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Illinois Adopts Click-Through Nexus Law

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Publication Date: March 14, 2011

On March 10, 2011, Illinois Governor Patrick Quinn (D) signed Public Act 96-1544 (H.B. 2659) into law, adding Illinois to a growing list of states that have adopted an "Amazon tax" or "click-through nexus" law.[1] Starting July 1, 2011, a retailer will be considered to maintain a place of business in Illinois, and therefore be expected to collect use tax on sales to Illinois purchasers, if:

1. the retailer has a contract with a person located in Illinois under which the person, for a commission or other consideration based upon the sale of tangible personal property by the retailer, directly or indirectly refers potential customers to the retailer by a link on the person's internet website; or,

2. the retailer has a contract with a person located in Illinois under which the retailer sells the same or substantially similar line of products as the person located in Illinois and does so using an identical or substantially similar name, trade name or trademark as the person located in Illinois, and the retailer provides a commission or other consideration to the person located in Illinois based upon the sale of tangible personal property by the retailer; and, in either instance,

3. the cumulative gross receipts for sales of tangible personal property to customers referred to by all persons in Illinois with whom the retailer has such contracts exceed $10,000 during the preceding four quarterly periods ending on the last day of March, June, September and December.[2]

The law also applies to a remote "serviceman" selling tangible personal property incident to the performance of a service.[3]

Governor Quinn signed Public Act 96-1544, which he has dubbed the "Mainstreet Fairness Bill", despite a vow by Amazon that it would terminate its Illinois affiliate relationships, upon enactment of the bill. In fact, late yesterday, in an email message sent by Amazon to its Illinois affiliates, it terminated its relationships with Illinois affiliates, stating:

"We had opposed this new tax law because it is unconstitutional and counterproductive. It was supported by national retailing chains, most of which are based outside Illinois, that seek to harm the affiliate advertising programs of their competitors. Similar legislation in other states has led to job and income losses, and little, if any, new tax revenue. We deeply regret that its enactment forces this action."

Amazon's action notwithstanding, the effect on Illinois as a result of this law has a further and significant reach. According to the Performance Marketing Association - an industry group for retailers that use affiliate programs - Illinois has one of the largest concentrations of affiliates and the country's largest concentration of "super affiliates" - entities that generate their revenues through the creation of affiliate programs, such as coupon and e-rebate websites. Accordingly, the blow dealt to Illinois business by this new legislation will be felt beyond just Amazon.

Illinois' new "click-through nexus" law is also the first such law to be passed since 2009. Although Public Act 96-1544 is similar to New York's original "click-through nexus" law, as well as the laws that were passed by North Carolina and Rhode Island, there are some Illinois-specific wrinkles worth noting.

Prospective Application

One positive effect of the law change is that it clarifies that indirect contacts of the type that create an Illinois use tax collection obligation under H.B. 2659 would not create an Illinois use tax collection obligation for periods prior to the July 1, 2011, effective date of the legislation.

This prospective language is particularly noteworthy because before H.B. 2659 was enacted the Illinois Use Tax Act included a provision that set forth a number of specified contacts with Illinois that would create an Illinois use tax collection obligation, including: (i) having an affiliated retailer in Illinois engaging in the same line of business; (ii) having a franchisee or licensee in Illinois that operates under the same trade-name and collects tax; (iii) engaging in substantial solicitation by mail; and (iv) benefitting from banking, financing, debt collection, telecommunication or marketing activities in Illinois. In fact, the provision went so far as to state that an Illinois use tax collection obligation would exist if a vendor engaged in any activities in Illinois that would give rise to nexus in the vendor's home state.[4] However, this provision was added to the Use Tax Act before the 1992 Quill[5] decision. Since Quill was decided, this provision has not been enforced by the Department of Revenue in the absence of some direct or indirect physical presence in Illinois by the remote vendor.

For the past seven to eight years, a private law firm styling itself as a whistle-blower has been relying on this previously unenforced provision to haul into court dozens of remote vendors in attempts to collect treble damages under the Illinois Whistleblower Reward and Protection Act. The Department of Revenue has not been a party to any of these whistle-blower cases. The new "click-through nexus" statute should insulate remote vendors from any tax collection liability imposed by the Department of Revenue for periods prior to the effective date, but this does not guarantee protection from additional whistle-blower suits seeking to enforce the pre-Quill standards.

Open To Interpretation, and Challenge

The new law does not provide any guidance on the meaning of a "person located in Illinois." Thus, in some situations, there may be uncertainty regarding whether a remote vendor's contracts with particular persons will cause the vendor to have Illinois nexus. There are companies incorporated in Illinois that have no physical presence in Illinois, just as there are companies incorporated and headquartered outside Illinois, with operations and facilities in Illinois. A "corporate" person may be located in Illinois and in many other places, too, at the same time, and its website may not even be located on an Illinois server. While newspapers and blogs discuss the plight of affiliates located in Illinois, i.e., companies entirely located within Illinois, the new law is not limited to that interpretation.

The new law also targets arrangements in which a remote vendor contracts with a "person located in Illinois" and potential customers are referred to the vendor through "a link on the person's internet website." However, it is not entirely clear how the new law would apply to an arrangement in which the person located in Illinois refers potential customers to the vendor, not through a website link, but instead through a website banner that includes the name and toll-free number of the vendor? It would appear that a commission could be earned from a referral through either arrangement, but only the website link would trigger nexus for the remote vendor under the new legislation. This suggests that there may be a potential argument that the new legislation makes a discriminatory classification between effectively identical vendors.

The new law also targets arrangements in which the "person located in Illinois" is paid a "commission or other consideration based upon the sale of tangible personal property." That would seem to exclude a flat-fee arrangement where the fee is paid regardless of whether there is a sale of tangible personal property by the remote vendor, e.g., a payment by a vendor for advertising, in which the advertiser is paid, regardless of whether the advertising results in a sale. Distinguishing between two remote vendors based merely on the different methods by which the vendors compensate the Illinois persons used to promote sales of the vendors' products may also result in a

discriminatory classification. Interestingly, according to the email sent by Amazon to its Illinois affiliates in which it terminated its affiliates program, Amazon intends to pay its Illinois affiliates for all "advertising fees" earned through April 15, 2011.

Certainly, by targeting remote vendors whose only link to Illinois is a commission arrangement tied to a link on the website of an Illinois person, the new legislation puts Illinois on a collision course with the physical presence requirement of Quill. However, it is possible that by encouraging a judicial challenge to Quill, the new legislation will eventually result in clarifying the continuing validity of Quill. The Quill decision, interpreting both the Due Process and the Commerce Clause, clearly required a vendor to have a direct or indirect "physical presence" in the taxing State for the tax collection obligation to pass muster under the Commerce Clause. In a situation in which the "person located in Illinois" does not do anything other than connect the potential customer with the remote vendor through a link to that vendor's site - i.e., the person does not interact with the potential consumer of the remote vendor - the "person located in Illinois" is not 'asking for the sale' and thus cannot be deemed to be soliciting sales on behalf of the vendor.

Finally, the $10,000 threshold is hardly a reliable indicator of the market-penetration or of the success of the 'purposeful exploitation' of the Illinois market. For example, selling $10,000 in paper clips would suggest much deeper market penetration and broader exploitation than selling $10,000 in personal computers. As a Due Process substitute for a "minimum contacts" analysis or even a "substantial nexus" analysis, the $10,000 monetary threshold is woefully arbitrary and inexact. Conceivably, a remote vendor having one referral and making one sale to an Illinois purchaser could be subject to a tax collection requirement, whereas a person receiving thousands of Illinois referrals and making one hundred Illinois sales could escape.

Conclusion

In 1967, Illinois was the leader in advancing the economic nexus as a jurisdictional standard for use tax collection, in National Bellas Hess[6]. Despite losing that case and thus ushering a bright-line approach tied to physical presence for nexus, Illinois has continued to advocate economic nexus. In the late 1980s, then Governor James Thompson testified before Congress in favor of a national economic nexus standard for mail-order vendors. In the face of Congressional inaction, Illinois amended its statute in 1989 to extend nexus beyond the bounds that National Bellas Hess had set forth, only to be unable to enforce the new provisions once the 1992 Quill decision revitalized the Commerce clause physical-presence requirement set forth in National Bellas Hess. For the past two years, the Illinois Department of Revenue has mulled the idea of imposing a "click-through nexus"

standard by regulation, but it appears to have listened to those who advised that if the State's goal was to encourage a judicial challenge that would lead to a reversal of the U.S. Supreme Court decision in Quill, the best approach would be to be bold and impose a "click-through nexus" standard through legislation. Like silent-screen star Norma Desmond in the movie Sunset Boulevard, forty-four years after National Bellas Hess, Illinois is once again ready for its close-up!

Reed Smith's state and local tax practice is comprised of 29 lawyers across seven offices nationwide. The practice focuses on state and local audit defense and refund appeals (from the administrative level through the appellate courts), as well as planning and transactional matters involving income, franchise, unclaimed property, sales and use, and property tax issues.

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1. Similar legislation has already been adopted in New York, North Carolina and Rhode Island.
2. Amending Section 2 of the Use Tax Act. 35 ILCS 105/2.
3. Amending Section 2 of the Service Use Tax Act. 35 ILCS 110/2.
4. 35 ILCS 105/2. Arguably, and constitutionally suspect, New York's Amazon law was already the law in Illinois with respect to New York vendors selling into Illinois.
5. Quill Corp. v. North Dakota, 504 US 298 (1992).
6. National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 753 (1967).