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**The facts behind Colorado’s new Internet sales tax law and the
termination of affiliates at Amazon.com**

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On March 1 a Colorado law designed to increase sales tax collection on Internet purchases went into effect. A week later, Amazon.com, one of the nation’s largest online retailers, terminated its contracts with all of its Colorado “marketing affiliates” — some 4,000 Coloradans.ⁱ These terminations have sparked a sizeable debate, with some blaming the Colorado Legislature for disregarding similar past outcomes in other states.

However, Colorado’s move to increase tax collections on Internet purchases was carefully crafted to avoid the pitfalls of past attempts. Indeed, the law in question intentionally removes affiliates from the legal framework of taxation. As a result, unlike in other states, Amazon’s mass firings in Colorado do nothing to change the company’s obligations under the law. The company’s action appears to be entirely punitive and threatening, designed to strong-arm Colorado into reversing the new law and in turn, discourage other states’ efforts to eliminate the unfair tax advantage afforded Internet commerce.

Marketing affiliates and “Amazon Laws”

Faced with decreasing sales tax collections due to Internet commerce and stalling efforts to modernize the approach to Internet sales taxation (See Appendix: “The Streamlined Sales and Use Tax Agreement” and “Out-of-state retailers and the sales tax”), several states have pursued new efforts to require sales tax collection on out-of-state Internet sales. New York led in 2008, passing a law requiring out-of-state online retailers to collect sales taxes because of their relationships with “marketing affiliates.”

In the world of Internet commerce, marketing affiliates are bloggers, owners of websites, and other parties who use their presence on the Internet to refer business to Internet retailers for a commission. An example of affiliate marketing is a blogger who posts a link to an online retailer selling a book she recommends, receiving a commission each time readers of her blog follow the link and give their business to the retailer.

The 2008 New York “Amazon law” — named after its biggest target — maintained that such affiliate relationships establish a physical presence in the state for Internet retailers. Thus even though remote retailers like Amazon.com had no brick-and-mortar stores in the state, these retailers would be required to collect sales tax on behalf of customers.ⁱⁱ (See Appendix: “A brief overview of the Colorado sales and use tax”) Following New York’s lead, many states have considered this “affiliate approach” to sales tax enforcement. In 2009 Rhode Island and North Carolina passed their own “Amazon laws.”ⁱⁱⁱ

The standard counter-attack from Amazon and its peers

As one of the nation's largest Internet retailers, Amazon.com has made a point of responding quickly to new "Amazon Laws." In New York, the retailer quickly mounted a legal challenge, which it lost in lower court and which Amazon is currently appealing.^{iv} With a legal challenge in place, the online giant began pursuing a bolder strategy in states to follow. In response to Rhode Island and North Carolina's copycat laws, Amazon chose instead to categorically terminate its in-state affiliate contracts, thus severing ties to the states and with them its obligations to collect sales tax.^v (See Appendix: "A brief overview of the Colorado sales and use tax") When other measures passed state legislatures in California and Hawaii, Amazon again terminated affiliate contracts in Hawaii, and its competitor Overstock.com did the same in California. As a result, governors in both states vetoed the bills.^{vi}

House Bill 1193: Colorado tries a different approach

Given the strong and adverse reactions following the wave of Amazon laws in 2008 and 2009, in the 2010 session the Colorado Legislature tried a different approach to the problem of lost Internet sales tax revenue with House Bill 1193. Passed in February 2010 and effective March 1, 2010, this bill avoids requiring out-of-state Internet retailers such as Amazon.com to collect sales tax.

Instead, the law stipulates that any retailer not collecting sales tax in Colorado must inform Colorado customers a use tax is still owed on the purchase. (See Appendix: "A brief overview of the Colorado sales and use tax") The law implements the notice requirement by obligating non-collecting retailers to produce a year-end statement summarizing total use tax owed to Colorado as a result of purchases during the year. This statement is to be sent to the customer and the Colorado Department of Revenue.^{vii}

While this law is an innovative approach to the problem of Internet tax avoidance, it is not the brash attack on Internet business some claim it to be.^{viii} Indeed, all local shops, Colorado-based Internet retailers, and national retailers with stores in Colorado already collect state sales tax. Since Colorado's new tax law requires out-of state retailers to only inform customers of their tax obligation, not collect taxes customers' behalf, the standard is lower for companies like Amazon.

Amazon strikes out against affiliates

Despite the fact the Colorado bill does not use the affiliate marketing connection to require out-of-state Internet retailers to collect sales tax, on March 8, 2010, Amazon.com announced it was terminating its Colorado affiliates.^{ix} Since these firings do not affect Amazon's legal obligation under the new tax law, it is clear the company has chosen to punish its associates for the sole purpose of forcing the Legislature to change the law.

As Amazon.com and other major Internet retailers struggle to preserve their avoidance of state sales and use taxes, they may face an uphill struggle. Indeed this year Georgia, Illinois, Maryland, Connecticut and Virginia are all considering Amazon laws of some kind.^x With Colorado's example of a non-affiliate-related approach to internet taxation, Amazon and others may be hard pressed to fight such measures with anything other than the threat of punitive action.

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Appendix

A brief overview of the Colorado sales and use tax

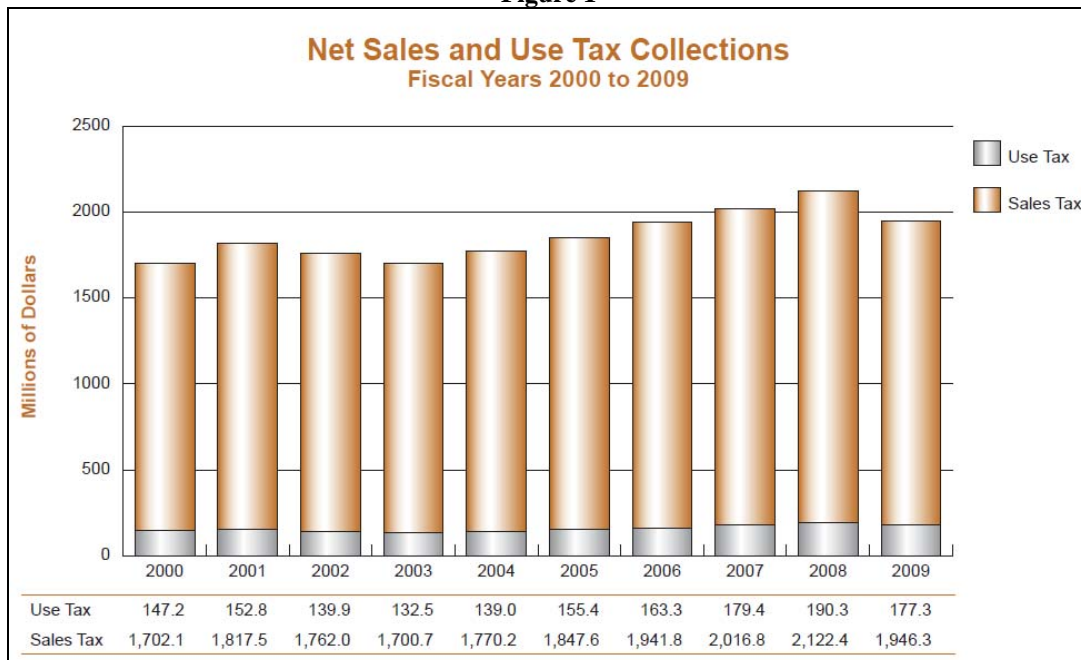
The Colorado sales tax is applied to the retail purchase of “tangible personal property” by Colorado residents. While payment of the sales tax is the responsibility of the purchaser, in practice the Colorado sales tax is actually collected by retailers, who then remit the tax revenues to the state. Colorado’s sales tax rate is 2.9 percent.^{xi}

The Colorado use tax is the complement to the state’s sales tax. A use tax is applied to sales of tangible personal property should a seller not collect a sales tax. The use tax is charged at the same rate as the sales tax (2.9 percent for the state of Colorado). However, collection and payment of this sales tax equivalent is the responsibility of the Colorado consumer.

A common example of a use tax obligation for a consumer is a purchase made from a remote retailer, since retailers without a physical presence in the state have no obligation to collect Colorado sales taxes from Colorado consumers. Because it is more convenient to have retailers collect a tax on purchases and because historically most purchases have been made from retailers obligated to collect sales tax, most consumers are unaware they even owe the use tax in the absence of a sales tax.

Overall, sales and use tax collections account for roughly one-quarter of all state tax revenues, or \$2.1 billion in 2009.^{xii} Colorado sales and use tax rates and collections are relatively low, ranking 44th nationally per \$1,000 of income in fiscal year 2004.^{xiii}

Figure 1



Source: Colorado Department of Labor 2009 Annual Report

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- ⁱ Avery, Greg. “Amazon.com to Drop Colorado Affiliates in Response to Tax Law.” *Denver Business Journal*, March 8, 2010.
- ⁱⁱ Lee, Trymaine, “State Steps Up Efforts to Collect a Sales Tax Owed by More in a Digital Age,” *The New York Times*, April 15, 2008.
- ⁱⁱⁱ Brunori, David, “Amazon Strikes Back at ‘Amazon’ Law,” *Tax Analysts: The Politics of State Taxation*, July 20, 2009, 1.
- ^{iv} Editorial, “Yes, You Owe That Tax,” *The New York Times*, November 27, 2009.
- ^v Geoffrey Fowler, “Amazon Drops More Affiliates to Avoid Tax,” *Wall Street Journal*, June 30, 2009.
- ^{vi} Geoffrey Fowler, “Amazon Cuts Affiliate Ties in Hawaii” *Wall Street Journal*, July 1, 2009. & Pollock, Lauren, “Overstock Drops Affiliates in 4 States to Protest Taxes,” *Wall Street Journal*, July 2, 2009.
- ^{vii} *Concerning the Collection of Sales and Use Taxes on Sales Made by Out-of-State Retailers, and Making an Appropriation Therefor*, HB 10-1193, 2010 Regular Session, Colorado Legislature, (2010), 2-4.
- ^{viii} Armstrong, Ari, “Stop the Amazon Tax!” *Free Colorado!* (Blog), March 10, 2010.
- ^{ix} Miles Mofteit and Jessica Fender, “Amazon.com Drops Retailers after Tax Law Enacted,” *The Denver Post*, March 8, 2010.
- ^x Engleman, Eric, “Amazon Warns Connecticut Over Sales Tax Bill,” *Puget Sound Business Journal: TechFlash (Seattle, WA)*, March 16, 2010.
- ^{xi} Colorado Legislative Council, *Colorado Tax Handbook: Report to the Colorado General Assembly* (Research Publication No. 536, 2005), 30.
- ^{xii} Colorado Department of Revenue, *2009 Annual Report* (DR 4000, 2010), 7.
- ^{xiii} *Tax Handbook*, 34.
- ^{xiv} This finding was reinforced in the most recent case on the matter, *Quill Corp. v North Dakota* (1992).
- ^{xv} Johnson, Carrie, “U.S. eCommerce 2005-2010,” *Forrester Research (September, 2005)*.
- ^{xvi} Streamlined Sales Tax Governing Board Inc., *Streamlined State Status 10-01-09*, <http://www.streamlinedsalestax.org/uploads/images/map100109.jpg> (May 15, 2010).
- ^{xvii} Maguire, Steven, Congressional Research Service, *The Streamlined Sales and Use Tax Agreement: A Brief Description*, Library of Congress, (Washington D.C.: February 2006), 3.
- ^{xviii} *Ibid*, 4.
- ^{xix} Full member states are in full compliance. Associate member and participating states have begun implementation and hare in partial compliance, respectively. Non-participating states have made no effort to comply.