

# THE WALL STREET JOURNAL.

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## Amazon Battles States Over Sales Tax

SEATTLE—Amazon.com Inc., the world's largest online retailer, hasn't charged sales tax in most states since its founding in 1994. And it has taken some extreme measures to keep it that way.

Among them: Staff traveling around the U.S. have been required to first consult a company map that shades each state red, yellow or green, said three people who have worked for the retailer. These people said they needed permission from managers or company lawyers before entering "red" states because a worker's actions might trigger laws that force Amazon to collect taxes in those states.

Such steps to avoid local levies allow Amazon to undercut in-state retailers by the amount they must add in sales tax, which can exceed 8%.

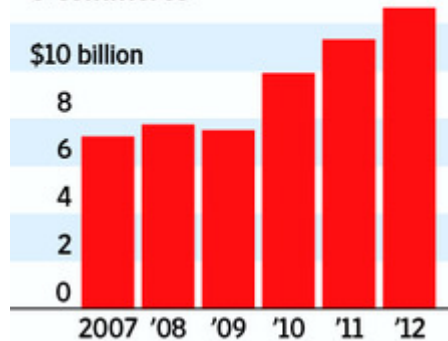
A close examination of Amazon's corporate practices, based on interviews with more than a dozen former employees and people who have done business with the Seattle company, as well as a review of corporate documents, indicates that the company believes its sales-tax policy is critical to its performance.

Credit Suisse recently estimated that if Amazon were forced to collect sales taxes in all states, it would lose as much as \$653 million in sales this year, or 1.4% out of an estimated \$45.5 billion in revenue.

Amazon says it doesn't win orders by nixing sales taxes. Spokeswoman Mary Osako said the company focuses on "low prices, vast selection and fast delivery," adding that Amazon earns more than half its revenue in jurisdictions, including many overseas, where it collects sales tax or the local equivalent. Ms. Osako cited a July report from William Blair & Co. that said if Amazon added sales tax it would still be priced lower than other major retailers on nearly half of the products the report surveyed.

### Lost in the Web

Estimated state and local revenue lost to nontaxed e-commerce



Source: University of Tennessee report

Like many online retailers, Amazon says it is obliged to add state and local sales taxes only on

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purchases from residents of states where Amazon has physical retail operations. But it also has defined retailing narrowly as selling, so related operations such as warehouses don't put it on the hook to charge tax, company representatives have said.

Amazon said it follows a 1992 U.S. Supreme Court ruling. Legal experts say the retailer's approach is aggressive but within the law.

In response, lawmakers in nine states have passed new legislation aimed at limiting Web retailers' wiggle room to avoid charging sales tax. Amazon is now challenging the bills through a lawsuit and a ballot initiative. It is simultaneously redoubling its efforts to avert triggering their requirements for tax collection by retreating from states it deems unfriendly.

State and local governments nationwide this year will lose \$10.1 billion to \$11.3 billion in sales taxes not collected by Web retailers, estimated University of Tennessee researchers in a 2009 report.



Brandon Sullivan for The Wall Street Journal

An Amazon warehouse.

Amazon's campaign marks a new chapter in a long-running battle over sales tax. Shoppers for years have crossed state lines to get lower rates. Before the Internet, many catalog-retailers didn't charge tax to out-of-state customers.

In the past two decades, the boom in Web retailing has turned a quirk of tax law into a nationwide fiscal battle, heightened by broader forces

affecting the economy. State budget deficits are growing and so is the volume of tax revenue states lose to Web commerce. But states' legal tools to claw back those funds largely predate the Internet.

"Eventually, it'll be the U.S. Supreme Court or the Congress that will be the final arbiter of the issue," predicts Richard Pomp, a professor of law at the University of Connecticut and expert on Internet tax issues.

Amazon advocates a national sales tax for online retailers, which it argues would simplify tax collection. Congress is now considering such a law, but previous attempts over recent years have failed.

"These complicated state-by-state tax rules perfectly illustrate the need for a simplified, federal solution which is the approach Amazon has supported for years," Ms. Osako said.

State authorities fume at Amazon's ability to elude their taxing powers, which are limited across state lines. Amazon Chief Executive Jeff Bezos has said the issue was forefront in his mind when he created the company.



California Assembly Democrats

California Assemblywoman Nancy Skinner, pictured, says facilities like an Amazon warehouse should prompt Web retailers to charge sales tax.

"Amazon has been quite clear...that they designed this business model to not have to collect sales tax," said Nancy Skinner, a California assemblywoman who sponsored legislation aimed at methods used by Web retailers. Ms. Osako

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denied that was the case.

Currently 45 states levy sales taxes and require any retailer with a physical presence to tack them on most in-state transactions. But businesses, lawmakers and legal minds have long debated what constitutes a physical presence. State legislators have recently moved to broaden the definition.

California earlier this year passed a law requiring any Web retailer that develops products in its state to include sales taxes on purchases there. New York has done likewise for any retailer with online-advertising affiliates based in the state. Illinois and other states have passed similar bills, informally dubbed "Amazon laws" because it is the biggest target.

But many of these laws are legally questionable, said John Swain, a University of Arizona law professor and tax expert. He said they may violate a 1992 U.S. Supreme Court ruling, *Quill Corp. v. North Dakota*, which stated retailers don't have to collect sales taxes in states where they lack a physical presence. He said Amazon has "the right to minimize their taxes lawfully," and its maneuvers appear valid.

Betty Yee, an elected member of a California board that oversees tax collection, said the new laws in many states are legal. "The world of commerce has changed so much that physical presence does not necessarily mean having a brick-and-mortar physical location," she said.

Amazon began as an online retailer of printed books before branching out to sell music, movies, electronics, clothing, household goods, groceries and other items. Since 2007, it has invested heavily in digital content such as music, video and books. The company now operates separate sites for at least eight countries, including China and the U.K.

Amazon's Mr. Bezos has said he established the company in Washington partly because it has a tech-savvy but relatively small population, so state taxes wouldn't affect many potential customers.

"It had to be in a small state," he said in a 1996 interview with *Fast Company* magazine. He even mulled basing Amazon on a California Indian reservation because he thought it would allow his company to avoid collecting sales taxes in the state, he added.

Amazon declined to make Mr. Bezos available for this article.

Amazon charges sales taxes on purchases from Washington state residents. It also collects sales taxes in Kansas, Kentucky and North Dakota, where it has sales operations.

The company has facilities such as warehouses and product-development labs in other states, including California and Texas. Amazon has said such operations shouldn't trigger tax collection because they don't sell products, only ship them.

To emphasize the distinction, Amazon controls these operations through wholly owned subsidiaries, using a legal tactic known as "entity isolation."

Several chain retailers, including bookstore Borders Group Inc., have also tried not to charge sales tax online, but were blocked. Borders argued that its Web operation was separate from its stores, but a California court in 2005 rejected the argument, ruling the two were intertwined. A spokeswoman for Borders, which faces bankruptcy liquidation, declined to comment.

State leaders in South Carolina and Tennessee assured Amazon that it could operate its planned warehouses in those states without collecting sales taxes, lawmakers and Amazon have said.

Many of Amazon's online-only peers do charge sales tax in states where they operate warehouses. But since they are smaller than Amazon, none faces issues in as many states.

California-based electronics retailer Newegg Inc. collects sales tax in the three states where it has warehouses. Newegg general counsel Lee Cheng said, "The entity isolation strategy is very questionable." Ms. Osako countered that Amazon is "compliant with state tax rules."

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Former Amazon staffers say the tactic is typical of its aggressive approach to minimizing sales tax. Early employees recall requirements to consult lawyers before arranging trips to states including California. Former staffers say they got grilled about the purpose of trips and warned to avoid soliciting new customers, promoting products and doing similar activities in certain states because of tax concerns.

In the 2000s, Amazon documented the restrictions in a U.S. map that shaded each state red, yellow or green and was given to new employees, said three people who saw it. It couldn't be determined precisely which staffers received it and to what extent the practice is followed today.

Other employees received a spreadsheet with two columns: "bad states" and "safe states," said a person who saw the document within the past year. One copy of the spreadsheet, reviewed by The Wall Street Journal, listed nine "safe states," including the four states where Amazon declares retail operations. The spreadsheet listed 19 "bad" states, including Arkansas, Connecticut, Illinois and Texas, which have sought to expand taxation of online sales.

Former employees said "red" states and "bad" states were those with strict laws about what employee actions would force a company to collect taxes there, or with aggressive tax offices. The workers were told to not do certain activities, such as soliciting new customers and promoting products, while in those states.

Employee conduct was also restricted in the 22 states that didn't appear on the spreadsheet, or that were shaded yellow on the company map, say people familiar with the matter. One example cited was that staff could attend trade shows but not actively solicit business in some states.

For travel to California, some former employees recall being instructed by lawyers and managers to use special business cards. Rather than distributing typical "Amazon.com" cards, they used ones from "Amazon Digital Services," a wholly owned subsidiary that sells digital content such as books and music. Representing a subsidiary, rather than core retail operations,

would help prevent state authorities from going after Amazon, the people said.

"It's a very unscrupulous practice," said Ms. Yee of the California tax board. She said Amazon employees visiting the state on business should present themselves clearly. If they don't, she added, "I think it's a conscious attempt to evade California's tax laws." She declined to comment on whether the practice was illegal. It couldn't be determined to what extent Amazon currently uses the method.

Three former employees recall Amazon lawyers and managers telling staff not to send work emails while in certain states. One example was a situation in February 2010, they said. Business-school students who had applied for Amazon's summer internship program received an email from an Amazon recruiter, Jamie Kezner, who said she was stuck in New York and "only able to communicate interview decisions when I am in Washington state," according to two applicants who received the email.

The email doesn't make an explicit link to sales taxes, but several former employees say it was likely a key factor. Ms. Kezner didn't respond to requests for comment.

At Northwestern University's Kellogg School of Management, in Evanston, Ill., Amazon for years sent Kellogg graduates on its staff back to recruit interns. But the company stopped doing so after recruiting for summer 2008, after Illinois officials started considering an "Amazon law."

Rather than hold gatherings, Amazon conducted video conferences with prospective Kellogg recruits. People who watched the conferences said Amazon recruiters explained openly that their presence in Illinois could force the retailer to collect sales taxes there. A Kellogg spokeswoman didn't return requests for comment.

Elsewhere, Amazon isn't as acquiescent. In six states that are pressing Web retailers to collect sales taxes because they have online affiliates, such as blogs that refer customers for a commission, Amazon has ended relationships with its affiliates. Amazon and a trade association

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representing the affiliates have said the ties were cut because of new laws.

In California, Amazon is working to repeal the state's new online-tax law. Ms. Osako of Amazon said that "the California law is unconstitutional."

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