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This Week in State Tax (TWIST)

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New York: Appellate court upholds Internet Activities Rule

A New York appellate court has upheld the "Internet Activities Rule" promulgated by the New York Department of Taxation and Finance. The regulation adopts parts of the updated statement regarding the application of Public Law 86-272 as articulated by the Multistate Tax Commission (MTC) in the most recent version of its Statement of Information Concerning Practices of Multistate Tax Commission and Supporting States Under Public Law 86-272 (MTC Statement). P.L. 86-272 is a federal law which prevents a state from imposing a net income tax on a person whose sole activity in the state is the solicitation of orders for tangible personal property. Under the MTC Statement, certain activities are considered to exceed the solicitation of orders for tangible personal property and therefore disqualify a business from P.L. 86-272 immunity. A few specific examples provided under the MTC Statement, and incorporated in the New York regulation, include a business placing "cookies" on a user's computer, assisting customers after a sale via email or electronic chat, and online applications for employment or credit cards among other similar activities conducted over the Internet. A trade association representing sellers who market merchandise via the telephone, catalogs, and the Internet challenged the regulation as violating due process and being preempted by P.L. 86-272. A trial court upheld the Department's regulation against the P.L. 86-272 challenge, and the plaintiff appealed to the New York Supreme Court, Appellate Division, Third Judicial Department.

The plaintiff's first argument on appeal was that the regulation impermissibly ignores the location where internet activities occur when determining whether a taxpayer exceeds P.L. 86-272 protection. In the court's view, the regulation, read as a whole, limits its scope to activities conducted "in New York State." Accordingly, the regulation preserves immunity when all in-state activities are limited to solicitation or are ancillary or de minimis; it denies immunity only when a taxpayer's in-state activities—regardless of how conducted—exceed those bounds.

Second, the plaintiff argued that the regulation was incompatible with the original meaning of P.L. 86-272 (i.e., how the law would have been understood when it was adopted in 1959), which could not have included any understanding of internet activities. On this point, the court determined that P.L. 86-272 was a "functional" statute that requires "consideration of the nature or purpose of the business activity, not the means through which that activity is conducted." Thus, "any tension between how business activity was considered to be occurring within a state in 1959 versus today is not enough to establish conflict preemption on the face of the regulation." Finally, the plaintiff argued that the Department's interpretation obstructed Congress's objective of providing "a clear rule of immunity for small businesses engaged in interstate commerce." Here, the court determined that the copious details and examples provided in the Department's regulation sufficed to meet this goal.

The court concluded by noting that it was merely ruling on the Department's regulation "as written," preserving the possibility of a future challenge to the application of the regulation by the Department. Contact Aaron Balken with questions on *American Catalog Mailers Association v. N.Y. Department of Taxation and Finance*.

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