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Massachusetts Requires Remote Sellers to Collect Sales Tax Beginning July 1, 2017

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The Massachusetts Department of Revenue (DOR) recently issued guidance under which it will require the collection of Massachusetts sales and use taxes by remote sellers that meet certain sales thresholds in Massachusetts. Beginning July 1, 2017, Directive 17-1 requires any "Internet vendor" that has made more than $500,000 of annual sales to Massachusetts customers in 100 or more transactions to register with DOR and to collect and remit sales and use taxes, even if such vendor does not have a physical presence in Massachusetts under traditional principles. For the period July 1, 2017 to December 31, 2017, the annual sales and transaction thresholds will be applied to a vendor's sales activity during the preceding 12 months, July 1, 2016 to June 30, 2017. For subsequent periods, the thresholds will be applied to a vendor's sales activity during the preceding calendar year.

Massachusetts follows other states, such as Alabama, South Dakota, Tennessee, and Vermont, that have enacted legislation that imposes sales tax collection responsibility upon out-of-state Internet vendors based upon the volume and/or value of sales made into the state. Massachusetts' approach differs, however, in that (i) Massachusetts did not enact new legislation, but is asserting such authority under its current statute and regulations and (ii) the Massachusetts DOR takes the position that this new rule satisfies the Constitutional requirements set forth in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

Quill – Physical Presence Test

A state's jurisdiction to impose a sales and use tax collection responsibility on out-of-state businesses is constrained by the U.S. Constitution. In *Quill*, the Supreme Court reaffirmed that both the Due Process Clause and the Commerce Clause limit the imposition of such responsibilities to situations where the vendor has a sufficient nexus, or connection, with the taxing state. Moreover, although the Court held in *Quill* that the Due Process Clause nexus requirement could be satisfied when a vendor targets a state's economic market through activities that are entirely outside the state, it held that the Commerce Clause requires an out-of-state vendor to have a physical presence in the state in order to be subject to a sales and use tax collection obligation. A physical presence is traditionally thought to require maintaining an in-state place of business, owning tangible property

within the state, or having employees or representatives in the state that are associated with the ability to establish and maintain a market in the state.

Other states have enacted recent legislation similar to the Massachusetts Directive in the event that the "physical presence" test of *Quill* is overturned by the Supreme Court or otherwise changed by federal legislation. In fact, the South Dakota legislation appears to have been enacted in order to initiate litigation aimed at overruling *Quill*. The State filed a declaratory judgment action that is currently on appeal at the South Dakota Supreme Court. In Vermont, similar legislation will be effective beginning in the first quarter after a U.S. Supreme Court decision or federal legislation abrogates the physical presence requirement.

Massachusetts – Physical Presence Test

In contrast to other states, the Massachusetts Directive interprets *Quill* as permitting the imposition of a sales tax collection responsibility on Internet vendors. In so doing, the Directive distinguishes Internet vendors from the mail-order retailer that was the subject of *Quill*, based on an assertion that Internet contacts with a state are qualitatively different from using the mail and common carriers. In particular, the Directive asserts that the following activities, among others, may constitute an in-state physical presence satisfying the Commerce Clause: (i) software that is downloaded (either affirmatively or by general use of a website) and used by in-state customers to facilitate in-state sales, (ii) storage of text data files ("cookies") on customers' computers or devices, (iii) contracts with content distribution networks to use in-state servers to accelerate the delivery of web pages to customers, and (iv) the use of "online marketplaces" or other service providers with an in-state presence.

What Comes Next

As in other states, the constitutionality of the new Massachusetts rule is likely to be challenged. In addition to federal constitutional challenges under the Due Process Clause and the Commerce Clause, the Directive may be subject to statutory challenge based on prior DOR interpretations of the governing statute, and may be challenged as violating the Internet Tax Freedom Act.

A lack of clarity in certain terms used in the Directive may also engender controversy. Although the Directive uses the term "Internet vendor," it does not define that term. The discussion in the Directive appears to extend to any person that sells goods or services to Massachusetts customers and that maintains a website accessible by its customers. It is unclear whether goods or services must be available for sale on the seller's website in order for the seller to be treated as an Internet vendor. There is also uncertainty concerning the application of the annual sales thresholds ($500,000 in 100 or more transactions). While a taxpayer might imagine that the threshold would be based on sales that are actually subject to Massachusetts sales or use tax, the Directive refers to "Massachusetts sales," which it defines as sales "of tangible personal property or services delivered into the state, however consummated." If that language were read literally, it would extend to sales that qualify for a specific statutory exemption, or possibly even to sales of services that are not subject to sales tax in the first place. The Directive also does not explain whether "transactions" are counted based on the number of orders, of invoices, of items on an invoice, or some other

measure.

Whether and, if so, when the Supreme Court will reexamine the *Quill* "physical presence" standard or there will be federal legislation that repeals such standard is unknown. Prior legislative efforts have been unsuccessful. The Massachusetts DOR is ready to enforce its new rule regardless of whether the *Quill* standard is changed. Although the Directive takes effect prospectively, beginning July 1, 2017, a footnote in the directive suggests that the DOR could attempt to apply the same principles retroactively to vendors who do not come into compliance beginning July 1. Therefore, out-of-state Internet vendors should be prepared to comply with the new Directive or rigorously challenge its application.

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