Internet Affiliates Fight Back in Court Against Illinois Retail Tax

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An organization that represents online affiliates filed suit in federal court this month challenging the constitutionality of a new Illinois law targeted at collecting sales tax from Web retailers. Internet retail giant Amazon.com has threatened to cut off its marketing affiliates in Illinois in an effort to avoid paying the tax, and other companies are threatening similar action. We have previously examined the potential effects on affiliates of this type of state tax.

Internet retailers cite a 1992 Supreme Court decision, *Quill Corporation v. North Dakota*, which ruled that states could require only companies that had a physical presence within the state to act as a tax collector. Online retailers have used this ruling to justify the payment of taxes only in the few states in which they have a physical presence.

The suit claims that the Illinois law goes beyond the state's power to regulate interstate commerce, since the state legislature seems to be taking the view that an online retailer, with no physical presence in the state, establishes a presence in Illinois merely by advertising on websites owned by Illinois affiliates.

With many states facing significant budget shortfalls, legislative momentum is growing throughout the country to tax Internet retailers. A University of Tennessee study has estimated that between 2007 and 2012, states will sustain over $52 billion in losses from uncollected taxes on e-commerce sales. Connecticut has already signed into law a state tax on online purchases earlier this month, and California lawmakers have passed a bill, now awaiting approval from the governor, that would force out-of state Internet retailers to collect taxes. Bills are pending in at least five other state legislatures.

These bills are all, in one way or another, efforts by the states to circumvent the court's ruling in *Quill*. Last year, New York enacted a law that stated that the practice of paying commissions to marketing agents based in the state constituted a presence in the state. Amazon has challenged the law in court. Several other states, including Arkansas, Colorado, Illinois, North Carolina, and Rhode Island all followed by passing laws similar to New York's.

With companies threatening to leave states that enact taxes and in some cases actually cutting all ties with the states, state legislatures are debating what to do. While some states are looking at enacting their own taxes, other states are considering different routes. In April, the South Carolina legislature defeated a law that would have provided a five-year sales tax exemption to Amazon in exchange for Amazon building a distribution center in the state. Amazon then cancelled its plans to build a distribution center in South Carolina.

The one action that would break the logjam would be federal legislation requiring states to collect sales tax on Internet retailers. Last summer a bill entitled the "Main Street Fairness Act," (H.R. 5660) was introduced in Congress that would require all businesses to collect taxes in the state where the consumer resides. The bill did not make it out of committee, but some feel that the tides are shifting towards federal action. Sen. Dick Durbin (D. Ill.) has stated that he plans to reintroduce legislation to tax online retailers, calling the idea "overdue." However, federal legislation could be complicated if voters perceive this as a new tax.

As states look to close the gap on budget shortfalls, there will be continued debate on the viability of taxing Internet retailers. Unless action occurs at the federal level, states will have to decide if it's preferable to tax Internet retailers and risk losing their presence in the state or not to tax them in an attempt to maintain or grow their presence in the state.

FTC Beat is authored by the Ifrah Law Firm, a Washington DC-based law firm specializing in the defense of government investigations and litigation. Our client base spans many regulated industries, particularly e-business, e-commerce, government contracts, gaming and healthcare.

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