AMERICAN CONSTITUTIONALISM
VOLUME I: STRUCTURES OF GOVERNMENT
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Supplementary Material

Chapter 11: The Contemporary Era – Federalism

Overstock.com v. New York State Department of Taxation and Finance, 2013 NY Slip Op 02102 (2013)

In 2008, the New York state legislature amended its tax law so that any New York resident who posted a link to an Internet site and received commissions on sales from that site would be treated as a vendor subject to the state sales tax. Amazon.com and Overstock.com were businesses located outside the state of New York that operated affiliate programs that allowed third parties to link to their websites and receive commissions on sales that were directed through that link. Both companies filed suit against the state taxing agency to block enforcement of the statute. The state trial court dismissed the suit, and the appellate court largely affirmed. On appeal, the New York Court of Appeals upheld the tax against the constitutional challenge that the statute violated the interstate commerce and due process clauses in a 4–1 decision.

What standard did the New York court apply to resolve the commerce claim? Is a constitutional rule requiring that a seller maintain a physical presence in the state for the state to impose a tax on its activities outdated? Should the same rules that applied to mail order businesses also apply to Internet businesses? Are Internet "associates" more like advertising or more like traveling salesmen? If a New York resident receives a commission on sales made to Japanese customers on a web server in Nevada, should New York be able to collect a sales tax?

LIPPMAN, CHIEF JUDGE.

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The dormant Commerce Clause has been interpreted to prohibit States from imposing an undue tax burden on interstate commerce. . . . However, in the absence of an improper burden, entities participating in interstate commerce will not be excused from the obligation to pay their fair share of state taxes. . . . To that end, a state tax impacting the Commerce Clause will be upheld "[1] when the tax is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State" (. . . *Complete Auto Transit, Inc. v. Brady* [1977]). The parties agree that the only prong at issue here is whether the statute satisfies the "substantial nexus" test.

In *National Bellas Hess, Inc. v Department of Revenue of Ill.* (1967), the United States Supreme Court held that a use tax could not be imposed on an out-of-state mail-order business that did not have offices, property or sales representatives in Illinois. The Court noted that it had never permitted such a tax where the seller's sole connection with its customers in the forum state was by mail or common carrier. . . .

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The world has changed dramatically in the last two decades, and it may be that the physical presence test is outdated. An entity may now have a profound impact upon a foreign jurisdiction solely through its virtual projection via the Internet. That question, however, would be for the United States Supreme Court to consider. We are bound, and adjudicate this controversy, under the binding precedents of that Court, the ultimate arbiter of the meaning of the Commerce Clause.

There are clearly parallels between a mail-order business and an online retailer — both are able to conduct their operations without maintaining a physical presence in a particular state. Indeed, physical presence is not typically associated with the Internet in that many websites are designed to reach a national or even a global audience from a single server whose location is of minimal import. However, through this statute, the legislature has attached significance to the physical presence of a resident website owner. The decision to do so recognizes that, even in the Internet world, many websites are geared toward predominantly local audiences. . . .

Viewed in this manner the statute plainly satisfies the substantial nexus requirement. Active, in-state solicitation that produces a significant amount of revenue qualifies as "demonstrably more than a slightest presence'" under *Matter of Orvis Co. v. Tax Appeals Trib. Of State of N.Y.*, 86 NY2d 165 (NY 1995). . . .

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Plaintiffs argue that the Internet tax violates due process because the statutory presumption is irrational and essentially irrebuttable. In order for the presumption to be constitutionally valid, there must be "a rational connection between the facts proven and the fact presumed, and . . . a fair opportunity for the opposing party to make [a] defense." . . .

Here, the fact proved is that the resident is compensated for referrals that result in purchases. The fact presumed is that at least some of those residents will actively solicit other New Yorkers in order to increase their referrals and, consequently, their compensation. It is plainly rational to presume that, given the direct correlation between referrals and compensation, it is likely that residents will seek to increase their referrals by soliciting customers. . . .

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In sum, plaintiffs have failed to demonstrate that the statute is facially unconstitutional under either the Commerce or the Due Process Clause.

Accordingly, in both cases, the judgment appealed from and the order of the Appellate Division brought up for review should be *affirmed*, with costs.

SMITH, J., dissenting.

The rules that govern this case are laid down in a series of United States Supreme Court decisions and are not in dispute. Under the Commerce Clause, a state may require an out-of-state retailer to collect use tax from in-state purchasers only if the retailer has a physical presence within the state (. . . *Quill Corp. v. North Dakota* [1992]). The solicitation of customers for the retailer by in-state sales representatives counts as a physical presence, even where the sales representatives are independent contractors . . . ; but mere advertising by the out-of-state retailer in in-state media does not. . . .

Our task here is to decide whether certain New York-based websites — Overstock's "Affiliates" and Amazon's "Associates" — are the equivalent of sales agents, soliciting business for Overstock and Amazon, or are only media in which Overstock and Amazon advertise their products. I think they are the latter.

The Overstock and Amazon links that appear on websites owned by New York proprietors serve essentially the same function as advertising that a more traditional out-of-state retailer might place in local newspapers. The websites are not soliciting customers for Overstock and Amazon in the fashion of a local sales agent. Of course the website owners solicit business for themselves; they encourage people to visit their websites, just as a newspaper owner would seek to boost circulation. But there is no basis for inferring that they are actively soliciting for the out-of-state retailers.

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The statute at issue here tries to turn advertising media into an in-state sales force through a presumption. . . . But of course a statutory presumption cannot by itself permit a state to do what the United States Constitution forbids. To presume that every website that has an agreement under which it

carries an Overstock or Amazon link is a sales agent for Overstock or Amazon would be to nullify the rule that advertising in in-state media is not the equivalent of physical presence.

Read literally, the statute would reach essentially all Internet advertising that links to a seller's website: it includes any agreement for referral of customers, by a link or otherwise, "for a commission or other consideration." Since this literal reading would unquestionably render the statute unconstitutional, the Department of Taxation and Finance has adopted a narrowing construction, largely ignoring the words "or other consideration," and applying the presumption only where the website receives a commission or similar compensation . . . . The narrowing construction, in my view, does not save the statute.

It was no doubt true before the Internet existed that advertising was usually sold for a flat fee, while sales agents usually worked on commission, but that has changed. When an advertisement takes the form of a link on a website, it is easy, as well as efficient, for the advertiser to compensate the website on the basis of results. But the link is still only an ad. . . .

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. . . . To infer, from an agreement to put a link on a website and to compensate the website owner in proportion to the resulting sales, that the website owner is actively soliciting business for the seller "is so strained as not to have a reasonable relation to the circumstances of life as we know them."

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JUDGE RIVERA took no part in the case.