

US Supreme Court may rule on the 'click-through' nexus

Illinois' Supreme Court ruled in October that Illinois Public Act 96-1544, a 'click-through' nexus law requiring out-of-state internet retailers to collect sales tax if they commission to Illinois affiliates who link to the retailer's website, is unenforceable. Sylvia Dion, Founder and Managing Partner of PrietoDion Consulting Partners LLC, a specialist tax consulting firm, analyses the background to the 'click-through' nexus law and whether the US Supreme Court will issue its decision on whether to hear these cases.

Since 2008, several US states have enacted nexus expanding laws which focus on the use of internet marketing affiliates: unrelated parties (individuals/businesses) that post web-links on their sites that link to the online stores of internet retailers and that are compensated when website visitors 'click-through' to the retailer's online store and complete a purchase. These so-called Amazon Laws have been enacted in an effort to circumvent the physical presence requirement established in the 1992 US Supreme Court decision, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). Because a state cannot compel an out-of-state retailer to collect its tax unless the retailer has 'substantial nexus' to the state (which *Quill* defined as a physical presence), states with 'click-through' nexus laws have taken the position that in-state marketing affiliates are effectively 'agents' of the out-of-state retailer which thereby satisfies the physical presence standard.

In 2011, Illinois enacted a 'click-through' nexus law (Illinois Public

Act 96-1544), which was largely modeled after New York's 2008 law. A suit was soon brought before the Circuit Court of Cook County, Illinois by the Performance Marketing Association, Inc. ('PMA'), an organisation that supports and advocates for the performance marketing industry. The Circuit Court agreed with the PMA's assertions that the Illinois 'click-through' nexus law is preempted by federal law and violated the Commerce Clause of the US Constitution.

The Illinois Supreme Court decision

On 18 October 2013, the Illinois Supreme Court agreed with a lower Circuit Court's decision that the Illinois 'click-through' nexus law was preempted by the federal Internet Tax Freedom Act of 2007 ('IFTA'), in accordance with the US Constitution's Supremacy Clause, rendering the Illinois law void and unenforceable. *Performance Mktg. Ass'n Inc. v. Hamer*, No. 114496 (Ill. 18 Oct 2013).

In holding that federal preemption applied, the Illinois Supreme Court focused primarily on two key elements of the IFTA: whether the requirement to collect the Illinois use tax met the IFTA's definition of a 'tax' and whether the 'tax' was a prohibited 'discriminatory tax on electronic commerce.'

On the first point, the Illinois Supreme Court held that the 'click-through' nexus provision, which expanded the definition of a retailer or serviceman required to collect the Illinois use tax, met the IFTA's definition of a 'tax' which the IFTA does not limit to 'revenue raising' measures, but extends to 'the imposition on a seller to collect and to remit to a governmental unit any sales or use tax imposed on a buyer by a governmental unit.'

The Illinois Supreme Court then focused on the 'discriminatory' nature of the Illinois law. Here the Court noted that the 'click-through' law specifically targeted out-of-state internet retailers with 'online' marketing affiliate contracts, but did not apply to out-of-state retailers who engage in 'offline' marketing affiliate campaigns such as with print publishers (catalogues, magazines, newspapers) and over-the-air (radio, TV) broadcasters even though both operate similarly. Whereas 'online' affiliate marketing campaigns generally involve affiliates posting web-links on their sites that refer visitors to the retailer's online store where they can consummate a sale for which the affiliate is compensated, 'offline' affiliate marketing campaigns may involve promotional codes being advertised in a local periodical or over the air. Customers who make a purchase from the retailer and cite the promotional code also generate a commission or other compensation for the 'offline' marketing affiliate. The Illinois Supreme Court opined that because 'online' affiliate marketing campaigns are treated differently from those conducted 'offline,' Illinois' 'click-through' provision imposed a 'discriminatory tax on electronic commerce.' On this point, the defendant argued that the 'click-through' nexus law was not discriminatory because a use tax collection obligation was already imposed on 'offline' affiliates under a different provision within the Illinois statute. (35 ILCS 105/2(3)) The Court, however, found the provision to which the defendant referred required that the 'offline' promotion be 'disseminated primarily to consumers located in the State and only secondarily to bordering jurisdictions,' whereas the publicly available webpages of

an 'online' marketing affiliate could be accessed from any computer or other digital device located anywhere in the world.

Finding that preemption rendered the Illinois law void and unenforceable, the Illinois Supreme Court did not reach the second argument, that being whether the Illinois 'click-through' law violated the US Commerce Clause. This came as a great disappointment to the Court's one dissenting member, Justice Karmeier, who noted that the IFTA is a temporary moratorium set to expire on 1 November 2014 and once lifted, the Illinois 'click-through' law would once again be valid and the Commerce Clause challenge would again present itself. Justice Karmeier noted his opposition to the conclusion and added that had preemption been the sole basis for the Circuit Court's ruling, judicial procedure would have obligated the Illinois Supreme Court to transfer the appeal to the Appellate Court and that the one issue that would have given the Court jurisdiction to render an opinion was whether the Illinois law violated the US Constitution.

Will the US Supreme Court render an opinion?

Earlier this year, the Court of Appeals of New York State (that state's highest court), considered and rejected a Commerce Clause challenge to New York's 'click-through' nexus law (Overstock.com, Inc. v. New York State Department of Taxation & Finance, 987 N.E. 2d 621, 622 (N.Y. 2013)). Thus, to date, two different states have rendered opposite opinions on whether to uphold what are essentially identical 'click-through' nexus laws.

It should be noted, however, that these conclusions were based on different principals. The New York court specifically addressed the

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Commerce Clause challenge and held that in-state marketing affiliates met the substantial nexus standard in Quill as they, in effect, solicited sales for the out-of-state internet retailer. As discussed above, the Illinois Supreme Court did not address the Commerce Clause issue because it found that federal preemption rendered the Illinois ruling void and unenforceable. Still, many in the legal community believe these two 'conflicting' rulings will spur the US Supreme Court to finally weigh in on 'click-through' nexus.

On 23 August, Amazon.com and Overstock.com, who challenged the New York law, filed a petition for *writ of certiorari* with the US Supreme Court (Overstock.com, Inc. v. New York State Department of Taxation and Finance, Docket No. 13-252; Amazon.com, LLC v. New York State Department of Taxation and Finance, Docket No. 13-259). Several interested parties filed *amicus curiae* briefs urging the Court to review the case.

However, on 26 November, the date on which it was anticipated that the US Supreme Court would issue its decision on whether to hear these cases, the Amazon and Overstock petition were excluded from the list of cases the Supreme Court agreed to review. The Supreme Court is expected to officially list the cases it has denied on Monday 2 December. At that point, it will be clear whether the Supreme Court will weigh in on 'click-through' nexus.

Impact of federal legislation

On 6 May 2013, the US Senate passed federal legislation, the Marketplace Fairness Act of 2013 (S. 743), which if enacted would grant certain states the authority to require many out-of-state (and foreign) sellers to collect tax on sales to in-state customers regardless of whether the seller has

a physical presence in the state. As it currently reads, the proposal does not require states to comply with the federal law meaning that state 'click-through' and other nexus expanding laws would not cease to exist. The proposal's prospect for final enactment is unclear. One reason is because the Chairman of the House Judiciary Committee, Bob Goodlatte (R-VA), to which the legislation has been referred, has publicly voiced his concern that the legislation does not require enough of states that would benefit from it.

But federal 'internet tax' legislation is not the only legislation that could impact the fate of 'click-through' nexus laws. Since the beginning of the year, there have been several proposals introduced by the US Congress which seek to make the IFTA permanent (two such proposals are H.R. 3086, the Permanent Internet Tax Freedom Act, introduced 12 September 2013; and H.R. 434, the Permanent Internet Tax Freedom Act, introduced 29 January 2013). If the IFTA becomes permanent prior to 1 November 2014, the date on which the current moratorium is set to expire, not only would the Illinois law likely remain void and unenforceable, but this would open the door to IFTA challenges in other states with 'click-through' nexus laws.

Conclusion

Without a doubt, these current US developments could have significant impact on whether internet retailers, in the US and abroad, will be required to collect tax on sales to customers in states in which they have no physical presence. There is much to come!

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