taxanalysts special report

California's Once and Future 'Amazon' Law

by Edward A. Zelinsky

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I. Introduction

California's recently enacted "Amazon" law[1] is important for three reasons. First, California is, well, California, the nation's most populous state and a bellwether of social trends and public policy. What happens in California doesn't stay in California. Second, California is home to two Amazon subsidiaries, A9.com Inc. and Lab126. If and when it takes effect, the new California legislation will require Amazon to collect California use taxes because of those subsidiaries. The California act thus highlights important constitutional limitations on the ability of states to mandate use tax collection obligations on out-of-state Internet and mail-order sellers.

Finally, at the end of the current session of the California State Legislature, a deal was brokered under which Amazon dropped its efforts to repeal by voter initiative California's new Amazon law. In return, Amazon obtained a one-year delay in the state's implementation of the new law. Those events suggest that we may be entering a new phase in the debate about the states' taxation of remote sales. Paradoxically, California's Amazon act, despite its practical and legal infirmities, may prove to be a game changer, the final straw for Amazon and its Internet peers. Coming after other states' efforts to impose tax collection responsibilities on out-of-state remote sellers, the California statute may have finally convinced Amazon and its Internet peers that they are better off with federal legislation than with the proliferation of state Amazon acts. We shall see.

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If it takes effect, California's Amazon law will make two fundamental changes to the Golden State's statutory definition of a retailer obligated to collect use tax on sales to California customers. First, emulating New York's version of an Amazon law, the California act will assert retailer status against otherwise out-of-state remote sellers based on those sellers' California associates that refer customers to those sellers. Second, borrowing from Colorado's Amazon act, the California statute will use common ownership to classify as retailers some sellers that are part of commonly owned groups including one member that provides services in California. By those changes, the new California law will purport to expand the use tax collection responsibilities of out-of-state Internet and mail-order sellers.

If they take effect in 2012, those provisions of California's new law will prove to be futile or unconstitutional. Internet sellers will respond to the associates-based portion of California's Amazon law by terminating their associates in the Golden State or by forbidding those associates from engaging in solicitation that will trigger the sellers' obligation to collect California use tax. California will thus gain no revenue from the associates-based provision of its

[1]In June, ABX1 28 amended Calif. Revenue and Taxation Code section 6203, effective immediately. Recently, AB 155 retroactively reinstated the prior version of section 6203 and delayed the effective date of the new version until September 15, 2012.

For ease of expression, in the footnotes, I designate as "section 6203 (current version)" the version of section 6203 in effect before the adoption of ABX1 28 in June and in effect now by virtue of AB 155. I describe as "section 6203 (new version)" the version of section 6203 embodied in ABX1 28, in effect during the summer and now delayed by AB 155.

Amazon act and may actually lose revenue from that provision because terminated associates will no longer earn commissions on their referrals and will thus cease to pay state income taxes on those commissions.

Insofar as the amended California statute will tie an out-of-state remote seller's obligation to collect use tax to common ownership with another corporation providing services in California, the statute will be unconstitutional as applied in specific cases. Under the dormant commerce clause, an out-of-state parent's ownership of a subsidiary operating in California does not substitute for the parent's own physical presence in California.

Thus, despite its moniker, California's Amazon law, if it goes into effect, will fail to effectively impose use tax collection responsibilities on Amazon itself. Amazon's termination of its California associates will avoid the application to Amazon of the new statute's associates-based provision. As a constitutional matter, Amazon's ownership of two service-providing subsidiaries operating in California will not, for dormant commerce clause purposes, overcome Amazon's physical absence from California.

However, those conclusions will be of secondary consequence if Amazon sincerely uses the recently obtained delay of the California law to secure federal legislation in place of that law and the other state acts imposing sales and use tax collection responsibilities on remote sellers. If Congress does pass that legislation, the California law (and the state Amazon laws that preceded it) will have ultimately achieved their aim by provoking federal legislation authorizing the states to tax all sales similarly, whether the vendor is a traditional bricks-and-mortar retailer or an out-of-state Internet or mail-order vendor. If so, paradoxically, California's Amazon law, which doesn't effectively reach Amazon, will have proved to be a game changer.

It is also possible that a year from now, Congress's continuing inaction will have perpetuated the sales and use tax status quo, thereby triggering the new California Amazon law. Which scenario occurs will largely depend on the good faith of Amazon and the other Internet retailers that say they will now seek federal legislation permitting the states to impose sales and use tax collection responsibilities on remote sellers.

In sum, California's Amazon law is an exercise in paradox. On the one hand, if it takes effect, the law will prove fiscally futile and unconstitutional in many applications. On the other hand, California's law may, in political terms, have provoked a game-changing response from Amazon and its Internet peers.

II. Legal Background

A legal assessment of California's Amazon law implicates three sets of well-established rules: the physical presence nexus test outlined in the dormant commerce clause decisions of the U.S. Supreme Court, the corporate law tenet that parent corporations and their subsidiaries are separate legal persons, and the doctrines of agency law.

The Court has demarcated the ability of the states to impose sales and use tax collection duties in four dormant commerce clause decisions: *National Bellas Hess v. Department of Revenue*,[2] *Quill Corp. v. North Dakota*,[3] *Scripto, Inc. v. Carson*,[4] and *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*.[5] *National Bellas Hess*, as modified and affirmed by *Quill*, holds that under the dormant commerce clause,[6] a state can thrust sales and use tax collection responsibilities on a retailer only if that retailer has physical presence nexus to the taxing state.[7] An out-of-state mail-order seller like National Bellas Hess or Quill Corp. cannot be required to collect sales or use taxes because such a seller lacks in-state physical presence if the seller only "solicits business through catalogs and flyers, advertisements in national periodicals, and telephone calls . . . [and] delivers all of its merchandise to its . . . customers by mail or common carrier from out-of-state locations."[8] In *Scripto* and *Tyler Pipe*, the Court held that a seller's physical presence in the taxing state can be established through employees and independent contractors undertaking in-state solicitation for the seller.[9]

"Subsidiary corporations and parent corporations are separate and distinct 'persons' as a matter of law, and the separate entity of corporations will generally be observed by the courts even where one company may dominate or control the other company."[10] Like many legal rules, the separate legal

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[2]386 U.S. 753 (1967).
[3]504 U.S. 298 (1992).
[4]362 U.S. 207 (1960).
[5]483 U.S. 232 (1987).
[6]*National Bellas Hess* had originally held that both the due process and the dormant commerce clauses of the U.S. Constitution require a retailer's physical presence nexus to a state for that state to impose upon the retailer a use tax collection responsibility. *Quill* modified *National Bellas Hess* so that today the physical presence nexus requirement arises only under the dormant commerce clause.
[7]For further discussion of *National Bellas Hess* and *Quill*, see Edward A. Zelinsky, "Rethinking Tax Nexus and Apportionment: Voice, Exit, and the Dormant Commerce Clause," 28 *Va. Tax Rev.* 1, 10-12, 14-16 (2008).
[8]*Quill*, 504 U.S. at 302.
[9]For further discussion of *Scripto* and *Tyler Pipe*, see Zelinsky, *supra* note 7, at 9-10 and 12-13.
[10]*Wooley v. Lucksinger*, 14 So. 3d 311, 410 (2008). *See also Baker v. Tremco, Inc.*, 890 N.E. 2d 73, 78 (Ind. Ct. App. 2008) ("Generally, a parent corporation and its subsidiary are

(Footnote continued on next page.)

identities of parent corporations and their subsidiaries may be qualified both by common law doctrines (for example, alter ego,[11] piercing the corporate veil[12]) and by statute.[13] However, "the law has for the most part treated parent companies and their subsidiaries as separate legal entities."[14]

"Agency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act."[15] "The common law of agency attributes the legal consequences of" an agent's actions to the principal[16] for whom the agent works and by whom the agent is controlled. Absent subsequent ratification of an unauthorized act,[17] an agent's unauthorized act does not bind a principal since "[a]n agent has such authority as the principal, actually or ostensibly, confers upon him."[18]

III. Factual Background: Amazon's California Subsidiaries

Amazon, the nation's largest Internet seller, is a Delaware corporation with its principal offices in Seattle.[19] Amazon itself has neither physical facilities nor personnel in California. However, Amazon has two subsidiaries operating in California. A9.com Inc., located in Palo Alto, "works on search technology."[20] A9.com is organized in Delaware and is registered to do business in California.[21] A9.com describes itself as a "wholly owned and operated subsidiary of Amazon.com."[22]

Lab126, based in Cupertino, designed Amazon's Kindle[23] and describes itself as "part of the Amazon .com, Inc. group of companies."[24] Lab126 is actually a dba for A2Z Development Center Inc., a Delaware corporation registered to do business in California.[25]

IV. The Once and Present California Use Tax Statute

California's use tax statute was amended by the state's Amazon act,[26] with the amendments taking effect as of June 28, 2011.[27] Recently, the California Legislature retroactively reinstated the pre-amendment law effective through September 15, 2012.[28] At that point, if Congress has not legislated in this area, the Amazon law's amendments to the California use tax statute will again go into effect.[29]

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considered to be separate legal entities, even if the subsidiary is wholly owned by the parent corporation").

[11]*See, e.g.*, *Gering v. Fraunhofer USA, Inc.*, 2009 U.S. Dist. LEXIS 79196 (E.D. Mich., S. Div. 2009) at *10 (discussing "the extent [that] Michigan courts have utilized the alter ego theory to pierce the corporate veil").

[12]*See, e.g.*, *Ruggiero v. FuturaGene, plc*, 948 A.2d 1124, 1135 (Del. Chan. 2008) (discussing "an argument to pierce the corporate veil") (internal quotation marks deleted).

[13]*See, e.g.*, Internal Revenue Code section 414(b) (providing that, for qualified plan purposes, "all employees of all corporations which are members of a controlled group of corporations . . . shall be treated as employed by a single employer").

[14]Stefan J. Padfield, "In Search of a Higher Standard: Rethinking Fiduciary Duties of Directors of Wholly-Owned Subsidiaries," 10 *Fordham J. Corp. & Fin. L.* 79, 112 (2004).

[15]Restatement of the Law, Third, Agency (2006) at section 1.01 (parentheses in original). *See also* Cal. Civ. Code section 2295 ("An agent is one who represents another, called the principal, in dealings with third persons. Such representation is called agency").

[16]Restatement of the Law, Third, Agency (2006) at section 2.01 Introductory Note. *See also* Cal. Civ. Code section 2330 ("An agent represents his principal for all purposes within the scope of his actual or ostensible authority, and all the rights and liabilities which would accrue to the agent from transactions within such limit, if they had been entered into on his own account, accrue to the principal").

[17]*See* Restatement of the Law, Third, Agency (2006) at section 4.02(1) ("ratification retroactively creates the effects of actual authority"). *See also* Cal. Civ. Code section 2310. *Wyndham Vacation Resorts, Inc. v. Architects Haw. Ltd.*, 703 F. Supp. 2d 1051, 1062 (2010) ("in order to be bound by an agent's authorized act, the principal needs full knowledge of the material facts and an intent to approve the agent's act"). (Emphasis deleted.)

[18]Cal. Civ. Code section 2315.

[19]NASDAQ, Amazon Company Description (as filed with the SEC), *available at* http://quotes.nasdaq.com/asp/SummaryQuote.asp?symbol=AMZN&selected=AMZN.

[20]A9.com, About A9.com, *available at* http://a9.com/-/company/.

[21]Lexis search: Public records/Corporation Filings/California Secretary of the State (last searched Sept. 1, 2011).

[22]*Supra* note 20.

[23]Lab126, home page, *available at* http://www.lab126.com/index.htm.

[24]*Id.*

[25]California State Board of Equalization, Sales and Use Tax Information found in Lexis California Business Locator. *See* Lexis/Public Records/Find a Business/California Business Locator; Sales & Use Tax Permit Holder Information.

[26]ABX1 28.

[27]Brown signed California's Amazon act on June 28, 2011. The signed bill took effect immediately. ABX1 28, section 5.

[28]Section 1 of AB 155 repeals the Amazon version of section 6203 of California's use tax law. This new variant of section 6203 took effect on June 28 by virtue of ABX1 28. In place of the ABX1 28 version of section 6203, section 2 of AB 155 reinstates the prior version of section 6203. Section 3 of AB 155 reenacts the Amazon version of section 6203 from ABX1 28. Section 6(a) of AB 155 makes sections 1 and 2 of that bill effective immediately, thus reinstating the older version of section 6203 immediately. Section 6(b)(2) of AB 155 provides that section 3 (the Amazon law) replaces section 2 (the current use tax law) on September 15, 2012, unless Congress adopts before then a new federal law "authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller." Section 6(d) of AB 155 effectively reinstates the prior version of section 6203 retroactively to June 28, 2011, when Brown signed the Amazon law.

[29]If Congress adopts legislation but California chooses not to implement it, California's Amazon law will go into effect on January 1, 2013. Section 6(b)(1) of AB 155.

California's once and present use tax law imposes the obligation to collect use taxes on "every retailer engaged in business in"[30] California "making sales of tangible personal property for storage, use, or other consumption in" the Golden State.[31] The current law defines three types[32] of sellers that are engaged in business in California and are thus retailers obligated to collect use tax on their California sales of tangible personal property. First, the California use tax statute declares a seller of tangible personal property to be engaged in business in the state if the seller "maintain[s], occup[ies], or us[es], permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business"[33] in California.

Second, California's use tax statute also defines a firm as a retailer engaged in business in the state if the firm "has any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in [California] under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property."[34] Third, the statute defines as a California retailer obligated to collect use tax "any retailer deriving rentals from a lease of tangible personal property situated in" California.[35]

With one important exception, the first two of these definitions of a California retailer reflect the rules laid down by the U.S. Supreme Court in *National Bellas Hess*,[36] *Quill Corp.*,[37] *Scripto, Inc.*,[38] and *Tyler Pipe*.[39] Defining a retailer as a person maintaining "an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business"[40] in California implements the physical presence test articulated in *National Bellas Hess* and *Quill* by tying retailer status to an in-state facility. *Scripto* and *Tyler Pipe* similarly inform the use tax statute's definition of a California retailer as a person with in-state personnel "for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property."[41]

The California use tax statute imposes the obligation to collect use tax on a retailer whether the retailer itself maintains an in-state facility or whether that facility is maintained in California for a retailer by the retailer's agent.[42] That aspect of the use tax statute is constitutionally unexceptionable; nothing distinguishes in-state facilities maintained directly by a retailer itself from facilities maintained by an agent acting for and under the control of the retailer. *Scripto* and *Tyler Pipe*, implementing fundamental principles of agency law, make clear that an in-state agent generates dormant commerce clause presence for the otherwise out-of-state retailer the agent represents.[43]

In contrast, it is constitutionally problematic for the California use tax statute to declare that a parent corporation is a Golden State retailer if its subsidiary has either a physical facility or personnel in California. If a subsidiary acts as its parent's agent in California, the agency relationship, rather than the parent's ownership of the subsidiary, makes the facilities and personnel maintained by the subsidiary/agent in California the retailer's facilities and personnel in California. It is irrelevant whether an agent is owned by its principal or not; an agent's assets and activities are imputed to the principal for whom the agent acts by virtue of the agency relationship between them. An agency affiliation does not depend on and is not established by common ownership. Rather, the crux of an agency relationship is that an agent is controlled by and works on behalf of the agent's principal.[44]

Consequently, the use tax statute's reference to a "subsidiary" is constitutionally problematic because corporate parents and their subsidiaries are, under traditional rules of corporate law, legally distinct

[30]Calif. Revenue and Taxation Code section 6203(a) (current version).

[31]*Id.*

[32]In addition to those three definitions, the California use tax statute provisionally imposes use tax collection responsibilities on some "retailer[s] soliciting orders for tangible personal property by mail if the solicitations are substantial and recurring" and meet other statutory requirements. Calif. Revenue and Taxation Code section 6203(c)(4)(A) (current version). This provision is to take effect only on the adoption by Congress of federal legislation "that authorizes states to compel the collection of state sales and use taxes by out-of-state retailers." *Id.* at section 6203(c)(4)(B). Because no such federal law has been adopted, this provision of the California use tax statute has not become effective.

[33]Calif. Revenue and Taxation Code section 6203(c)(1) (current version).

[34]Calif. Revenue and Taxation Code section 6203(c)(2) (current version).

[35]Calif. Revenue and Taxation Code section 6203(c)(3) (current version).

[36]386 U.S. 753 (1992).

[37]504 U.S. 298 (1992).

[38]362 U.S. 207 (1960).

[39]483 U.S. 232 (1987).

[40]Calif. Revenue and Taxation Code section 6203(c)(1) (current version).

[41]Calif. Revenue and Taxation Code section 6203(c)(2) (current version).

[42]Calif. Revenue and Taxation Code section 6203(c)(1) (current version).

[43]Zelinsky, *supra* note 7, at 9-10 and 12-13.

[44]Restatement of the Law, Third, Agency (2006) at section 1.01.

persons.[45] It is unpersuasive for the statute to declare an out-of-state corporation to be a California retailer by virtue of a California subsidiary — unless that subsidiary is its parent's agent, in which case the California subsidiary's status as a subsidiary is irrelevant.

The use tax statute's reference to a 'subsidiary' is constitutionally problematic because corporate parents and their subsidiaries are, under traditional rules of corporate law, legally distinct persons.

Instructive in this context is the opinion of the California Court of Appeal in *Current, Inc. v. State Board of Equalization*.[46] Current Inc. was a Delaware corporation that operated a mail-order business from Colorado, principally selling greeting cards and gift wrapping paper.[47] Current Inc. had no employees, buildings, or other physical presence in California, but it did sell by mail or common carrier[48] to California customers.

Deluxe Corp., a Minnesota corporation, acquired Current on December 31, 1987.[49] Deluxe had substantial physical presence in California, including plants as well as sales and supervisory personnel in California.[50] Deluxe was primarily in the business of producing and selling checks at wholesale.[51] In its factual findings, the appellate court emphasized the separate corporate identities of Current and Deluxe, despite their parent/subsidiary relationship:

> Neither Current nor Deluxe was the alter ego or agent of the other for any purpose. Neither solicited orders for the products of the other, and neither accepted returns of the merchandise of the other or otherwise assisted or provided services for customers of the other. Each owned, operated and maintained its own business assets, conducted its own business transactions, hired and paid its own employees, and maintained its own accounts and records. Current and Deluxe did not have integrated operations or management.
>
> Current and Deluxe were organized and operated as separate and distinct corporate entities. Neither held itself out to customers or potential customers as being the same as, or an affiliate of, the other. Each had its own trade name, goodwill, marketing practices and customer lists and marketed its products independently of the other. Neither exploited the trade name, corporate identification or goodwill of the other or purchased goods or services from the other.[52]

At the time, the California use tax statute[53] required a retailer to collect California use tax if the "retailer [was] owned or controlled by the same interests which own or control any retailer engaged in business in the same or similar line of business in" California. As a statutory matter, the appeals court found that Current and Deluxe were not engaged in "the same or similar line of business."[54]

More importantly, the appellate court found that given the separate corporate identities of Current and Deluxe, Deluxe's physical presence nexus to California could not as a constitutional matter be imputed to Current: "Current's physical nexus with the State of California [was] insufficient to justify the imposition of a use tax" collection responsibility under *Quill*.[55] Had Deluxe acted as Current's agent in California, the court's conclusion would have been different. However, the parent/subsidiary relationship, by itself, is insufficient to find that an out-of-state corporation has in-state presence for dormant commerce clause purposes.[56]

As we shall see,[57] if the Amazon amendments to the California use tax statute become effective again in 2012, the amended statute will suffer from the same constitutional malady exposed by the appeals court in *Current, Inc.*, that is, improperly imputing the California presence of a non-agent subsidiary to its out-of-state parent. An otherwise out-of-state seller does not become an in-state retailer for use tax purposes simply because the seller has an in-state subsidiary. That subsidiary must also act as its parent's in-state agent in California to generate in-state physical presence for the parent and thus

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[45] *Wooley v. Lucksinger*, 14 So. 3d 311, 410 (2008); *Baker v. Tremco, Inc.*, 890 N.E. 2d 73, 78 (Ind. Ct. App. 2008).

[46] 24 Cal. App. 4th 382 (1st App. Dist., Div. Two 1994).

[47] *Id.* at 386.

[48] *Id.*

[49] *Id.* at 387.

[50] *Id.*

[51] *Id.*

[52] *Id.* at 389.

[53] *Id.* at 390 (quoting Calif. Revenue and Taxation Code section 6203(g) before its repeal).

[54] *Id.* at 391-392.

[55] *Id.* at 391.

[56] Other courts have come to the same result in the use tax context. *See SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666, 673 (1991) (It remains "a fundamental principle of corporate law that the parent corporation and its subsidiary are treated as separate and distinct legal persons") (internal quotation marks and citation deleted); *Bloomingdale's By Mail, Ltd. v. Commonwealth of Pennsylvania*, 567 A.2d 773, 778 (1989) (Under *National Bellas Hess* and *Scripto*, the relevant constitutional test is whether the in-state corporation "acts as an agent or representative for" the separately incorporated mail-order firm).

[57] *See* notes 106 through 117, *infra*, and accompanying text.

make the parent a California retailer obligated to collect California use tax on its sales to California customers.

V. California's Amazon Act: The Once and Future California Use Tax Statute

California's Amazon act[58] originally took effect on June 28, 2011.[59] The Legislature has now deferred the act's effective date to September 15, 2012.[60]

If it becomes operative, the law will amend the California use tax statute to define as a retailer engaged in business in the Golden State "any retailer that has substantial nexus with [the] state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."[61] To implement this language, the amended statute provides that the definition of a California retailer "specifically includes, but is not limited to"[62] five kinds of retailers. The first three of these categories track the retailer definitions of the current version of the statute, that is, a retailer with an in-state place of business,[63] a retailer with in-state personnel,[64] and a retailer that leases tangible personal property located in California.[65]

The Amazon statute's fourth definition of a California retailer will be new to the state's use tax statute and will be based on the common ownership of a remote seller and a corporation providing services in California.[66] Under that recently added definition, a person will be a California retailer, required to collect use taxes on sales to California customers, if (1) the retailer "is a member of a commonly controlled group," (2) the retailer is also "a member of a combined reporting group" for California income tax purposes, and (3) the combined reporting group "includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in [California] in connection with tangible personal property to be sold by the retailer."[67]

The services triggering retailer status under this definition will include, but not be 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."[68] Common control will generally be defined for these purposes in terms of majority ownership.[69] Thus, a parent and its subsidiary will be deemed commonly controlled if the parent "owns stock possessing more than 50 percent of the voting power of" the subsidiary.[70] In terms of brother/sister corporations, two corporations will be deemed commonly controlled if "the same person" owns "stock representing more than 50 percent of the voting power" of each corporation.[71]

> ***The California version (unlike the comparable Colorado law) applies even in the absence of an agency relationship between an out-of-state seller and the in-state corporation commonly owned with the seller.***

This fourth definition emulates the approach pioneered by Colorado[72] under which an otherwise out-of-state seller is brought within the jurisdiction of Colorado's use tax statute on the basis of common ownership with an in-state corporation. However,

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[58]ABX1 28.

[59]Brown signed California's Amazon act on June 28, 2011. The signed bill took effect immediately. ABX1 28, section 5.

[60]Section 6(b)(2) of AB 155.

[61]Calif. Revenue and Taxation Code section 6203(c) (new version).

[62]*Id.*

[63]Calif. Revenue and Taxation Code section 6203(c)(1) (new version). *Cf.* Calif. Revenue and Taxation Code section 6203(c)(1) (current version).

[64]Calif. Revenue and Taxation Code section 6203(c)(2) (new version). *Cf.* Calif. Revenue and Taxation Code section 6203(c)(2) (current version).

[65]Calif. Revenue and Taxation Code section 6203(c)(3) (new version). *Cf.* Calif. Revenue and Taxation Code section 6203(c)(3) (current version).

[66]Calif. Revenue and Taxation Code section 6203(c)(4) (new version).

[67]*Id.*

[68]*Id.*

[69]*Id.* (incorporating Calif. Revenue and Taxation Code section 25105).

[70]Calif. Revenue and Taxation Code section 25105(b)(1)(A).

[71]Calif. Revenue and Taxation Code section 25105(b)(2).

[72]Colo. Rev. Stat. section 39-26-102(3)(b)(II). An important difference between the Colorado and California laws is that the Colorado statute imposes reporting, rather than collection, responsibilities on remote sellers. *See* Edward A. Zelinsky, "The Siren Song of 'Amazon' Laws: The Colorado Example," *State Tax Notes*, Mar. 7, 2011, p. 695, *Doc 2011-3777*, or *2011 STT 44-2*; Zelinsky, "The Constitutionality (and Futility) of Colorado's 'Amazon' Law," *State Tax Notes*, Apr. 12, 2011, p. 113, *Doc 2010-6273*, or *2010 STT 69-11*. For a different analysis of Colorado's Amazon law, *see* Andrew J. Haile, "Defending Colorado's Use Tax Reporting Requirement," *States Tax Notes*, Sept. 20, 2010, p. 761, *Doc 2010-16462*, or *2010 STT 181-1*. Oklahoma's Amazon law also uses tests of common ownership to impose on remote sellers the obligation to notify their purchasers about the state's use tax. *See* Zelinsky, "The Paradoxes of Oklahoma's 'Amazon' Statute," *State Tax Notes*, Oct. 25, 2010, p. 241, *Doc 2010-20645*, or *2010 STT 205-1*.

the California version (unlike the comparable Colorado law) applies even in the absence of an agency relationship between an out-of-state seller and the in-state corporation commonly owned with the seller.

To explore the applications and limitations of this new use tax definition of a California retailer, assume initially that Giant Inc., a Delaware corporation, is an Internet seller based in Seattle. Let us suppose that Giant itself has no personnel or facilities in California, but it has two wholly owned California subsidiaries with both offices and employees in the Golden State. Assume further that one of these subsidiaries, Sales Inc., employs personnel who solicit sales of tangible personal property in the Golden State for Giant Inc. Assume as well that Giant's other California subsidiary, R&D Inc., operates a lab in California that develops products for Giant to manufacture and sell. Finally, suppose that Giant, Sales, and R&D file California tax returns as a combined reporting group.

Under the fourth definition to be added to California's use tax statute by California's Amazon act,[73] Sales will cause Giant to be a California retailer for use tax purposes since Sales and Giant are members of a common control group (Giant owns all the stock of Sales) and are also members of a combined reporting group for income tax purposes. Moreover, Sales' business is "the solicitation of sales of tangible personal property on behalf of"[74] Giant. Thus, under this new statutory definition, Giant, by virtue of Sales, will be a California retailer, obligated to collect California use tax on Giant's sales of tangible personal property into the state.

However, under the current use tax statute, Giant is already a California retailer by virtue of Sales and Sales' activity on behalf of Giant in the Golden State. California's present law deems a firm like Giant to be a California retailer for use tax purposes because of Giant's in-state "agent," that is, Sales Inc., which sells and takes "orders for any tangible personal property"[75] for Giant. Thus, Sales triggers for Giant the obligation to collect California use taxes under current law. Moreover, since this provision of the present use tax statute will be carried over as the second definition of the new law,[76] in this hypothetical, the fourth definition of California's Amazon act will be superfluous since the Giant/Sales agency relationship will make Giant a California retailer.

The relationship between Giant and its R&D subsidiary is different from Giant's relationship to Sales and, in this context, the amendments made by California's Amazon act will produce a different result from that obtained under the prevailing version of the California use tax law. Under the current California use tax statute, R&D does not trigger California retailer status for Giant because R&D does not engage in "selling, delivering, installing, assembling, or the taking of orders"[77] for Giant. However, under the new version of the California law, R&D does "design and develop . . . tangible personal property [to be] sold by" Giant.[78] Consequently, under the new law, R&D will trigger in-state retailer status for Giant by virtue of their common ownership and R&D's "design and development" activities in California. This statutory language is evidently aimed at Amazon and its California subsidiaries, A9.com Inc. and Lab126.

The fifth statutory definition added by the California Amazon act[79] adapts New York's associates-based Amazon statute.[80] Under this new definition, a seller of tangible personal property will presumptively be a California retailer, obligated to collect California use taxes, if three tests are satisfied. First, the seller must enter into one or more agreements with one or more California residents under which such residents, "for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise."[81] Second, during

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[73]Calif. Revenue and Taxation Code section 6203(c)(4) (new version).

[74]*Id.*

[75]Calif. Revenue and Taxation Code section 6203(c)(2) (current version).

[76]*Compare* Calif. Revenue and Taxation Code section 6203(c)(2) (current version) with Calif. Revenue and Taxation Code section 6203(c)(2) (new version).

[77]Calif. Revenue and Taxation Code section 6203(c)(2) (current version).

[78]Calif. Revenue and Taxation Code section 6203(c)(4) (new version).

[79]Calif. Revenue and Taxation Code section 6203(c)(5) (new version).

[80]NY CLS Tax Law section 1101(b)(8)(vi). *See* Edward A. Zelinsky, "New York Appellate Division Upholds 'Amazon' Law: Analysis," *State Tax Notes*, Jan. 10, 2011, p. 93, *Doc 2010-26057*, or *2011 STT 6-1*.) [hereinafter, Zelinsky, "Appellate Division"]; Zelinsky, "New York's 'Amazon' Law: Constitutional but Unwise," *State Tax Notes*, Dec. 7, 2009, p. 715, *Doc 2009-24938*, or *2009 STT 232-1*) [hereinafter Zelinsky, "Constitutional but Unwise"]. Illinois's Amazon act incorporates and modifies the associates-based provisions of the New York law. Under the Illinois statute, an Internet seller with Illinois associates is per se required to collect Illinois tax. The seller has no statutory opportunity to demonstrate that its Illinois associates refrain from active in-state solicitation on the seller's behalf. *See* Zelinsky, "Lobbying Congress: 'Amazon' Laws in the Lands of Lincoln and Mt. Rushmore," *State Tax Notes*, May 23, 2011, p. 557, *Doc 2011-7795*, or *2011 STT 99-3*.

[81]Calif. Revenue and Taxation Code section 6203(c)(5)(A) (new version).

the prior 12 months, the seller must have sold through those referrals more than $10,000 of tangible personal property to California purchasers.[82] Third, during the prior 12 months, the seller's total sales of tangible personal property to California purchasers must have exceeded $1 million.[83] A seller of tangible personal property satisfying these three tests will avoid classification as a California retailer, obligated to collect use taxes, if the retailer can demonstrate that the California resident with whom the retailer has a referral agreement "did not engage in referrals in [California] on behalf of the retailer that would satisfy the requirements of the commerce clause of the United States Constitution."[84]

The evident purpose of this definition is, like the New York law on which the California law is based, to assert physical presence nexus against otherwise out-of-state Internet sellers on the basis of their in-state associates and other persons who similarly refer customers to these sellers. However, there are important differences between the California statute and the New York law on which it is based. The California law is more restrictive than the New York statute insofar as the California law will impose retailer status on a seller of tangible personal property only if the seller's total sales to California customers are more than $1 million in the prior 12 months.[85] The New York statute has no equivalent provision. However, the new California statute is more expansive than the New York law insofar as the fifth, associates-based definition of the California law will extend retailer status (and the consequent obligation to collect California use tax) to a person who is commonly owned with a retailer which triggers this fifth definition.[86] For this purpose, the new California statute incorporates IRC section 1504 and its 80 percent ownership test.[87]

The California statute will also create a safe harbor for some advertising agreements between out-of-state sellers and California persons.[88] Under that safe harbor (which has no counterpart in the New York statute), an agreement between an out-of-state seller of tangible personal property and a California resident will not trigger the seller's obligation to collect California use tax if the agreement is merely for "advertisements . . . to be delivered on television, radio, in print, on the Internet, or by any other medium" unless the retailer pays the California resident for that advertising by means "of commissions or other consideration that is based upon sales of tangible personal property."[89]

Thus, to continue our example, if Giant Inc., based in Seattle, pays the *Los Angeles Times* a flat fee for a full-page newspaper advertisement, that advertisement will not trigger retailer status for Giant under the new California use tax statute because Giant's payment to the *Times* is a fixed amount unrelated to Giant's sales resulting from the ad. Suppose, however, that Giant also pays a Los Angeles TV station to run an ad for Giant's products, that the TV ad displays an 800-number customers can call to order Giant's merchandise, that the fee paid by Giant for such ad depends on the number of sales consummated through this 800-number, that Giant sold more than $10,000 of merchandise through this ad and other similar California referrals in the prior 12 months, and that during this 12-month period, Giant's total sales of tangible personal property to California purchasers exceed $1 million. In this alternative example, the TV station will presumptively make Giant a California retailer, obligated to collect California use tax, because of the commission-style compensation Giant pays to the TV station. Giant could still avoid retailer status for purposes of California's new use tax law if Giant "can demonstrate that" the TV station "did not engage in referrals . . . that would satisfy the requirements of the commerce clause of the United States Constitution."[90]

A second statutory safe harbor only pertains to advertising "on an Internet Web site" operated by a California person.[91] If a seller engages a California person for such Internet advertising, that advertising will not trigger retailer status under the use tax for the seller unless the California person operating the site "also directly or indirectly solicits potential customers in [California] through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in [California]."[92] If a California person takes the seller outside this second safe harbor, the other statutory tests under the new law must be met for the seller to be a California

[82]Calif. Revenue and Taxation Code section 6203(c)(5)(A)(i) (new version).

[83]Calif. Revenue and Taxation Code section 6203(c)(5)(A)(ii) (new version). The original version of ABX1 28 set this number at $500,000. AB 155 changed this number to $1 million.

[84]Calif. Revenue and Taxation Code section 6203(c)(5)(E) (new version).

[85]Calif. Revenue and Taxation Code section 6203(c)(5)(A)(ii) (new version).

[86]Calif. Revenue and Taxation Code section 6203(c)(5)(D) (new version).

[87]*Id.* (incorporating IRC section 1504).

[88]Calif. Revenue and Taxation Code section 6203(c)(5)(B) (new version).

[89]*Id.*

[90]Calif. Revenue and Taxation Code section 6203(c)(5)(E) (new version).

[91]Calif. Revenue and Taxation Code section 6203(c)(5)(C) (new version).

[92]*Id.*

retailer, that is, the seller must make $10,000 in California sales in the prior 12 months through referrals by California persons and must make $1 million in California sales overall.

To see the operation of this second safe harbor, suppose that Giant has associates in California that place Giant ads on their websites but are strictly forbidden from engaging in any solicitation on Giant's behalf. Under the new California use tax statute, Giant will not be a California retailer by virtue of those associates because Giant can demonstrate that no associates are permitted to undertake *Scripto*- or *Tyler Pipe*-type solicitation within the Golden State. Suppose instead that these California associates routinely sponsor with Giant's acquiescence house parties at which invited customers sample Giant's products. In that case, Giant will no longer be protected by this second safe harbor because of the associates' "direct . . . solicitation specifically targeted at potential customers in" California.[93]

Amazon funded a voter initiative to repeal California's Amazon act.[94] At the end of the current legislative session, a compromise was reached, cancelling that initiative and delaying the effective date of California's Amazon act until September 15, 2012.[95] This compromise reinstated the current statute.[96] Published reports indicate that Amazon pledges to use this one-year delay to lobby for federal legislation giving the states authority to collect tax on remote sales.[97]

VI. Analysis

If it goes into effect again, California's Amazon law will make two fundamental changes to the state's statutory definition of a retailer obligated to collect use tax on sales to California customers. First, emulating New York's version of an associates-based Amazon law, the California act will assert retailer status against otherwise out-of-state remote sellers based on those sellers' California associates and other California residents who refer customers to those sellers. Second, borrowing from Colorado's Amazon act, the California statute will use common ownership to classify as retailers some sellers that are part of commonly owned groups. These changes to California's use tax statute by the state's Amazon act will (like other states' Amazon laws) prove unproductive or unconstitutional.

Ironically, California's Amazon law will not reach Amazon. The law thus highlights the pressing need for federal legislation to eliminate the unfairness and inefficiency of the sales and use tax status quo by permitting California and other states to impose the duty to collect tax on out-of-state Internet and mail-order sellers. Yet, paradoxically, California's statute, coming on top of other states' Amazon laws, may prove to be a political game changer by finally forcing Amazon and other Internet sellers to seriously pursue federal legislation authorizing the states to collect taxes from out-of-state retailers.

A. Retailer status based on in-state associates. Consider first the new statutory provision that will define an otherwise out-of-state seller of tangible personal property as a California retailer by virtue of the seller's Internet associates in California and other persons who refer customers to the seller from within the Golden State.[98] Internet sellers like Amazon and Overstock.com have demonstrated that they will terminate their relationships with associates in the states that adopt laws imposing on those sellers an associates-based obligation to collect use taxes.[99] When those terminations occur, the state loses money. In the face of those terminations, the

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[93]*Id.*

[94]David Streitfeld, "Amazon Pushes Hard to Kill a Tax," *The New York Times*, Sept. 5, 2011, at B1 ("In an unusual move that opponents say is a violation of the state constitution, Amazon is taking directly to voters its argument that it should not be required to collect sales tax"); Laura Mahoney, "California Retailers, Lawmakers Try to Undercut Amazon's Campaign to Repeal Use Tax Law," 167 *BNA Daily Tax Rpt.* H-1 (2011) ("Amazon.com's campaign to repeal a new law requiring use tax collection from California purchasers"); Aaron Glantz, "Amazon Spends Millions to Fight Internet Sales Tax," *The New York Times*, Aug. 28, 2011, at A25 ("More than nine months before a proposed June 2012 referendum asking that California's new Internet sales tax law be overturned, Amazon, the Seattle-based online retailer, has already spent $5.25 million"); Stu Woo, "Amazon Battles States Over Sales Tax," *The Wall Street Journal*, Aug. 3, 2011, at A1, A10 ("In California, Amazon is working to repeal the state's new online-tax law").

[95]Section 6(b)(2) of AB 155; David Streitfeld, "California Lawmakers Give Amazon Tax Reprieve," *The New York Times*, Sept. 11, 2011, at A14.

[96]Sections 1, 2, 6(a), and 6(d) of AB 155.

[97]Stu Woo and Vauhini Vara, "Amazon Pursues Internet Tax Deal," *The Wall Street Journal*, Sept. 9, 2011, at B3 ("Darrell Steinberg, the state Senate leader and a Democrat, said he and some of his colleagues agreed to give Amazon until next July to lobby Congress into passing federal tax-collection legislation on online sales"); Marc Lifsher, "Amazon

(Footnote continued in next column.)

Deal With Legislature a 'Classic Compromise,'" *Los Angeles Times*, Sept. 10, 2011 (quoting Paul Misener, Amazon's vice president for global public policy, that AB 155 "will allow us to continue to work with Congress and the states to obtain a federal resolution to the sales tax issue as soon as possible").

[98]Calif. Revenue and Taxation Code Section 6203(c)(5) (new version).

[99]*See, e.g.*, Associates Program Operating Agreement, updated as of Aug. 2, 2011, at section 2, *available at* https://affiliate-program.amazon.com/gp/associates/agreement at section 2 ("if at any time following your enrollment in the Program you become a resident of Arkansas, California, Colorado, Illinois, North Carolina, Rhode Island, or Connecticut, you will become ineligible to participate in the Program, and this Operating Agreement will automatically terminate, on the date you establish residency in that state").

state receives no additional use taxes because out-of-state sellers that fire their associates thereby avoid retailer status for use tax collection purposes. Moreover, the terminated associates receive no sales commissions from the out-of-state sellers with whom they are no longer affiliated. Those former associates consequently cease to pay state income taxes on the commissions they no longer earn. The upshot is a net loss to the state treasury — no use tax, less income tax.[100]

Alternatively, faced with the kind of associates-based duty to collect use taxes adopted in the new California Amazon statute, Internet sellers may respond by instructing their associates to avoid any solicitation activity that would transform those associates from passive conveyers of advertising into active in-state sales representatives as described in *Tyler Pipe* and *Scripto*. If so, those sellers "can demonstrate"[101] that they lack physical presence nexus to California since their associates, rather than being active in-state sales personnel, are merely passive conveyors of information analogous to the "catalogs[,] . . . flyers [and] advertisements in national periodicals"[102] aimed at customers by National Bellas Hess and Quill Corp. In this scenario also, the out-of-state seller will avoid retailer status and the consequent duty to collect California use taxes if the California's new law takes effect again in 2012.

Thus, an associates-based Amazon law like California's or New York's, while it can be construed to pass dormant commerce clause muster,[103] will produce little or no revenue for the state. Faced with an associates-based use tax statute, an out-of-state seller can terminate its in-state associates to avoid the duty to collect use tax or can instead avoid that duty by insisting that its associates refrain from active in-state solicitation on the seller's behalf.

Yet another possibility is that if its amended statute goes into effect again in 2012, California will assert an Internet seller's obligation to collect use tax because of associates' unauthorized solicitation activity. To illustrate that possibility, let us return to Giant Inc. and further assume that Giant Inc. has associates in California. Let us also suppose that Giant on its publicly available website contractually forbids its California associates from doing more than posting a link to Giant's website and explicitly precludes its California associates from engaging in active solicitation for Giant within the Golden State.

Let us further assume that one rogue associate, despite Giant's contractual prohibition of in-state solicitation, throws a party for Giant customers at the associate's California home and actively displays and promotes Giant's products and trade name at this party. In that situation, the dormant commerce clause physical presence nexus test of *National Bellas Hess*, *Quill*, *Scripto,* and *Tyler Pipe* precludes California's imposition of retailer status on Giant. The authorized activity of an agent is properly imputed to the principal.[104] In contrast, activity that an agent has openly and explicitly been forbidden to undertake is not attributable to the principal.[105] Thus, in this setting, California (or any other state adopting a New York-style, associates-based Amazon law) will lack authority under the dormant commerce clause to impose use tax collection responsibilities on Giant because, as a matter of agency law, the associate's solicitation activity, forbidden by Giant, is *ultra vires* and thus not attributable to Giant.

> ***The associates-based style of Amazon act pioneered by New York and now replicated by California as of 2012 produces little or no revenue for the state treasury.***

In short, the associates-based style of Amazon act pioneered by New York and now replicated by California as of 2012 produces little or no revenue for the state treasury. The act may even cost the state revenue as terminated associates cease to pay state income taxes on the sales commissions they no longer earn. Even if an Internet seller retains its in-state associates in the face of California's Amazon statute, the seller can instruct those associates to refrain from engaging in the solicitation activity described in *Scripto* and *Tyler Pipe*. In that case, California will have neither a statutory nor a constitutional basis for imposing on the Internet seller the obligation to collect use tax. California can

[100]Amazon's competitors have announced that they will engage as associates the persons Amazon has terminated. *See* John Buhl, "What's Fueling the 'Amazon' Law Debate," *Doc 2011-5564* or *2011 STT 52-1* (2011) ("retailers such as Wal-Mart, Sears, Barnes & Noble, and Best Buy had already issued letters publicly welcoming displaced [Amazon] affiliates"). To some extent, this may mitigate state income tax losses as former Amazon associates, newly affiliated with these other Internet firms, generate sales commissions. It is, however, unlikely that these associates will be able to restore their commissions to the levels they earned from their affiliations with Amazon.

[101]Calif. Revenue and Taxation Code section 6203(c)(5)(E) (new version).

[102]*Quill*, 504 U.S. at 302.

[103]Zelinsky, "Appellate Division," *supra* note 80; Zelinsky, "Constitutional but Unwise," *supra* note 80.

[104]Restatement of the Law, Third, Agency (2006) at section 2.01 Introductory Note. *See also* Cal. Civ. Code section 2330.

[105]Cal. Civ. Code section 2315.

expect no revenue from the associates-based portion of its new Amazon act. Indeed, on balance, California is more likely to lose revenue as terminated associates cease to pay state income taxes on the commissions they no longer earn.

B. Retailer status based on common ownership. Emulating Colorado's version of an Amazon Act,[106] California's recently adopted law will in two ways use common ownership to classify remote sellers as retailers obligated to collect use tax on their sales to California purchasers. First, the new associates-based definition of a California retailer will extend the obligation to collect use tax to corporations commonly owned with a corporation deemed to be a retailer by virtue of its California associates.[107] For that purpose, the California law incorporates the federal definition of an affiliated group for consolidated return purposes.[108]

In some applications, this provision of the California Amazon act will prove unconstitutionally broad, imposing use tax collection responsibility on remote sellers with no physical presence nexus to California. Common ownership is not a substitute for physical presence.

Let us now assume that Giant Inc. maintains its network of California associates and permits those associates to solicit in the California for Giant Inc. Let us also assume that Giant Inc. owns 100 percent of a mail-order company, Mail-R-Us Inc., a Vermont corporation with no employees, associates, or facilities in California. Mail-R-Us ships all the tangible personal property it sells to California customers by U.S. mail or by UPS, FedEx, or other common carrier from its offices in Bennington, Vt.

Common ownership is not a substitute for physical presence.

In this hypothetical, Giant, for itself, will accept retailer status and the consequent obligation to collect California use tax under the new law by letting Giant's in-state associates, through their solicitation activities, establish physical presence nexus between Giant and California. However, based on Giant's ownership of Mail-R-Us Inc., the new California statute will also extend retailer status and the duty to collect use tax to Mail-R-Us, which has no physical presence in California.

In this setting, California's Amazon statute will run afoul of the problem identified in *Current, Inc.* and other decisions[109] — that is, Mail-R-Us Inc., a wholly owned subsidiary of Giant, has a distinct legal identity from its parent and, unlike its parent, has no physical presence nexus to California. Thus, per *National Bellas Hess* and *Quill*, California has no constitutional basis for imposing on Mail-R-Us Inc. the duty to collect California use tax, though the new statute will.

The second place in which the new California use tax statute will use common ownership is the statute's definition[110] of retailer status, which is triggered if a seller is (1) "a member of a commonly controlled group," (2) "a member of a combined reporting group" for income tax purposes, and (3) if the combined reporting group "includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in [California] in connection with tangible personal property to be sold by the retailer." In particular cases, that provision will also overreach constitutionally because a California member of a commonly controlled group may perform services without creating physical presence nexus to California for other members of the group.

Assume now that Giant Inc., otherwise unconnected to California, has a wholly owned California subsidiary, Art Restore Inc., which conducts an art restoration business. Suppose that Giant, before it sells any paintings or sculptures, ships those art works by common carrier to Art Restore, which cleans and repairs these artworks and then sends them back to Giant for sale on the Internet. Assume further that Giant pays Art Restore the same price for restoration services that Giant would pay on an arm's-length basis to an independent third party. Assume as well that Giant and Art Restore, commonly controlled by virtue of Giant's 100 percent ownership, file for California income tax purposes as a combined group.

On these facts, the new California statute, if and when it takes effect again in 2012, will declare Giant to be a California retailer, obligated to collect California use tax. However, per *National Bellas Hess* and *Quill*, Giant in this example has no physical presence nexus to California. Hence, the California statute in this setting will unacceptably use common ownership as a substitute for the physical presence Giant lacks in the state.

To see this, assume that in addition to Art Restore, Giant also ships paintings and sculpture for

[106]The Colorado statute uses common ownership to impose notification responsibilities rather than the obligation to collect tax.

[107]Calif. Revenue and Taxation Code section 6203(c)(5)(D) (new version).

[108]*Id.* (incorporating Internal Revenue Code section 1504).

[109]*SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666, 673 (1991); *Bloomingdale's By Mail, Ltd. v. Commonwealth of Pennsylvania*, 567 A.2d 773, 778 (1989).

[110]Calif. Revenue and Taxation Code section 6203(c)(4) (new version).

restoration to Golden State Restorers Inc., an independently owned and operated company in San Francisco. By U.S. mail, Giant sends artwork to Golden State Restorers, which, after making repairs, sends the repaired pieces back to Giant for sale on the Internet. Golden State Restorers is not Giant's agent in California; rather, it is a third-party independent contractor that deals with Giant at arm's length. Nothing in *National Bellas Hess*, *Quill*, *Scripto*, or *Tyler Pipe* suggests that Golden State Restorers establishes for use tax collection purposes physical presence nexus between Giant and California.

The new California statute will distinguish Art Restore from Golden State Restorers because Giant owns the former but not the latter.[111] However, for dormant commerce clause purposes, the relevant test is not ownership but physical presence.[112] Giant owns Art Restore. However, that ownership does not transform Art Restore into Giant's California agent, nor does that ownership make Art Restore's physical plant in San Francisco a Giant facility in the Golden State. Art Restore and its parent are legally distinct persons.[113] Absent an agency relationship between Art Restore and Giant, Art Restore does not establish physical presence in California for Giant.

Instructive in this context is a comparison of the common control provision of Colorado's Amazon act with the portion of the new California statute that adapts that provision of the Colorado law. As amended by Colorado's Amazon law, Colorado's use tax statute[114] creates a presumption that an out-of-state seller is a retailer doing business in Colorado and is thus obligated to collect use tax if the seller "is part of a controlled group of corporations" and one member of that controlled group is itself "a retailer with physical presence in" Colorado. An out-of-state seller can rebut this presumption of Colorado retailer status by proving that the in-state member of the control group that is a Colorado retailer "did not engage in any constitutionally sufficient solicitation in [Colorado] on behalf of" the out-of-state seller.[115]

The California version of this statutory rule[116] will similarly premise an otherwise out-of-state seller's obligation to collect California use tax on the seller's membership in a commonly controlled group that includes a member conducting business in California. However, under the California law, retailer status will be imposed on an out-of-state seller if a member of the commonly owned group "performs any services in California in connection with tangible personal property to be sold by the" out-of-state seller.[117] The California statute, unlike the Colorado law, will not require the in-state member of the common control group to be a retailer or to solicit on behalf of the out-of-state seller with which the California-based corporation is commonly controlled.

More critically, the California law (unlike the Colorado statute) will not create a presumption of in-state physical presence. Rather, as amended by the California act, California's use tax law will irrebuttably impose retailer status on a commonly owned out-of-state seller of tangible personal property even if the California-based member of the group does not function as an agent for that out-of-state seller. The California statute will not afford an out-of-state seller the opportunity to demonstrate that despite its common ownership with a corporation operating in California, the seller itself has neither direct nor indirect physical presence nexus to the Golden State.

> ***The California statute will not afford an out-of-state seller the opportunity to demonstrate that the seller itself has neither direct nor indirect physical presence nexus to the Golden State.***

Thus, in some factual settings, California's new use tax statute will deploy common ownership to impose retailer status on out-of-state sellers that lack physical presence nexus to the state. In these settings, the California statute will transgress the dormant commerce clause tests outlined in *National Bellas Hess* and affirmed in *Quill* by requiring out-of-state Internet and mail-order sellers to collect California use taxes even though those sellers lack physical presence in California. Absent an agency relationship between an out-of-state corporation and a commonly owned California firm, an out-of-state corporation is beyond California's use tax jurisdiction. As a constitutional matter, common ownership is not a substitute for physical presence in the taxing state.

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[111]Calif. Revenue and Taxation Code section 6203(c)(4) (new version) ("a member of a commonly controlled group").

[112]*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967).

[113]*Current, Inc. v. State Board of Equalization*, 24 Cal. App. 4th 382 (1st App. Dist., Div. Two 1994); *SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666 (1991); *Bloomingdale's By Mail, Ltd. v. Commonwealth of Pennsylvania*, 567 A.2d 773 (1989).

[114]Colo. Rev. Stat. section 39-26-102(3)(b)(II).

[115]*Id.*

[116]Calif. Revenue and Taxation Code section 6203(c)(4) (new version).

[117]*Id.*

C. Will California's Amazon act reach Amazon? No. Amazon and other Internet sellers have responded to California's Amazon act by terminating their California associates.[118] Consequently, the amended use tax statute's associates-based definition of a California retailer will not encompass Amazon because Amazon no longer has associates (or other similar referral sources) within the Golden State.[119]

Even if Amazon had not terminated its California associates, this new associates-based use tax definition of a California retailer will not encompass Amazon. Amazon's contract with its associates[120] limits the activities those associates may undertake on Amazon's behalf. Those contractual limits do not permit associates to undertake solicitation activity for Amazon of the sort described in *Scripto* and *Tyler Pipe*. Thus, even if Amazon had continued its associates program in California, those associates would not have provided dormant commerce clause physical presence nexus between California and Amazon since any associate's solicitation activity is *ultra vires*.

California's other new use tax definition of a Golden State retailer[121] is evidently aimed at Amazon and its two California subsidiaries, A9.com Inc. and Lab126. Both of those subs "perform . . . services in [California] in connection with tangible personal property to be sold by" Amazon.[122] A9.com Inc. "works on search technology"[123] for Amazon. Lab126 designed Amazon's Kindle.[124] Thus, as a statutory matter, the amended California use tax law will define Amazon as a California retailer obligated to collect California sales tax by virtue of Amazon's wholly owned subsidiaries which provide services to Amazon from California.

However, on the facts as they appear in the public record, that statutory result will violate the constitutional constraints imposed on the states in *National Bellas Hess*, *Quill*, *Scripto*, and *Tyler Pipe*. These dormant commerce clause decisions permit California to impose on Amazon the obligation to collect California use tax only if Amazon is itself physically present in California (no one claims that) or if Amazon's agent is physically present in California on Amazon's behalf. From the facts that are publicly available, neither Amazon's relationship to A9.com Inc. nor Amazon's relationship to Lab126 rises to the level of principal and agent.

There are factual differences between those relationships and the relationship between Current Inc. and Deluxe Corp.[125] A9.com Inc.[126] and Lab126[127] both disclose that they are Amazon subsidiaries. Both produce products (search software and Kindle designs) that are integral to Amazon's business, and both apparently sell their outputs only to Amazon. However, Amazon, A9.com Inc., and Lab126 have kept their corporate identities separate and intact. Each apparently has its own operations, its own assets, and its own payroll. Although there could be facts that do not appear in the public record, the publicly available facts indicate that for dormant commerce clause purposes, the relationship among Amazon and its California subsidiaries does not generate physical presence nexus between Amazon and California. These corporations are legally separate persons from Amazon.

National Geographic Society v. California Board of Equalization is instructive in this context.[128] In that case, National Geographic maintained two California offices from which employees solicited advertising for the society's *National Geographic* magazine.[129] The society also conducted a mail-order business from Maryland and the District of Columbia.[130] The U.S. Supreme Court held that the society's California offices created sufficient physical presence by the society in the state to justify California's imposition of use tax collection responsibilities for the society's mail-order sales from Maryland and the District of Columbia to California customers.

Amazon has carefully planned to avoid that result by incorporating and operating its California activities through separate subsidiaries. Amazon (unlike the National Geographic Society) does not itself own or operate any California facilities or employ any California personnel. As a matter of policy, the result

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[118] *See, e.g.*, Associates Program Operating Agreement, *supra* note 99.

[119] Amazon says that it will reinstate its California associates because of the compromise embodied in AB 155. Based on its behavior to date, we can expect Amazon to terminate these associates again if the new version of section 6203 goes into effect on September 15, 2012.

[120] *Supra* note 99, at section 10 ("You will not issue any press release or make any other public communication with respect to this Operating Agreement, your use of the Content, or your participation in the Program") and section 16 ("You and we are independent contractors, and nothing in this Operating Agreement or the Operational Document will create any partnership, joint venture, agency, franchise, sale representative, or employment relationship between you and us or our respective affiliates").

[121] Calif. Revenue and Taxation Code section 6203(c)(4) (new version).

[122] *Id.*

[123] *Supra* note 20.

[124] *Supra* note 23.

[125] *Current, Inc. v. State Board of Equalization*, 24 Cal. App. 4th 382 (1st App. Dist., Div. Two 1994).

[126] *Supra* note 20.

[127] *Supra* note 23.

[128] 430 U.S. 551 (1977). *See* Zelinsky, *supra* note 7, at 13-14.

[129] *Id.* at 554, n.2.

[130] *Id.* at 554.

— Amazon need not collect California use tax — is one I disagree with and feel should be overturned by Congress. However, absent that federal legislation, California's Amazon act will fail prevailing dormant commerce clause norms by imposing use tax collection responsibilities on Amazon when Amazon is not physically present in California. It is Amazon's subsidiaries, not Amazon itself, that are present in the Golden State.

D. The future. The saga of California's Amazon act confirms Bismarck's adage that those who love laws and sausages should see neither being made. It is not a pretty story: The California Legislature passed the Amazon law to take effect immediately.[131] Amazon retaliated by starting a voter initiative campaign to repeal the law. At the very end of the legislative session, a bipartisan deal was achieved, reinstating California's pre-Amazon act use tax law retroactively and delaying implementation of the state's Amazon act until September 15, 2012.[132] Some report that Amazon has committed to use this delay to lobby Congress for federal legislation that would allow the states to impose sales tax collection responsibilities on out-of-state Internet and mail-order sellers.[133]

Based on the history to date, I am skeptical of Amazon's motives in reaching this compromise. Amazon has consistently said that it supports federal legislation authorizing the states to tax electronic sales by Internet firms like Amazon.[134] However, Amazon's claims ring hollow. If Amazon truly signaled to its supporters in Congress that it favors federal legislation authorizing the states to impose tax collection responsibilities on out-of-state sellers, that legislation could be adopted in the proverbial heartbeat. Moreover, that legislation could be quite simple — indeed, it need include only two provisions. First, federal legislation must permit the states to impose sales and use tax collection responsibilities once an out-of-state seller's annual sales into the state pass some basic threshold, for example, $10,000 in the prior year. Second, federal legislation should also contain provisions (like Internal Revenue Code section 1563) specifying when corporations will be aggregated to determine whether such threshold has been met. Aggregation along those lines is necessary to prevent Internet (and mail-order) firms from artificially dividing themselves into myriad corporations to keep their sales below the statutory minimum.[135]

Amazon instead ties its support for federal legislation to the Streamlined Sales Tax Project, an effort to homogenize the sales and use tax statutes of the various states.[136] The premise of the SSTP is that Internet sellers can be expected to collect sales and use taxes throughout the nation only if the states simplify and coordinate their laws. However, that premise has been proved incorrect. Today, many "click-and-brick"[137] sellers, like Walmart.com and Staples.com, are the Internet arms of firms that sell both electronically and through conventional bricks-and-mortar stores. These click-and-brick sellers have physical presence in the various states through their conventional (often big-box) stores and thus collect sales and use taxes on their Internet sales. These click-and-brick sellers successfully collect sales taxes today on their Internet sales without the interstate coordination promised by the SSTP. If those firms can collect the various states' taxes on their electronic sales today, so too can Amazon.

Coordinating and simplifying the states' sales tax laws has proved to be detailed, difficult, and time consuming. Despite the skill and energy brought to the SSTP, actually coordinating the states' sales taxes anytime soon remains doubtful — even as click-and-brick sellers like Walmart.com and Staples.com have demonstrated that Internet retailers can successfully collect sales taxes without such coordination.

In short, there is no reason to wait for the adoption of federal legislation that would now require all Internet and mail-order sellers to collect states' sales and use taxes. Amazon knows that. If Walmart.com can collect taxes under the existing system of myriad state sales and use tax laws, so can Amazon.

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[131]Section 5 of ABX1 28.

[132]Section 6(b) of AB 155.

[133]Stu Woo and Vauhini Vara, "Amazon Pursues Internet Tax Deal," *The Wall Street Journal*, Sept. 9, 2011, at B3 ("Darrell Steinberg, the state Senate leader and a Democrat, said he and some of his colleagues agreed to give Amazon until next July to lobby Congress into passing federal tax-collection legislation on online sales"); Marc Lifsher, "Amazon Deal With Legislature a 'Classic Compromise,'" *Los Angeles Times*, Sept. 10, 2011 (quoting Paul Misener, Amazon's vice president for global public policy, saying that AB 155 "will allow us to continue to work with Congress and the states to obtain a federal resolution to the sales tax issue as soon as possible").

[134]"Amazon Sends E-Mail to Terminate Colorado-Based Associates," *Doc 2010-5064* or *2010 STT 46-5* (Mar. 10, 2010) (Amazon is "not opposed to collecting sales tax within a constitutionally permissible system applied even-handedly").

[135]Zelinsky, *supra* note 7, at 75-76.

[136]Walter Hellerstein, Kirk J. Stark, John A. Swain, and Joan M. Youngman, *State and Local Taxation: Cases and Materials* 781 (9th ed. 2009); Richard D. Pomp and Oliver Oldman, *State and Local Taxation*, 6-47 (5th ed. 2005).

[137]I am indebted to Prof. Haile for introducing me to this colorful phrase, which succinctly captures the business model of firms that have both conventional retail stores (brick) and Internet sales (click). I have previously labeled these firms as hybrid sellers, but "click-and-brick" is a much better appellation. *See* Andrew J. Haile, "Affiliate Nexus in E- Commerce," *available at* http://papers.ssrn/sol3/papers.cfm?abstract_id=1924510.

Given the futility and unconstitutionality of California's Amazon law, why did Amazon agree to terminate its voter referendum campaign in return for a one-year delay of that law? The most cynical explanation is that Amazon will use this delay to buttress its opposition to collecting taxes on its sales. Among other possibilities, Amazon might spin off or relocate its California subsidiaries — just as Amazon has terminated its California associates. Given Amazon's hardball practices to date, that possibility cannot be dismissed.

Another, and more optimistic, guess is that Amazon has finally decided that it pays too high a public relations price for its continued opposition to state Amazon laws. Those laws have highlighted the extent to which Amazon's business model is to be an enabler of nationwide use tax evasion.

Amazon might spin off or relocate its California subsidiaries — just as Amazon has terminated its California associates.

From this perspective, we should soon see Amazon lobbying Congress for a simple federal law to permit the states to collect taxes on remote sales. If so, the states' Amazon laws, culminating in the California act, will have succeeded in lobbying Congress to overturn *National Bellas Hess* and *Quill*, thereby permitting the states to impose use tax collection responsibilities on out-of-state Internet and mail-order sellers.

Others view the proliferation of the state Amazon acts as aimed at the U.S. Supreme Court.[138] These commentators hope that the Court will review one of these acts and, as part of such review, overturn *National Bellas Hess*, *Quill*, and the dormant commerce clause physical presence test these decisions confirm.

Like others,[139] I am skeptical of this litigation-based strategy. The Court hears few cases and hears even fewer tax cases. The Court, in *Quill*, was explicit that it deemed Congress to be the appropriate branch of government to overturn the physical presence nexus text.[140] As the story of Curt Flood makes clear,[141] the Court is reluctant to overturn earlier decisions that Congress can repeal or modify — as Congress ultimately did in *Flood*.[142]

Although you should never say never,[143] I doubt that the outpouring of state Amazon laws will lead the Supreme Court to reverse *Quill* and the dormant commerce clause physical presence test. The profusion of state laws may instead reinforce the Court's inclination to refrain from intervening in this area and thereby short-circuit the political and legislative discussion among the states, local bricks-and-mortar retailers, pure Internet firms like Amazon and Overstock.com, and the Internet arms of big-box retailers.

The sales and use tax status quo is neither fair nor efficient. Congress is the forum in which the problem must be resolved via federal legislation that would permit the states to impose the duty to collect tax on out-of-state Internet and mail-order sellers. I am skeptical of purportedly happy endings, at least as they regard tax policy. But perhaps — *perhaps* — California's Amazon act will finally convince Amazon and its Internet peers that federal legislation is now in their long-term best interests.

Conclusion

If it goes into effect, California's new Amazon law will prove to be futile or unconstitutional. California will gain no revenue from the associates-based provision of its Amazon act and may actually lose revenue from that provision since terminated associates no longer earn commissions on their referrals and thus cease to pay state income taxes on those commissions. Moreover, the new California use tax statute will prove unconstitutional as applied in specific cases. Under the dormant commerce clause, an out-of-state parent's ownership of a subsidiary

[138] *See, e.g.*, David Brunori, "It's Time to Overturn *Quill*," *State Tax Notes*, Feb. 15, 2010, p. 497, *Doc 2010-2948*, or *2010 STT 30-2*; Dolores W. Gregory, Steven Roll, and William Carlile, "Tough Economy, Waning Prospects for Federal Legislation May Increase Interest in Alternatives to Streamlined System," 225 *BNA Daily Tax Rpt.* J-1 (Nov. 24, 2010) ("the governing board has already discussed another option to the federal legislation — filing a lawsuit to overturn *Quill v. North Dakota*").

[139] *See, e.g.*, Arthur R. Rosen and Matthew P. Hedstrom, "*Quill — Stare* at the *Decisision*," *State Tax Notes*, June 27, 2011, p. 931, *Doc 2011-11848*, or *2011 STT 123-2*.

[140] *Quill*, 504 U.S. at 318 ("the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve").

[141] For baseball fans (and perhaps for others), *Flood v. Kuhn*, 407 U.S. 258 (1972), is the most famous instance of the U.S. Supreme Court's adhering to a precedent that many anticipated the Court would overturn. Among the many books on Curt Flood and his litigation are Brad Snyder, *A Well-Paid Slave: Curt Flood's Fight for Free Agency in Professional Sports* (2007). My thinking on the *Flood* decision was helped by an excellent lecture on the case delivered by the Hon. Frank J. Williams on June 3, 2011, at the 23rd annual Cooperstown Symposium on Baseball and American Culture, sponsored jointly by National Baseball Hall of Fame and Museum and SUNY College at Oneonta.

[142] Curt Flood Act of 1998, P.L. 105-297, codified at 15 U.S.C. section 26b.

[143] Although many lay claim to this iconic phrase, I believe the appropriate citation is: Fievel Mousekewitz, *An American Tail* (1986).

operating in California does not substitute for the parent's own physical presence in the Golden State.

It is neither fair nor efficient for pure Internet sellers like Amazon and Overstock.com to avoid use tax collection responsibilities while sellers with conventional bricks-and-mortar stores must collect sales tax on both their electronic and in-store sales. Federal legislation granting the states the authority to impose tax collection responsibilities on out-of-state Internet and mail-order sellers is long overdue.

Perhaps the events in Sacramento concerning California's Amazon act will finally lead to such federal legislation. If so, California's (and other states') Amazon laws, while futile and unconstitutional, will paradoxically have proved to be political game changers. We shall see. ☆