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Sales Tax Treatment of Direct Mail and Online Communications Post-Wayfair

TUESDAY, AUGUST 20, 2019, 1:00-2:50 pm Eastern

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Sales Tax Treatment of Direct Mail and Online Communications Post-*Wayfair*

August 20, 2019

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ESSENTIAL CONCEPTS CONCERNING TAXABILITY; DIRECT MAIL AND ELECTRONIC COMMUNICATIONS

Discussing Direct Mail Sales/Use Tax After *South Dakota v. Wayfair, Inc.*

- The Supreme Court's landmark decision in *South Dakota v. Wayfair, Inc.*, 138 S.Ct 2080 (2018) greatly expanded state tax authority over multistate companies.
    - Direct mail and electronic communications are a primary tool of multistate businesses in reaching customers.
    - The expansion of state taxing power potentially exposes all participants in a direct mail transaction to increased state sales and use tax obligations.
    - We will discuss the ramifications of *Wayfair* for the state tax treatment of direct mail and electronic communications.

Direct Mail Before *Wayfair*

- Traditional direct mail – i.e., printed mail pieces sent to a large group of designated recipients – has generally been treated for state tax purposes as tangible personal property or the product of printing services.
    - Many states have treated direct mail as taxable (often applying specific rules addressing aspects of a typical direct mail transaction).
    - Some states, and in particular a few larger states (e.g., CA, NY, PA), have exempted certain types of direct mail from sales/use tax (particularly promotional direct mail).
- Electronic communications have generally been treated as non-taxable (but may be taxable under special classifications).

Direct Mail Before *Wayfair*

- The typical direct mail transaction involves a sale of printed mail pieces by a printer to a purchaser that uses the mail pieces to reach recipients in multiple states.
    - The printer is the seller, with a potential state sales/use tax collection obligation.
    - The printer's customer is the user of the direct mail (also typically considered by states and courts as the distributor of the direct mail pieces), with a potential obligation to self-report use tax if the printer does not collect the tax.

Direct Mail Before *Wayfair*

- Prior to the Supreme Court's decision in *Wayfair*, certain constitutional principles (physical presence nexus) and state tax principles (destination sourcing) tended to limit the extent to which direct mail was subject to sales/use tax.
  - Many purchasers of direct mail had physical presence in only a handful of states and thus lacked constitutional nexus.
  - Since sales and use tax laws generally apply at the location where tangible personal property is delivered, a company purchasing direct mail was not taxable in its home state on most, or even all, printed pieces purchased.
  - As a result, states focused relatively little attention on direct mail.

Direct Mail Before *Wayfair*

- Companies with a wider physical presence footprint, such as multi-channel retailers with stores in numerous states who distributed catalogs, were the primary enforcement target of states.
- This began to change somewhat in the years leading up to *Wayfair* as printers established widespread nexus.
  - Many states pressured printers subject to their taxing jurisdiction to collect tax from non-nexus customers.
  - This was resolved through state acceptance of "no nexus" letters as a kind of exemption certificate upon which printers could rely.

State Definitions of "Direct Mail"

- What are the basic principles of direct mail tax treatment?
- 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 23 states.

State Definitions of "Direct Mail"

- 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."

State 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?

- 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 (none added since 2011).
  - 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).
- SSUTA received favorable mention in the *Wayfair* decision.

Examples Of Types Of Direct Mail Materials

- 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 <u>not</u> considered to be advertising/promotional direct mail, but some may qualify in certain jurisdictions:
  - Non-printed advertising materials such as mouse pads, 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

- As "tangible personal property," direct mail is presumptively subject to state and local sales/use tax, unless an exemption applies.
  - As noted, 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 KY, NJ, OH, OK, RI, TN, 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

- Delivering the same content, to the same recipients, but via electronic means, will 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., Florida DOR Tech. Assist. Adv. 18A-015 (Aug. 31, 2018); 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.
    - Several report that the state does not tax products delivered electronically (e.g., AR, GA, IN, KS, MI, NJ, OH, WV) but other tax categories could apply.

Overview Of Taxability Of Electronic Communications

- 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.
- Electronic communications are potentially taxable under a variety of different tax treatments, depending upon the nature/characteristics of the communications.
- A service provider needs to evaluate carefully how to describe and price its service(s) especially when offerings include data processing, information services and/or other components in connection with delivery of messages.

Overview Of Taxability Of Electronic Communications

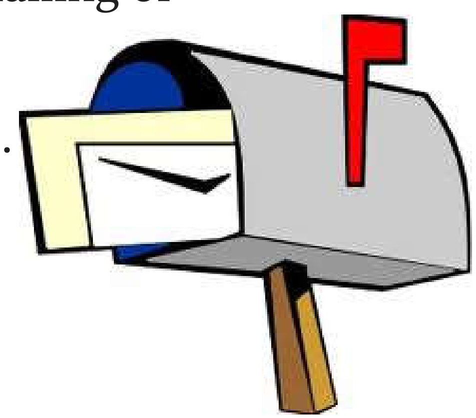
- State may apply the taxability of a comparable product in tangible form (e.g., CO, ME, TX, UT).
- Electronic delivery may be taxable as "**data processing** services." States with a tax on data processing services include CT, DC, OH, TX.
- Tax on "**information services**" may apply, depending upon the source and content of the communication (e.g., NJ, NY, OH).
- Some states impose tax on 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 (Rev. Rul. 17-2)).

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., GA, IN, 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

- 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 U.S. Mail:
  - Missouri (*see Office Depot, Inc. v. Dir. Of Revenue,* Mo. Admin. 12-2190 (Apr. 30, 2015) (citing *May Dep't Stores Co. v. Dir. Of Revenue* (Mo. 1988)(en banc)).
  - Michigan (*Sharper Image Corp. v. Dep't of Treasury*, 550 N.W.2d 596 (Mich. App. 1996)).
  - Illinois (*see* Ill. DOR Gen. Info. Letter ST 01-0003-GIL (Jan. 5, 2000)).
  - Virginia (*see* Ruling of Virginia Tax Comm'r, P.D. 97-61 (Feb. 10. 1997)).

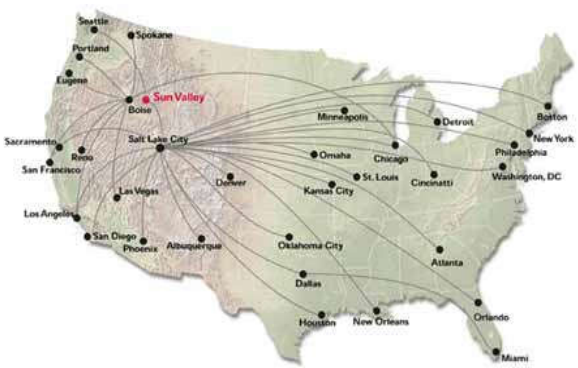
Typical Tax Issues For Purchasers

- In light of *Wayfair*, 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? More likely, post-*Wayfair.*
- 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

- In light of *Wayfair, i*s my company required to collect the state's sales/use tax?
  - Does my company have nexus in the state?
  - Have we obtained a direct pay, direct mail, or exemption certificate from the purchaser?
- 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: 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.)

- In addition, several non-SSUTA states (e.g., AZ, CA, 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.)

- 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, aspects of the 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?

- Typically, a seller (printer) 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.)

- 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.)

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 to assess an additional amount based on the difference in rates.

Sourcing Issues: Double Taxation?

- SSUTA default rules create a risk of double taxation.
- For promotional direct mail, the default rule is the location from which the materials were sent (SSUTA 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," default rule is the purchaser's business address (SSUTA Section 313.B.1).
  - Applies whenever purchaser fails to give a direct pay permit or direct mail certificate, even when purchaser provides 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 could be subject to tax collection and remittance obligations in two or more jurisdictions.

Sourcing Issues: Electronic Delivery

- 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.
- If treated as a service:
  - Most likely the place where the "(benefit of the) service is received."
  - May be the location at which the service is provided.

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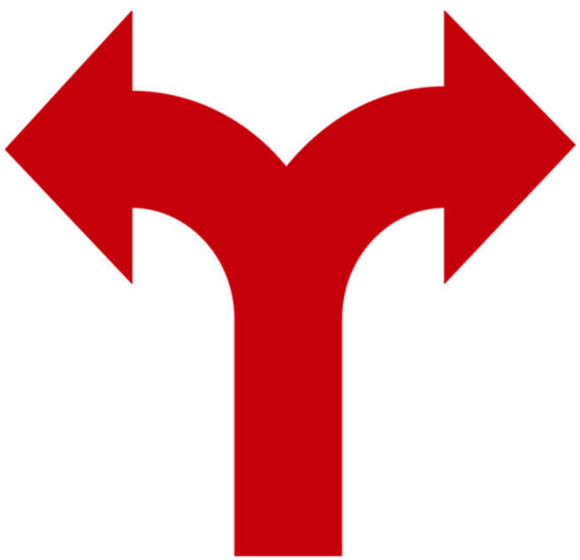
LATEST STATE ACTIONS – INCLUDING *WAYFAIR*

Issues Addressed

- The U.S. Supreme Court's decision in *South Dakota v. Wayfair, Inc.*, 138 S.Ct. 2080 (2018).
- The States' responses to *Wayfair*.
- The impact of *Wayfair* on publishers/purchasers of printed materials.
- The impact of *Wayfair* on printers.
- Other developments.

The Decision



- On June 21, 2018, the US Supreme Court issued its *Wayfair* decision.
- 5-4 decision:
  - Justice Kennedy authored the majority opinion joined by Justices Ginsburg, Thomas, Alito and Gorsuch.
  - Chief Justice Roberts authored the dissenting opinion joined by Justices Breyer, Kagan and Sotomayor.
- Case remanded to South Dakota Supreme Court/Circuit Court for a hearing on whether there is undue burden/discrimination against interstate commerce.

Physical Presence is Not the Test

- The *Quill* and *National Bellas Hess* physical presence standard of nexus abrogated.

- Court did not develop a new bright line rule for state sales tax, but opted for the Commerce Clause "case-by-case analysis of purposes and effects." *Id*. at 2094.

Substantial Nexus Test

- Reaffirms *Complete Auto* four part test for state taxes; reinterprets substantial nexus prong.
- Economic presence standard of nexus : "Taxpayer 'avails itself of the substantial privilege of carrying on business' in that jurisdiction."
    - Similar to due process standard, but not "identical or coterminous." *Id*. at 2093.
    - Due process requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Id*.

Determining Substantial Nexus

- "economic **and** virtual" contacts. *Id*. at 2099.
  - Economic-delivery of goods in the state.
  - Large national companies that have an "extensive virtual presence." *Id*. at 2099.
    - "targeted advertising;" "instant access to most consumers through an internet-enabled device," leaving cookies saved to the customers' hard drives; a "virtual showroom;" and the download of a retailer's app by customers. *Id*. at 2095.
  - Mailings of materials in the state would likely create economic nexus.

An Additional Test

- Court emphasized that States may not discriminate against, or "unduly burden," interstate commerce.
  - Court did not specify the test for undue burden but noted that the relevant burdens are those imposed on "companies that do business in multiple states." *Id*. at 2093.
  - Court looked to certain factors in considering whether the other aspects "of the Court's Commerce Clause doctrine . . .might invalidate" the SD law. *Id.* at 2099.

The *Wayfair* Factors

- The Court referred to the following factors (the *Wayfair* Factors) of the SD law as likely avoiding undue burden:
  - Safe Harbor for small seller to State.
    - Annual sales of $100,000 <u>or</u> 200 transactions.
  - "[N]o obligation to remit the sales tax may be applied retroactively." *Id*. at 2099.
  - SSUTA membership.

The Wayfair Factors: The SSUTA

- Benefits of the SSUTA:
  - SSUTA standardizes taxes to reduce compliance costs:
    - a single, state level administration;
    - uniform definitions of products and services and other uniform rules (e.g. exemption certificates);
    - simplified tax rate.
  - SSUTA provides access to software paid for by the State ("Certified Service Providers" are paid by the State).
  - Use of the software provides immunity from audit liability.

The *Wayfair* Effect: Physical Presence Is Not a Commerce Clause Requirement

- Effect One:
  - Removes the Commerce Clause Physical Presence requirement for all taxes.
    - First time that the U.S. Supreme Court ruled that physical presence not required for any tax.
    - Most importantly, a remote retailer does not have a nexus defense under the Commerce Clause that it is not liable for the use tax on distribution of direct mail materials into the state.

Home Rule Jurisdictions May Seek to Impose Taxes Based on Sales Alone

- Six home rule jurisdictions of Alabama, Alaska, Arizona, Colorado, Idaho, and Louisiana.
    - Tax is administered by the local jurisdictions, so that there is registration and tax filings at both the state and local level as well as separate tax base and audit enforcement.
- Only state with home rule jurisdictions that threatens to impose sales tax on companies without a physical presence is Louisiana.

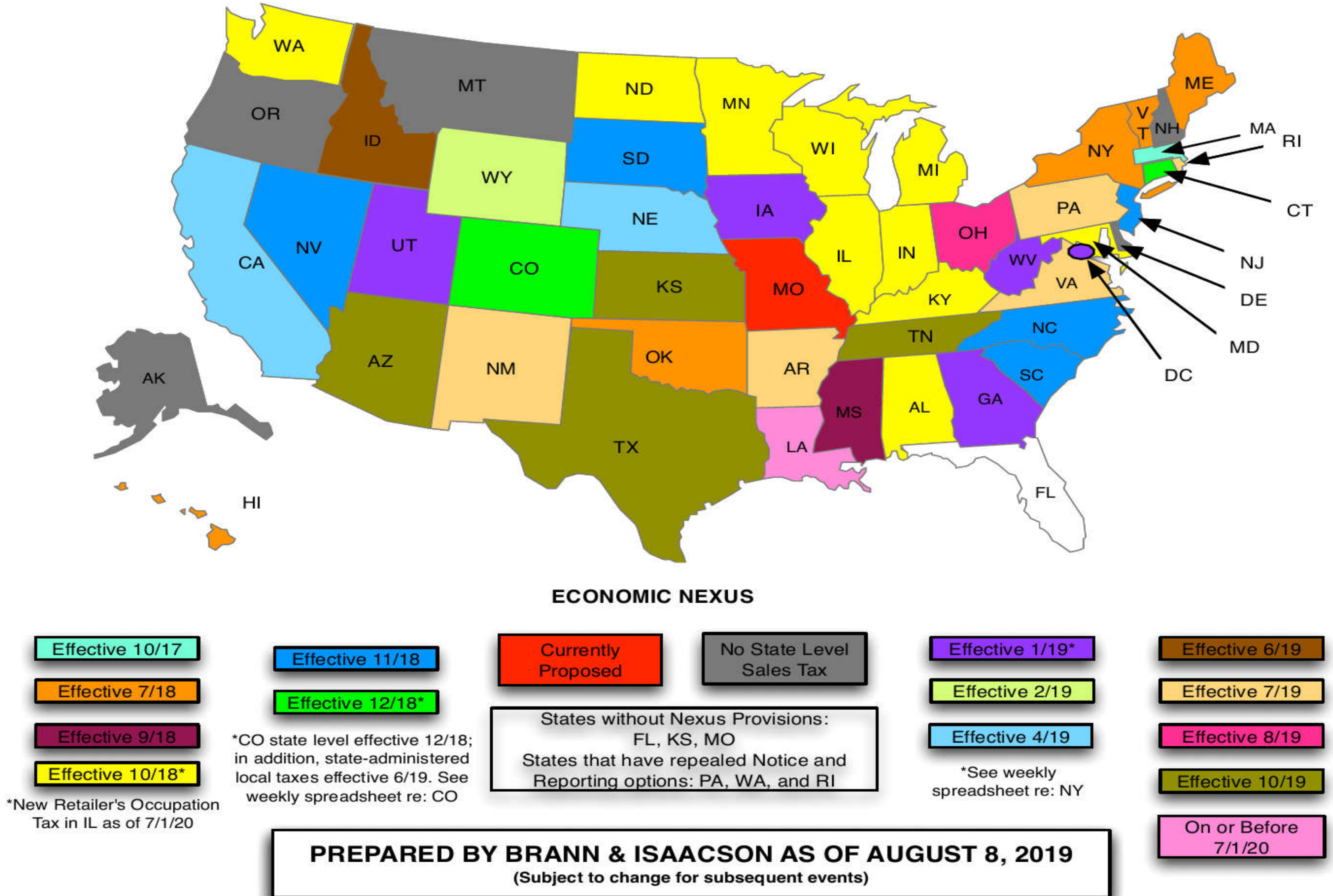
Limitations on a State's Power to Tax

- Constitutional Limitations.
  - Commerce Clause.
    - Economic nexus standard.
    - Discrimination/ Undue Burden.
    - External consistency-fair apportionment prong.
  - Due Process Clause.
- Statutory Limits.

States' Tax On Direct Mail Materials

- State law must provide for nexus for the direct mailer and the printer (*see* accompanying map (next slide)).
  - Nexus for sales tax collection purposes is sufficient for obligation to pay use tax.
- The state taxes the distribution of direct mail materials in the state.

State Tax Statute Must Authorize



Impact of *Wayfair* on a Direct Mailer

- The good news:
  - No state has publicly taken the position that a direct mailer that has nexus for purposes of tax collection on sales to the state is required to pay use taxes on the direct mailer's purchase of promotional materials into the state, *but* . . .

Impact of *Wayfair* on Direct Mailers/Publishers

- The bad news:
  - Contracting with a printer to print and distribute materials is deemed to be the sale/purchase of tangible personal property. *See, e.g., Service Merchandise Co. v. Schwartzberg*, 971 P.2d 654 (Colo. Ct. App. 1997).
  - It is likely not a defense that the *Wayfair* economic nexus laws apply only to tax collection on a company's sales, and not nexus for purposes of paying use tax on its purchases.

Impact of *Wayfair* on Printers

- Printers are sellers of tangible personal property.
- Many large printers have traditionally had a physical presence in the state, so that Wayfair does not change their tax obligations.
  - Prior to *Wayfair*, most printers would accept a "no nexus" letter/certificate from its customers as a basis not to collect sales and use tax of a state.

Determining if the Publisher and Printer Have Nexus

- Compile findings in a matrix on a state by state basis:
  - List company's annual sales (dollars and transactions) for states where direct mail materials are shipped.
  - List any physical presence in the state.
  - Describe *Wayfair* state law.
  - Determine if company has physical presence and/or economic presence in the state and when it occurred.

Develop Action Plan: Printer

- If the printer has nexus in a state, then consider:
  - Silent registration or VDA if previously not registered.
  - Determine the applicability of the exemption:
    - The following states exempt under certain circumstances the distribution of direct mail materials: California, DC, Florida, Illinois, Michigan, Missouri, New York, Ohio, Pennsylvania, Virginia, and Wisconsin.
    - Obtain exemption certificates.

Develop Action Plan: Printer

- If the printer has nexus in a state, then consider:
  - Accepting no nexus letters/certificates from customers.
  - Accepting direct pay permits.
    - SSUTA Exemption Certificate – acts effectively as a direct pay permit for each SSUTA member state. (TN not yet.)
    - Only Hawaii and New Mexico of non-SSUTA states do not issue Direct Pay permits.
    - Some states have minimum purchasing volume thresholds.

Lack Of Nexus Of Mailer: Is Use Tax Due?

- 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.
  - 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.
  - Good faith basis for printer to receive such a certificate.

Develop Action Plan: Publisher

- Provide exemption certificates if the exemption applies.
- Consider whether to insist on no nexus letters where the publisher does not have nexus.
- Consider self assessing and providing direct pay permit.

Additional Questions For the Printer and the Publisher

- Does the printer collect, and does the publisher remit only the state tax rate or does it include the local rate?
- May the printer collect, and does the publisher remit, at a flat rate in certain states?
  - Alabama Simplified Sellers Use Tax - does not apply to sales by a company with physical presence or to purchases by a remote retailer.
  - Texas-single rate of 8%, limited as in Alabama.
- Terms of Sale—See TN and MO cases.
- Itemize charges to minimize sales/use tax.

Other Developments: Sales Tax Due

- In *Check Printers, Inc. v. David Gerregano*, No. M2018-01030-COA-R3-CV (Tenn. Ct. App. May 8, 2019), the court upheld sales tax assessment on materials printed in TN but shipped to other states, because title transferred in TN.
  - Similar result in *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).

Valpak of Omaha LLC v. Dept. of Revenue (Neb. Supreme Ct. Mar. 27, 2015)

- A seller of cooperative direct mail advertising is subject to use tax on payments made to a printer of advertising materials.
  - Valpak of 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.
  - 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.)

- <u>Backstory</u>: 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.)

- 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

- 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.)

- The Tax Commissioner found each of the services to be exempt.
  - 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.
  - Better reasoning would have found that they were services and not TPP.

Remember The Devil Is In The Details

- Electronic communications: SC 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 complied 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.
  - Department sustained the tax despite a letter from the printer attesting that the price included non-taxable postage and even taxes.

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EXAMPLES OF SPECIFIC STATE LAWS AND TAX POLICIES

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 or by contract carrier. TSB-A-13(16)S; TB-ST-692 (2014); *In the matter of Supermedia LLC*, Div. Tax App. No. 826264 (Sept. 20, 2018).

- Element 3: Without charge to the purchaser's customers.
  - Membership fee that includes rights to materials is a charge. TSB-A-13(16)S.
- Note: Purchaser must use NYDTF Form ST-121.2.

Examples Of Specific State Laws: New York Information Services

- NY Tax Law §§ 1105(c)(1) and (c)(9) tax information services, on both 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 <u>excluding</u>:
    - 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).

Examples Of Specific State Laws: Florida

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

- Department strictly construes the exemption, but honors it when all conditions are met. *See* FL DOR Tech. Assist. Adv. 18A-015 (Aug. 31, 2018).

Examples Of Specific State Laws: Florida (cont.)

- 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); FL DOR Tech. Assist. Adv. 18A-015.

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: 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 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 <u>to prospective customers</u> for ordering, but also arguably because of function of catalogs.

Recent State Decisions

- Need to be certain to satisfy all elements of an exemption.
  - *Wegman's Food Markets, Inc. v. Tax Appeals Tribunal*, 2019 WL 2618068 (N.Y. June 27, 2019) (reports created from public data were not sufficiently personalized for exclusions from information services tax).
  - *In the matter of Supermedia LLC*, NY Div. Tax Appeals No. 826264 (Sept. 20, 2018) (taxpayer fails to show delivery via common carrier).
  - *Spencer Gifts, LLC v. Director, Div. of Taxation*, 2018 WL 4275487 (Sept. 6, 2018) (taxpayer fails to prove of out-of-state delivery).
  - *But see* Florida DOR Tech. Assist. Adv. No 18A-015 (Aug. 31, 2018) (all elements of promotional materials exemption met).
- Separately stating charges will not always avoid tax on components.
  - Kansas DOR Private Letter Ruling O-2015-002 (Dec. 21, 2015) (law prohibits breaking direct mail transaction into series of taxable and non-taxable steps).

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TAXABILITY OF POSTAGE, SHIPPING AND OTHER MAILING SERVICES

Assuming Nexus and Taxability of Direct Mail Materials

- What is the taxable measure?
  - Some of the components of the services provided by a printer are taxable.
  - Some of the services that may be provided by a printer are non-taxable services.
- Turns on whether the invoice from the printer provides one charge or itemizes the services provided.

Bundled Charges

- "One bad apple spoils the bunch" in most cases and states.
  - A price for a bundle of separate products and services in which one product is taxable and another product/service is not taxable means that the entire charge is taxable.
    - NY cheeseboard rule. *N.Y. Comp. Codes R & Regs. Tit. 20, section 527.1(B).*
  - De minimis rule:
    - SSUTA: Less than 10% of the provider's cost or price.
    - TX: Less than 5%.

Itemizing Charges On The Invoice

- Cardinal Principle: Separately price and invoice separate charges for different services/products.
- Separate pricing of products/services has limits:
  - If service is auxiliary or related to main product that is taxable then the auxiliary service may be deemed taxable.
    1. E.g. shipping and handling.
    2. TX rule regarding related services (information services):
       a. *34TAC3.330(e)(3)* (Charges for services/expenses related to and incurred while providing the taxable service are taxable and may not be separated from taxable charges. Examples would be charges for meals, telephone calls.)
       b. *34TAC3.330(e)(1)* provides that a service is unrelated if it is commonly sold on a stand alone basis and is a distinct service from the information service.

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	Taxable, except for postage
Hawaii	Taxable
Idaho	Excluded if charges are separately stated
Illinois	Excluded if charges are separately stated
Indiana	Taxable, except for postage

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

Taxability Of Other Cost Components

- Preliminary Materials: Photographs, Design, 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.
  - Who prepares the materials?
- Manufacturing Charges: Printing, Binding, Collating.
  - Generally taxable.

Taxability Of Other Cost Components

- Mailing Services:
  - Collating; sorting; metering; addressing.
  - Not taxable in several states if separately charged.
- Sale of Names from Mailing List.
  - Not taxable in most states because treated as a service and not the sale of tangible personal property. *See, e.g. Grolier Enterprises, Inc. v. Gruppo*, (Ct. Sup. Ct. 2/28/92).
  - DC: Taxable as sale of an information service. *See* https://otr.cfo.dc.gov/page/taxable-and-non-taxable-services.

Taxability Of Other Cost Components

- Shipping charges for bulk shipment:
  - Example: Loading one PO truck with materials from several customers going to the same geographic area/post office Distribution Center.
    - Should not be taxable because it is a service.
- Data Processing charges:
  - E.g. manipulating and managing data to optimize mailings.
  - Taxable in only a handful of states.