REPORT #648

TAX SECTION

New York State Bar Association

Report on Proposed Rule Amending
20 NYCRR Sections 526.10, 533.1(a) and 539.2

December 6, 1989

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TAX SECTION
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February 15, 1990

VIA FEDERAL EXPRESS

The Honorable James W. Wetzler
Commissioner of Taxation and Finance
New York State Department of
Taxation and Finance
W.A. Harriman Campus
Albany, New York 12227

Dear Commissioner Wetzler:

Enclosed are comments of the Tax Section of the New York State Bar Association on your proposed rule amending the definition of a "vendor" for sales tax purposes. These comments were prepared by the Tax Section's Committee on Sales, Property, and Miscellaneous Taxes and were approved as a formal report of the Section by the Section's Executive Committee at its meeting yesterday.

The Tax Section recommends that additional guidance be given merchants in several areas of the proposed regulation, that more thought be given to the way the two presumptions will work in actual practice, and that certain changes of a technical nature be made.

I hope the report proves useful to you.

Sincerely,

Arthur A. Feder, Chair

Enclosure
cc: Hon. William F. Collins
Terrence M. Boyle, Esq.

NEW YORK STATE BAR ASSOCIATION TAX SECTION

Committee on Sales, Property, and Miscellaneous Taxes*

Comments on Proposed Rule Amending 20 NYCRR Sections 526.10, 533.1(a) and 539.2 Relating to the Definition and Responsibilities of a "Vendor" under the New York State Sales and Use Tax Law.

I.D. No. TAF-52-89-00002-P
Proposed December 6, 1989

In 1989 the Legislature amended New York's Tax Law by altering the definition of the term "vendor" for sales tax purposes and by prescribing certain responsibilities for persons covered by this enlarged definition. L. 1989 ch. 69 §§ 246-249. The law as enacted was a limited revision of a Governor's Budget Bill introduced as Senate 2459/Assembly 3659, and commented upon by this Committee on April 4, 1989.

In its 1989 comments this Committee did not oppose New York's seeking to fill the gap left by Federal legislative inaction concerning mail order and cross-border sales, but stated its belief that any action taken by New York should be sensitive to both the uncertainty surrounding the extent to

* These comments were prepared by E. Parker Brown, II. Helpful suggestions were contributed by Robert E. Brown, Jeffrey M. Fetter, Sherry S. Kraus, James A. Locke, Arthur R. Rosen and Marvin Rosenthal.

which National Bellas Hess v. Department of Revenue, 386 U.S. 753 (1967), and Miller Bros, v. Maryland, 347 U.S. 340 (1954), had been eroded by subsequent United States Supreme Court decisions and also to the practical problems of tax administration in this area. The Committee felt that these considerations together militated in favor of legislation reaching only those cases where there are truly significant invasive marketing efforts and sufficient actual transactions to produce enough tax revenue to justify the burdens of both compliance and enforcement. And finally, the Committee suggested several changes to the Budget Bill to decrease uncertainty ensure that realistic standards are applied to merchants' conduct, and improve upon the presumption mechanism as then drafted.

The Legislature did not revise the Governor's bill in the ways suggested by this Committee, but made other modifications, primarily of a technical nature, which did not fundamentally change the thrust of the original proposal. The law as passed is faithfully reflected in the proposed rule here under review. Furthermore, the law is explicit in matters of detail, leaving relatively few policy choices open to the Commissioner of Taxation and Finance.

In light of the closeness of the proposed rule's text to the statute and the general absence of refinements, the Committee's comments focus on whether enough guidance has been provided, whether prescribed procedure is workable, the clarity and correctness of examples and the like. The Committee recommends, among other things, that the list of additional connections satisfying the statutory nexus requirement be treated as exclusive rather than illustrative, i.e., connections not included in the list should clearly not be treated as constituting nexus. The Committee recommends that a fuller explanation of the effect of statutory presumptions be provided in the regulation, including statements that the presumptions are rebuttable and of the degree of protection afforded persons who do not exceed the presumptions' thresholds. The Committee suggests that the regulation recognize and speak to the reality that the reasonableness of expectations constituting exceptions to the presumptions will often have to be determined well after the fact. The Committee calls for more guidance as to the reach of the phrase “any other means of solicitation” for purposes of the test not requiring an additional connection to New York. And finally, the Committee recommends that the Commissioner make clear that the proposed rule and the presumptions contained in it are to be applied only prospectively.

I. CHANGES IN THE DEFINITION OF A "VENDOR"

A. Solicitation Via Advertising Matter and an Additional Connection

The proposed rule would add three new provisions to 2 0 NYCRR 526.10(a), describing additional persons to be included within the term "vendor". The first of these is a person who solicits business by the distribution of catalogs or other advertising matter, without regard to whether this distribution is the result of regular or systematic solicitation,[1] if the person has some additional connection which satisfies the nexus requirement of the United States Constitution and by reason thereof makes sales to persons within New York of tangible personal property or services the use of which is subject to tax.

Last year this Committee criticized the "additional connection" approach as too uncertain to be included in a statute, but included it was. The proposed rule commendably addresses the Committee's point by specifying several types of additional connection. Those enumerated are familiar: (a) the operation of retail stores in the state, as in Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941), and Nelson v. Montgomery Ward & Co., 312 U.S. 373 (1941); (b) the presence of traveling sales representatives[2] as in General Trading Co. v. State Tax

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[1] This phrase, added by the Legislature to the Budget Bill, language and incorporated verbatim into the proposed rule, distinguishes this category from one of the other two new categories of persons to be discussed below, but does so inartfully. The phrase "is the result of" would be better replaced in the statue by "constitutes" or "is part of".

[2] For exhibitors of products lacking sales authority, see Mtr. of Franklin Mint Corp. v. Tully, 94 A.D.2d 877 (3rd Dep't 1983), aff'd mem., 61 N.Y.2d 980 (1984).

Commission, 322 U.S. 335 (1944); (c) the presence of independent contractors or agents, as in Scripto, Inc. v. Carson, 362 U.S. 207 (1960); (d) the presence of service representatives, a factor treated as constituting nexus in many of New York's sister states; (e) the maintenance of a post office box in the state for receiving responses to solicitations, as in Matter of Clark Color Laboratories, State Tax Commission, Mar. 28, 1980[3] ; and (f) the maintenance of an office in the state, even if it performs no activities related to the sales solicited, as in National Geographic Society v. California Board of Equalization, 430 U.S. 551 (1977).

While this specificity is desirable, the fact remains that the list is not stated to be exclusive. This threatens to render the regulation inadministerably vague since auditors may seize upon other "connections". A better approach would be to delete the phrase "but not be limited to"; add new connections to the list, as the need arises, by amending the regulation; and apply any further types of connection only prospectively after a decent interval allowing merchants time to react. The Committee believes that such an approach would enhance the chances of proposed 20 NYCRR 526.10(a)(4)'s surviving judicial challenge and that it would add a desirable element of fundamental fairness by giving merchants fair notice of those activities which will subject them to vendor status in New York.

[3] Unless there is other support for this point of which the Committee is unaware, it would appear uncertain whether this factor constitutes a significant indicium of nexus.

In Example 6 following the list of additional connections, an otherwise pure Bellas Hess mail order firm “in certain instances” sends service representatives into the state, and this is described as sufficient to make the firm a New York vendor. Is it significant that this occurred on more than one occasion or would one service call constitute enough additional connection? If the Department's position is that one visit is enough, it should say so, although this policy would leave the Department clearly vulnerable in the event of litigation. If a de minimis standard will be applied in practice, it should be reflected in the regulation. The example goes on to state that the result would be the same if the mail order firm “arranged for” a local New York company to provide service to the firm's New York customer (singular) on the firm's behalf. Does this mean that the New York service company is the agent of the out-of-state firm? Absent this factor -- which should be clearly stated -- this part of the example may well go too far to pass constitutional muster.

Example 8 is a variation on the National Geographic theme: an otherwise pure direct mail retailer, which maintains an office in New York whose only function is to sell advertising in the retailer's magazine and, for this reason, has nexus with New York. The second paragraph of the example supplies the additional facts that certain of the retailer's customers receive a complimentary subscription to the magazine and that the cost of publishing the magazine is defrayed in part by advertising revenue. These additional facts should be deleted because they complicate the example, add nothing essential and will be read as allowing escape from the statute when they are not present. Without these facts the retailer

would still have nexus with New York under National Geographic.[4]

B. Sales Coupled with Regular Deliveries

The second new category of persons included within the term "vendor" is a person who makes sales of tangible personal property or services, the use of which is subject to tax, and who regularly or systematically delivers such property or services in New York by means other than the United States mail or common carrier. Compare with Miller Bros. v. Maryland, supra. The regulation here essentially tracks the amended statute and is directed primarily to near-border sales, predominantly in the New York City metropolitan area. A person is presumed to be regularly or systematically delivering property or services if the cumulative total number of occasions the person or his agent came into New York to deliver property and/or services exceeded 12 during the immediately preceding four sales tax quarters.

This Committee argued unsuccessfully when the underlying legislation was pending that a 12-delivery threshold should have been dropped as too low and as inconsistent with the higher and more realistic sales figures in the companion presumption, to be discussed below.[5] Furthermore, the Committee recommended that the presumption mechanism be replaced by a safe harbor (viz. $300,000 / 100 transactions).

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[4] If, contrary to the implication of proposed 20 NYCRR 526.10(a)(4)(ii)(f), it is the Department's intention, by inserting the additional facts, to signal that it does not intend to go as far as National Geographic would allow, it should say so more directly.

[5] It should be noted, additionally, that there were evidently more than 12 deliveries in Miller Bros., a case in which the United States Supreme Court found insufficient nexus to support the application of sales and use tax to goods delivered in the state.

The presumption approach, the Committee felt, left uncertain the status of a merchant whose activity does not rise to the threshold level.

The presumption in the proposed rule is taken almost directly from the statute without any gloss. The rule should explain that the presumption is rebuttable and at least illustrate by example how this might be done. On the other hand, if the presumption in actual practice will be treated as conclusive -- which the Committee believes is unwarranted -- the regulation should openly say so. Additionally, the rule should address the status of the person whose deliveries do not rise above the threshold. Is such a person presumed not to be regularly or systematically making deliveries in the state, and, if so, can the Department rebut this presumption?

Example 11 is a comprehensive illustration of the presumption. A furniture reupholsterer located in New Jersey delivers furniture in New York on 14 occasions during the four sales tax quarters beginning September 1, 1988 and ending November 30, 1989; and, thus, should be presumed to be regularly or systematically delivering property or services in the state. However, the proposed rule states that the reupholsterer “is a vendor”, instead of “is presumed to be regularly. ...” This suggests that the draftsperson viewed the presumption as conclusive and highlights the need for a fuller explanation of the presumption in the text of the rule.[6]

[6] A cross-reference at the end of Example 11 to the new registration procedure at 20 NYCRR 539.2(c) would be helpful. A similar cross-reference should be placed at the end of Example 16 to 20 NYCRR 539.2(d). Additionally, the parenthetical sentence following Example 11 should be strengthened by appending the clause “, only delivery trips are considered.”

By statute, notwithstanding the presumption based on past deliveries, if a person can demonstrate to the satisfaction of the Tax Commissioner that the person cannot reasonably be expected to deliver property and/or services on more than 12 occasions during the next succeeding four sales tax quarters, the person will not be presumed to be regularly or systematically delivering property or services in the state. In Example 12 a merchant apparently exceeded 12 deliveries into New York in the period September 1, 1988 - August 31, 1989, thus regularly or systematically delivering property or services into the state.[7] (Again, the fact that the deliveries only raise a presumption is overlooked.) Effective August 31, 1989, however, the merchant closed its store near New York City making sales into the state. Accordingly, the merchant "will not be presumed to be a vendor and will not be required to register as such provided it does not otherwise qualify as a vendor in New York."

This example addressed only the easiest case in which business activity with New York totally ceases. As pointed out in this Committee's comments last year, the reasonableness of the expectation will often come into question on audit years after the point at which a person would or would not have been presumed to be regularly making deliveries. What if the expectation, as of September 1, 1989 in the example, was reasonable at the time, but turned out to be wrong? There should be an example illustrating this possibility and showing that the merchant did not become a vendor for New York sales tax collection purposes.

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[7] The dates used in all examples should be changed to dates well in the future so that the rule cannot be construed as having retroactive effect.

Developing the point a bit further, the language of the statute and proposed rule is in the present tense, “that he cannot reasonably be expected,” instead of “could not”. This is consistent with the only procedure in the rule applicable to the expectation exception, proposed 20 NYCRR 539.2(e), which deals with a person who files a certificate of registration and obtains a certificate of authority solely by reason of the new deliveries provision and then applies to the Commissioner for cancellation of the certificate of authority on the grounds that (he has discovered that) he cannot reasonably be expected, etc. But Example 12 clearly shows a merchant deciding for himself that the exception applies, which would inevitably raise question on audit and involve hindsight.[8]

C. Regular Solicitation by Distribution of Advertising Matter without an Additional Connection

The third new category of persons included within the term “vendor”, in the phraseology of the proposed rule, is defined as a person who regularly or systematically solicits business in the state by the distribution to persons within the state, by mail or otherwise, without regard to the location from which the distribution originated or in which the materials were prepared, of catalogs, advertising flyers or letters, or by any other means of solicitation of business from persons in the state, and by reason thereof makes sales of tangible personal property, the use of which is subject to tax. The language here does not simply track the statute. Clarifying phrases were added,

[8] A cross-reference is needed to the procedure at 20 NYCRR 539.2(e). A similar reference should be placed at the end of Example 17 to 20 NYCRR 539.2(f).

and minor changes were made from an earlier version of this proposed rule. See TAF-37-89-00003-P.

There is one significant deletion from the statute's wording, the qualifying phrase “if such solicitation satisfies the nexus requirement of the United States constitution”. Admittedly this might be confused with the “additional connection” standard, described earlier, which includes the same requirement. However, if the regulation is to follow the law very closely, as the proposal generally does, this limitation cannot be ignored.

In the proposed rule the phrase “any other means of solicitation” is defined to include advertisements directed to persons in New York or which can reasonably be expected to result in sales of tangible personal property to persons in the state and a telecommunication or television shopping system which is transmitted in or into New York by cable television or other means of broadcasting. The 1989 Budget Bill had an extensive list of types of “solicitation” which would bring an out-of-state merchant within the statute, including billboard advertising, newspaper and periodical advertisements, radio or television broadcasts, various types of telecommunications and cable television, video cassettes or compact disks distributed in the state and various means of solicitation by telephone, computer data base, microwave transmission and the like. This enumeration was omitted from the law as finally enacted, but incorporated in the earlier version of this proposed regulation. The current proposal opts for a general statement about advertising, but, for some unexplained reason, singles out and retains specific treatment for telecommunications and television.

The proposed rule's treatment of the vital advertising area is too vague, particularly in view of the prior history just described. The regulation should take a clear position one way or the other on those types of advertising mentioned in the Budget Bill and prior draft of the regulation. What would be the effect of an advertisement in a national newspaper or magazine such as the New York Times or The New Yorker read predominantly by New Yorkers or of an advertisement in a national periodical such as Time magazine? Are television advertisements directed to persons in New York when they are received in New York via satellite technology? Does distribution of video cassettes still constitute a "means of solicitation" or does its deletion from the proposal mean that the Department will not take this into consideration? How would solicitation by computer data base occur, and is this still included? The Department may wish to avoid seeming to restrict itself to the technology of the moment (a problem bedeviling the coherent sales taxation of information services), but retailers need and are entitled to specific guidance. This is not a statute. More examples can be added as times change and merchants' inventiveness takes new forms.[9]

The regulation presumes a person to be regularly or systematically soliciting business in New York if, for the immediately preceding four sales tax quarters, the cumulative total of the person's gross receipts from sales of property delivered in the state exceeded $300,000 and the person made more

[9] Examples A and B following proposed 20 NYCRR 526.10(a)(6)(ii) should be renumbered 13 and 14, and the examples thereafter should be brought into line.

than 100 sales of property delivered in the state.[10] Examples 13 through 16 are excellent illustrations of this presumption, but in each case conclude by finding that the merchant is presumed or is not presumed to be a vendor, with no statement that this presumption can be rebutted. As discussed above in connection with the deliveries presumption, there needs to be an explanation that the presumption is not conclusive -- if this is how it will be administered -- and an illustration of how rebuttal can be made. Furthermore, the status of a person whose receipts and transactions do not rise above the thresholds should be addressed.[11]

Notwithstanding the presumption based on past receipts and volume of transactions, if a person can demonstrate to the Tax Commissioner's satisfaction that he cannot reasonably be expected to have gross receipts in excess of $3 00,000 or more than 100 sales of property delivered in New York over the next succeeding four sales tax quarters, the person will not be presumed to be regularly or systematically soliciting business in the state. Example 17 accompanying the exception to the presumption is particularly useful since it illustrates a case in which the expectation that receipts and transactions will not

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[10] The Budget Bill's presumption, modified by the Legislature, was keyed to cumulative totals of sales of property and services. Services were deleted from the presumption, probably to make the presumption parallel the new vendor category itself, i.e., a person who regularly or systematically solicits ... by the distribution ... of catalogs ... or by any other means ... and by reason thereof makes sales of tangible personal property.... The rationale for not including services either in the vendor category or the presumption was perhaps that direct mail retailers, to whom this is addressed, do not usually sell services.

[11] For purposes of counting receipts and transactions in sales tax quarters, the reader might wish to be certain when a sale is deemed to occur. For this purpose a cross-reference, following Example 16, to 20 NYCRR 526.7 would be helpful.

exceed threshold limits in the next four succeeding periods is reasonable because of technological obsolescence of a retailer's main product. As in the case of the exception to the deliveries presumption, however, the example shows the retailer making the determination on its own that the exception applies, whereas the only applicable procedure in the proposed rule deals with the vendor which registers and then wishes the registration cancelled. See Proposed 20 NYCRR 539.2(f). There is no recognition in the regulation of the complicating factor that the reasonableness of the retailer's determination may have to be assessed well after the determination is made.

II. RESPONSIBILITIES OF INTERSTATE VENDORS

Proposed 20 NYCRR 526.10(c)(1) would impose responsibility for collection of tax on property or services delivered in New York on all persons outside New York making sales to persons in the state who maintain a place of business or solicit sales as defined in essentially unchanged paragraphs of the existing vendor regulation, as well as on persons who become New York vendors by virtue of the first two new categories described above.[12] Proposed 20 NYCRR 526.10(c)(1) imposes the same obligation on persons deemed to be vendors because they fall in the third new category. However, as prescribed in the statute, a person who is a vendor solely by reason of regular deliveries under 526.10(a)(5) or regular solicitation under 526.10(a)(6) is not a “person required to collect tax” (as used in Tax Law Sections 1131(1) and 1133) until 2 0 days after the date by which the person is required to file a certificate of registration.

[12] The “of” in the first line is surplusage and should be deleted.

III. REGISTRATION

Pursuant to Tax Law Section 1134 a vendor in the past ' has been required to register for sales tax purposes 20 days before commencing business. The proposed regulation, closely following the amended statute, in effect, waives this requirement for persons who become vendors solely by reason of deliveries under 526.10(a)(5) or solicitation under 526.10(a)(6). In these instances the person must submit a certificate of registration within 30 days “after the first day of the quarterly sales tax reporting period, which period immediately follows the four consecutive . . . periods during which the cumulative total number of occasions such person came into the State to deliver property or services exceed 12,” or “... the cumulative total of such person's gross receipts from sales of property delivered in this State exceeded $300,000 and the number of such sales exceeded 100.” This rephrases the law somewhat. While awkward, it is clearer than the statute, and probably the best that can be done.[13]

The useful example following proposed 20 NYCRR 539.2(c)(2)(iv)[14] makes it clear that a person who becomes a vendor as of, say, December 1, 1989, must submit a certificate of registration by December 31, 1989, and will be required to collect tax on and after January 20, 1990, twenty days following the last day in the registration period.

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[13] Illustrations at Proposed 20 NYCRR 539.2(c)(2)(ii) and (iv) and (d)(2)(ii) and (iv) appear merely cumulative.

[14] This and following examples should be numbered.

The procedure, already mentioned, for obtaining cancellation of a certificate of authority because an exception to one of the presumptions exists is set out at proposed 20 NYCRR 539.2(e) and (f). It seems sensible. While considerable duplication arises from treating the (a)(5) and (a)(6) exceptions separately, there is no feasible alternative if clarity is to be ensured.[15] However, a reasonable time limit should be placed on the Registration and Licensing Services Bureau's consideration of a request for cancellation, and all notifications should be required to be given by registered or certified mail.

IV. OTHER COMMENTS

While these comments are directed primarily to the implementation of Chapter 69 of the Laws of 1989, one aspect of the current regulation merits attention. Proposed 20 NYCRR 526.10(2)(ii), which is essentially the same as current 526.10(c), states that a vendor[16] shall be considered to be maintaining a place of business in the state if it, either directly or through a subsidiary, has a store, etc. Notwithstanding the fact that the phrase “through a subsidiary” has been in the regulation a long time, the Committee is doubtful of this standard's validity absent the requirement that the subsidiary be found to act as the parent's agent or alter ego.

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[15] Cross-references to appellate rights might usefully be added after proposed 20 NYCRR 539.2(e)(3)(ii) [mislabeled (3)(b)] and (f)(3)(ii).

[16] “Person” would be preferable to “vendor”, which is the term being defined.

As it now stands, the regulation could be read to mean that any place of business of a subsidiary in New York may be attributed to the parent. For example, if an out-of-state parent corporation which manufactures widgets has a New York subsidiary which operates a grocery store in New York, the regulation could be interpreted to make the parent a vendor solely as a result of the subsidiary's store. Such a result cannot be justified by the statute, and may well go beyond permissible constitutional limits.

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