

New York – High court affirms facial constitutionality of remote seller law

April 5, 2013

In brief

On March 28, 2013, the New York Court of Appeals (the state's highest court), held that New York's 'vendor presumption' law is not unconstitutional on its face, with one justice dissenting. The law generally imposes a rebuttable presumption that a seller is soliciting business in the state if an in-state resident refers potential customers to the seller, whether by a link on an internet website or otherwise. New York taxpayers affected by the vendor presumption law should be aware that the law remains susceptible to an as-applied constitutional challenge. [[*Amazon.com and Overstock.com v. New York State Dept. of Tax'n and Finance*](#), New York Court of Appeals, Case Nos. 33 and 34, (3/28/13)]

In detail

New York's vendor presumption law

New York law creates a rebuttable presumption that an out-of-state seller is soliciting business in New York, and therefore required to collect and remit the state's sales and use tax, if the seller enters into an agreement with a New York resident under which the resident, "for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website or otherwise, to the seller," if the cumulative gross receipts from these and other New York representative referrals over the preceding four quarterly periods exceeds \$10,000.

After the statute's enactment, the Department of Taxation and

Finance issued two Technical Services Bureau Memoranda providing that: (1) the statutory presumption would only be triggered by commission-based referral agreements, as opposed to flat-fee agreements; (2) the presumption could be rebutted by establishing that the seller's in-state representatives' 'only activity' in the state was advertising (e.g., placing Internet links connecting their websites to the out-of-state seller's website, and not actively engaging in customer solicitation); and (3) a safe harbor from the presumption would be established if the seller included in its business-referral agreements a provision prohibiting its in-state representatives from "engaging in any solicitation activities in New York State that refer potential customers to the

seller" and requiring each of these representatives to submit a signed annual certification stating that it had not engaged in any such solicitation during the prior year.

Facts and procedural history

Amazon.com and Overstock.com (Taxpayers) had essentially the same relevant facts. Both had an 'associates' program through which third parties agreed to place links on their websites that, when clicked, directed users to the Taxpayer's website. The associates were compensated on a commission basis, measured by the sales generated when a person click's on the associate's link and completes a purchase from the Taxpayer. The Taxpayers challenged the

vendor presumption law as facially unconstitutional under the US Constitution's Commerce and Due Process Clauses.

The New York State Supreme Court, Appellate Division, found that the law was facially constitutional and remanded the decision to the trial court for further proceedings regarding whether the law was unconstitutional 'as applied' to the Taxpayers ([click here](#) for our summary of the Appellate Division's ruling). The Taxpayers later abandoned their 'as applied' constitutional challenge and appealed the facial constitutional determination to the New York Court of Appeals.

Vendor presumption law constitutional on its face – commerce clause challenge

The court acknowledged a dispute regarding the appropriate standard for evaluating a facial challenge under the Commerce Clause. The standard is either (1) whether the taxpayer can establish that no set of circumstances exists under which the statute would be valid; or (2) whether the statute has a 'plainly legitimate sweep,' a stricter standard. The court failed to acknowledge which standard applied because the court found that the vendor presumption law is facially constitutional using either standard.

The Commerce Clause challenge involved whether a 'substantial nexus' exists between the state and the remote seller under the vendor presumption law. While in-state physical presence is necessary, it need not be substantial. Rather, the requirement may be satisfied by demonstrating more than a 'slight presence' and such a presence includes the in-state conduct of economic activities on the taxpayers' behalf.

The court found that active in-state solicitation that produces a significant amount of revenue qualifies as more than a slight presence. The court reasoned that "a vendor is deemed to have established an in-state sales force" through its associate agreements and if a vendor is paying in-state residents to actively solicit business in the state, "there is no reason why that vendor should not shoulder the appropriate tax burden."

The court noted that the statute allows for a range of possible types of compensation, including flat fee arrangements. However, the court makes clear that substantial nexus would be lacking if New York residents were merely engaged in passive advertising on their websites.

Vendor presumption law constitutional on its face – due process challenge

The Taxpayers also argued that the statute violates the US Due Process Clause because it creates a presumption that is both irrational and irrebuttable.

While physical presence is not required to satisfy due process, the court noted that a constitutionally valid presumption must offer a "rational connection between the facts proven and the fact presumed, and . . . a fair opportunity for the opposing party to make [a] defense."

The court found the 'fact proved' is that the in-state resident is compensated for referrals that result in purchases and the 'fact presumed' is that at least some of those residents will actively solicit other New Yorkers in an effort to increase their referrals and their compensation. The court concluded that it is not unreasonable to assume such efforts would take place.

Further, the court noted that the Taxpayers' claim that the presumption was 'irrebuttable' due to being extremely difficult, if not impossible, to disprove was unfounded. The court pointed to Department guidance establishing when retailers are deemed to have rebutted the presumption (such as contractual prohibitions against solicitation and annual documentation certifying no solicitation took place).

Dissenting opinion – website links essentially the same as newspaper advertising

In the dissenting opinion, one judge argued that there was no basis for inferring in-state website owners were actively soliciting for out-of-state retailers. The judge noted further that the statute "tries to turn advertising media into an in-state sales force through a presumption." In opining that the vendor presumption law is unconstitutional, the judge noted "to infer, from an agreement to put a link on a website and to compensate the website owner in proportion to the resulting sales, that the website is actively soliciting business for the seller is so strained as not to have a reasonable relation to the circumstances of life as we know them."

The takeaway

It is unfortunate that the Taxpayers abandoned their 'as-applied' constitutional argument as there are elements of the opinion and the dissent that suggest an alternative analysis may have been employed (whether an alternative outcome would have resulted is unknown). The majority opinion stressed that substantial nexus would not exist if New York residents were merely posting passive advertisements on their websites. While the court equated the Taxpayers' associate agreements with an in-state sales

force, what if the agreements contained restrictions on the associates' ability to solicit? Could their relationship be viewed more like advertising than soliciting (despite the certain comparison to the Department's standards for rebutting the presumption)? The dissent would suggest so. Even under the facts presented, the dissent asserts that the affiliates provide media in which the Taxpayers advertise their products, which is not active solicitation.

The majority opinion also invited a distinction between compensation by

commission and compensation unrelated to actual sales by observing that it would be "difficult to distinguish that arrangement from traditional advertising." However, because the court was limited to a facial challenge, the potential 'constitutional infirmity' was irrelevant. It is unknown whether the court would have ruled otherwise if facts reflected associates contracted under an alternative compensation scheme. Given the Department's position that the presumption is triggered only by a commission

arrangement, it is questionable whether the law will be applied to a flat-fee arrangement.

Also of note, the court may have given an indication as to its disapproval of *Quill's* physical presence standard. The court stated that the "world has changed dramatically" in the last two decades, and it may be that the physical presence test is outdated." However, the court acknowledged that it was 'bound' by precedent and the question of revisiting physical presence is one for the US Supreme Court.

Let's talk

If you have any questions regarding the *Amazon.com and Overstock.com* decision, please contact:

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