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Massachusetts Department of Revenue Adopts a Novel Administrative Position Requiring Large Out-of-State Internet Vendors To Collect Massachusetts Sales Tax – Will Other States Adopt the Same Position?

By: Karl P. Fryzel, Geoffrey Polma and Brianna L. Reed

According to new Directive 17-1 issued by the Massachusetts Department of Revenue, beginning July 1, 2017, all out-of-state internet vendors that in the prior taxable year had greater than $500,000 in Massachusetts sales and had 100 or more sales transactions with delivery in Massachusetts will be required to collect and remit sales and use tax on their Massachusetts sales.

Massachusetts' new policy is the latest development in the states' longstanding and vigorous pursuit of sales taxes on internet sales. The 45 states that collect sales and use taxes have a strong desire and incentive to require remote sellers to collect sales and use taxes, both to realize new revenues and to provide a level playing field for in-state retailers that collect such taxes. A key constraint on the states' ability to achieve this objective is the United States Supreme Court case *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), which held that under the dormant Commerce Clause of the United States Constitution, a state could not require an out-of-state vendor making sales delivered via common carrier to collect its sales tax unless the vendor also had an in-state physical presence.

Quill recognized explicitly that Congress has authority to revoke the Commerce Clause physical presence test by adopting national standards for sales tax collection by remote vendors. In every Congress since 2010, bills have been introduced to do just that–and all have floundered and failed. The Marketplace Fairness Act of 2013, which would have authorized states to require remote sellers to collect and remit sales tax subject to certain uniformity and simplification requirements, has gotten the farthest. The Senate approved the bill by a comfortable margin, but the bill died in the House. Although the states' and the brick and mortar retailers' hopes for national standards spring eternal, Congress' inability thus far to enact legislation reflects both the complexity of the issue and the considerable political resistance toward national legislation vesting states with broad authority to compel remote seller sales tax collection.

In the face of Congressional inaction, the states for years have been developing strategies and arguments to expand sales tax collection under the constraints imposed by *Quill*. States have seized upon every conceivable connection between vendors and the states to assert on a fact-specific, vendor-by-vendor basis that an in-state presence exists. For example, states often assert that a third party's in-state activities can be attributed to an out-of-state seller, and thereby create an in-state presence, if the third party acts "on behalf of" the out-of-state seller to help create and maintain an in-state market. Certain states have also asserted that an out-of-state seller has a presence in the state if it has any "click through" advertising agreements with third parties that are located in the state.

Recently, Alabama, South Dakota, Tennessee, and Wyoming have simply defied *Quill*, enacting statutes providing that sales tax collection nexus *per se* exists for any remote vendor whose sales exceed a specified dollar threshold. These states hope or expect that challenges to their statutes will result in

a judicial overturning of the *Quill* physical presence test as an outdated standard superseded by the realities of modern commerce. The South Dakota statute has been challenged in court, and recently the South Dakota Sixth Judicial Circuit Court held that the state's law was unconstitutional under *Quill*. The state's likely strategy is to appeal the decision to the South Dakota Supreme Court and then request review (which is discretionary) by the United States Supreme Court in an attempt to overrule *Quill*. South Dakota and the other bright-line rule states may have been emboldened by Justice Kennedy's concurrence in *Direct Marketing Association v. Brohl*, 135 S. Ct. 1124 (2015), which seemed to invite states to challenge *Quill* by noting that due to "far reaching systemic and structural changes in the economy" and "…changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*."

With its new Directive, Massachusetts has cleverly and creatively melded the fact-specific and the bright-line approaches. In Directive 17-1, Massachusetts adopted a bright-line nexus rule – but supported it by an extensive analysis intended to establish that the internet vendors captured by the rule inevitably and without exception possess operational facts that satisfy *Quill's* requirements for an in-state physical presence. For example, the Department of Revenue posited that large out-of-state internet vendors' software is downloaded and used by Massachusetts customers on their devices to facilitate vendors' sales, and also that out-of-state vendors store "cookies" on Massachusetts customers' devices when potential customers visit their websites. According to Massachusetts, downloaded software and/or cookies are uniformly used by large internet vendors and are considered tangible property owned by the vendors in the state, creating *Quill* in-state presence for the vendors.

Unsurprisingly, however, Directive 17-1's analysis is not objective or neutral, but rather is more like an advocate's piece supporting the desired result without discussion of contrary arguments and considerations. One weakness is the Directive's presumption that out-of-state vendors of a certain size always utilize such software and cookies and thus always have an in-state presence, when this may not always be the case. Another soft spot is the Directive's assumption that relatively minor software code or cookies are, in fact, a sufficient in-state physical presence to satisfy the *Quill* test. It is also possible that the Directive violates the Internet Tax Freedom Act. That Act is designed to prevent state governments from discriminatorily taxing e-commerce by imposing a higher tax burden on internet sales when compared to sales made by other means. Since mail-order retailers are not subject to the Directive, arguably the Directive violates the Act by discriminating against internet retailers in favor of other remote vendors.

We can debate the merits and weaknesses of the new Directive, but as a practical matter internet retailers who have not historically collected Massachusetts tax and who fall afoul of the bright-line rule now must make a choice: Comply, register, and begin collecting Massachusetts tax; or instead take the position that the Directive is an invalid overreach and disregard it, bracing themselves for a possible fight with the state.

Karl P. Fryzel | 617-517-5577 | karl.fryzel@lockelord.com
Geoffrey Polma | 214-740-8644 | gpolma@lockelord.com
Brianna L. Reed | 617-239-0605 | brianna.reed@lockelord.com