of New York, a lower trial level court in New York, dismissed Amazon's complaint in its entirety, ruling that Amazon had no basis for legal action. Amazon has appealed this decision.

## Other States

New York, North Carolina and Rhode Island have all adopted legislation that is similar to the provisions set forth in this bill. In California and Hawaii, Amazon-type statutes have been approved by the state legislatures, only to be subsequently vetoed by the states' governors. In several other states, including Connecticut, Illinois, Minnesota, Maryland, and Tennessee, legislation has been proposed but rejected.

### **North Carolina:**

North Carolina's Amazon statute, which was adopted in 2009, is substantively identical to this bill. (N.C. Gen. Stat. § 105-164.8(b)(3) ). The statute has met with opposition since before its inception, prompting Amazon.com and Overstock.com to end their affiliate programs before the bill became effective. It has been reported that Market America, an affiliate marketing company with 3 million customers, also relocated to Florida as a result of this legislation.

### **Rhode Island:**

Rhode Island's statute differs from this bill in that the gross receipts from sales by the retailer to customers in Rhode Island who are referred to the retailer through this type of an agreement must be in excess of \$5,000, rather than \$10,000. The statute does not specify how the presumption can be rebutted. As in North Carolina, Amazon.com and Overstock have ended their affiliate programs in this state. Nevertheless, there is no effort under way currently to repeal the Amazon Law in Rhode Island.

### **California:**

Upon New York's adoption of its Amazon statute, Overstock.com canceled affiliate agreements with its New York affiliate advertisers in May, 2008, and later announced that it would discontinue its use of affiliate advertisers in California, as well as other states. When California's legislature voted in favor of the Amazon statute, Governor Schwarzenegger quickly announced its veto on July 1, 2009, citing the potential for job and business losses in the state. He then notified Overstock.com, which immediately reversed its decision to cease its affiliate agreements in California.

### **Hawaii:**

In 2009, Hawaii governor Linda Lingle also vetoed versions of the Amazon law passed by her state legislature. Governor Lingle stated that it would be premature to enact legislation similar to New York's, noting that the New York law was still being litigated, and adding that the legislation was "not well thought out" and could have negative consequences for many smaller businesses.

## Proposal

This bill would create a rebuttable presumption that an out-of-state dealer who enters into an agreement with a Virginia resident, under which the resident, for a commission or other consideration, refers potential customers to the dealer is soliciting or transacting business in Virginia by independent contractors, agents, or other representatives, and is thus required to collect the Retail Sales and Use Tax pursuant to Virginia's nexus statute. The referral could be provided by a link on the out-of-state retailer's Internet site, or by some other means.

In order for the out-of-state retailer to be deemed to be soliciting or transacting business in Virginia, the cumulative gross receipts from sales by the dealer to purchasers in the Commonwealth who are referred to the dealer by residents with this type of agreement with the dealer must be in excess of \$10,000 during the preceding four quarterly periods. The statute provides that the presumption may be rebutted by proof that the resident with whom the dealer has an agreement did not engage in any solicitation in the Commonwealth on behalf of the dealer that would satisfy the nexus requirement of the United States Constitution during those four quarterly periods.

The effective date of this bill is not specified.

cc : Secretary of Finance

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