

What Is New York's Amazon Tax on Internet Commerce?

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INTRODUCTION

Internet commerce retail sales volume has been growing rapidly from \$80 billion in 2000 (Kaufman, 2000) to \$107 billion in 2006, \$127 billion in 2007 (U.S. Dept. of Commerce, 2009), and \$156 billion in 2008 (Perry, 2009). It concerns \$13 billion in sales taxes a year (The Wall Street Journal, 2009). The sales taxes belong to the state jurisdiction. The stake is so high that the state governments are making strenuous efforts to collect the taxes. What taxing authorities do the state governments have? In the age of internet commerce the answer can be fuzzy and controversial. On April 23, 2008 the New York State legislature enacted a new law that imposes the so called "Amazon tax" on online retailers. What is it? What does it apply? Who are involved? What is its impact on Internet commerce? This paper will explain whether the seller is responsible for collecting sales taxes from the buyer depends on whether there is a nexus between the seller and the state. Nexus requires physical presence. However, New York Amazon tax law has changed the concept. As long as there is a website linkage between the out-of-state online retailer and the affiliate in the state, it is construed to have nexus. This has raised the decision problem as to whether the retailers should terminate contracts with the affiliates in New York. This article will point out its impact. It will also offer many examples for demonstrative purposes. These aspects sustain the substance of this article.

CURRENT STATUS OF INTERNET COMMERCE TAXATION

The Internet commerce taxation is governed by the "Internet Tax Freedom Act of 1998" (ITFA) (Internet Tax Freedom Act of 1998 (1)). It concerns the taxation on Internet access fees. Telecommunication services, such as telephone, are subject to Federal excise tax and state and local taxes. Nowadays, Internet access services are mingled with communication services. For example, Verizon provides both Internet access and telephone services as a package. Should the Internet access fees be also subject to Federal excise tax and state and local taxes? The Act prohibits the taxation on Internet access fees with a specific deadline, but it was amended in 2004 and now becomes permanent (U.S. Senate bill S-43, 2009). Internet access may be achieved by means of conventional telephone dial up service, fiber optical system, "digital subscriber lines" (DSL), TV cable, wireless linkage, iPhone, twitter, cell phones, laptop computers, satellite linkage, etc. By Internet access it includes all information services provided by the internet service provider, such as e-mail, chat room, yellow pages, medical information, stock quotes, news report, corporate financial information, library services, magazines, journal articles, real estate listing, job search sites, consumer product evaluation, etc. In other words, any service associated with internet access is tax-free. Therefore, there is a need to distinguish Internet access charges from telecommunication service fees.

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For example, Verizon offers \$69 fees a month for internet access or \$100 for both internet access and unlimited telephone calls. What is non-taxable and what is taxable? The \$69 Internet access fee is non-taxable, while the remaining \$31 (\$100 – 69) telephone service is taxable. It should be noted that, for the internet access fees to be tax-free, it must be clearly and separately identified.

If the Internet service provider fails to do so, the entire package becomes taxable. The amended ITFA provides that “If charges for Internet access are aggregated with and not separately stated from charges for telecommunications services or other charges that are subject to taxation, then the charges for Internet access may be subject to taxation unless the Internet access provider can reasonably identify the charges for Internet access from its books and records kept in the regular course of business” (Internet Tax Freedom Act of 1998 (2)). This indicates that the tax treatments for Internet access services and telecommunication services are quite different. There is a necessity to make a distinction. If no distinction is made, the entire amount of fees is taxable.

For example, AT&T offers \$100 monthly fees for both Internet access and unlimited telephone services. What is non-taxable and what is taxable? The entire \$100 fees for the “bundling-up” services are taxable, because there is no way to decompose the Internet access fees.

However, a transaction executed by means of Internet access may not be tax-free. For example, a student purchases a e-book from a publisher who in turn downloads the book to the student's hard drive. The e-book is not tax-free; instead, it is subject to sales tax. Other examples are downloads of movies, games, music, copies of archived journal articles, software to prepare income tax return (e.g., TurboTax), etc. In other words, these transactions are nothing but the electronic transformation of the hard copies. Internet access does not give rise to a tax-free transaction.

The ITFA did not change the law governing the rules of sales taxes. Only the sales of tangible personal property or services are subject to sales taxes (New York Tax Law, 1). The state government is given the authority to collect sales taxes. If an online retailer is not required to collect the sales taxes, the buyer must pay use tax to the buyer's own state government (New York Tax Law, 2). Further, the sales from business to business are not subject to sales taxes. All these tax rules remain the same.

THE CONCEPT OF “NEXUS” IN SALES TAX

The sales taxes are borne by the consumer (buyer) of the state resident on the amount of consumption, not on the basis of income. Who is required to collect the sales taxes? If the seller and the buyer reside in the same state, it is the seller's responsibilities. If they don't reside in the same state, it is the buyer's duties to remit the due amount of sales taxes to his/her own state government. This is known as “use tax.” This sounds simple and easy. In reality, the seller's state residency can be fuzzy. For example, the seller may have a customer service office in the state. Is the seller an in-state entity? Worse yet, in today's e-business, Internet is reachable worldwide. The Internet businesses can be referred to each other online. What is the online retailer's state residency? If an in-state resident purchases a merchandise online, can the state government require the online retailer to collect sales taxes from its in-state buyer? This is no easy question, and there is no easy answer. In fact, this question is so controversial that it involved two United State Supreme Court decisions, as outlined below.

The first court case was *Scripto vs. Carson* in 1960 (The U. S. Supreme Court, 1960). Scripto was a pen manufacturer in Georgia. It hired Carson as an independent contractor, not as an employee, to sell pens in Florida on commission basis. The state of Florida attempted to collect sales taxes from Scripto. Scripto argued that Carson is only an independent contractor rather than an employee. It has no control

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