

Illinois Bill Would Expand Attributional Nexus Concept to Untested Lengths

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Statutes providing that a nonresident retailer agreeing to pay commissions to an in-state “associate” who merely refers customers to the retailer creates a substantial nexus between the state and the retailer have drawn considerable attention throughout the country. These “Amazon” laws, in place in New York and two other states,¹ create a presumption that a resident associate actively solicits fellow residents to buy from the foreign retailer, thereby establishing the physical presence needed as a prerequisite for the state being allowed to require the retailer to collect the state’s sales and use tax.

The Illinois General Assembly has passed a bill that reaches beyond any other state’s effort to expand its taxing jurisdiction. HB 3659,² now awaiting the governor’s approval, would require collection of tax by an out-of-state retailer whose only Illinois connection is a contract under which someone located in Illinois links his or her website to the retailer and receives commissions based on the retailer’s sales to customers who click through the website to the retailer. While other states rely on such a referral contract to establish a rebuttable

presumption that the in-state associate is actively soliciting business for the foreign retailer, the Illinois bill is inflexible: The contract for a commission on a click-through sale, standing alone, establishes the foreign retailer’s collection duty. The authority for this is questionable under the commerce clause’s substantial nexus requirement. Further, the bill invites challenge under the Internet Tax Freedom Act (ITFA) by targeting online associates.

I. Summary of New Legislation

The bill amends the definitional sections of the Use Tax Act and Service Use Tax Act to specify that a business becomes a “retailer maintaining a place of business” in Illinois, and is therefore required to collect tax, when it contracts with a person located in Illinois to pay a commission in return for the person’s direct or indirect referral of customers through a website link. That provision, effective July 1, 2011, applies only when the retailer’s quarterly gross receipts from click-through referral sales through persons in Illinois exceed \$10,000 in each of the previous four quarters. The bill targets online referral programs like Amazon Associates³ under which associates can link their websites to a retailer’s website and receive commissions from resulting sales.⁴

³See, e.g., <http://affiliate-program.amazon.com>.

⁴The bill also requires out-of-state retailers under a commission relationship with in-state retailers selling the “same or substantially similar line of products or services” using an “identical or substantially similar name, trade name, or trademark” to collect tax and imposes a similar \$10,000 threshold. This test may pass constitutional muster in some scenarios, such as where a consumer goes to a bricks-and-mortar retailer, requests a product not available in the store, and then places an online or catalog order through the store. In that situation, it seems clear that an in-state representative has solicited business for the out-of-state retailer in exchange for a commission and thus created nexus under *Exchange for a Commission*, 362 U.S. 207, 212-213 (1960).

¹N.Y. Tax Law section 1001(b)(8)(vi); N.C. Gen. Stat. section 105-164.8(b)(3); R.I. Gen. Laws section 44-18-15(a)(2).

²HB 3659, 96th Ill. Gen. Assem. (2011) (amending 35 ILCS 105/2 to add definitions 1.1 and 1.2 of “retailer maintaining a place of business in this State”; and amending 35 ILCS 110/2 to add definitions 1.1 and 1.2 of “serviceman maintaining a place of business in this State”). The service use tax is imposed on tangible personal property provided as part of a sale of services. 35 ILCS 110/1 *et seq.* For convenience, the remainder of this article generally refers to “retailers,” but the tests apply verbatim to “servicemen” under the service use tax.

II. A Questionable Lack of ‘Rebuttable Presumption’

Illinois’s proposed law differs from existing Amazon laws by dispensing with the notion that the associate relationship creates a rebuttable presumption that the in-state associate is actively soliciting. Instead, the mere existence of a contract requiring the payment of a commission for click-through referrals requires collection of tax when those referrals generate sales. In failing to require in-state solicitation as an element triggering nexus, Illinois steps beyond existing constitutional precedent to claim nexus based on passive linkage alone.

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The commerce clause requires that a seller must solicit business and have a physical presence in the taxing state before it becomes subject to a collection obligation.⁵ Under *Scripto* and *Tyler Pipe*, it makes no difference whether the seller does its own solicitation or uses an independent contractor to work on its behalf.⁶ However, it is also clear that directing advertising into a state does not give that state jurisdiction: Sellers “who do no more than communicate with customers in the State by mail or common carrier as a part of a general interstate business”⁷ do not establish nexus. New York’s and other states’ Amazon laws acknowledge accepted jurisprudence that the foreign retailer does not create nexus by merely advertising in the state: The resident associate “actually has to engage affirmatively in customer solicitation before the out-of-state vendor becomes subject to the statute.”⁸ New York’s Amazon law seeks to establish the active solicitation require-

ment by *presuming* that in-state associates are soliciting for the retailer if sales to New York customers through associate programs exceed a dollar threshold.⁹ The retailer can rebut the presumption by showing that its associates are not actively soliciting business.¹⁰

Although the validity of the New York formula is unresolved, the New York courts that have sustained that state’s Amazon law have found that the retailer’s ability to rebut the presumption of in-state solicitation is critical to the law’s validity.¹¹ The Appellate Division (the state’s middle-level court) held that the provision is constitutional on its face under the commerce and due process clauses. It considered the web link from the New York associate to the out-of-state retailer to be “passive advertising” that did not create nexus, analogous to direct mail or telephone solicitation.¹² For the retailer to have nexus, the New York associates must do more than link websites; the associates must actively solicit within New York on behalf of the seller.¹³ Because New York’s presumption of in-state solicitation can be rebutted, the court found it to be facially valid under the commerce clause.¹⁴

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The Illinois Amazon bill rests on the idea that it is the associate’s provision of a website link itself — and not the presumption that the Illinois associate is taking additional steps to urge other Illinois residents in the associate’s community to buy from the retailer — that is sufficient physical presence. All a retailer must do to meet the Illinois test is have a contract with a person located in Illinois who

⁵*Quill Corp. v. North Dakota*, 504 U.S. 298, 317 (1992). Illinois courts have recognized this standard. *Brown’s Furniture, Inc. v. Wagner*, 171 Ill. 2d 410, 665 N.E.2d 795, 802 (1996); *Irwin Industrial Tool Co. v. Ill. Dept. of Revenue*, No. 109300 (2010), slip op. at 8. (For the *Irwin* decision, see *Doc 2010-20936* or *2010 STT 186-12*).

⁶*Scripto*, 362 U.S. at 212-13; *Tyler Pipe Indus., Inc. v. Wash. State Dep’t. of Revenue*, 483 U.S. 232, 250-51 (1987).

⁷*Nat’l Bellas Hess, Inc. v. Dep’t of Revenue*, 386 U.S. 735, 758 (1967).

⁸*Amazon.com LLC v. N.Y. State Dep’t of Taxation and Fin.*, 2010 N.Y. App. Div. LEXIS 7943, at *4 (N.Y. App. Div. Nov. 4, 2010), *aff’g and rem’g* 877 N.Y.S.2d 842 (N.Y. Sup. Ct. 2009). The Appellate Division remanded to the trial court for additional factual findings in order to rule on the as-applied constitutional challenges. (For the Appellate Division decision, see *Doc 2010-23836* or *2010 STT 214-18*.)

⁹N.Y. Tax Law section 1001(b)(8)(vi).

¹⁰*Id.* (“This presumption may be rebutted by proof that the resident with whom the seller has an agreement did not engage in any solicitation in the state on behalf of the seller that would satisfy the nexus requirement of the United States constitution during the four quarterly periods in question.”) A no-solicitation clause in the agreement between the New York associates and out-of-state Internet sellers and annual certifications by those associates to the seller declaring that the associates are in compliance with the contractual commitment of non-solicitation are recommended methods to rebut the presumption of solicitation. N.Y. State Dep’t. of Taxation and Fin., TSB-M-08(3.1)S, 2008 WL 2620914 (June 30, 2008).

¹¹See *supra* note 8.

¹²2010 N.Y. App. Div. LEXIS 7943, at *9.

¹³*Id.* at *9-10.

¹⁴*Id.*

receives a commission for referring potential customers by a link on that person's Internet website. Yet the link itself is no indication that the retailer is targeting the Illinois market. The website is equally available to everyone in the world with access to the Internet. Without some further in-person effort to solicit Illinois residents, Illinois does not confer any benefit on the retailer for which it can demand that it serve as the state's tax collector.

Failing to include solicitation as a requirement also raises an issue under the Illinois constitution's requirement that tax classifications be uniform. The uniformity clause¹⁵ requires that similarly situated taxpayers be afforded the same tax treatment unless there is a "real and substantial" difference between them.¹⁶ The use tax includes other definitions of remote sellers who are treated as "maintaining a place of business in this State," but those definitions require in-state solicitation. For example, remote sellers who use television shopping systems or who broadcast advertising on radio or cable television must specifically target Illinois residents to fall within the statute's definition of one who is maintaining a place of business in Illinois.¹⁷ HB 3659 does not have a similar limitation for remote sellers using the Internet. There does not seem to be a real and substantial difference between remote sellers who use cable television and those using the Internet that justifies the different classifications.

III. Discrimination Against Online Businesses

The Illinois Amazon bill also may discriminate against electronic commerce, in violation of the ITFA.¹⁸ The ITFA prohibits a state or political subdivision from imposing "discriminatory taxes on electronic commerce," and a tax is discriminatory if it "imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means."¹⁹ Whereas the New York Amazon law applies to referral arrangements by "an Internet web-

site or otherwise,"²⁰ Illinois's bill applies only to referrals through an "Internet website." Illinois has not sought to impose tax collection requirements on otherwise identical associate arrangements that do not involve electronic commerce. This bill seems to invite a challenge under the ITFA.

IV. Conclusion

By not requiring that the Illinois associate perform in-state solicitation for the foreign retailer, the Illinois bill breaks with the template for other Amazon statutes. That is not an oversight. For several years, the Illinois Department of Revenue had informally considered proposing an Amazon regulation that took the same approach as HB 3659: The existence of a contract paying commissions to an Illinois associate establishes nexus regardless of the associate's lack of in-state solicitation. The department was well aware of the difference between the proposed regulation's approach and the New York establishment of a presumption of in-state solicitation. The bill appears to be a calculated expansion of the state's taxing power, consistent with the current commentary urging the states to escape *Quill's* physical presence requirement by looking to attributional nexus theories.²¹

If the governor signs the bill, it can survive a commerce clause challenge only if an out-of-state retailer's contract with a person in the taxing state for services not necessarily related to the retailer's active solicitation of the taxing state's market constitutes substantial nexus. Because HB 3659 applies that principle, the service performed in Illinois is the reference of potential customers from anywhere in the world — not just from Illinois — to the retailer. If nexus exists without in-state solicitation, a foreign business could establish nexus by contracting for advertising with a national magazine published in Illinois. Indeed, it does not require much of a leap to conclude that an out-of-state firm creates nexus by simply buying raw material from an Illinois supplier without setting foot in the state. In both cases, the foreign business is using a person located in Illinois to obtain an item it needs to carry on its business. HB 3659 thus opens a completely new front in debate and merits close attention. ☆

¹⁵Ill. Const., Art. IX, section 2.

¹⁶*Searle Pharms., Inc. v. Dep't of Revenue*, 512 N.E.2d 1240, 1246 (Ill. 1987).

¹⁷35 ILCS 105/2; 35 ILCS 110/2.

¹⁸Pub. L. 105-277, div. C, Tit. XI, section 1101 *et seq.*, as amended (codified at 47 U.S.C. section 151 note).

¹⁹ITFA sections 1101(a)(2), and 1105(2)(A)(iii).

²⁰N.Y. Tax Law section 1001(b)(8)(vi). Both North Carolina's and Rhode Island's Amazon laws refer to "Internet website or otherwise." N.C. Gen. Stat. section 105-164.8(b)(3); R.I. Gen. Laws section 44-18-15(a)(2).

²¹*See, e.g.*, Robert D. Plattner, Daniel Smirlock, and Mary Ellen Ladouceur, "A New Way Forward for Remote Vendor Sales Tax Collection," *State Tax Notes*, Jan. 18, 2010, p. 187, *Doc 2009-28458*, or *2010 STT 11-2*.