

Cuomo's proposal would wring taxes from out-of-state sellers

Every year, New York loses millions of dollars of sales tax revenue because it can't require out-of-state companies to collect tax on online sales to New Yorkers.

The state would love to make these companies collect the tax, but its ability to do so is subject to limitations under the U.S. Constitution.

Gov. Andrew Cuomo's executive budget proposes a novel mechanism for the state to benefit from more of these sales by focusing on the fact that many occur through online marketplaces, such as Ebay and the Amazon marketplace. This change, if enacted, would have significant effects on both in-state and out-of-state retailers that sell products through these online "marketplaces."

Under the U.S. constitution, in order for a state to require a company to collect and remit sales on its sales, the company must have a certain type of close connection with the state known as "nexus."

States can require sellers that have a physical presence in the state to collect sales and use taxes. However, they cannot impose this requirement on sellers that only communicate with people in the state remotely as part of a nationwide business.

Under the Supreme Court's rulings, however, the physical presence required to establish nexus does not have to be substantial: It only needs to be "demonstrably more than the slightest presence." Indeed, the Supreme Court has held that regular solicitation of sales by independent sales representatives (and not employees) is sufficient to establish a sales and use tax collection obligation by an out-of-state company with no physical presence in the state.

These rulings limit New York's ability to require out-of-state Internet websites to collect sales tax on their online sales. Most such websites do not have any physical presence in New York, even though they make many sales here. Accordingly, under constitutional principles, New York cannot require them to collect and remit sales tax.

In 2008, New York passed its so-called "Amazon law," which attempted to get around these limits by focusing on a common marketing strategy used by Internet websites.



TAXING MATTERS

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New York's Amazon law states that nexus is presumed if an out-of-state seller enters into an agreement with a resident of New York under which the resident is paid a commission for referring potential customers to the out-of-state seller through links on the resident's website. Because Amazon has entered into thousands of such relationships with New Yorkers, it is required to collect and remit sales tax here, as are many other online stores that use this business strategy. Amazon challenged the New York law in court but lost.

However, where a website does not sell products directly, but merely provides a forum for other people to buy and sell products, it is not required to collect sales and use tax on these sales, even under New York's Amazon law.

Even though Amazon has nexus in New York under the Amazon law when it sells products directly, this nexus is not attributed to the thousands of third-party vendors that use its marketplace.

The governor's budget proposal would subject these sales to New York taxation. It states if a sale is facilitated through a physical or online marketplace, the "marketplace provider" (a website like Ebay or Amazon) would be required to collect tax on the sale if the provider itself has nexus in New York.

Today, for example, if you buy a T-shirt on Ebay from an independent design shop in San Francisco, Ebay would not be required to collect sales tax, despite its presence here. The transaction is between you and the California vendor, so Ebay's nexus in New York isn't relevant. Though I believe it is unclear whether the technical language of the statute would actually do so, according to the governor's memoran-

dum in support of the new law, the proposal is intended to change this by requiring Ebay itself to collect and remit the tax.

This change would effectively expand New York's sales tax base. Though New Yorkers who buy products from out of state without paying sales tax are technically required to pay a compensating use tax, very few people do so. The governor estimates that the proposal would raise almost \$60 million annually.

One of the most interesting implications of the proposal is for in-state sellers on "marketplace" websites. Say that the T-shirt shop above was located in Williamsburg, Brooklyn, rather than San Francisco. Today, the shop would be required to collect and remit sales tax on its Ebay sales. The proposed legislation, however, would shift this responsibility to Ebay.

The shop would collect and remit sales tax on sales from its physical store in Williamsburg and New York sales through its own website. However, under the proposed law's mandatory rules, sales tax collection for New York sales on Ebay or any other third-party marketplace would be the marketplace's responsibility.

The governor's proposal is exceedingly clever, as it sidesteps the constitutional nexus issues that have made it difficult for the state to impose sales tax on Internet sales by out-of-state vendors. Rather than claim New York nexus over thousands of small to midsize Internet vendors, it forces a small number of huge marketplace providers that already have New York nexus to collect and remit tax on behalf of out-of-state vendors that do not.

Within a few years of the passage of New York's Amazon law, similar laws were passed across the country. If the governor's proposal to impose tax collection responsibilities on marketplace vendors is successful, this approach may sweep the country as well. The new approach would change the party responsible for sales tax compliance in many online transactions and significantly increase state sales tax collections.

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