

Colorado Legislative Council Staff Fiscal Note

**STATE & LOCAL
REVISED FISCAL IMPACT**

(replaces fiscal note dated January 29, 2010)

Drafting Number: LLS 10-0739
Prime Sponsor(s): Rep. Pommer
 Sen. Heath

Date: February 2, 2010
Bill Status: Senate Finance
Fiscal Analyst: Fiona Sigalla (303 866-3556)

TITLE: CONCERNING THE COLLECTION OF SALES AND USE TAXES ON SALES MADE BY OUT-OF-STATE RETAILERS, AND MAKING AN APPROPRIATION THEREFOR.

Fiscal Impact Summary	FY 2009-2010	FY 2010-2011	FY 2011-2012
State Revenue General Fund	Up to \$0.9 million	Up to \$4.7 million	Up to \$4.6 million
State Expenditures			
FTE Position Change			
Effective Date: Upon signature of the Governor, or upon becoming law without his signature. Effective for sales occurring on or after March 1, 2010.			
Appropriation Summary for FY 2010-2011: None required.			
Local Government Impact: Undetermined revenue gain.			

Summary of Legislation

This reengrossed bill requires online retailers to collect sales tax from Colorado residents starting March 1, 2010, if they have a referral relationship with at least one affiliate in the state who engages in active solicitation on behalf of the retailer. An affiliate is defined as a person residing in Colorado who publicly, not including electronically, solicits business by means of their physical presence in Colorado. The requirement to collect sales tax only applies if the retailer's cumulative gross receipts from Colorado sales generated by all affiliates in the state exceeds \$10,000 in the preceding year. Sales tax must also be remitted for local jurisdictions.

The Department of Revenue is authorized to subpoena information from any out-of-state retailer. This subpoena power can be used to obtain customer information to enforce use tax collection.

The Department of Revenue is required to account for the revenue attributable to this bill, and to the extent information is available, make quarterly reports to the legislature about the revenue gain. The bill directs that none of the new revenue be used to fund additional state FTE.

Background

Current law requires Colorado residents to remit "use" tax on purchases from out-of-state firms if the same purchase would have been subject to sales tax when bought from an in-state firm. This requires consumers to declare tax obligations and remit payment voluntarily.

A 1967 U.S. Supreme Court ruling held that the U.S. Constitution prohibits a state from requiring retailers whose only connection with customers in the state is by common carrier or mail to collect and remit sales and use tax.¹ In 1992, the U.S. Supreme Court clarified that states can only make companies collect sales tax if they have a physical presence in the state.²

What is affiliate marketing? Affiliate marketing is where a business pays commission for each customer brought to its website from an affiliate's marketing efforts. Affiliate marketing can take many forms, including through e-mail newsletters, preferential treatment in search engines, reward sites, and by using one website to drive traffic to another. For example, an affiliate marketing website may compare items for purchase, review books or music, and then link to the retailer's website so the consumer can purchase items. This bill, as revised by the House Finance Committee, applies only to affiliate marketing when a Colorado-based individual, such as a religious leader or club president, orally and publicly encourages a group of individuals to participate in an affiliate marketing relationship.

In 2008, New York state clarified the definition of sales tax vendor to include online retailers with New York-based remote affiliates.³ The state asserts that New York-based affiliates, who encourage customers to purchase from the online retailer, establish the physical presence necessary to be under state jurisdiction. The New York law requires retailers making more than \$10,000 in annual sales in the state through affiliates to charge sales tax on all sales in the state, not just those resulting from the affiliate program. North Carolina and Rhode Island have passed similar laws.

The New York law is being challenged in court, but the state of New York is expected to be able to keep revenue remitted under the new law, even if the law is found to be unconstitutional because the tax was legally due from consumers.

State Revenue

General Fund revenue will increase up to \$0.9 million in FY 2009-10, up to \$4.7 million in FY 2010-11, and up to \$4.6 million in FY 2011-12. The revenue estimate for FY 2009-10 represents a partial-year impact. The revenue impact decreases in FY 2011-12 because, under current law, vendors will begin retaining 3.33 percent of the taxes they collect on July 1, 2011.

¹ National Bellas Hess, Inc. v. Department of Revenue of State of Illinois, 386 U.S. 753 (1967).

² Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

³ Chapter 57 of the Laws of 2008, State of New York. Tax Law Section 1101 (b)(8) and Sales and Use Tax Regulations Section 526.10(a)(3).

Colorado is estimated to generate about 1/5 (\$159 million) of New York's total Internet sales based on a report by William Fox of the University of Tennessee and New York Internet sales tax projections for FY 2009-10. Applying a 2.9 percent tax rate generates state revenues of \$900,000 in FY 2009-10. Sales taxes are estimated to increase 2.5 percent in FY 2010-11.

This revenue estimate assumes that Colorado's experience with out-of-state tax collections generated by affiliates will be similar to that of New York. Internet retailers discontinued relationships with affiliate marketers in North Carolina and Rhode Island following the adoption of a similar law. If Internet retailers discontinue their relationships with Colorado-based affiliates, the revenue generated by this bill would be less than currently estimated. North Carolina and Rhode Island are still estimating the revenue gain associated with this new law. Rhode Island is unsure if the new law has generated additional revenue. North Carolina has increased collections, but can not quantify the gain at this time.

Local Government Impact

This bill will result in an undetermined increase in revenue for local government entities because online retailers will collect local sales tax in addition to state sales tax.

Departments Contacted

Revenue