

## New York

### Court Hears Oral Argument In Amazon, Overstock Appeals

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#### News Analysis

A five-judge panel of the New York Supreme Court, Appellate Division, First Department, heard oral argument on October 29 in the *Amazon.com LLC* and *Overstock.com, Inc.* cases, which consider the constitutionality of New York's "Amazon" statute.

The statute presumes that an out-of-state online retailer is soliciting business in New York through an in-state representative — and thus is responsible for collecting and remitting sales and use tax — if two conditions apply:

- the online retailer enters into an agreement or agreements with a New York resident or residents under which the resident receives a commission or other consideration for referring potential customers to the vendor's website by link on a website; and
- the cumulative gross receipts from sales by the online retailer to customers in New York state as a result of referrals from online advertisers totals more than \$10,000 during the four preceding quarters. (N.Y. Tax Law section 1101(b)(8)(vi).)

Legislative history makes clear that the statute targeted Amazon and similarly situated out-of-state online retailers that had not been collecting New York sales and use tax. In *Amazon.com LLC* and *Overstock.com, Inc.*, the companies challenged the constitutionality of the statute on its face and on as-applied grounds. The New York Supreme Court held that the complaints must be dismissed in their entirety for failure to state a cause of action. (For the supreme court's decision in *Amazon.com LLC et al. v. New York State Dep't of Taxation and Finance et al.*, see *Doc 2009-641* or *2009 STT 8-16*.)

Surprisingly, the analysis in the decision did not focus on whether the in-state online advertisers "are significantly associated" with online retailers' ability to "establish and maintain a market" in the state, but instead reasoned that the Amazon statute and

administrative guidance contain safeguards that ensure that only a limited number of online retailers will be forced to collect and remit sales and use tax. In the wake of the decision, a number of states considered passing their own Amazon laws, which won enactment in Rhode Island and North Carolina. (For prior coverage of the enactment of the Rhode Island budget, including the Amazon provisions, see *State Tax Notes*, July 6, 2009, p. 10, *Doc 2009-15007*, or *2009 STT 124-25*. For prior coverage of the enactment of the North Carolina budget, including the Amazon provisions, see *State Tax Notes*, Aug. 17, 2009, p. 431, *Doc 2009-18179*, or *2009 STT 153-24*.)

At oral argument before the state supreme court, Randy Mastro, arguing for Amazon, noted that companies that advertise in New York-based publications such as *The New York Times* and that have no physical presence in New York are not required to collect use tax on sales made to purchasers with New York addresses. He contended that there is no principled reason why Web page advertisements should create nexus with New York for out-of-state retailers when other forms of advertising do not.

Mastro, a partner at Gibson, Dunn & Crutcher LLP, New York, noted that in accordance with administrative guidance (see TSB-M-08(3)S (January 8, 2008)), online retailers must collect use tax if they pay online advertisers based on commissions but do not have to collect use tax if they pay online advertisers based on the number of times an advertisement is clicked. Mastro said there is no legal basis for predicating nexus on a seller's mode of paying compensation.

Mastro also emphasized that the *Tyler Pipe* attributional nexus test provides that an out-of-state seller is not taxable unless there is an in-state representative "significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." Mastro pointed to evidence in the record showing that less than 1.5 percent of Amazon's sales to New York addresses result from Web page advertisement referrals. He said this low percentage demonstrates that New York online advertisers do not establish and maintain a market for Amazon in the state.

Daniel Connolly, managing partner at Bracewell & Giuliani, New York, arguing on behalf of Overstock, focused on the statute's "presumption" that an online retailer is soliciting through a representative when it enters into an agreement with an online advertiser that is a resident of New York. He noted

that there is case law holding that statutory presumptions that cannot be rebutted offend both the due process and commerce clauses.<sup>1</sup>

The judges seemed both familiar with and interested in this area of the argument, noting that many of the more recent cases in this area are criminal cases, and asking for a recent civil case striking down an irrebuttable statutory presumption on constitutional grounds. They seemed to accept, or at least did not ask any questions suggesting that they contest, the proposition that the presumption in the statute cannot realistically be rebutted.

Peter Karanjia, representing the New York State Department of Taxation and Finance, received a number of tough questions from the judges.

Regarding the statutory presumption, one judge asked how companies like Amazon and Overstock could conceivably keep track of the activities of 8,000 in-state online advertisers to make sure that they are not engaging in any in-state solicitation activities.

The judges also asked Karanjia if it was rational for the statute to presume that online advertisers linking to online retailer Web sites would also necessarily engage in in-state solicitation activities for online retailers. Karanjia's response was that online advertisers have a financial incentive to tell their friends to purchase items from their Web sites, which Karanjia said provides a rational basis for the statute's presumption.

The judges seemed to want actual evidence that online advertisers solicit sales in New York on behalf of Amazon and Overstock. Karanjia offered an e-mail from Amazon in which online advertisers were encouraged to forward to their friends (presumably in New York), encouraging them to buy items from Amazon. One of the judges suggested that the cases should not hinge on that one e-mail and pressed Karanjia for further evidence of New York solicitation. He referenced specific pages in the record that he said showed proof of in-state solicitation.

Besides the statutory presumption issue, the judges also asked Karanjia to distinguish between solicitation and advertising. One of the judges asked for a definition of solicitation. Karanjia answered by describing Amazon's associate program. A judge called this "sophistry" and accused Karanjia of con-

tending that Amazon was soliciting in New York while also contending that the definition of solicitation was paying online advertisers. The judges did not seem satisfied with Karanjia's attempts to distinguish between solicitation and advertising.

The judges asked the representatives where Web sites are located and what it means, in the Internet age, for solicitation to occur "in-state." Also, the judges asked some hypothetical questions. In one, the purchaser is using a laptop in Vail, Colo.; an online advertiser is located in New York; and purchased goods are shipped to a state other than New York. It did not appear that any of the parties scored any points answering these questions, but the questions did seem to clarify to the judges that the residence of online advertisers and the amount of in-state sales generated by referrals from online advertisers is what matters for purposes of the statute.

During rebuttal Connolly noted that the State Department of Taxation and Finance defends the constitutionality of the statute only by pointing to evidence of in-state solicitation activities. But he also noted that there is already a statutory provision providing that in-state solicitation creates nexus. (See N.Y. Tax Law section 1101(b)(8)(i)(C)(I), which states that the term vendor includes "a person who solicits business . . . by employees, independent contractors, agents or other representatives.") He questioned what function the Amazon statute serves if it is only constitutional when a company is engaging in activity that would already make the company taxable under a preexisting statute.

The judges said they are aware that there is a spotlight on the *Amazon* and *Overstock* cases and that online retailers, practitioners, and state taxing authorities are following the case closely. Interestingly, the judges did not ask questions about the revenue effects of the statute or how the statute affects local businesses compared with out-of-state businesses. The judges also did not ask the parties to identify differences between the Amazon and Overstock online advertisement programs, nor did the judges ask the parties to compare the activities conducted by the jobbers in *Scripto* (or the representatives in *Tyler Pipe*) with the activities conducted by the program participants.

It is notoriously difficult to predict how judges will rule based on oral argument, and it is not unheard of for judges to blast one party during oral argument before writing a unanimous decision in favor of that party. However, based on oral argument alone, it sounded like the judges were at least questioning the constitutionality of the statutory presumption and were not fully convinced that Web site links could be characterized as something other than advertising.

*(The author's firm submitted an amicus brief on behalf of the Tax Foundation in these matters.) ☆*

<sup>1</sup>For a New York State due process clause case addressing this issue, see *Eff-Ess, Inc. v. New York Edison Co.*, 237 A.D. 315 (1st Dep't 1932) (providing that a presumption will satisfy due process only when it "is not unreasonable and not made conclusive of the rights of the person against whom raised"); see also *Heiner v. Donnan*, 285 U.S. 312, 329 (1932) (stating that the U.S. Supreme Court "has held more than once that a statute creating a presumption which operates to deny a fair opportunity to rebut it violates the due process clause of the Fourteenth Amendment").