MORRISON | FOERSTER

Legal Updates & News

Bulletins

Significant Sales Tax Changes for Online Retailers Take Effect in NY

June 2008
by Irwin M. Slomka, Aaron Russell

Related Practices:

- Corporate
- State and Local
- Tax

State and Local Tax Update, June 3, 2008

Effective June 1, 2008, certain online retailers that use New York resident businesses or organizations to refer customers to their websites in exchange for commissions or other compensation are required to register and begin collecting New York State and local sales tax on all sales made into the state (Chapter 57, N.Y. Laws of 2008).

This represents a significant change in the New York sales tax law, in that it reaches online sellers located entirely outside New York that previously were not required to collect sales tax on sales to New York customers. The amendments are unprecedented — indeed, no other state has enacted such sweeping legislation. The United States Supreme Court has held that, under the Commerce Clause of the United States Constitution, a state may only impose a sales tax collection obligation on a seller that is physically present in the state. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). The new law may violate *Quill*, and lawsuits have already been brought challenging its constitutionality.

Under the new law, a seller located entirely outside New York will be presumed to be a New York sales tax vendor, and thus required to collect and remit sales tax on sales made into New York State, if (1) it has agreements with New York State resident businesses or organizations to refer customers in exchange for a commission or other compensation, and (2) its aggregate gross receipts from sales to New York customers referred under these arrangements exceed $10,000 during the preceding four quarterly sales tax periods. The presumption can be rebutted by establishing that the New York resident's only activity on behalf of the seller is a link provided on the representative's website to the seller's website. If the seller is considered a vendor, it will be required to collect sales tax on *all* sales it makes to New York customers, not merely on sales resulting from these arrangements.

Although the New York State Department of Taxation and Finance has issued a pronouncement interpreting certain aspects of the new law ("New Presumption Applicable to Definition of Sales Tax Vendor," TSB-M-08(3) S, May 8, 2008), many open issues still remain, including the following:

- A seller that merely advertises on the Internet, including having its website link appear on a New York resident's website, will not be considered a sales tax vendor. What additional actions by the New York resident would be considered to exceed advertising?
- What is meant by the reference in the new law to "direct or *indirect*" customer referrals that give rise to the presumption of taxability?
- Assuming the definition of "direct or indirect" referrals is sufficiently clear, how will a seller know — and then demonstrate to the Department — whether a New York resident is actually operating its website, and engaging in "solicitation," within New York?
- The presumption arises even where the out-of-state seller uses a third-party service provider to make the arrangements with the New York residents that carry the seller's link on their website. Will it make a difference whether the service provider is located in New York?

Pending the outcome of the court challenges to the new law, out-of-state sellers seeking to avoid having to now collect New York sales tax should, among other things, consider whether their contractual arrangements with New York residents should be revised to avoid nexus-created in-state solicitation by those residents.