



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	04/27/10	Bill No:	AB 2078
Tax:	Sales and Use	Author:	Calderon
Related Bills:	AB 178 (Skinner) AB 193 (Budget Committee) ABx3 19 (Evans) ABx3 27 (Calderon) SBx3 17 (Ducheny) SBx8 8 (Budget Committee)		

BILL SUMMARY

This bill would require retailers making sales of tangible personal property subject to use tax that are not required to collect the tax to provide readily visible notification on its retail Internet Web site or catalogue that tax is imposed on the storage, use, or other consumption in this state of the tangible personal property purchased from the retailer that is not exempt, and is required to be paid by the purchaser.

SUMMARY OF AMENDMENTS

The amendments to this bill since our last analysis deleted provisions that would have (1) created a rebuttable presumption related to any retailer is engaged in business in this state if the retailer is part of a controlled group of corporations that has a component member that is a retailer engaged in business in this state, and (2) required larger retailers not required to register with the Board who sell tangible personal property subject to use tax to file a report with the Board regarding those sales.

ANALYSIS

CURRENT LAW

Under federal law, Article I, Section 8, Clause 3 of the United States Constitution, known as the Commerce Clause, states that Congress has the exclusive authority to manage trade activities between the states, with foreign nations, and Indian tribes. The "Dormant" Commerce Clause, also known as the "Negative" Commerce Clause, is a legal doctrine that courts in the United States have implied from the Commerce Clause. The idea behind the Dormant Commerce Clause is that this grant of power implies a negative converse — a restriction prohibiting a state from passing legislation that improperly burdens or discriminates against interstate commerce. The question of to what extent states can legally compel remote retailers to collect the tax, however, has been a subject of extensive disagreement.

Under California's Sales and Use Tax Law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code, a use tax is imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The use tax is imposed on the purchaser, and unless that purchaser pays the use tax to a retailer registered to collect the California use tax, the purchaser is liable for the tax, unless the use of that property is specifically exempted or excluded from tax. The use tax is the same rate as the sales tax and is generally required to be remitted to the Board on or before the last day of the month following the quarterly

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

period in which the purchase was made, or a purchaser may report the tax on the purchaser's state income tax return (if that purchaser is not registered with the Board).

Section 6203 of the Sales and Use Tax Law describes various activities which constitute "engaging in business in this state" for purposes of determining whether an out-of-state retailer has sufficient business presence (also known as "nexus") in California such that the state will impose a use tax collection responsibility on sales made to California consumers. If a retailer has sufficient business presence within the terms of Section 6203, that retailer is required to register with the Board pursuant to Section 6226 and collect the applicable use tax on all taxable sales to California consumers.

Under Sales and Use Tax Section 7055, in administration of the use tax, the Board may require the filing of reports by any person or class of persons having in his or their possession or custody information relating to sales of tangible personal property the storage, use, or other consumption of which is subject to the tax. The reports shall be filed when the board requires and shall set forth the names and addresses of purchasers of the tangible personal property, the sales price of the property, the date of sale, and such other information as the Board may require.

PROPOSED LAW

The bill would add Section 6208 to the Sales and Use Tax Law to require each retailer making sales of tangible personal property, the storage, use or other consumption of which is subject to tax, that is not required to collect use tax to provide notification on its retail Internet Web site or catalogue that tax is imposed on the storage, use, or other consumption in this state of the tangible personal property purchased from the retailer that is not exempt, and is required to be paid by the purchaser. The bill would require that the notification be readily visible.

The provisions of the bill would become effective on January 1, 2011.

BACKGROUND

One of the greatest controversies in the field of state taxation today concerns the constitutional authority of the states to impose a use tax collection responsibility on out-of-state retailers for the sale of goods shipped into the taxing state. Such transactions are generally conducted either through mail order, telephone orders, or via the Internet.

Under constitutional law, states lack jurisdiction to require out-of-state retailers to collect a sales or use tax when the retailer has no "physical presence" in the taxing state. In 1992 the Supreme Court issued an opinion in *Quill Corporation v. North Dakota* (1992) 504 U.S. 298 and held that satisfying due process concerns does not require a physical presence, but rather requires only minimum contacts with the taxing state. Thus, when a mail-order business purposefully directs its activities at residents of the taxing state, the Due Process Clause does not prohibit the state's requiring the retailer to collect the state's use tax. However, the Court further held that physical presence in the state was required for a business to have a "substantial nexus" with the taxing state for purposes of the Commerce Clause. The Court therefore affirmed that in order to survive a Commerce Clause challenge, a retailer must have substantial nexus in the taxing state before that state can require the retailer to collect its use tax.

Since the late 1990s, online shopping has taken off as an increasing number of businesses and consumers purchase increasingly diversified products on the Internet. That, combined with the states' inability to require a use tax collection requirement on

many out-of-state retailers, has prompted many states to seek new ways to enforce their use tax laws (every state that has a sales tax imposes the use tax). Recently, the states of New York and Colorado have enacted laws with different approaches. In 2008, New York revised its statutes to create a presumption that a retailer “solicits” business in the state if an in-state entity (commonly referred to as an affiliate) is compensated for referring customers directly or indirectly to the retailer. This change in law required the larger Internet retailers that have affiliate programs, such as Amazon.com and Overstock.com, to begin collecting the tax on sales to New York purchasers (both retailers have filed suit, and the New York Supreme Court dismissed those suits; however, the matters are currently on appeal).

Colorado’s approach became effective in March 2010. Colorado’s new law requires a reporting requirement for Internet sellers, including:

- Invoices to Colorado customers must note that use tax applies to taxable purchases and must be reported by the purchaser.
- An annual report must be provided to their Colorado customers on all purchases.
- An annual report must be filed with the Colorado Department of Revenue with customer names and addresses and total amount of purchases.

Colorado’s law also provides for a penalty of \$5 per invoice without use tax information, and \$10 penalty per failure to provide annual customer reports. Colorado’s emergency regulation related to these provisions specifies that out-of-state retailers that made total gross sales in the prior year of less than \$100,000 and reasonably expects sales in the current year will be less than \$100,000 shall be exempt from these requirements.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author. It is intended to minimize the use tax gap by imposing a use tax information reporting obligation on those out-of-state retailers that are not regarded as “engaged in business” in California.
2. **The April 27, 2010 amendments** delete provisions that would have (1) created a rebuttable presumption that any retailer is engaged in business in this state if the retailer is part of a controlled group of corporations that has a component member that is a retailer engaged in business in this state, and (2) required larger retailers not required to register with the Board who sell tangible personal property subject to use tax to file a report with the Board regarding those sales.
3. **What happens if an out-of-state retailer fails to comply with the reporting requirements?** It is not certain whether the Board has the authority to enforce these tax obligation notifications due to the U.S. Supreme Court cases holding that a retailer must have a substantial nexus in the state in order to be required to collect use tax. It is unclear whether the notification mandate in the bill requires the same level of presence that a use tax collection obligation has. Also, the bill does not include any civil penalties or sanctions if an out-of-state retailer fails to comply.
4. **Related legislation.** During this 2009-10 Regular Session and extraordinary sessions, there have been several bills (i.e., AB 178, Skinner; ABx3 19, Evans, and ABx3 27, Calderon) introduced that would expand the definition of “retailer engaged in business in this state.” Unlike this bill, these other measures would have incorporated provisions in California law similar to New York’s described previously.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.

Only one of these bills was approved by the Legislature; however, it was vetoed by the Governor (SBx3 17).

COST ESTIMATE

Absorbable costs would be incurred in notifying affected out-of-state retailers through press releases and notices, and updating the Board's website and other publications.

REVENUE ESTIMATE

It is unknown how many out-of-state retailers would comply with the requirements of the bill, or how many California consumers would voluntarily report the use tax as a direct result of a retailer complying with the notice requirements in this bill. To the extent compliance with this bill is achieved, state and local revenues could increase. However, it is difficult to determine with any degree of certainty the amount of any increase.

Analysis prepared by:	Sheila T. Waters	(916) 445-6579	04/28/10
Contact:	Margaret S. Shedd	(916) 322-2376	

ls

2078-2sw.doc

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.