

Alert 10-132



## California Online Tax Bill Could Have Major Implications for Out-Of-State Retailers

As California continues to grapple with an unprecedented budget crisis, some state lawmakers are drawing notice—and from some constituencies, outrage—for their support of legislation, which, if enacted, would impose an obligation upon all online retailers making sales into California to notify their California customers of their obligation to pay use-tax to California. Assembly Bill 2078—commonly known as the Online Tax Bill—gained momentum recently when it passed by a 46-28 vote in the Assembly and was referred to the Senate's Committee on Revenue and Taxation.<sup>1</sup> With budget projections for the legislation reported between \$100 million and \$150 million annually<sup>2</sup>, and strong support among the Senate majority, passage of AB 2078 is considered likely. If the bill as introduced in the Assembly is passed, it would make California only the second state (after Colorado) to impose a notice requirement on online retailers.

As introduced by Assembly Member Charles Calderon, the Online Tax Bill would have: (1) amended California law to create a rebuttable presumption that any retailer that is part of a controlled group of corporations that has a component member that is a retailer in California, is presumed to be engaged in business in the state and is obligated to collect California sales and use tax; (2) added a new provision requiring each retailer not obligated to collect California use-tax to provide notification on its website or catalog that any California purchaser is obligated to remit use-tax on its purchases to California and; (3) amended California law to require all retailers making sales into California that are subject to use-tax to provide the Board of Equalization with the names of the purchasers and a listing of items purchased.<sup>3</sup> Although the version of Online Tax Bill ultimately passed by the Assembly eliminated all but the addition of new purchaser notification requirement<sup>4</sup>, there is a strong movement among Democratic Senators to restore the other two provisions included in Assembly Member Calderon's original proposal. While the large Democratic majority in the Senate makes passage of Online Tax Bill as introduced likely (the Senate currently has 25 Democrats, 13 Republicans, and two vacancies), more than half of all Senators are facing re-election this fall, which makes the passage of any measure to raise taxes uncertain. That said, with few alternatives available to make up for the budget shortfall, legislators may feel they have no choice than to pass the Online Tax Bill as originally introduced in the Assembly. Notably, that version would obligate out-of-state retailers to provide the Board of Equalization with information about their California customers. Some out-of-state retailers would likely find this obligation so burdensome and invasive, that they may simply take an alternative approach: to collect sales tax on all of their sales to California customers—a measure that will likely generate needed revenue for the state.<sup>5</sup>

The Online Tax Bill comes on the heels of recently enacted laws in New York, North Carolina, and Colorado that impose a use-tax collection obligation on out-of-state, online retailers. New York's "click-through" affiliate nexus law—also called the "Amazon law"—creates a presumption that any out-of-state, online retailer is soliciting in that state when an in-state affiliate is compensated for referring consumers to the retailer's website.<sup>6</sup> Colorado's law—similar to the version of Online Tax Bill introduced by Assembly Member Calderon—contains a rebuttable presumption that any retailer that is part of a controlled group of corporations that is engaged in business in the state is a retailer engaged in business in the state.<sup>7</sup> Notably, the Colorado law contains a three-pronged reporting requirement for out-of-state, online retailers, whereby they must provide: (1) invoices to all Colorado customers at the time of purchase, notifying them of a use-tax obligation; (2) an annual statement of all sales made to a Colorado customer, reminding them of their use-tax obligation and; (3) an annual report that must be filed with the Colorado Department of Revenue containing the names of all of that customer's annual purchases.<sup>8</sup> A challenge to New York's "Amazon" law is currently pending, and similar challenges are

likely to follow in North Carolina and Colorado.<sup>9</sup>

Although the Online Tax Bill represents the most serious effort thus far by California legislators to extend the existing Sales and Use Tax laws to online sales, it is by no means the first time that the state has taken up the issue. In 2009, Gov. Arnold Schwarzenegger vetoed Assembly Bill 178, legislation similar in approach to New York's "Amazon" law. In vetoing the bill, Gov. Schwarzenegger noted that if the bill became law, retailers would end their relationships with in-state affiliates—hurting California businesses and resulting in little, if any, revenue for the state. Notably, at least one other state that has enacted affiliate nexus laws has experienced just this sort of harm to in-state affiliates.<sup>10</sup>

Another interesting issue raised by Assembly Bill 2078 is whether or not the legislation will be perceived as the enactment of a tax increase. The California Constitution requires a two-thirds vote on any legislation that would increase taxes. If this bill is interpreted as the state increasing the tax to be paid by either the consumer remitting the use-tax or, in the alternative, the retailer bypassing the reporting requirements and imposing a new sales tax, opponents to the law might raise a challenge to its enactment, based on a failure to conform to the procedural rules set forth in the California Constitution.

Whether—and in what form—California will pass the Online Tax Bill remains unknown. However, passage of this legislation—especially in a form close to the version originally proposed by Assembly Member Calderon—will result in marked changes for both in-state and out-of-state retailers. Many out-of-state, online retailers would likely implement sales tax collection as an alternative to undertaking the burdensome process of notifying consumers of their use-tax obligations and providing customer information to the Board of Equalization. However, many in-state retailers would likely view passage of the legislation as a beneficial step in leveling the playing field between locally owned-and-operated retailers and online conglomerates.

\* \* \* \* \*

For more information on the Online Tax Bill, please contact any of the authors of this *Alert*, or the Reed Smith attorney with whom you regularly work. For additional information on Reed Smith's State Tax Practice, visit [www.reedsmith.com/CAtax](http://www.reedsmith.com/CAtax).

1. A.B. No. 2078, California Legislature 2009-10 Regular Session, Legislative Counsel's Digest, p. 97.
2. Transcript, Hearing of the Assembly Committee On Revenue and Taxation (April 19, 2010, page D).
3. A.B. No. 2078.
4. *Assembly Record, California Legislature 2009-10 Regular Session, p. 5049.*
5. Transcript, Hearing of the Assembly Committee on Revenue and Taxation (April 19, 2010, page D).
6. *NY CLS Tax Law Section 1101(b)(8)(vi).*
7. *C.R.S. section 39-21-112.*
8. *Id., Colo. Emerg. Regs. 39-21-112.3.5*
9. Amazon has filed a lawsuit against North Carolina's Department of Revenue to prevent the state from getting the names of every resident that bought anything from the retailer since 2003. *Amazon.com LLC v. Lay*, U.S. District Court for the Western District of Washington, No. 2:10-CV-00664-BAT, filed April 19, 2010.
10. When North Carolina enacted its "click-through" affiliate law in 2009, Amazon promptly responded by cancelling its affiliate program in that state.

→ [Marty Dakessian](#)  
Partner, Los Angeles  
+1 213 457 8310

→ [Kelley Cooper Miller](#)  
Associate, Philadelphia  
+1 215 851 8855

### About Reed Smith

Reed Smith is a global relationship law firm with nearly 1,600 lawyers in 22 offices throughout the United States, Europe, Asia and the Middle East. Founded in 1877, the firm represents leading international businesses, from Fortune 100 corporations to mid-market and emerging enterprises. Its lawyers provide litigation and other dispute resolution services in multi-jurisdictional and other high-stakes matters; deliver regulatory counsel; and execute the full range of strategic domestic and cross-border transactions. Reed Smith is a preeminent advisor to industries including financial services, life sciences, health care, advertising, technology and media, shipping, energy trade and commodities, real estate, manufacturing, and education. For more information, visit [reedsmith.com](http://reedsmith.com)

U.S.: [New York](#), [Chicago](#), [Los Angeles](#), [Washington](#), [San Francisco](#), [Philadelphia](#), [Pittsburgh](#), [Oakland](#), [Princeton](#), [Northern Virginia](#), [Wilmington](#), [Silicon Valley](#), [Century City](#), [Richmond](#)

Europe: [London](#), [Paris](#), [Munich](#), [Greece](#)

Middle East: [Abu Dhabi](#), [Dubai](#)

Asia: [Hong Kong](#), [Beijing](#)

© Reed Smith LLP 2010. All rights reserved.

Business from offices in the United States and Germany is carried on by Reed Smith LLP, a limited liability partnership formed in the state of Delaware; from the other offices, by Reed Smith LLP of England; but in Hong Kong, the business is carried on by Richards Butler in association with Reed Smith LLP (of Delaware, USA), and in Beijing, by Reed Smith Richards Butler LLP. A list of all Partners and employed attorneys as well as their court admissions can be inspected at the firm's website.

Attorney Advertising. This Alert may be considered advertising under the rules of some states. Prior results described cannot and do not guarantee or predict a similar outcome with respect to any future matter that we or any lawyer may be retained to handle.