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California Governor signs law imposing sales tax collection responsibility on remote sellers

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On June 29, 2011, California Governor Jerry Brown signed a bill requiring certain retailers to collect taxes on remote sales. In general, the bill includes a click-through nexus provision and language granting the State Board of Equalization authority to impose nexus requirements to the fullest extent allowable under the U.S. Constitution. [[California ABX1 28](#), enacted 6/29/11].

Background

California sales and use tax is imposed upon retailers engaged in business in the state. The tax is measured by the gross receipts from the sales of tangible personal property sold at retail or stored, used or consumed in the state. "Retailers engaged in business in this state" includes retailers that engage in specified activities in the state. ABX1 28 expands that definition to include any retailer with substantial nexus with California and a retailer upon whom federal law permits the state to impose a use tax collection duty.

Affiliate nexus

Specifically included as a retailer engaged in business in the state is any retailer that is a member of a commonly controlled group and is a member of a combined reporting group that includes another member that pursuant to an agreement, performs services in the state in connection with the tangible personal property sold by the retailer. These services include, but are not limited to, the design and



development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer.

Click-through nexus

The bill also includes as a retailer engaged in business in the state any retailer that enters into agreements with a person in the state who, for a commission or other consideration, refers potential purchasers to the retailer by an internet-based link or web site. This so called "click-through" nexus provision only applies where the retailer had total California sales of more than \$10,000 in the preceding 12 months that originated from such referral agreements and, within the same time period, total cumulative California sales of more than \$500,000.

An agreement under which a retailer purchases advertisements from a person in California is not a referral agreement as described above, unless the advertisement revenue paid to the person in California consists of commissions or other consideration that is based upon the sales of tangible personal property.

The "click-through" nexus provision does not apply if the retailer can demonstrate that the person in California with whom the retailer has an agreement did not engage in referrals in the state on behalf of the retailer that would satisfy the requirements of the Commerce Clause of the U.S. Constitution.

Effective date

ABX1 28 is effective immediately.

PwC observes

"This budget trailer bill, AB1X28, is a combination of three bills that addressed "the use tax gap" - AB 153, AB 155 and SB 234. There is a question as to whether the provisions of AB1X 28 are constitutional and it is expected to be challenged in court," observes Joan Armenta-Roberts, Managing Director at PwC in San Jose, California. "The physical presence requirement for a business to have 'substantial nexus' provided in *Quill* arguably has been ignored. In addition to the 'click through' nexus and affiliate nexus provisions, the bill contains a 'long-arm' nexus provision that, per the BOE's analysis 'provides California with the tools it needs to allow for use tax collection to the fullest extent federal law and the U.S. Constitution permit. Any nexus limitations previously included under California law have been eliminated.'"

"It's unclear what the Legislature intended by removing the nexus limitations," continues Armenta-Roberts. "However, it appears they wanted to make sure the statute did not have restrictive standards. In fact, there is a question as to whether the measure expands the definition of nexus to include out-of-state Internet and mail order retailers and out-of-state retailers that use independent California contractors to perform warranty and repair work on products they sell."

"Interestingly, the BOE's revenue analysis questioned the likelihood of actually realizing the estimated revenues and specifically stated that it will depend entirely on '(1) internet retailers' (such as Amazon and Overstock) willingness to continue their affiliate programs, and (2) other retailers' willingness to continue to sell on eBay and to fully comply with the added use tax collection obligations imposed by the bill. It is now a known fact that Amazon, along with other companies, has terminated their

relationship with their California affiliates. Consequently, the actual revenue received will be lower than projected and it is predicted that this will have an adverse impact on the state's employment, which will lead to lower revenues from personal income and corporation tax."

"The BOE will soon be amending the affected regulations and will have to identify what specific activities are considered to constitute substantial nexus under their interpretation of the U.S. Commerce Clause. As part of the regulation process, there will be interested party meetings conducted. PwC will attend the meetings and will provide updates of the decisions being considered."

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