

# Memorandum

**To** : Mr. Ramon J. Hirsig  
Executive Director

**Date:** June 19, 2008

**From** : Randie L. Henry, Deputy Director  
Sales and Use Tax Department

**Subject** : **Nexus and Online Retailers**  
**July 8, 2008 Business Taxes Committee Meeting**

Please place the following item on the Board's July 8, 2008 calendar under the Business Taxes Committee. Board Member Yee has scheduled an informational hearing regarding recent actions in other states related to use tax collection and online retailers. Mr. Jeffrey McGuire and Mr. Randy Ferris will introduce this item.

Business Taxes Committee

1. Informational Hearing

Nexus and Online Retailers; Recent Actions in New York and Texas

RLH:lw

Attachment

cc: Ms. Diane Olson (MIC 80)  
Mr. Randy Ferris (MIC 82)  
Mr. Jeff McGuire (MIC 92)

Approved: \_\_\_\_\_  
Ramon J. Hirsig, Executive Director

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### Nexus and Online Retailers; Recent Actions in New York and Texas

Recent news reports about nexus issues in New York and Texas have caused the Board of Equalization to receive numerous inquiries about when out-of-state companies are required to collect tax on sales of products shipped into California.

#### Background

California Revenue and Taxation Code section (Section) 6203 describes various activities which constitute “engaged in business in this state” for purposes of determining whether an out-of-state retailer has sufficient business presence (also known as “nexus”) in California to warrant a use tax collection responsibility on sales made to California consumers. If a retailer has sufficient business presence within the terms of Section 6203, that retailer is required to register with the Board of Equalization and collect the applicable use tax on all sales to California consumers.

Under Section 6203(c), the following retailers are considered “engaged in business in this state” and are required to collect the California use tax on sales made to California consumers:

1. Any retailer maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business.
2. Any retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property.
3. Any retailer deriving rentals from a lease of tangible personal property situated in this state.

Out-of-state companies that are not “engaged in business” in California are not required to collect use tax on shipments into California. For these transactions, California must collect the use tax directly from the purchaser.

#### Nexus Issues in the News

New York Law Changes. New York has revised its nexus statutes to require more out-of-state retailers to collect New York sales and use tax. The law is specific to retailers that have New York affiliates who receive commissions for redirecting customers from their website to the out-of-state retailer’s website.

Beginning June 1, 2008, the new legislation provides that a seller who makes taxable sales of tangible personal property or services in New York is presumed to be a vendor required to collect sales tax on all of its taxable sales in New York State, if **both** of the following conditions are met:

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- The seller enters into an agreement with a New York State resident under which, for a commission or other consideration, the resident representative directly or indirectly refers potential customers to the seller, whether by link on an Internet website or otherwise.
- The cumulative gross receipts from sales by the seller to customers in New York State as a result of referrals to the seller by all of the seller's resident representatives under the type of contract or agreement described above total more than \$10,000 during the preceding four quarterly sales tax periods.

The state of New York has issued a guidance memo explaining their new nexus provisions; the memo is available from New York's Department of Taxation and Finance website at [http://www.nystax.gov/pdf/memos/sales/m08\\_3s.pdf](http://www.nystax.gov/pdf/memos/sales/m08_3s.pdf).

Amazon.com and Overstock.com have filed lawsuits challenging the constitutionality of New York's new law. However, beginning June 1, 2008, Amazon began collecting tax on items shipped to destinations within the state of New York. Overstock.com has discontinued its affiliate program with New York residents.

Amazon Subsidiary in Texas. The Texas Comptroller's office is examining Amazon's business presence in Texas to determine whether Amazon should collect Texas sales and use tax on shipments into Texas. Making news headlines is an Amazon distribution center located in Irving, Texas. A spokesperson for Amazon explained that Amazon.com is not required to collect taxes under Texas law as the distribution center is independently operated by their subsidiary Amazon.com.kydc.

In general, a retailer would have a physical presence in Texas if they operated a store or warehouse in the state. However, Texas operates under the separate legal entity theory and will not hold one legal entity liable for activities performed by a subsidiary, affiliate, parent, or other related entity - unless that entity happens to act as an agent for the other entity. For example, Internet sellers are considered to be engaged in business in Texas if there is a related or affiliated entity in the state that will accept returns of merchandise sold by the Internet seller.

#### What About California?

Affiliate Programs. Out-of-state online retailers also offer affiliate programs with persons in California. The California person's website includes specially formatted links that connect customers to the online retailer's website to purchase items. The online retailer tracks these sales and pays the affiliate referral fees on qualifying revenue made through their links. Online retailers maintain that these links are similar to website banner ads, and affiliates are advertisers, not salespeople operating on behalf of the out-of-state company.

As explained in the Background section, an out-of-state company has nexus in California if it has a salesperson engaged in authorized selling activities on behalf of the out-of-state retailer. Staff does not believe that a link on a retailer's affiliate's website suffices to establish that the affiliate is an authorized salesperson of the out-of-state retailer under section 6203(c). Consequently, under the current provisions of California law, staff does not require out-of-state companies to

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collect tax based solely on such links on affiliates' websites. However, other California activities an affiliate may engage in to promote the link may suffice to establish that the affiliate is an authorized salesperson of the out-of-state retailer.

If staff's understanding of New York's law is correct, the main difference between New York's approach and California's approach regards who has the burden to prove (or disprove) that other activities in support of the link exist that are sufficient to create nexus. Since New York's approach involves a rebuttable presumption, staff believes that under New York law, as under California law, the existence of a link on an affiliate's website does not, on its own, conclusively create nexus.

Subsidiaries. Section 6203 provides that "engaged in business" includes maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business in California. Thus, subsidiaries that are engaged in selling activities on the out-of-state retailer's behalf create nexus in California for the out-of-state retailer. The out-of-state retailer will be required to collect sales and use tax on all of its sales of taxable property in California. The Board's Out-of-State District office routinely investigates subsidiaries located in California to determine if their activities create nexus for their out-of-state parent companies. Staff is not aware of an Amazon subsidiary in California that participates in a selling activity on behalf of Amazon.com, such as a warehouse or distribution center.

Prepared by the Tax Policy Division, Sales and Use Tax Department

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