

## Navigating Sales Tax Treatment of Direct Mail and Online Promotional Communications

TUESDAY, MAY 5, 2015, 1:00-2:50 pm Eastern

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# Navigating Sales Tax Treatment of Direct Mail and Online Promotional Communications

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May 5, 2015

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# Today's Program

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**Matthew P. Schaefer, Brann & Isaacson**

**ESSENTIAL CONCEPTS WITH  
RESPECT TO TAXABILITY OF  
DIRECT MAIL AND  
ELECTRONIC  
COMMUNICATIONS**

# How Do States Define “Direct Mail”?

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- Streamlined Sales and Use Tax Agreement (SSUTA) definition:
  - **Direct mail** means printed material delivered or distributed by U.S. mail or other delivery service to a mass audience or to addressees on a mailing list provided by the purchaser or at the direction of the purchaser, when the cost of the items are not billed directly to the recipients. “Direct mail” includes tangible personal property supplied directly or indirectly by the purchaser to the direct mail seller for inclusion in the package containing the printed material. “Direct mail” does not include multiple items of printed material delivered to a single address (underlining added).
  - Applicable in nearly 25 states.



# How Do States Define “Direct Mail”? (cont.)

- Other states define a broader category of materials (e.g. “promotional materials”) or a narrower subset (e.g. “cooperative” direct mail) for particular tax treatment.
- Some states have no specific definition and treat direct mail largely like other tangible personal property.
- Some states treat direct mail as the product of printing services and impose tax on “printed materials.”



# Greater Regulatory Focus On Promotional Direct Mail

- SSUTA subcategories
  - “Advertising and Promotional Direct Mail”:
    - Printed material that meets the SSUTA definition of direct mail, the primary purpose of which is to attract public attention to a product, person, business or organization, or to attempt to sell, popularize or secure financial support for a product [or service], person, business or organization.
  - “Other Direct Mail”:
    - Any direct mail that is not “advertising and promotional direct mail” regardless of whether “advertising and promotional direct mail” is included in the same mailing.
- Several non-SSUTA states have specific treatment for promotional direct mail.



# What Is The SSUTA?

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- A multi-state compact among participating states, each of which must substantially conform its laws to the terms of the Agreement.
- “It is the purpose of this Agreement to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance.”
- Twenty-four member states.
  - Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin, Wyoming (but Tennessee not yet in full compliance).
- Conformity legislation has been introduced in other states, but no new member has been added since 2011. Proposed federal sales tax legislation appears to have dampened interest among states.

# Examples Of Types Of Direct Mail Materials

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- These items are generally considered to be advertising/promotional direct mail, although some may be excluded in certain jurisdictions:
  - Mail order catalogs
  - Flyers/brochures
  - Advertising circulars/newspaper inserts
  - Coupons (sometimes “cooperative” direct mail)
  - Advertising folders, envelopes
- These items are generally not considered to be advertising/promotional direct mail, but some may qualify in certain jurisdictions:
  - Non-printed advertising materials such as video tapes, computer disks, refrigerator magnets, etc. (*unless* they fall within a state’s definition of promotional materials)
  - Billing invoices/account statements
  - Stockholder reports
  - Legally required mailings
  - Privacy notices

# Overview Of Taxability Of Direct Mail

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- As “tangible personal property,” direct mail is presumptively subject to state and local use tax, unless an exemption applies.
  - A number of large states have exemptions for some types of direct mail (e.g., CA, NY, PA, OH, IL, VA).
  - Most SSUTA member states subject direct mail to tax (with exceptions for specific types in OH, OK, RI, WI, WY and MI (per prior case law)).
- In some cases, the purchase of services associated with the production or delivery of direct mail may not be taxable (e.g., advertising or letter shop services), but often such services are considered part of the taxable “sales price.”

# Overview Of Taxability Of Electronic Communications

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- Delivering the same content, to the same recipients, but via electronic means, will fundamentally alter its tax treatment in most jurisdictions.
  - Communications delivered electronically are no longer considered tangible personal property in most states (with some exceptions), eliminating the presumption of taxability. See, e.g., Missouri DOR LR 7407 (Mar. 7, 2012).
  - Electronically delivered communications do not meet the definition of “direct mail” under the SSUTA or the laws of most states because they are no longer printed materials.
  - SSUTA specifically requires states to comment on the taxability of “products transferred electronically” (separate from digital audio and audiovisual products and books). See SSUTA State Taxability Matrices, Ref. No. 31000.
  - For non-SSUTA states that do not treat electronic communications as TPP, they must be evaluated against the categories of taxable services in each state.

# Overview Of Taxability Of Electronic Communications

- Electronic communications are potentially taxable under a variety of different tax treatments, depending upon the nature/characteristics of the communications.



- State may follow the taxability of a comparable product in tangible form (e.g., CO, ME, TX, UT).
- Electronic delivery may be taxable as “data processing services.” States with a tax on data processing services include CT, DC, OH, TX.
- State tax on “information services” may apply, depending upon the source and content of the communication (e.g., NJ, NY, OH).
- Some states tax receipts from all goods and services, absent a specific exemption (HI, NM, SD, WV).
- A very broad state “communications” tax may potentially apply (e.g., SC).

# Delivery Charges For Direct Mail

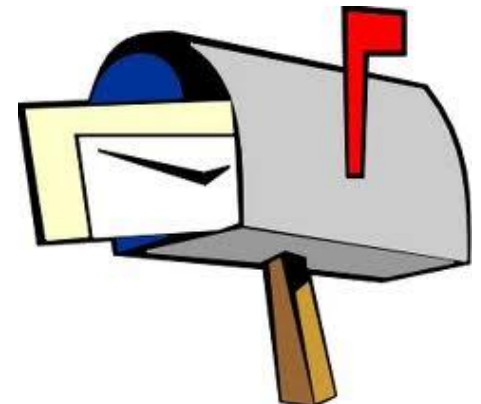
- As a percentage of the total cost of a transaction, shipping/transportation/postage is typically much higher for direct mail than for other products (such as consumer goods).
- Many states exclude separately stated delivery charges from the sales price for purposes of calculating sales and use tax.
- Some states exclude postage but not shipping (e.g., NE, SD, TX).
- The SSUTA permits its members to have special rules for the tax treatment of delivery charges for direct mail.





# Delivery Charges For Direct Mail (cont.)

- Under the SSUTA, unless delivery charges are stated separately on the invoice, they are not eligible for exclusion from sales tax.
- If delivery charges are stated separately, SSUTA member states can choose whether to exclude them from sales tax, or to exclude specific aspects of delivery charges:
  - Handling, crating, packing, preparation for mailing or delivery, and similar charges.
  - Transportation, shipping, and similar charges.
  - Postage.



# Exemptions Available By Statute, As Well As Under Court And Administrative Decisions

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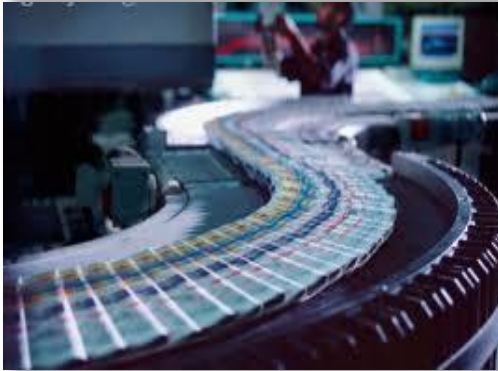
- Statutory exemptions:
  - California “printed sales messages” exemption (Cal. Rev. & Tax. Code § 6379.5; Cal. Code Regs. § 1541.5).
  - New York “promotional materials” exemption (NY Tax Law § 1115(n)(4)).
  - Massachusetts “direct and cooperative direct mail promotional advertising materials” exemption (Mass. Gen. L. ch. 64H, § 6(ff)).
- Exemptions by court decision or administrative ruling for materials delivered from outside the state by US Mail:
  - Michigan (*Sharper Image Corp. v. Department of Treasury*, 550 N.W.2d 596 (Mich. App. 1996)).
  - Illinois (see Ill. Department of Revenue, General Information Letter ST 01-0003-GIL (Jan. 5, 2000)).
  - Virginia (see Ruling of Virginia Tax Commissioner, P.D. 97-61 (Feb. 10, 1997)).

# Typical Tax Issues For Purchasers

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- Is my company subject to a sales/use tax obligation in the state(s) into which we are mailing?
- Does the printer charge tax, where applicable?
- Do my direct mail materials qualify for an exemption in any relevant jurisdictions? What is the correct exemption certificate to issue the printer?
- How might SSUTA default rules affect my business? What other documentation should I provide the printer?
- Is postage/shipping exempt and if so, in which jurisdictions?
- Will my company's IT system properly accrue the correct use tax, where applicable, if the printer does not charge the appropriate tax?
- Are there storage issues with direct mail advertising literature or materials?

# Typical Tax Issues For Printers



- Is my company required to collect the state's sales/use tax?
  - Have we obtained a direct pay, direct mail, or exemption certificate from the purchaser?
  - Does my company have nexus in the state?
  - Does the purchaser have nexus?
- Does the mailing list received from my customer contain the information needed to comply with state or SSUTA sourcing rules?
- Does my billing system have the ability to charge the appropriate tax for each jurisdiction?
- Are there storage issues with direct mail materials?

# Sourcing Issues

- What state's (and possibly locality's) law applies to determine if tax is due?
- Which party – the seller or the purchaser – bears the responsibility for determining and collecting / reporting the applicable tax?



# Sourcing Issues: Taxability

- The majority rule is “destination” sourcing, i.e., the sales/use tax is determined under the law of the jurisdiction where the tangible materials are ultimately delivered.
- For example, the SSUTA generally provides for “destination” sourcing (Sections 310, 313), but ...
- The SSUTA permits “origin” sourcing, under which the sales/use tax is determined based on the point of sale, for intrastate sales (see SSUTA, Section 313.1), although this has been adopted so far by only two member states (UT, WA).
- To complicate matters, a “use” might occur in a state even when the sales transaction does not.



# Sourcing Issues: Taxability (cont.)

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- In addition, several non-SSUTA states (e.g., AZ, CA, IL, PA, TX) have a general rule that calls for “origin” sourcing, *however*:
  - such “origin” sourcing rules may apply only to intrastate transactions/deliveries; and
  - in the case of interstate sales, including the delivery of direct mail to other states, such rules are typically superseded by express exemptions, rules, or enforcement practices that acknowledge underlying constitutional principles applicable to interstate commerce (and thus result in destination sourcing based on the “use” of direct mail in the state(s) where it is delivered).

# Sourcing Issues: Taxability (cont.)

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- The structure of a direct mail transaction may create challenges in determining what state’s law applies.
- If a printer does not also arrange for mailing to end user recipients, but instead delivers in bulk to a purchaser or letter shop to complete the mailing, the purchase of direct mail may be viewed as a bulk sale and aspects of tax treatment may change, such as exemptions, sourcing and even tax on postage.
- If a printer lacks sufficient information to allocate and source a sale of direct mail based on the delivery location(s), the printer may be required to collect sales tax under a default assumption.
  - The SSUTA requires the printer to source to the shipping location for advertising and promotional direct mail, and to the address of the purchaser for “other” direct mail. (SSUTA, Section 313.A.4, B.1.)
  - Non-SSUTA states may vary, creating challenges for the printer.



# Sourcing Issues: Who Must Report?

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- Typically, a seller must determine sourcing and collect any applicable sales/use tax. (Note: The purchaser is only relieved of the obligation if the seller collects.)
- Because direct mail is delivered to multiple jurisdictions, as to which the seller may have insufficient information for tax purposes, direct mail can present difficulties for the seller.
- The SSUTA, and some non-SSUTA states, offer procedures or exemptions that place sourcing and reporting burdens on the purchaser.
- Either way, local sourcing/taxes make reporting a challenge.

# Sourcing Issues: Who Must Report? (cont.)

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- Under the SSUTA and the laws of some other states (e.g., TX), a seller is relieved of the obligation to collect tax where the purchaser provides a direct pay permit or a “direct mail certificate” indicating that the purchaser will report tax. See SSUTA, Section 313.A.2, B.2.
- Some states provide express exemptions from tax for direct mail materials delivered to locations outside the state. (Such exemptions do not mean that the destination state’s tax is inapplicable, however.)
- The issue may be complicated where a purchaser lacks nexus in the destination state(s).

# Sourcing Issues: Double Taxation?

- Conflicting sourcing rules can lead to cases where more than one jurisdiction has a claim to some portion, or even all, of a mailing of printed materials.
- In many cases, such conflicts are resolved, at least in part, by credit provisions in state tax laws designed to avoid double taxation.
  - But state provisions are often premised on a credit against the use tax for sales tax already paid. Direct mail may involve two states each claiming the sale. Which prevails?
  - A taxpayer typically gets credit only to the extent tax was paid to another jurisdiction, so a state with a higher tax rate may seek the difference.



# Sourcing Issues: Double Taxation?

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- SSUTA default rules present a significant risk of double taxation.
- For promotional direct mail, the SSUTA default rule is the location from which the materials were sent (Section 313.A.4).
  - Non-SSUTA, destination sourcing states may seek tax on some portion.
  - SSUTA provides that member states may disallow credits if default applies.
- For “other direct mail,” SSUTA default rule is the purchaser’s business address (Section 313.B.1).
  - Applies whenever purchaser fails to give direct pay permit or direct mail certificate, even when purchaser gives shipping information.
  - If the printer has nexus in both the purchaser’s home state and one or more destination states to which mail is delivered, the printer would be subject to tax collection and remittance obligations in two or more jurisdictions.

# Sourcing Issues: Electronic Delivery

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- How electronic delivery is sourced will depend on the basis of its taxability: Are electronically delivered materials the equivalent of TPP, or taxable as a service?
- If treated as TPP:
  - Direct mail sourcing rules in SSUTA states would no longer apply, because electronically delivered materials are not “direct mail.”
  - The majority rule for TPP is destination sourcing, though SSUTA states have a cascading set of default rules.
  - Do you know the destination state of electronically delivered materials?
- If treated as a service:
  - May be the place where the “(benefit of the) service is received.”
  - May be the location at which the service is provided.

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# **LATEST STATE ACTIONS**

# *Valpak of Omaha LLC v. Dept. of Revenue* (Neb. Supreme Ct. Mar. 27, 2105)

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- A seller of cooperative direct mail advertising is subject to use tax on payments made to a printer of advertising materials.
  - Appellant Valpak of Omaha (“Valpak Omaha”) was a franchisee of the national cooperative direct mail firm, Val-pak Direct Marketing Systems, Inc. (“VDM”), a Florida corporation.
  - Valpak Omaha solicited advertisements from local businesses for inclusion in a package to be delivered to targeted groups of local consumers via direct mail. Valpak Omaha contracted with VDM to print and send the cooperative direct mail packages directly to consumers.
  - Valpak Omaha neither collected tax on its charges to customers nor paid tax on its purchases from VDM. The Nebraska DOR assessed Valpak \$417,000 in unpaid use tax on payments to VDM over a five-year period.



# *Valpak of Omaha LLC v. Dept. of Revenue* (cont.)

- Backstory: A prior licensee of VDM had lost a use tax challenge in 1996 on similar payments, on grounds that the licensee:
  - Was an “advertising agency” under DOR rules;
  - Was the consumer of the goods and services it purchased from VDM.
- Taxpayer may have been optimistic it could take advantage of a victory by another VDM franchisee in *Val-Pak East Valley, Inc. v. Arizona Dept. of Revenue*, 229 Ariz. 164 (Ct. App. 2012).
- Arizona Court found no taxable use of printed materials in the state by VDM franchisee.



# *Valpak of Omaha LLC v. Dept. of Revenue*

## **(cont.)**

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- Valpak Omaha secured a stipulation from the Nebraska DOR that sales tax did not apply to its charges to its customers, setting up question of whether Valpak Omaha was subject to Nebraska use tax – but to no avail.
- Instead of addressing the case as turning on the use of the printed materials, the Nebraska Supreme Court held that Valpak was liable for tax as an advertising agency on its purchases of labor (i.e., services) from VDM, while glossing over certain tricky questions.
- Lesson: The complexities of applying sales and use tax principles to direct mail often allow for a variety of different rationales in determining tax treatment. Such complexities require considerable care from sellers and purchasers of direct mail.

# Virginia Ruling PD 14-14: Electronic Communications Are Exempt

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- Virginia Tax Commissioner was asked by a provider of printing, direct mail, and electronic document services to review an assessment of sales tax on electronic document services provided over the Internet.
- Three different electronic communication services were involved:
  - eView/eApprove - A service that allows customers to view online documents such as bank statements.
  - DocSight - A service that permits third-parties to view electronic versions of a document through a website.
  - PDF Image Transfer - The electronic transfer of documents in a PDF format.
- The auditor found that the electronic document services were billed in connection with sales of printed materials and thus subject to tax.

# Virginia Ruling PD 14-14: Electronic Communications Are Exempt (cont.)

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- The Tax Commissioner found each of the services to be exempt from tax.
  - Virginia Code section 58.1-609.5 includes an exemption for “services not involving an exchange of tangible personal property which provide access to or use of the Internet and any other related electronic communication service, including software, data, content and other information service delivered electronically via the Internet.”
  - The Tax Commissioner also agreed with the taxpayer that, although they were billed on the same invoice, the electronic document services were entirely separate from the sales of printed materials.
  - Finding the exemption to apply, the Tax Commissioner eliminated the tax.
- Proper outcome, but the Commissioner’s reasoning is of concern because he relied upon the exemption, rather than the fact that the separate electronic document services were not properly within the scope of taxable TPP.

# Recent Rulings Remind Us That For Sales Tax, The Devil Is In The Details

- Electronic communications: South Carolina Department of Revenue Private Letter Ruling #14-5 (Dec. 10, 2014).
  - South Carolina taxes “communications” (as TPP) but excludes “data processing.”
  - Taxpayer offered a non-taxable service in which it compiled and manipulated claims data for insurers, and gave clients remote access to the data.
  - DOR noted that merely providing access to data electronically, without manipulating/processing the data, would be taxable.
- Promotional direct mail: Indiana Department of Revenue Letter Ruling 04-21040079 (Aug. 27, 2014).
  - Purchaser of printed promotional materials paid single price, with no components separately stated.
  - Department sustained the tax despite a letter from the printer attesting that the price included non-taxable postage and even taxes.



# Expanded Catalog Exemption In Wisconsin

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- Wis. Stat. § 77.54(59) (2013) expanded the exemption for promotional materials to exclude from sales and use tax “[t]he sales price from the sale of and the storage, use, or other consumption of advertising and promotional direct mail [as defined in the SSUTA.]”
  - Regulations published by the Wisconsin Department of Revenue provide that the exemption includes any charges for the delivery of advertising and promotional direct mail, as well. (See Wis. Reg. Tax 11.70, 11.94)
  - Note that other Wisconsin statutory provisions (Wis. Stat. § 77.54(15), § 77.54(25m)) exempt specific categories of direct mail materials, including, in particular, catalogs.

# Recent State Laws And Legislation Regarding Tax Treatment Of Direct Mail

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- Maine adopts exemption for free publications, including promotional materials included in the publication (36 M.R.S.A. sec. 1760(14-A)):
  - Any “publication” purchased for distribution without charge is exempt.
    - “Publication” means printed paper material such as newspapers, magazines and trade journals issued at intervals not exceeding 3 months.
    - “Publications” do not include materials consisting primarily of advertisements or the promotion of a single seller’s products or services.
  - Exemption extends to printed promotional materials for inclusion in the publication. Affidavit form verifies the exemption. Form ST-A-125.
- SSUTA Member states continue to clarify/adjust their laws:
  - With regard to direct mail sourcing and default rules (OH, NV, NC, TN).
  - With regard to postage and/or shipping (GA, NE, WA).
- Florida bill to watch: SB 858 (2015), if passed, would fully exempt “direct mail advertising literature.”

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# **EXAMPLES OF SPECIFIC STATE LAWS AND TAX POLICIES**



# Examples Of Specific State Laws: Pennsylvania

- Statute (72 P.S. §7204(35)) exempts:
  - Catalogs and advertising literature or materials, which are defined as tangible personal property that is intended to promote a business interest, create goodwill or engage the attention or interest of a recipient, and includes envelopes, address labels, application forms and mailing charges (Reg. Sections 31.29 and 32.36)
    - Annual corporate and financial reports and financial prospectuses are exempt but proxy materials and other publications are taxable
  - Advertising inserts as part of a newspaper
  - One-time use of a list of names (list rental) and mailing addresses



# Examples Of Specific State Laws: Pennsylvania (cont).

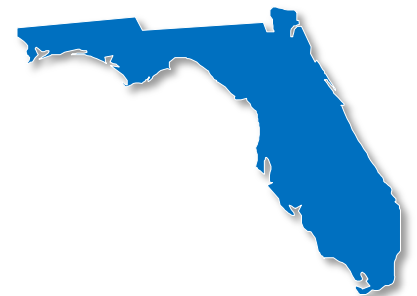
- Key requirement: Distributed through the U.S. Postal Service.
  - Will be deemed taxable if distributed by other means.
  - Key exclusion from exemption:
    - If the advertiser supplies the paper, printing charges are subject to sales tax and direct advertising exemption does not apply, because printing services are deemed taxable (Reg §32.36).
    - Unclear whether printing on advertiser-supplied paper outside of Pennsylvania is subject to use tax.
  - Note: No requirement that advertiser be the mailer. *Merion Publications, Inc. v. Commonwealth*, 890 A.2d 436 (Commonwealth Court 2006).



# Examples Of Specific State Laws: Florida

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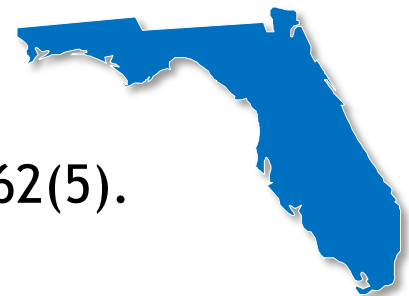
- Statute (Fla. Stat. §212.08(7)(w)) exempts:
  - Free
  - Circulated publications
  - Published on a regular basis
  - Composed of primarily advertising
  - Distributed through the mail, home delivery or newsstand.
- Department strictly construes exemption.



# Examples Of Specific State Laws: Florida (cont.)

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- Catalogs and other direct advertising materials arguably fit within this definition.
- The biggest issue regarding promotional materials is showing that they are "published on a regular basis."
  - Department argues that catalogs distributed on different days in a month, from year to year, may not meet the regularity requirement.
- Electronic Communications
  - Not taxable in FL even though FL taxes information services. See Rule 12A-1.062(5).



# Examples Of Specific State Laws: Ohio

- Statute exempts sales for which:
  - (1) The “purpose” of the consumer is to use or consume the things transferred in making retail sales; and (2) The items are newspaper inserts, catalogs, coupons, flyers, gift certificates or other advertising material that prices and describes tangible personal property offered for retail sale. (Rev. Code Ann. Sec. 5739.02(B)(35)).
  - Also exempts printed matter that offers free merchandise or chances to win a sweepstakes, if mailed to potential customers with materials described in the first bullet.



# Examples Of Specific State Laws: Ohio (cont.)



- Sales of preliminary materials to direct marketers that are used in printing are also exempt (photographs, artwork, pre-press).
- Ohio statute is silent on mailing lists.
- Distribution by taxpayer to retail stores of store displays does not satisfy the requirement that the consumer use the materials transferred in making retail sales. Opinion of Tax Commissioner 94-004.
  - Catalogs distributed by salesman are exempt per *Curtis Industries*, BTA 1964.
  - Suggests requirements that materials be distributed by advertiser to prospective customers for ordering, but also arguably because of function of catalogs.

# Examples Of Specific State Laws: New York Tax Law Sec. 1115(n)(4)

- Three Elements of Exemption.
  - Element 1: Printed promotional materials and promotional materials upon which services are performed.
    - Broad definition includes advertising material, related tangible personal property (e.g. free gifts, complimentary maps, applications, order forms and return envelopes), raw materials and envelopes used exclusively for delivering materials.
    - Exempt are mailing lists, including merge purge services, for promotional materials.
    - Exempt are shipping and handling charges.
    - Does not include invoices, statements, or similar items.



# Examples Of Specific State Laws: New York Tax Law Sec. 1115(n)(4) (cont.)



- Element 2: Shipment by purchaser by mail or common carrier.
  - Does not include shipment by printer's trucks. TSB-A-13(16)S; TB-ST-692 (2014).
- Element 3: Without charge to the purchaser's customers.
  - Membership fee that includes rights to materials is a charge. TSB-A-13(16)S.
- Purchaser must use Form ST-121.2.
  - Is not a concession of nexus by the purchaser.



# Examples Of Specific State Laws: New York Information Services

- NYS §1105(c)(1) and (c)(9) tax information services, both on printed and electronic media.
  - Information services are defined as furnishing of information, including the services of collecting, compiling or analyzing information and furnishing reports thereof to other persons, but excluding:
    - Furnishing information that is personal or individual in nature and not substantially incorporated in reports to other persons.
    - Advertising services, which are defined as placement of advertisements with the media.
      - Note: An Internet service that enables its customers to capture, display and review customer feedback is deemed a nontaxable advertising service. TSB-A-15(1)(S).



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# **NEXUS-RELATED ISSUES**

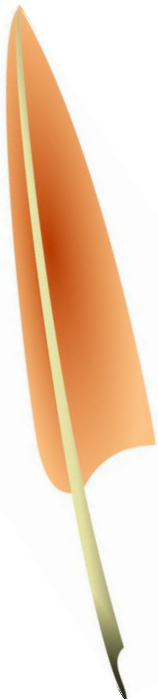
# Nexus-Related Issues: General

- *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)) sets the constitutional standard.
- *Quill* requires that a retailer have a physical presence.
  - Through its own employees, properties or facilities.
  - Attribution nexus: Agent/representative.



# Nexus-Related Issues: General (cont.)

- *Quill* states (quoting *Bellas Hess*):
  - There is a “sharp distinction ... between mail-order sellers with retail outlets, solicitors, or property within a state and those who do more than communicate with customers in the state by and or common carrier as a part of general interstate business.” (505 U.S. at 307) (emphasis added).
  - There are few court cases concerning the presence of inventory. *Advance Magazine Publishers, Inc. v. Huddleston*, Chancery Court, 20<sup>th</sup> Judicial District (Tennessee)(Aug. 20, 1997) (presence of inventory of paper at printer does not establish franchise tax nexus).
  - But, see statement in *Quill* that *Quill* did not have nexus because it did not own tangible personal property; also, see *AOL v. Johnson* (Tenn. Ct. App. 2002) (presence of modems in state creates nexus).



# Nexus Implications To Mailer

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- Storage of paper:
  - Most large promotional materials mailers contract with paper brokers or directly with mills to purchase paper, and cause paper to be supplied to the printer or printers.
  - Paper must be stored at the printer for short or longer periods.
  - Storage of paper creates a high nexus risk in the state of the printer, but an argument can be made otherwise.
    - See previous slide.
    - Does the activity “make a market” in the state for the out-of-state mailer? (see *Tyler Pipe Industries, Inc. v. WA. State Dept. of Revenue*, 483 U.S. 232 (1987)).

# Nexus Implications To Mailer (cont.)

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- **Solutions:**

- Transfer of title to printer.



- Accomplished with bill of sale to printer.
- Invoice price from printer includes cost of paper (Avoid up-charge or paper management fee).
- Issues:
  - Requires accounting for paper.
  - Credit risk?
  - Is there economic substance?

# Nexus Implications To Mailer (cont.)

- Solutions re: paper storage: Print in states with safe harbors.

STATE	STATUTE – REGULATION - CODE
Connecticut	CGA § 12-407(15)(b), 12-213(a)(20)(B)
Florida	FL ST § 212.0596(2), 212.06(2)(d) Technical Assistance Advisement, No. 06A-03
Georgia	OCGA § 48-7-1
Illinois	35 ILCS § 105/2(1), 35 ILCS § 5/205(f)
Indiana	IN Code § 6-2.5-3-1, 6-2.5-8-8.5, 6-3-2-2.3
Kentucky	KRS § 139.340(2)
Maine	36 MRSA § 1754-B(1)(G)(5)
Minnesota	MN ST § 297A.66 (Subdivision 3)(b))
New York	N.Y. Dept. of Taxation and Finance TSB-M-96(3)C, (10)S Counsel Opinion (October 3, 1996)



# Nexus Implications To Mailer (cont.)

- Solutions re: paper storage: Print in states with safe harbors.

STATE	STATUTE – REGULATION - CODE
Ohio	ORC § 5741.17, 5733.09(D), 5747.30b
Oklahoma	68 OS § 1376
Pennsylvania	72 PS § 7201
South Carolina	SC Code § 12-36-75, § 12-6-555
Tennessee	Tenn. Code Ann. §67-6-203(b)
Utah	UT Code § 59-7-102(2)
Virginia	VA Code § 58.1-401(7), 58.1-612(D)
West Virginia	TAA 96-003
Wisconsin	WSA § 77.51(13h), 71.23(3)

# Nexus Implications To Mailer (cont.)

- Possible limitations on safe harbors:
  - Maine and Minnesota do not specifically permit storage of paper at printer.
  - Storage of catalogs is not necessarily exempt.
    - Do not take title to catalogs or mailings until sent by interstate commerce, not when invoiced by printer.
  - Visits by personnel of mailer to state may not be protected in Florida, Georgia, Kentucky, Maine and Minnesota; because the safe harbor in the statute doesn't address whether visits create nexus.
  - Constitutional argument: Infrequent visits to state do not create nexus. (See *Dept of Rev. v. Share International, Inc.*, 676 So.2d. 1362 (Fla. 1996); *Appeal of Intercard, Inc.*, 14 P.3d 1111 (Kan. 2000); but see *Orvis Co., Inc. v. Tax App. Tribunal of New York*, 654 N.E.2d 954 (N.Y. 1995)).



# Nexus Implications To Mailer (cont.)

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- Potential issues:
  - When work is done in more than one state, one of which has a safe harbor and the other does not. For example, facility in one state prints pages 1-25, and facility in another state prints the remaining pages.
  - Make sure that the contract specifies that the printing facility in the safe state is responsible for the printing job, including mailing of materials.
- Useful tips:
  - Include anti-agency clauses in contracts.
  - Do not store catalogs or promotional materials with printers unless, based on review of statute, it is safe to do so.
  - A contract with printer should specify states where printing takes place.

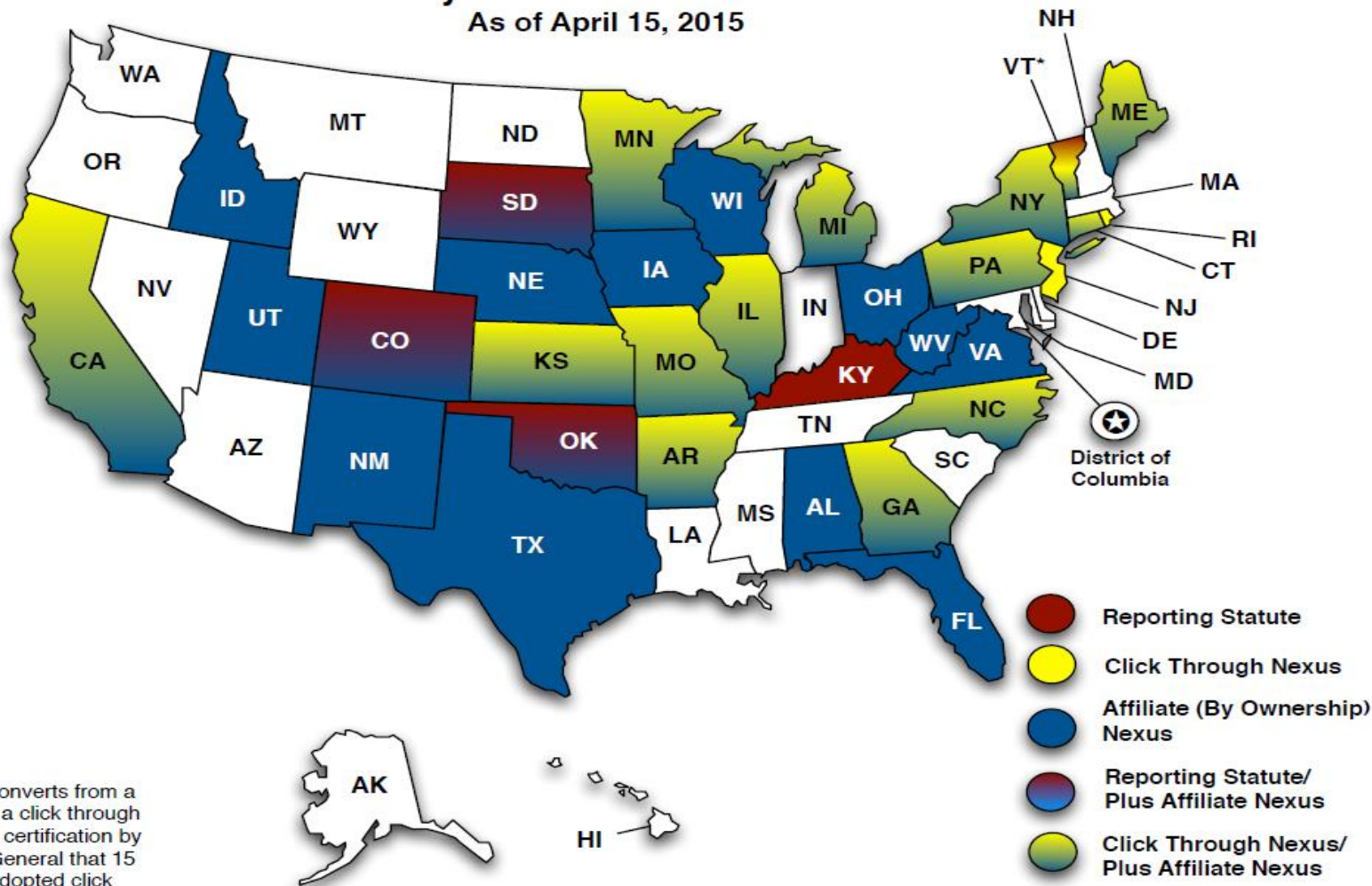
# Other Nexus Implications To Mailer

- Basic principle: Mailing promotional materials from outside of state into a state does not create nexus in the destination state.
  - But, distributing promotional materials within a state may create nexus.
    - Example: Catalogs distributed at trade shows or kiosks.
    - Example: Coupons.
    - Tax authorities could argue that the person distributing is an agent or representative soliciting sales in the state; i.e., the person is helping to make a market in the state for the advertiser.
      - See *Borders Online, LLC v. Cal. Board of Equalization*, 129 Cal.App. 4<sup>th</sup> 1129 (Cal. App. 2005) and the *Appeal of Scholastic Book Clubs, Inc.*, 920 P2d 947 (Kan. 1996).
  - Does use of affiliates create nexus?

# Affiliate Nexus Laws

By Brann & Isaacson

As of April 15, 2015



\* Vermont statute converts from a reporting statute to a click through nexus statute upon certification by Vermont Attorney General that 15 other states have adopted click through nexus statutes.

# Click Through Nexus Legislation: The New York And Illinois Statutes

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- NY 2008: Adoption of Click Through Nexus (“Web Affiliate“) Statute
  - Rebuttable presumption of nexus if:
    - Retailer has agreements with NY residents (“web affiliates“) for referrals from the affiliate’s website.
    - Retailer pays the affiliate a commission or other consideration for referrals.
    - Preceding four quarter sales from such referrals are greater than \$10,000.
- IL 2011 statute similar to New York statute but set up a *per se* finding of nexus based on satisfaction of similar conditions as in New York.

# *Amazon/New York And Performance Marketing/Illinois*

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- NY Court of Appeals decision in *Amazon.com and Overstock.com, Inc. v. New York Department of Taxation & Finance*, 20 N.Y.S. 3d 586 (N.Y. 2013) held that New York statute is not unconstitutional on its face.
  - Internet retailer given opportunity to demonstrate that affiliates did not engage in any solicitation in NY saves constitutionality.
- *Performance Marketing*: Lower court found that Illinois statute violated the Commerce Clause principle of *Quill* and anti-discrimination clause of the Internet Tax Freedom Act.
  - Supreme Court of Illinois addressed only the ITFA and held that the Illinois law violated the ITFA and the Supremacy Clause. *Performance Marketing Ass'n v. Hamer*, 2013 IL 114496.

# Other Noteworthy Nexus Statutes

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- California Click-Through Nexus Statute
  - Provides presumption of nexus if cumulative annual sales in California are greater than \$1 million and sales to California residents as referred by affiliates exceed \$10,000 for the preceding 12 months.
    - Affiliate is a person in California with whom retailer enters into an agreement in which person in California for a commission or other consideration directly or indirectly refers potential purchasers to the retailer by an Internet based link or other forms of advertisement such as catalogs.



## Other Noteworthy Nexus Statutes (cont.)

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- Person in California requires the person to be physically present in California when operating website or distributing advertisements.
- Excludes advertisements including direct mail materials if advertisement revenue is not based on sales of tangible personal property (i.e., not commission based).
- Excludes advertisements if affiliate does not solicit customers in California through use of flyers, newsletters, email or other means specifically targeted at potential customers in California.
- Presumption is overcome if retailer can demonstrate that affiliate did not engage in referrals in California that would satisfy nexus requirements of Commerce Clause.
  - i.e., in-state solicitation

# Other Noteworthy Nexus Statutes (cont.)

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- Safe Harbor (Cal. Regulation 1684):
  - Agreement with affiliate prohibits in-state solicitation by newsletters, flyers, etc.
  - Annual certifications by affiliates.
    - Certifications accepted in good faith.
  - Statement by non-profit on website.

# New Illinois Affiliate Nexus Statute

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- In response to Illinois Supreme Court decision in *Performance Marketing*, in September 2014 the Illinois legislature changed the prior law to:
  - Create only a rebuttable presumption of nexus, similar to NY statute.
  - Expand definition of affiliates to any person (includes websites, radio and print media) located in IL who is paid a commission/ consideration based on the retailer's sale, and directly or indirectly refers potential customers to the retailer by providing a promotional code or other mechanism that allows the retailer to track purchases referred by such persons.

# Lack Of Nexus Of Mailer: Is Tax Due From The Printer?



- The problem:
  - Printers frequently have nexus with many states other than those in which printing takes place.
  - Is a printer required to collect tax on promotional materials mailed/sent to a state where the mailer does not have nexus?
    - For a state other than one in which materials are printed, i.e., a use tax.

# Lack Of Nexus Of Mailer: Is Use Tax Due? (cont.)

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- Constitutional argument against use tax in destination states because of lack of substantial nexus with transaction under *Complete Auto Transit* four-prong test: *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977); also *D.H. Holmes Company, Ltd. v. McNamara*, 486 U.S. 24 (1988) based on nexus aplenty of the purchaser of catalogs.
- Most state laws impose use tax on purchaser and require the seller to collect.
- Argument is that since tax cannot be imposed on the purchaser, printer has nothing to collect.

# Lack Of Nexus Of Mailer: Is Use Tax Due?

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- Most printers permit a no nexus letter or accept an exemption certificate that is a variation of the MTC Multijurisdictional Tax Certificate or the SSUTA Exemption Certificate (see attached).



# Lack Of Nexus Of Mailer: Is Use Tax Due? (cont.)



- Sect. 317 of SSUTA, and Rule 317.1, provide that a seller is relieved of liability if it obtains a fully completed paper exemption certificate or an electronic filing that has all of the information contained in the SSUTA form.
  - Sect. 5 of SSUTA form provides an exemption category (L) of "Other."
  - Lack of nexus can be deemed "Other."

# Lack Of Nexus Of Mailer: Is Use Tax Due? (cont.)

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- Does the lack of nexus constitute an adequate basis for an exemption certificate?
  - Most state laws provide an exemption or exclusion from tax, if imposition of tax is unconstitutional.
    - See, e.g., Code of Iowa §423.3; WY Statutes §39-16-105(a)(i)(A).
  - Good faith basis for printer to receive such a certificate.



## Lack Of Nexus Of Mailer: Is Sales Tax Due On Materials Sent To Residents Of Printer's State?



- Is sales tax due for catalogs shipped to residents of the state where the printer's facility is located even if mailer/purchaser doesn't have nexus?
  - Arguably different since the state has a substantial nexus with the transaction and a sales tax is likely due. *Oklahoma Tax Com'n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995).
  - Turns on if a taxable sale under the statute.
    - Issue is where title transfers.
  - Conclusion: State where printer located likely can assess taxes on materials shipped to residents of the state.

## Is Tax Due To State Of Printer When Materials For Non-Nexus Purchaser Shipped Outside of State?

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- Is sales tax due in printer's state for shipments to other states?
  - See, e.g., *VisionStream, Inc. v. Missouri Director of Revenue*, CCH Par 203-912 (8/26/2014) (use tax due on items shipped from Missouri to other states because title passed when delivered to common carrier).
- Taxpayer in *Vision Stream* did not argue lack of nexus with the transaction.

# Is Tax Due To State Of Printer When Materials For Non-Nexus Purchaser Shipped Outside of State? (cont.)

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- Taxpayer's argument in *Vision Stream* about interstate commerce exemption did not prevail because under applicable rule title must pass outside of Missouri. See 12 CSR 10-113.200.
  - Printing industry practice: Title passes when printed materials delivered to carrier.
  - Note Minnesota Section 297A.68, Subdivision 11, providing for exemption for items shipped outside of Minnesota regardless of where title passes.
- Conclusion: Must determine the kind of tax (and the incidence of tax) at issue (sales tax or use tax), and tailor the contract to account for the law of the state where materials are printed to minimize the tax effect in printer's state.

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Martin I. Eisenstein, Brann & Isaacson

# TAXABILITY OF POSTAGE, SHIPPING AND OTHER COST COMPONENTS

# Taxability Of Postage/Shipping

STATE	SALES TAX ON SHIPPING COSTS
Alabama	Excluded if (1) shipped by common carrier and (2) charges are billed separately and paid by the purchaser
Arizona	Excluded if charges are separately stated
Arkansas	Excluded if charges are separately stated and the tangible personal property being shipped is not taxable.
California	Excluded for “separately stated” charges if shipping directly to the purchaser by common carrier, USPS or independent contractor
Colorado	Excluded if charges are both (1) separable from the sales transaction, and (2) stated separately on a written invoice or contract
Connecticut	Taxable
District of Columbia	Excluded if charges are separately stated, and delivery occurs after the sale
Florida	Excluded if charges are (1) separately stated and (2) may “be avoided by a decision or action solely on the part of the purchaser”
Georgia	Exclude if the charges are (1) separately stated and (2) passed on dollar for dollar with no mark-up
Hawaii	Taxable
Idaho	Excluded if charges are separately stated
Illinois	Excluded if charges are separately stated
Indiana	Taxable

# Taxability Of Postage/Shipping (cont.)

STATE	SALES TAX ON SHIPPING COSTS
Iowa	Excluded if charges are separately contracted for and separately stated
Kansas	Excluded if charges are separately stated
Kentucky	Taxable
Louisiana	Excluded if charges are separately stated, and delivery occurs after the sale
Maine	Excluded if (1) shipment is made direct to the purchaser, (2) charges are separately stated, and (3) the transportation occurs by means of common carrier, contract carrier or USPS
Maryland	Excluded if separately stated
Massachusetts	Excluded if charges (1) reflect the costs of preparing and delivering goods to a location designated by the purchaser, (2) are separately stated on the bill, and (3) are set in good faith and reasonably reflect the actual costs incurred by the vendor
Michigan	Excluded if charges are separately stated
Minnesota	Excluded if charges are separately stated

# Taxability Of Postage/Shipping (cont.)

STATE	SALES TAX ON SHIPPING COSTS
Mississippi	Taxable
Missouri	Excluded if the charges are (1) separately stated and (2) delivery service not required as part of the sale price (i.e., shipping optional)
Nebraska	Taxable, except for separately stated postage charges.
Nevada	Excluded if the charges are separately stated (handling, crating, and packing are taxable)
New Jersey	Taxable
New Mexico	Taxable
New York	Not taxable; separately stated charges to ship promotional materials are not taxable due to exemption; postage charges for non-promotional direct mail also exempt (other shipping charge unclear)
North Carolina	Excluded if charges are separately stated
North Dakota	Taxable.
Ohio	Not taxable if within direct advertising exemption; taxable if other direct mail
Oklahoma	Excluded if separately stated on invoice
Pennsylvania	Not taxable if direct billing to customer by UPS or if subject to direct advertising exemption; otherwise taxable
Rhode Island	Excluded if charges are separately stated, except for envelopes



# Taxability Of Postage/Shipping (cont.)

STATE	SALES TAX ON SHIPPING COSTS
<b>South Carolina</b>	Generally taxable, unless F.O.B. origin and buyer pays directly; but cooperative direct mail advertising materials are excluded.
<b>South Dakota</b>	Taxable, except for postage
<b>Tennessee</b>	Excluded if charges are separately stated
<b>Texas</b>	Taxable, except for postage
<b>Utah</b>	Excluded if charges are separately stated
<b>Vermont</b>	Excluded if charges are separately stated
<b>Virginia</b>	Excluded if charges are separately stated
<b>Washington</b>	Excluded if charges are separately stated
<b>West Virginia</b>	Taxable
<b>Wisconsin</b>	Excluded if charges are separately stated
<b>Wyoming</b>	Excluded if interstate delivery

# Taxability Of Other Cost Components

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- Preliminary Materials: Photographs, Pre-press and Copy.
  - Is it Tangible Personal Property?
  - Does statute exempt preliminary materials?
  - How are materials transmitted to the Printer? To the mailer?
    - By email or Internet connection.

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