TSB-A-91 (7) S
Sales Tax
TSB-A-91 (1) I
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Corporation Tax
January 17, 1991

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. Z901002B

On October 2, 1990, a Petition for Advisory Opinion was received from Mitchell Sorkin, 100 Jericho Quadrangle, Jericho, New York 11753.

The issues raised by Petitioner, Mitchell Sorkin, are:

1) Whether out-of-state vendors who sell merchandise through video terminals owned and operated by Petitioner's client located at airports within and without New York State and subsequently ship the merchandise to customers located in New York State are required to collect sales tax on such sales.

2) Whether Petitioner's client is liable for the collection of sales tax on sales made by out-of-state vendors referred to in issue "1" by virtue of the fact that it is receiving fees from the vendors who solicit sales through its video terminals.

3) Whether the out-of-state vendors referred to in issue "1" are subject to income tax pursuant to Article 22 of the Tax Law or business corporation franchise tax pursuant to Article 9-A of the Tax Law by virtue of the fact that they sell merchandise through the video terminals referred to in issue "1".

Petitioner's client (hereinafter the "client") is about to begin doing business in New York State. The client will be conducting a computerized advertising business at metropolitan airports within and without New York State. Travelers will be able to order a consortium of goods via the computerized video terminal owned by the client. When the goods are to be ordered, the customer will be able to direct dial an out of state vendor (hereinafter the "vendor") using the vendor's 800 number to place his order. The goods will then be shipped from the vendor's warehouse which is located outside of New York directly to the New York customer, located in New York State.

Under Article 28 of the Tax Law every person who makes retail sales of tangible personal property in New York (which includes sales where the property is delivered to the customer in New York) is required to register with the Tax Commission and to collect the sales tax due with respect to such sales.

Section 1101(b)(8) of the Tax Law provides in part:

(i) The term "vendor" includes:

(A) A person making sales of tangible personal property or services, the receipts from which are taxed by this article;

(B) A person maintaining a place of business in the state and making sales, whether at such place of business or elsewhere, to persons within the state of tangible personal property or services, the use of which is taxed by this article;

(C) A person who solicits business either:

(I) by employees, independent contractors, agents or other representatives; or

(II) by distribution of catalogs or other advertising matter, without regard to whether such distribution is the result of regular or systematic solicitation, if such person has some additional connection with the state which satisfies the nexus requirement of the United States constitution;

and by reason thereof makes sales to persons within the state of tangible personal property or services, the use of which is taxed by this article;

*   *   *

(E) 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;

Section 1101(b)(8)(iv) of the Tax Law provides: "For purposes of clause (E) of subparagraph (i) of this paragraph, 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."

Section 1131(1) of the Tax Law provides in part that "person required to collect any tax imposed by this article" shall include: every vendor of tangible personal property or services;

Section 1131(4) of the Tax Law provides in part that "Property and services the use of which is subject to tax" shall include: (a) all property sold to a person within the state, whether or not the sale is made within the state,. . ."

Section 1134(a)(1) of the Tax Law further provides in part that "Every person required to collect any tax imposed by this article commencing business, or opening a new place of business,..shall file with the Tax Commission a Certificate of Registration, in a formprescribed by it, at least twenty days prior to commencing business. . ."

In 1967, the U.S. Supreme Court held in National Bellas Hess v. Department of Revenue (386 US 753), that a mail order company whose only contacts with Illinois were the mailing into the State of its biannual catalogs and its occasional advertising flyers, and the delivery into the State of its goods by mail or common carrier, did not have sufficient nexus with the State to allow Illinois to require the mail order company to collect the use tax owed on the use of its goods by customers in Illinois.

Prior to the National Bellas Hess decision, the Supreme Court had found nexus for use tax purposes where the out-of-state company had in the state both agents and offices for soliciting sales (Felt and Tarrant Manufacturing Co. v. Gallagher, 292 US 86, 1934); where the company had a division operating in the state which was separate from the mail order division (Nelson v. Sears, Roebuck & Co., 312 US 359, 1941); where the company had traveling salesmen present in the state (General Trading Co. v. State Tax Commission, 322 US 335, 1944); and where the company used independent contractors or jobbers to solicit sales in the state (Scripto, Inc. v. Carson, 362 US 207, 1960). There was one case decided earlier than National Bellas Hess where the Court found an absence of nexus. In that case, Miller Bros. v. Maryland (347 US 340, 1954), the Court held that the infrequent delivery into Maryland by a Delaware company in its own trucks and the incidental effects of general advertising in Delaware newspapers that had circulation in Maryland were not sufficient to provide nexus with Maryland.

As part of the fall-out of the National Bellas Hess decision, the mail order industry has been able, in the past 20 years, to grow tremendously and to enjoy a competitive advantage over local businesses. Although technically a use tax is owed by the customers on mail order purchases,under National Bellas Hess the mail order companies have not been compelled tocollect that tax, while local companies selling similar goods to similarlysituated customers have been compelled to collect the sales tax. Further,since the rate of voluntary compliance by individuals with the use tax is very low and the tax is difficult to enforce against individual customers, mail order purchases are commonly viewed as tax free transactions.

In recent years, however, while the direct marketing industry has grown markedly, the U.S. Supreme Court has given indications that if a situation similar to that presented in National Bellas Hess came before it again, it would find sufficient nexus to compel the collection of tax. The Court in the years since National Bellas Hess was decided has expanded its interpretation of nexus for both tax and civil jurisdiction purposes. Pursuant to the U.S. Supreme Court's decision in International Shoe Co. v. Washington, (356 U.S. 310, 1955), the standards for nexus for judicial jurisdiction purposes and tax jurisdiction purposes should be considered to be the same. In that case the Court was called upon to decide whether International Shoe had sufficient contacts with Washington to allow the State to subject it to personal jurisdiction in a suit to recover unpaid unemployment insurance taxes and subject the corporation to the unemployment insurance tax. In finding nexus, the Court stated: "The activities which establish [International Shoe's] 'presence' subject it alike to taxation by the state and to suit to recover the tax" (326 US at 321).

In National Geographic Society v. California Board of Equalization (430 US 551), decided in 1977, the Supreme Court expanded its interpretation of nexus for use tax purposes. This case involved California's efforts to require National Geographic to collect use tax on its mail order sales. The mail order business was conducted entirely outside or California. However, National Geographic had offices in the State which solicited advertising for its magazine. The Court found that National Geographic's California offices provided sufficient contacts with California for the State to compel it to collect use tax, noting that

> "the relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the state, but simply whether the facts demonstrate 'some definite link, some minimum connection, between [the state and] the person. . .it seeks to. . ." require to collect the tax. (430 US at 561).

In Tyler Pipe Industries v. Washington Department of Revenue (483 US 232, 107 S Ct 2810, 1987), the Supreme Court noted the importance played by a company's activities related to establishing a market for its goods in determining whether that company has nexus with a state, when it quoted the following language from the Washington Supreme Court's decision in this case:

> ". . .'the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales'" (107 S Ct at 2821)

Further, the Court has expanded the concept of nexus for civil jurisdiction purposes to cover instances where the defendant, although not physically present in the State, has purposefully directed his activities toward persons in the State. In World,Vide Volkswagen Corp. v. Woodson (444 US 286, 1980), the Court denied Oklahoma personal jurisdiction over a nonresident defendant, noting a total absence of "affiliating circumstances" that were required for an exercise of state court jurisdiction. Included in its list of such affiliating circumstances was the solicitation of business either through salespersons or through advertising reasonably calculated to reach the State (444 US at 295). The Court stated that the

> "forum state does not exceed its powers under the Due Process Clause if it asserts personal jurisdiction over a corporation that delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum state" (444 US at 297-298).

The Court reaffirmed these principles in another judicial jurisdiction case, Burger King v. Rudzewicz (471 US 462, 1985). Here the Court noted that

> ". . .it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a state in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' toward residents of another state, we have consistently rejected the notion that an absence of physical contactscan defeat personal jurisdiction there" (471 US at 476).

Finally, the Supreme Court gave a strong indication that National Bellas Hess may fall in the most recently decided tax jurisdiction case, D.H. Holmes Company, Ltd. v. McNamara (486 US 24, 100 LEd2d 21, 1988). The issue in that case was whether the Holmes Company had to pay Louisiana use tax on catalogs printed outside the State and directly mailed to customers within the State. In discussing the significance of the catalogs and their distribution by the Holmes Company, the Supreme Court used the following language:

> "Finally, we believe that Holmes' distribution of its catalogs reflects a substantial nexus with Louisiana. The distribution of catalogs to approximately 400,000 Louisiana customers was directly aimed at expanding and enhancing its Louisiana business. There is 'nexus' aplenty here." (100 LEd2d at 28-29)

It should be noted that because of Holmes' significant economic presence in the State (i.e., it had stores located in Louisiana), the Court distinguished this case from National Bellas Hess rather than overruling it. However, this does not diminish the significance of the Court's dictum quoted above. It appears that the U.S. Supreme Court is ready to recognize that a company making sales in a state through the distribution of catalogs has sufficient contacts with the state to allow the state, through legislation, to require a mail order company to collect its use tax. To date, other than New York, at least eighteen states, including California, Florida and Massachusetts, have enacted such legislation.

In the instant case the prospective customer of the Petitioner would be regularly or systematically soliciting business in New York through the use of Petitioner's video terminals, and as a result thereof would bemaking sales of tangible personal property to persons in New York State. Therefore the prospective customer would be a "vendor" pursuant to, either section 1101(b)(S)(i)(C)(I) or sections 1101(b)(8)(i)(C)(II) and 1101(b)(8)(i)(E) of the Tax Law since there would be sufficient nexus under the case law discussed above. Since the prospective customer is a "vendor" pursuant to the aforesaid sections it would be required to register as a vendor for New York State sales tax purposes and to collect sales and use taxes on its mail order sales to New York residents in accordance with the provisions of Sections 1101(b)(8), 1131(1) and 1134(a)(1) of the Tax Law.

Section 1105(c)(1) of the Tax Law provides in part that:

> On and after June first, nineteen hundred seventy one, there is hereby imposed and there shall be paid a tax of four percent upon:

* * *

(c) The receipts from every sale, except for resale, of the following services:

> (1) The furnishing of information by printed, mimeographed or multigraphed matter or by duplicating written or printed matter in any other manner, including the services of collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof to other persons, excluding the services of advertising or other agents, or other persons acting in a representative capacity,

Section 527.3(b)(5) of the Sales and Use Tax Regulations provides in part that:

> Fees for the services of advertising agencies or other persons acting in a representative capacity are excluded from the tax. Advertising services consist of consultation and development of advertising campaigns, and placement of advertisements with the media without the transfer of tangible personal property.

Section 1101(b)(8)(ii) of the Tax Law provides that:

> In addition, when in the opinion of the tax commission it is necessary for the efficient administration of this article to treat

> any salesman, representative, peddler or canvasser as the agent of the vendor, distributor, supervisor or employer under whom he operates or from whom he obtains tangible personal property sold by him, or for whom he solicits business, the tax commissioner may, in its discretion, treat such agent as the vendor jointly responsible with his principal, distributor, supervisor or employer for the collection and payment over of the tax.

Section 526.10(e) (formerly Section 526.10(f)) of the Sales and Use Tax Regulations provides that:

> Co-vendor. (1) Every person operating a club or similar merchandising plan, or operating as <u>an independent contractor</u> representing a particular supplier selling tangible personal property is a vendor for sales tax purposes and must collect tax on merchandise sold by him.
>
> > (2) (i) Such person shall undertake all of the responsibilities of a vendor, as listed in subdivision (b) of this section. The person supplying the merchandise to him is also deemed to be a vendor, and shall undertake all of the responsibilities, as listed in subdivision (b) of this section.
> > (ii) Both the representative and his supplier shall be jointly responsible for the collection and remitting of the taxes and filing of returns.
> > (3) (i) A person supplying merchandise to a club plan secretary or independent vendor shall collect in advance from the club plan secretary or independent contractor a tax based on the retail selling price of the property at the tax rate in effect where possession of the property is taken by the club secretary or independent contractor.
> > (ii) A club plan secretary or independent contractor whose supplier has registered and is complying with the responsibilities of a vendor shall not be required to register as a vendor. (emphasis added)

Therefore where the client receives a fee strictly for the advertising of a vendor's merchandise through a video terminal, such fee for the advertising services is not subject to sales tax pursuant to Section 1105(c)(1) of the Tax Law and Section 527.3(b)(5) of the Sales and Use Tax Regulations. However, where the client's fee is a commission based on a vendor's sales, the client and the vendor will be deemed to be co-vendors, and the client will be liable for the collection of sales tax on the vendor's sales to its customers pursuant to Section 1101(b)(8)(ii) of the Tax Law and Section 526.10(e) of the Sales and Use Tax Regulations.

Section 1-3.2(a)(3) of the Business Corporation Franchise Tax Regulations provides that:

> Pursuant to Public Law 86-272 (15 U.S.C.A. sections 381-384), a foreign corporation is not subject to the tax imposed by article 9-A if its activities are limited to those described in that law. That is, the solicitation of orders by corporation's representatives or independent contractors for sales of tangible personal property, which orders are sent outside New York State for approval or rejection, and, which if approved, are filled by shipment or delivery from a point outside New York State.

Section 1-3.4(b)(9) of the Business Corporation Franchise Tax Regulations provides in part that:

> The following corporations are exempt from taxation under article 9-A:
>
> (9) corporations which are exempt pursuant to the provisions of Public Law 86-272 (15 U.S.C.A. §§ 381-384).
>
> (i) A foreign corporation whose income is derived from interstate commerce is not subject to tax under article 9-A if the activities of the corporation in New York State are limited to either, or both of the following:
>
> (a) the solicitation of orders by employees or representatives in New York State for sales of tangible personal property and the orders are sent outside New York State for approval or rejection; and, if approved, are filled by shipment or delivery from a point outside New York State, and
>
> (b) the solicitation of orders by employees or representatives in New York State in the name of or for the benefit of a prospective customer of such corporation if the customer's orders to the corporation are sent outside the State for approval or rejection; and, if approved, are filled by shipment or delivery from a point outside New York State.
>
> (ii) For purposes of this exemption, a corporation will not be considered to have engaged in taxable activities in New York State during the taxable year merely by reason of sales in New York State or the solicitation of orders for sales in New York State,

of tangible personal property on behalf of the corporation by one or more independent contractors. A corporation will not be considered to have engaged intaxable activities in New York State by reason of maintaining an office in New York State by one or more independent contractors whose activities on behalf of the corporation in New York State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(iii) The term <u>independent contractor</u> means a commission agent, broker, or other independent contractor who is engaged in selling, or in soliciting orders for the sale of tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities. The term <u>representative</u> does not include an independent contractor.

Therefore in the instant case the activities of the out-of-state vendors in soliciting orders in New York State through the client's video terminals where such orders are sent outside the State for approval or rejection; and, if approved, are filled by shipment or delivery from a point outside New York State, are exempt from taxation under Article 9-A, assuming they have no other contact with the State, in accordance with the meaning and intent of Sections 1-3.2(a)(3) and 1-3.4(b)(9) of the Business Corporation Franchise Tax Regulations and Public Law 86-272.

Further, in accordance with said Sections, the out-of-state vendors would be exempt from taxation even if the client is considered to be an independent contractor engaged in selling or soliciting orders for the sale of tangible personal property for the out-of-state vendors. <u>Giftmaster Inc</u>., Adv 0p, Comm T & F, October 13, 1988, TSB-A-88(23)C.

It is noted that the same rules would apply to an out-of-state vendor who would otherwise be taxable under Article 22 of the Tax Law.

DATED: January 17, 1991

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.