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California Lawmakers Propose Use Tax Reporting Requirements for Out-of-State Retailers

By Carley A. Roberts and Timothy A. Gustafson

California lawmakers introduced two bills last week which would require online retailers to collect and remit use tax on sales to California customers. By amending the term “retailer engaged in business in this state” in Section 6203 of the California Revenue and Taxation Code, the bills provide in relevant part that nexus exists if a retailer uses California affiliates to sell its products¹ or if a retailer is part of a commonly controlled group of companies and one member of the group performs services in California in connection with property to be sold by the retailer.²

AB 153 would create “click-through nexus” for an online retailer who forms advertising agreements with California businesses and the cumulative sales total from all of the retailer’s sales within the preceding 12 months to California customers who are referred pursuant to such agreements exceeds \$10,000.³ The bill, similar to the “Amazon” laws enacted in New York and North Carolina, would amend the statutory definition of “retailer engaged in business in this state” for California use tax purposes to include any retailer that enters into an agreement under which a person in California, for a commission or other consideration, directly or indirectly refers potential purchasers of tangible personal property to the retailer.⁴ The California State Legislature passed a similar bill in 2009, which was vetoed by then-Governor Arnold Schwarzenegger.⁵

AB 155 proposes to amend the definition of “retailer engaged in business in this state” to include any retailer who has a “substantial nexus” with the state for purposes of the Commerce Clause of the U.S. Constitution and any retailer upon which federal law permits California to impose a use tax collection duty.⁶ In addition, if AB 155 is enacted, a commonly controlled group of companies would be considered to be doing business in California for use tax nexus purposes if one of the group members performs services in California connected to the products the companies sell.⁷

The remaining provisions of AB 155 warrant additional discussion. AB 155 requires retailers *not* “engaged in business in

¹ AB 153 § 1, as introduced in the California Assembly on January 18, 2011.

² AB 155 § 1, as introduced in the California Assembly on January 18, 2011.

³ AB 153 § 1.

⁴ *Id.*

⁵ Senate Bill X3 17 (2009), vetoed on June 30, 2009.

⁶ AB 155 § 1.

⁷ *Id.*

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this state” (i.e., retailers with no nexus) but with at least \$500,000⁸ in annual sales to California customers to notify their customers and to file use tax returns.⁹ If a retailer fails to comply, it will face substantial penalties.¹⁰

Specifically, AB 155 provides in relevant part:

Section 7055 of the Revenue and Taxation Code is amended to read:

(b) (1) Every person that sells tangible personal property, the storage, use, or other consumption of which is subject to use tax, that is not registered with the board, shall annually file with the board a report that sets forth the names and addresses of purchasers of the tangible personal property, the sales price of the property, the date of sale, and other relevant information as may be required by the board.

(2) Paragraph (1) shall not apply to a person whose receipts from sales described in paragraph (1) are less than five hundred thousand dollars (\$500,000) in the prior calendar year, and are reasonably expected to be less than five hundred thousand dollars (\$500,000) in the current calendar year.

(3) Each person required to comply with paragraph (1) shall be subject to a penalty of ten dollars (\$10) per violation *for each name of a purchaser that was not included in the report for each annual period.* [...]

(c) (1) Each person required to comply with paragraph (1) of subdivision (b) shall annually send a notice to each purchaser showing the total amount of purchases made by that purchaser in the prior calendar year. The notice shall inform the purchaser of the obligation to file the appropriate sales and use tax returns. The notice shall be sent separately to each purchaser, by first-class mail, with the following notice contained on the exterior of the envelope: “Important Tax Document Enclosed.”

(2) Each person required to comply with paragraph (1) shall be subject to a penalty of ten dollars (\$10) per violation *for each purchaser to whom notice is not sent.* [...] ¹¹

(Emphasis added.)¹²

AB 155 reflects a budding trend among states to impose use tax notification and/or reporting requirements on out-of-state retailers. In 2010, Oklahoma enacted a law that obligates certain remote sellers to post notice of consumers’ obligations to pay Oklahoma use tax on electronic and mail-order purchases of tangible personal property.¹³ Colorado also enacted

⁸ This amount is comparable to the economic presence component of the new “doing business” nexus standard for California corporation franchise income tax purposes, which came into effect January 1, 2011. (Cal. Rev. & Tax. Code § 23101.)

⁹ AB 155 § 3.

¹⁰ *Id.*

¹¹ *Id.*

¹² The bill does allow for relief from the penalties, but only if “failure to comply [...] is due to reasonable cause *and* circumstances beyond the person’s control, *and* occurred notwithstanding the exercise of ordinary care and the absence of willful neglect.” (AB 155 § 3, emphasis added.)

¹³ 68 Okl. St. § 1406.1.

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a law last year that, as discussed below, mirrors in large part the provisions of AB 155.¹⁴ In addition, the Multistate Tax Commission last year prepared a Draft Model Sales & Use Tax Notice and Reporting Act.¹⁵

AB 155 is similar to Colorado's law, which imposes upon retailers that are not obligated to collect Colorado sales tax because they lack physical presence in the state, an obligation to (1) inform customers that the buyer may owe use tax on the sale; (2) provide customers with an annual report of their transactions subject to use tax; and (3) provide the Colorado Department of Revenue with an annual report identifying customers who may owe use tax and the amounts of such customers' taxable purchases.¹⁶

Colorado's law is under attack. Shortly after the provisions were enacted in 2010, they were challenged in federal court as unconstitutional on the grounds that Colorado's reporting requirements discriminate against out-of-state retailers, violate the privacy rights of consumers, and curb the exercise of free speech.¹⁷ More recently, members of the Colorado State Legislature have introduced a bill in the Colorado Senate to repeal the use tax notification and reporting requirements imposed on out-of-state retailers under the 2010 law.¹⁸

The fate of AB 155 is uncertain, even if it ultimately becomes law. The California State Board of Equalization (the "Board"), in analyzing a similar bill introduced during the 2009-2010 California legislative session,¹⁹ questioned whether it even had "the authority to enforce these tax obligation notices and the information reporting requirements."²⁰ Moreover, the Board noted the potential burden on the state in collecting, compiling and analyzing the "significant" "volume of information" that will be required to be reported.²¹ Finally, the Board highlighted that such legislation "could cause concern [for] many consumers whose private information and buying habits would now be shared with a government tax agency."²²

Nevertheless, for out-of-state retailers with significant sales to California customers, the fate of AB 155 is worth tracking. The potential compliance burden associated with meeting the notice requirements, the potential customer backlash from disclosure of private information, and the potential penalties arising from the failure to comply with the new provisions give reason to take notice. Stay tuned for further developments.

¹⁴ Colo. Rev. Stats. § 39-31-112; see also Reg. 39-21-112.3.5.

¹⁵ Multistate Tax Commission, Model Sales & Use Tax Notice and Reporting Statute (July 15, 2010).

¹⁶ Colo. Rev. Stats. § 39-31-112; see also Reg. 39-21-112.3.5.

¹⁷ *Direct Marketing Ass'n v. Huber*, No. 10-CV-01546-REB-CVS (D. Colo., filed June 30, 2010).

¹⁸ Senate Bill 73, as introduced in the Colorado Senate on January 19, 2011.

¹⁹ The bill, AB 2078 (2010), died in the California Senate during the last legislative session.

²⁰ SBE Bill Analysis of AB 2078 (2010), dated Apr. 12, 2010, p. 5.

²¹ *Id.*

²² *Id.*

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