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TAX ALERT

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Spotlight on SALT:
Amazon.com Decisions Highlight Cutting-Edge Issues

In two recent court decisions involving Amazon.com, a New York appellate court held in favor of that state's broad assertion of tax jurisdiction, while a Federal District Court enjoined the North Carolina Department of Revenue's administrative summons issued to Amazon. These recent decisions, discussed below, address cutting-edge issues involving sales and use taxes, and may be instrumental in many states establishing future tax policy.

The Amazon Decisions

A. *Amazon.com LLC v. New York State Dept. of Taxation and Finance (November 4, 2010)*. As an e-commerce retailer, Amazon (and Overstock.com, involved in a companion case), has an Associates program whereby independent individuals (Associates) provide a link on their websites or blogs to the Amazon.com website. If a visitor to an Associates' blog or website clicks on the link and makes a purchase from the Amazon website, the Associate is paid a commission. Any purchase made by the visitor takes place solely with Amazon, and all customer inquiries, returns, refunds, and so on are handled by Amazon without any involvement of an Associate.

In 2008, New York state amended its sales and use tax statute to provide an irrebuttable presumption requiring e-retailer vendors with Associate programs similar to Amazon's to collect New York sales and use taxes on purchases made by New York residents from such e-retailer vendors if the annual gross receipts from sales to New York customers by the e-retailer exceed $10,000. If the threshold is met, the e-retailer is required to collect sales and use taxes on all of its New York sales, not just those sales relating to an Associate. The New York appellate court found it important that the amended statute provides an exemption from collection if the e-retailer's agreement with an Associate prohibited the Associate from "engaging in any solicitation activities in New York."

The New York appellate court was persuaded that Amazon's Associates program was not passive advertising in New York. Instead, the program encouraged the Associates' active solicitation of customers in New York for purposes of growing Amazon's New York market. In addition, according to the Appeals Court, the above-referenced exemption from collection provided by the statute prevented the statute from facially violating the Commerce Clause of the U.S. Constitution. Likewise, the Appeals Court found that the statute's irrebuttable presumption was rational (because of the exemption), was not unconstitutionally vague, and did not facially violate the Due Process Clause.

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Nonetheless, the Appeals Court held that it was unable on the record to determine if the statute "as applied" to Amazon violated the Commerce Clause. As a result, the Appeals Court remanded the case to the trial court to determine if Amazon's Associates program was "substantially associated with [Amazon's] ability to establish and maintain" a New York market - - relying on a 1987 United States Supreme Court decision in *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*.

After the New York Department of Taxation and Finance's trial court victory, a number of states were encouraged and some enacted similar legislation, including Colorado, North Carolina, and Rhode Island. While other states considered but failed to enact such a statute, they should be expected to try again during 2011 legislative sessions. Although the remand is encouraging, developments so far in the New York courts with regard to Amazon's and Overstock.com's challenges to the statute reflect the trend in states to broaden their tax jurisdiction not only with respect to e-commerce, but also over services, intellectual property transactions, financial services and other virtual connections to a state's economy.

B. *Amazon.com LLC v. Lay, (October 25, 2010).* As noted above, North Carolina is one of the states to follow New York's lead in adopting similar Amazon.com legislation. However, this second recent decision involving Amazon, which was rendered by a Federal District Court in the State of Washington, did not address the constitutionality of such legislation, but rather the appropriateness of certain disclosures demanded of Amazon by North Carolina.

By way of background, the North Carolina Department of Revenue (NCDOR) audited and attempted to require Amazon to collect North Carolina sales and use taxes on its sales to North Carolina residents. Like New York and most other states, Amazon had no direct physical presence in North Carolina. As part of this dispute, the NCDOR requested information from Amazon regarding its sales to North Carolina residents. Amazon complied with the Department's request, providing information which included titles and descriptions of books, DVDs, and music purchased by North Carolina customers. The NCDOR followed up with a request for the name, address and other identifying information of Amazon's North Carolina customers, which Amazon refused to provide. In response, the NCDOR threatened to issue a summons and Amazon thereafter filed a complaint for injunctive and other declaratory relief in the Federal District Court for the Western District of Washington.

Amazon argued that the NCDOR's request violated its customers' First Amendment rights, because the information sought by the Department was the "expressive content of all purchases" by North Carolina residents. Intervenors, represented by the American Civil Liberties Union, intervened on behalf of Amazon in the case.

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After ruling in favor of Amazon and Intervenors that the First Amendment claims were ripe, the Federal District Court held that the Tax Injunction Act and principles of comity did not remove jurisdiction from the Federal Court. The Tax Injunction Act is a federal law that bars federal courts from enjoining the assessment or collection of state taxes when there is a plain, speedy, and efficient state remedy available to a taxpayer. Because Amazon's complaint did not seek to enjoin the assessment or collection of North Carolina sales and use taxes and did not implicate the validity of North Carolina's taxing scheme, the court held the Tax Injunction Act and principles of comity did not bar its jurisdiction. Further, the court distinguished the U.S. Supreme Court's recent 2010 decision on state tax comity, Levin v. Commerce Energy, on the basis that the information already provided by Amazon was sufficient, without the customer identifying information, for the NCDOR to calculate tax, and Amazon was not requesting the court to declare North Carolina's taxing scheme invalid.

Turning to the merits, the Federal District Court agreed with Amazon that its North Carolina customers' First Amendment rights were implicated. The First Amendment protects a buyer from having the expressive content of that buyer's purchase of books, music and audiovisual material disclosed to the government. Thus, First Amendment rights are implicated when the government seeks disclosure of reading, listening and viewing habits. As a result, the NCDOR was enjoined from requesting customer identifying information from Amazon. Further, the Federal District Court also held that Amazon qualified as a "video tape service provider" under the federal Video Privacy Protection Act (VPPA) and that the NCDOR's request ran afoul of the VPPA. The NCDOR's request for "all information for all sales" was sufficiently expansive so as to include in the request the protected information about Amazon's North Carolina customers' video titles.

This Federal District Court decision could have wide-ranging consequences not only with respect to e-commerce retailers, but any remote retailer or business involved in a state tax audit that has sold expressive digital or tangible content to a customer in the audit state. Further, this decision could have implications for state audits outside of tax, including unclaimed property and other state government investigations.

Conclusion

These decisions involving Amazon represent two of the battle lines in the sales/use tax struggles between aggressive taxing states and many remote vendors. We anticipate these battle lines will spread as states struggle with their fiscal conditions and remote vendors are forced to confront similar challenges in other states.

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If you would like to discuss matters particular to either of these decisions or their implications on state taxing jurisdiction and state tax or unclaimed property audits in general, please contact one of the following attorneys in our Tax Department:

Washington, D.C.

James W. McBride	202.508.3467	jmcbride@bakerdonelson.com
Scott D. Smith	202.508.3430	sdsmith@bakerdonelson.com

Atlanta, Georgia

Nedom A. Haley	404.221.6505	nhaley@bakerdonelson.com
Michael M. Smith	404.589.3419	mmsmith@bakerdonelson.com
Michael S. Evans	404.221.6517	mevans@bakerdonelson.com

Birmingham, Alabama

Thomas J. Mahoney Jr.	205.250.8346	tmahoney@bakerdonelson.com
William R. Sylvester	205.250.8372	bsylvester@bakerdonelson.com
Vincent J. Schilleci	205.244.3827	vschilleci@bakerdonelson.com

New Orleans, Louisiana

Robert W. Nuzum	504.566.5209	rnuzum@bakerdonelson.com

Baton Rouge, Louisiana

Alton E. "Biff" Bayard III	225.381.7019	abayard@bakerdonelson.com

Jackson, Mississippi

Stacy E. Thomas	601.351.2484	sthomas@bakerdonelson.com
Jon D. Seawright	601.351.8921	jseawright@bakerdonelson.com
David P. Webb	601.969.4678	dwebb@bakerdonelson.com

Memphis, Tennessee

William H.D. Fones Jr.	901.577.2247	wfones@bakerdonelson.com
Adam C. Flock	901.577.8167	aflock@bakerdonelson.com

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East Memphis, Tennessee

James R. "Josh" Hall Jr.	901.579.3126	joshhall@bakerdonelson.com
Christopher J. Coats	901.579.3127	ccoats@bakerdonelson.com

Nashville, Tennessee

Carolyn W. Schott	615.726.7312	cschott@bakerdonelson.com
John B. Burns	615.726.5599	jburns@bakerdonelson.com

Chattanooga, Tennessee

Carl E. Hartley	423.756.2010	chartley@bakerdonelson.com
Virginia C. Love	423.209.4118	vlove@bakerdonelson.com

Knoxville, Tennessee

Angelia M. Nystrom	865.971.5182	anystrom@bakerdonelson.com