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MEMORANDUM

TO: Mark Micali

FROM: George S. Isaacson

DATE: May 15, 2008

RE: New York Technical Services Bulletin Regarding Affiliate Marketing Legislation

The New York State Department of Taxation and Finance, Office of Tax Policy Analysis, issued on May 8, 2008 a Technical Services Bulletin [TSB-M-08(3)S] regarding the Department's interpretation of the recent and controversial nexus-expanding legislation. The amendment to the New York tax law creates a presumption that remote sellers will be required to collect New York sales/use taxes if they enter into agreements for the referral of potential customers through links on New York-based Web sites. TSB-M-08(3)S is significant because in certain respects it limits the reach and applicability of the new legislation. A copy of the bulletin is attached. Please take special note of item 4 below.

1. Mere Advertising Does Not Give Rise to a Nexus Presumption.

The bulletin provides that:

... a business is not considered a vendor ... merely because the business stores advertising on a server or other computer equipment located in New York State, or has advertising disseminated or displayed on the Internet. [page 1]

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2. Pay-Per-Click Compensation Arrangements Will Not Create a Nexus Presumption.

The bulletin refers to the situation where an Internet retailer pays “a set fee based only on the number of clicks on the link to [the Internet retailer’s] Web site, whether or not sales are made.” In that situation, the bulletin concludes that the Internet retailer:

... is merely ... plac[ing] advertising on the organizations’ Web sites. Therefore, [the Internet retailer] is not presumed to be a vendor making taxable sales in New York State Therefore, the [Internet retailer] is not required to register for sales tax purposes. [page 4]

3. Agreements With Non-Resident Affiliate Marketing Network Providers Will Be Covered By The New Law If Those Companies, In Turn, Provide Links With New York Web Sites.

The bulletin provides that the presumption of nexus will arise not only when there is a direct contractual relationship with a New York resident, but

... a seller is also considered to have met the condition of having an agreement with a New York State resident where the seller enters into an agreement with a third party under which the third party, in turn, enters into an agreement with the New York resident to act as the seller’s representative. [page 2]

4. Rebutting the Nexus Presumption

The most significant provision in TSB-M-08(3)S is that a remote seller can rebut the presumption that a New York-based Web site link creates nexus, if the retailer can prove that there is no additional solicitation activity:

... the Tax Department will deem the presumption rebutted where the seller is able to establish that the only activity of its resident representatives in New York State on behalf of the seller is a link provided on the representatives’ Web sites to the seller’s Web site and none of the resident representatives engage in any solicitation activity in the state targeted at potential New York State customers on behalf of the seller. [page 4]

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In other words, unless there is some additional solicitation activity that occurs in New York by the New York Web site owner, then the link on the New York Web site alone will not be considered sufficient to create nexus. The Technical Services Bulletin presents two examples (with different outcomes) showing how this *something more* element is necessary to create nexus. First, if the New York Web site owner distributes “flyers” in New York State that promote the presence of links on its Web site to the out-of-state retailer, then the presumption of nexus will not have been rebutted, and the out-of-state retailer must register for sales/use tax collection. In the other example, however, where the link on the New York Web site is not promoted “through the use of flyers, newsletters, telephone calls or e-mails,” then the presumption of nexus created by the presence of a New York Web site link can be successfully rebutted, and no sales/use tax registration and collection is required.

This more conservative position taken by the Department of Taxation and Finance is of critical importance to direct marketers. It means that if retailers are vigilant in monitoring their affiliate marketing relationships to be certain that, other than the New York Web site link, no additional in-state solicitation activity occurs on the part of the New York affiliate, then the mere Web site link relationship should not create nexus.