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# Fiscal Fact

## Trend #5: “Amazon” Taxes

### Top 10 State Tax Trends in Recession and Recovery, 2008 to 2012

By

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The taxing power of the states generally extends only to their individual borders: since the adoption of the U.S. Constitution, states have not been able to impose tax collection obligations on businesses that have no property or employees within the state.<sup>1</sup> In 2008, however, **New York** adopted a law that imposes such an obligation on a person or business with no physical presence in the state if it (1) enters into agreement with in-state resident involving commissions for referring potential customers; and (2) has gross receipts from sales by out-of-state companies from referrals within the state which total more than \$10,000 in a 12-month period. This law, nicknamed a “click-through nexus” or “Amazon tax” law (after their most visible targets), has been copied by a few other states and is the subject of much controversy.<sup>2</sup>

Amazon.com and Overstock.com responded to the New York law by terminating affiliate programs in the state, and Amazon.com filed a lawsuit in state court. The law was upheld by a trial judge (New York's trial courts are called the “New York Supreme Court,” causing confusion about who upheld the Amazon tax as constitutional); the judge concluded that Amazon.com's in-state affiliates are necessary and significant to establishing and maintaining the out-of-state company's market in the state. But because they make up only 1.5% of sales, that was the basis for the appeal. The New York Supreme Court, Appellate Division ruled in late 2010 that the law is not facially unconstitutional but may be unconstitutional for Amazon. The case was remanded to the lower court, but Amazon is appealing to state's highest court, the New York Court of Appeals. The case is ongoing.

In 2009, **Rhode Island** and **North Carolina** adopted identical New York-style laws. Neither has seen any revenue and Rhode Island has actually seen revenue loss due to reduced income tax collections from terminated in-state affiliates. The head of the Rhode Island revenue analysis office, Paul Dion, stated in

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<sup>1</sup> Some advocates of “Amazon” taxes misleadingly claim that this cornerstone of federalism dates only from a 1992 Supreme Court ruling.

<sup>2</sup> See, e.g., Joseph Henchman, “Amazon Tax” Laws Signal Business Unfriendliness and Will Worsen Short-Term Budget Problems, TAX FOUNDATION SPECIAL REPORT NO. 176 (Mar. 8, 2010), <http://www.taxfoundation.org/news/show/25949.html>; Joseph Henchman, *Louisiana Considers Adopting “Amazon” Tax on Out-of-State Online Sellers*, TAX FOUNDATION FISCAL FACT NO. 271 (May 26, 2011), <http://www.taxfoundation.org/news/show/27296.html>; Joseph Henchman, *California Becomes Seventh State to Adopt “Amazon” Tax on Out-of-State Online Sellers*, TAX FOUNDATION FISCAL FACT NO. 276 (Jul. 1, 2011), <http://www.taxfoundation.org/news/show/27416.html>.

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 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>

Laws were also passed in **California** and **Hawaii** but vetoed. **Illinois** has also passed such a law but it was ruled unconstitutional in 2012.<sup>6</sup> Many other states have considered these laws but not passed them.

In 2010, **Colorado** considered the same law but faced opposition from in-state affiliates. Instead it adopted a law (H.B. 10-1193) designed to push Amazon into collecting use taxes without explicitly requiring it. If any out-of-state retailer that is part of "a controlled group of corporations" has at least one member with physical presence in Colorado, all the retailers in the group have nexus with Colorado. Retailers must then comply with a notification process that is so cumbersome and complicated that its real purpose must be to force tax collection.

**North Carolina** followed Colorado by adopting a regulation with a similar notification requirement, and demanded out-of-state companies provide them with all customer purchase information dating from 2003. Amazon.com and the ACLU filed lawsuit in federal court, arguing that "[e]ach order of a book, movie, CD or other expressive work potentially reveals an intimate fact about an Amazon customer." Examples of purchases by North Carolina residents:

- Bipolar Disorder: A Guide for Parents and Families
- He Had It Coming: How to Outsmart Your Husband and Win Your Divorce
- Living with Alcoholism: Your Guide to Dealing with Alcohol Abuse and Addiction While Getting the Alcoholism Treatment You Need
- What to Do When You Can't Get Pregnant: The Complete Guide to All the Technologies for Couples Facing Fertility Problems
- Outing Yourself: How to Come out as Lesbian or Gay to Your Family, Friends, and Coworkers
- Lolita (1962)
- Brokeback Mountain (2005)
- Fahrenheit 9/11 (2004)

A federal judge struck down the North Carolina regulation as violating the First Amendment in October 2010.

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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>.

<sup>6</sup> See Joseph Henchman, *Illinois "Amazon Tax" Ruled Unconstitutional*, TAX FOUNDATION TAX POLICY BLOG (Apr. 26, 2012), <http://www.taxfoundation.org/blog/show/28168.html>.

**California** enacted an “Amazon tax” law but after a possible repeal referendum was proposed, the state and Amazon.com reached an agreement whereby Amazon.com will develop a physical presence in the state (i.e., build warehouses). Amazon.com has been seeking similar agreements in other states as it expands its distribution network.

Contrary to the claims of supporters, Amazon taxes do not provide easy revenue. In fact, the nation's first few Amazon taxes have not produced any revenue at all, and there is some evidence of lost revenue. For instance, Rhode Island has seen no additional sales tax revenue from its Amazon tax, and because Amazon reacted by discontinuing its affiliate program, Rhode Islanders are earning less income and paying less income tax.

Enacting an Amazon tax law sends a signal of hostility to businesses engaged in interstate commerce, runs the serious risk of retaliation from other states and from affected businesses, and undermines efforts to improve the uniformity of state sales taxes.

While efforts continue at the state level to enact these laws, their dubious constitutionality and lack of success in raising revenue or leveling the playing field has shifted attention to the federal level, where Congress is considering proposals to set standards for state sales tax collection on interstate sales. Two recent proposals in particular would eliminate the physical presence rule but otherwise make advances towards ensuring that states reduce the burdens associated with collecting their sales taxes. Example provisions include requirements that states have a single state-level agency that administer all sales tax rules; offer one tax return and audit for the entire state; require one uniform tax base for the entire state; provide software that identifies the applicable tax rate for a sale, including local rates and hold sellers harmless for any software errors or mistakes by the state; provide 30 days’ notice of any local sales tax rate change; and exempt sellers with a *de minimis* level of collections.<sup>7</sup>

Effective simplification is a necessity for any federal proposal, as is a defined limit to the reach of state tax power. While some constitutional principles surely must be revisited to be applied to new circumstances, the idea that parochial state interests should be stopped from burdening interstate commerce remains a timeless principle regardless of how sophisticated technology may become.

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<sup>7</sup> See generally *The Proper Role of Congress in State Taxation: Preventing Harm to the National Economy*, Hearing before the U.S. Senate Finance Committee (Apr. 25, 2012) (statement of Joseph Henchman), <http://www.taxfoundation.org/news/show/28165.html>.