taxnotes®

state & local

Volume 91, Number 6 ■ February 11, 2019

New York Had *Wayfair* Guidance All Along!

by Joseph N. Endres and Timothy P. Noonan

Reprinted from *State Tax Notes*, February 11, 2019, p. 481

New York Had *Wayfair* Guidance All Along!

by Joseph N. Endres and Timothy P. Noonan

Joseph N. Endres

Timothy P. Noonan

Joseph N. Endres and Timothy P. Noonan are partners in the Buffalo and New York offices of Hodgson Russ LLP.

In this installment of Noonan's Notes, the authors discuss New York's surprising guidance regarding *Wayfair*, which states that a 1989 statute is now in effect.

Over recent months, in the wake of *South Dakota v. Wayfair Inc.*, states have been scrambling to enact and enforce new legislation with South Dakota-like economic nexus thresholds.[1] New York, however, remained uncharacteristically silent. Most of us expected the state was waiting to announce the enactment of *Wayfair* thresholds in mid-January 2019, when the governor traditionally outlines the state budget for the upcoming year, usually including new tax proposals. But on January 15, when Gov. Andrew Cuomo (D) outlined dozens of new tax proposals, there was no mention of *Wayfair* or economic nexus. Later in the day, though, we learned why: because New York apparently had such thresholds in place all along!

On January 15 the New York Tax Department issued an "Important Notice" with its view on the implications of *Wayfair*, titled "Notice Regarding Sales Tax Registration Requirements for Businesses with No Physical Presence in New York State."[2] In this article, we'll discuss this new guidance and address some of the issues that are likely to arise as a result.

I. New York's 'Dormant' *Wayfair* Threshold

Since *Wayfair*, of the 46 jurisdictions that impose a general sales and use tax (45 states and the District of Columbia), 41 have previously either passed legislation, enacted an administrative rule, or have a pending proposal for economic nexus. Most of these states followed the *Wayfair* model, with an economic nexus threshold of $100,000 in sales or 200 transactions, though there has been some variation. Until January 15 New York was one of the five holdout states — the others being Arizona, Florida, Kansas, and New Mexico — where no guidance was forthcoming.[3]

Most of the states, like South Dakota, enacted their *Wayfair* thresholds via legislation or other official regulatory guidance, so we were expecting New York to do the same. But with the mere issuance of a three-paragraph notice, New York officially joined the ranks of the states that will impose *Wayfair*-like economic nexus. According to the notice, because of *Wayfair*, "certain existing provisions in the New York State Tax Law that define a sales tax vendor became immediately effective."[4] And under these existing tax law provisions, an out-of-state vendor with no

[1] *South Dakota v. Wayfair Inc.*, 585 U.S. ___ (2018), 138 S. Ct. 2080 (2018).

[2] Important Notice N-19-1 (Jan. 2019).

[3] Alaska, Delaware, Montana, New Hampshire, and Oregon do not impose a general sales and use tax.

[4] *Id.*

physical presence would be required to collect and remit New York sales tax if, during the immediately preceding four sales tax quarters, the business made more than $300,000 in sales of tangible personal property delivered in the state; *and* the business conducted more than 100 sales of tangible personal property delivered in the state.

So it was there all along . . . all of us were waiting for *Wayfair* guidance and it was right under our noses! More to the point, what the heck is going on here?!

II. Open Questions Regarding New York's Guidance

Here's what you need to know about New York's new guidance:

Question: Doesn't New York have to pass a law (or at least a formal regulation) to impose economic nexus?

According to the notice, the law was already on the books. The department is taking the position that *Wayfair* caused two seemingly dormant provisions in New York's tax law, enacted in 1989, to become "immediately effective." The notice cites Tax Law sections 1101(b)(8)(i)(E) and 1101(b)(8)(iv). Section 1101(b)(8)(i)(E) says that if a seller systematically solicits business in the state by any means, then it qualifies as a vendor, stating:

> A person who regularly or systematically solicits business in this state by the distribution, without regard to the location from which such distribution originated, of catalogs, advertising flyers or letters, or by any other means of solicitation of business, to persons in this state and by reason thereof makes sales to persons within the state of tangible personal property, the use of which is taxed by this article, if such solicitation satisfies the nexus requirement of the United States constitution.

Note that the law doesn't refer to solicitation over the internet, which is not shocking, since it didn't exist as we know it in 1989. Whatever the case, even after *Wayfair*, this provision would be constitutionally suspect. Solicitation alone, without physical presence, creates nexus? There's no way that's constitutional, even after *Wayfair*. But this provision is definitionally tied to the other provision cited in the notice: Tax Law section 1101(b)(8)(iv), which defines "regular and systematic" solicitation as:

> A person shall be presumed to be regularly or systematically soliciting business in this state if, for the immediately preceding four quarterly periods ending on the last day of February, May, August and November, the cumulative total of such person's gross receipts from sales of property delivered in this state exceeds three hundred thousand dollars and such person made more than one hundred sales of property delivered in this state, unless such person can demonstrate, to the satisfaction of the commissioner, that he cannot reasonably be expected to have gross receipts in excess of three hundred thousand dollars or more than one hundred sales of property delivered in this state for the next succeeding four quarterly periods ending on the last day of February, May, August and November.

This law, with its $300,000 and 100-transaction threshold, has been on the books for 30 years. But note the limiting language in the first provision, which states that this nexus rule only applies if "such solicitation satisfies the nexus requirement of the United States constitution." The department is clearly taking the position that with the Supreme Court's rejection of the physical presence standard in *Wayfair*, its nexus thresholds now satisfy the Constitution's nexus requirements.

So while many have been subtly criticizing New York for being late in providing guidance regarding economic nexus, could it be that New York was way ahead of the game? The department sure thinks so; from what we have heard, for now, this will be the only *Wayfair* guidance the state will issue, and no legislative changes are forthcoming.

Question: When does New York's economic nexus rule become effective?

The answer could be 1989, if we're getting technical about it. But according to the notice,

economic nexus has been in force at least since the *Wayfair* decision, even if the department is just now getting around to telling us. The notice states that *Wayfair* "eliminated the prohibition on a state imposing sales tax collection responsibilities on businesses that have no physical presence in that state. Due to this ruling, certain existing provisions in the New York State Tax Law that define a sales tax vendor immediately became effective." If the provisions became effective as of the ruling, then economic nexus has been in force in New York since at least June 21, 2018. And arguably, since the Supreme Court's rejection of the physical presence standard did not have an effective date, New York could take the position that its nexus thresholds can be enforced in all open periods. But there are a couple of problems with this analysis.

First, if New York ends up enforcing economic nexus beginning June 21, 2018 (or earlier), it could face a significant legal challenge. Indeed, nearly all states that have imposed economic nexus have done so on a prospective basis only. The vast majority of these new state laws and rules took effect in the fourth quarter of 2018 or as of January 1, 2019. And in almost all cases, these dates were after the enactment of the new law or publication of the new rule. This is consistent with *Wayfair*. One of the Court's key considerations was the compliance burden the rule change would create, and the Court specifically noted that South Dakota's law was prospective only. A rule that is enforced retroactively to a date before the announcement of the rule could, under a *Wayfair* analysis, jeopardize the rule's constitutionality.

What will New York do? Unfortunately, we have informally heard from department sources that retroactive application is a possibility. Such a position could trigger another legal battle that, years from now, could find its way back to the Supreme Court.

Next, and probably more important, it is not obvious that *Wayfair* actually means that New York's provisions are now constitutional. Remember, the Court did not officially bless the South Dakota threshold. All the Court did was declare that the *Quill* physical presence rule was no longer valid. It left the issue of constitutionality to the South Dakota Supreme Court. And while the Court did signal, in dicta, that thresholds like South Dakota's would probably pass constitutional scrutiny, it stopped short of blessing them completely.[5] The Court also pointed to South Dakota's participation in the Streamlined Sales and Use Tax Agreement as relevant to its finding that the economic nexus thresholds would not likely impose an undue burden on interstate commerce. As a full member of the SSUTA, South Dakota's sales tax law is arguably more uniform and consistent with the sales tax laws in other member states — at least the Supreme Court thinks so.[6] New York, to be sure, is not an SSUTA member.

Thus, we think it is a bit of a stretch for the notice to proclaim that *Wayfair* simply "eliminated the prohibition on a state imposing sales tax collection responsibilities on businesses that have no physical presence in that state." A more accurate statement would be that *Wayfair* eliminated that prohibition and established the potential constitutionality of economic nexus, provided other safeguards designed to ease the compliance burden are also in place. Without these other safeguards, the department's belief that its dormant economic nexus provisions immediately became constitutional and effective is questionable.

Question: What types of out-of-state businesses can still sell into New York without having to collect and remit the state's sales tax?

Both the notice and the tax law apply these economic presence provisions exclusively to sales of tangible personal property. Thus, out-of-state service providers with no physical presence in the state still appear to be under no legal obligation to collect and remit New York tax. For example, if a New York customer purchases a taxable information service from a seller located exclusively out of state, the service provider appears to be able to sell the service without collecting and remitting the New York tax (of course, the customer has an obligation to pay use tax on the transaction).

But a word of caution. New York taxes software as the sale of tangible personal property,

[5] *Wayfair*, 138 S. Ct. at 2098-2099.

[6] *Id.* at 2098.

even if the software is remotely accessed and not actually transferred to the customer — that is, through a software-as-a-service model. Moreover, software is invariably used in conjunction with online services such as remote payroll processing, inventory tracking, and business data management. Thus, any service that uses software that the customer accesses could be treated by the tax department as a sale of software (tangible personal property) and not the sale of a service.

Question: Is New York's rule broader than other *Wayfair* thresholds?

No, it's arguably more limited. First, as noted above, it only applies to sellers of property. New York also uses an "and" test for the thresholds, requiring both $300,000 in sales and 100 transactions.

For example, let's say I'm a high-end online art dealer or auction house with no physical presence in New York. The items I sell typically cost more than $200,000. I only hold auctions sporadically throughout the year and have customers located across the country. In a given year, I might make 50 sales to New York customers, the total amount of which will exceed several million dollars. Despite the large amount of revenue I receive from New York customers, I am not obligated to collect and remit tax on those transactions because while I am above the $300,000 threshold, I am below the 100-transaction threshold. New York's economic nexus test requires that I satisfy both parts before the state can obligate me to collect and remit sales tax. Connecticut has a similar rule ($250,000 in sales and 200 transactions), making it and New York outliers. The vast majority of states impose an "or" test similar to the law at issue in *Wayfair*.

III. Other Questions

This is just the beginning. Because of New York's unique approach — announcing such an important change in a three-paragraph notice usually reserved for announcing new interest rates — there are several more questions that will need to be fleshed out in the coming months. For example:

- **Are wholesale transactions counted toward the applicable thresholds?** As of now, the answer looks like a yes.
- **Will the state expand its economic nexus to cover services?** This looks to be a no.
- **Will the state amend its tax law to align with the South Dakota model, or is this it?** We're hearing that this is it.
- **How does a taxpayer prove to the satisfaction of the commissioner that, even though it passes the thresholds in the previous year, it doesn't expect to in the coming year?** Get in line on this one . . . we don't know either!

We'll likely have to wait for the answers to these and other questions. But one thing is for sure: As usual, New York is charting its own path on state tax issues, proving once again that there's never a dull moment for us New York practitioners! ■