

DIGITAL MEDIA, TECHNOLOGY & PRIVACY

>>ALERT

INTERNET VENDORS NOW FACE NEW TAX OBLIGATIONS IN MASSACHUSETTS

States, backed by brick-and-mortar stores, have been in a long-running battle with Internet vendors to collect sales taxes for online sales by out-of-state Internet retailers to their residents. In the latest twist in this battle, a new regulation by the Massachusetts Department of Revenue (the Department) requires that starting October 1, 2017, certain Internet vendors must register, collect and remit Massachusetts sales or use tax to that state's authorities – even though they do not maintain a physical presence in the state of Massachusetts.

THE REGULATION

The Department's regulation, 830 CMR 64H.1.7: Vendors Making Internet Sales, cites three situations where an Internet vendor – including an Internet affiliate marketer – would be deemed “physically present” and “engaged in business” in Massachusetts and, therefore, as having a ‘nexus’ to the state to make it subject to the state's sales and use tax rules. The three requirements are:

- 1) The Internet vendor distributes or stores “cookies” or apps on an in-state customer's computer or other device.
- 2) The Internet vendor contracts with a “content distribution network,” resulting in the use of servers or other computer hardware in Massachusetts or the receipt of server or hardware-related in-state services.
- 3) The Internet vendor contracts with an “online marketplace facilitator” –

THE BOTTOM LINE

Internet marketers and vendors with customers in Massachusetts, Ohio and Rhode Island should pay particular attention to the new regulation and legislation that expands the tax nexus for out-of-state vendors making Internet sales in those states. Vendors should consult with a tax professional in order to evaluate if they meet the sales and transaction thresholds, and, if so, bring their sales tax practices into compliance with the new legislation. In addition, Internet vendors with operations in other states should recognize that a similar regulation or statute may be proposed or enacted in their state and prepare accordingly.

such as Amazon – or with a delivery company resulting in in-state services.

Under the regulation, an out-of-state Internet vendor that meets any one of these three requirements must register, collect and remit Massachusetts sales or use taxes with respect to Massachusetts sales if the vendor has over \$500,000 in annual online sales in Massachusetts in 100 or more transactions.

The Department has suggested that its regulation would close an “unjustifiable legal ‘loophole’ that has operated inequitably to benefit large [i]nternet vendors at the expense of Massachusetts retailers, large and small.”

Of course, e-commerce and other retailers with an actual physical presence in Massachusetts already were subject to the state's sales and use tax rules and therefore will not be affected by this new regulation.

>> continues on next page

DIGITAL MEDIA, TECHNOLOGY & PRIVACY

>>ALERT

CHALLENGES EXPECTED

Those impacted may challenge the new regulation in court. To start, it is not clear that cookies alone are sufficient within the nexus standards prescribed by the U.S. Supreme Court for an e-commerce retailer to be deemed physically present in Massachusetts – or in any other state.

The stakes are large, and other states undoubtedly are studying the Massachusetts regulation and awaiting a final determination as to its validity. Already, new laws in Ohio and Rhode Island impose similar tax obligations as the proposed Massachusetts regulation for Internet sellers that use software, including apps, to make sales or employ a system of network servers in the state. However, in the case of the Massachusetts regulation and the statutes in Ohio and Rhode

Island, nexus is not created solely by the presence of cookies on in-state customers' computers. Nexus is created only when the Internet software cookies are combined with annual sales revenue or total number of transactions reaching certain monetary thresholds.

Despite this, if the Massachusetts regulation and the laws in Ohio and Rhode Island withstand the likely court challenges, other states are likely to follow with their own "cookie rule." While the federal government has failed in its previous attempts to pass comprehensive legislation to address the nexus issue, dozens of states have passed their own versions of nexus laws which seek to collect sales tax from out-of-state retailers and have resulted in various court challenges with often inconsistent outcomes.

FOR MORE INFORMATION

Gary A. Kibel
Partner, Digital Media, Technology & Privacy
212.468.4918
gkibel@dglaw.com

Brian Gallagher
Partner, Taxation
212.468.4816
bgallagher@dglaw.com

Rohini C. Gokhale
Associate, Advertising, Marketing & Promotions
212.468.4978
rgokhale@dglaw.com

or the D&G attorney with whom you have regular contact.

Davis & Gilbert LLP
212.468.4800
1740 Broadway, New York, NY 10019
www.dglaw.com

© 2017 Davis & Gilbert LLP