American Catalog Mailers Assn. v Department of Taxation & Fin.

2025 NY Slip Op 31588(U)

April 25, 2025

Supreme Court, Albany County

Docket Number: Index No. 903320-24

Judge: James H. Ferreira

STATE OF NEW YORK
SUPREME COURT COUNTY OF ALBANY

AMERCIAN CATALOG MAILERS ASSOCIATION,

Plaintiff,

-against-

DEPARTMENT OF TAXATION AND FINANCE, and AMANDA HILLER in her capacity as the ACTING COMMISSIONER OF TAXATION AND FINANCE,

Defendants.

DECISION AND ORDER
Index No.: 903320-24

(Supreme Court, Albany County Motion Term)

APPEARANCES: Brann & Isaacson
Martin I. Eisenstein, Esq.
Attorneys for plaintiff
113 Lisbon Street, P.O. Box 3070
Lewiston, Maine 04243-3070

Rivkin Radler LLP
David Gise, Esq.
Local Counsel for Plaintiff
66 South Pearl Street, 11th Floor
Albany, New York 12207

Letitia James, Attorney General of the State of New York
Ryan W. Hickey, Esq., Assistant Attorney General
Attorneys for Defendants
NYS Office of the Attorney General
The Capitol
Albany, New York 12224

HON. JAMES H. FERREIRA, Acting Justice:

Plaintiff American Catalog Mailers Association[1] commenced this action in April 2024

[1] Plaintiff "has members large and small located across the country, including merchant members that sell merchandise to customers in all 50 states through catalogs, by telephone, and/or over the internet. Some [ ] members currently have no property or payroll in New York and conduct no business activities within the physical boundaries

against Defendants Department of Taxation and Finance (DOTF) and Amanda Hiller, in her capacity as Acting Commissioner of Taxation and Finance, seeking a declaration pursuant to CPLR 3001 that certain regulations promulgated by defendants (see 20 NYCRR 1-2.10) are invalid as they conflict with and are preempted by the Interstate Income Tax Act of 1959, codified as 15 USC 381-384, commonly referred to as Public Law 86-272 (PL 86-272).[2] Specifically, plaintiff claims, among other things, that the "Internet Activities Rule" (NYSCEF No. 2, ¶36), set forth in 20 NYCRR 1-2.10, impermissibly and in violation of the Supremacy Clause of the United States Constitution, rewrites and expands the State's right to impose income taxes on sellers that do not engage in business activities in New York, despite the Federal limitations provided under PL 86-272.[3] Plaintiff now moves, pursuant to CPLR 3212, for summary judgment on its complaint. Defendants cross-move, pursuant to CPLR 3212, for summary judgment dismissing the complaint.

SUMMARY JUDGMENT STANDARD

The grant of summary judgment pursuant to CPLR 3212 is a drastic remedy which should only be granted where there are no doubts as to the existence of a triable issue of fact (see Rotuba Extruders v Ceppos, 46 NY2d 223, 231 [1978]; Andre v Pomeroy, 35 NY2d 361, 364 [1974]; Black v Kohl's Dept. Stores, Inc., 80 AD3d 958, 959 [3d Dept 2011]). "[T]he proponent of a summary judgment motion must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact" (Alvarez v

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of New York" (NYSCEF No. 2, ¶2).

[2] Because the challenged regulations were promulgated specifically in response to and reference PL 86-272, this Court will refer to 15 USC 381 et seq as both PL 86-272, and by its codification as part of the USC.

[3] Plaintiff asserts two causes of action, the first seeking a declaratory judgment determining that the challenged regulations are invalid, and the second seeking a declaration that retroactive application of the challenged regulations results in a violation of the due process clauses of the Fourteenth Amendment of the United States Constitution and Article I, Section 6 of the New York Constitution.

Prospect Hosp., 68 NY2d 320, 324 [1986]; see Smalls v AJI Indus., Inc., 10 NY3d 733, 735 [2008]; Baird v Gormley, 116 AD3d 1121, 1122 [3d Dept 2014]). If the proponent's burden is met, "the burden shifts to the party opposing the motion for summary judgment to produce evidentiary proof in admissible form sufficient to establish the existence of material issues of fact which require a trial of the action" (Alvarez v Prospect Hosp., 68 NY2d at 324; see Town of Kirkwood v Ritter, 80 AD3d 944, 945-946 [3d Dept 2011]). In considering a summary judgment motion, the Court "must view the evidence in a light most favorable to the nonmoving party and accord that party the benefit of every reasonable inference from the record proof, without making any credibility determinations" (Black v Kohl's Dept. Stores, Inc., 80 AD3d at 959; see Winne v Town of Duanesburg, 86 AD3d 779, 780-781 [3d Dept 2011]).

INTERSTATE INCOME TAX ACT OF 1959, CODIFIED AS 15 USC 381-384, AND COMMONLY REFERRED TO AS PUBLIC LAW 86-272 (PL 86-272)

15 USC 381, commonly referred to as PL 86-272, provides, in pertinent part that

"**(a) Minimum standards**

No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders

described in paragraph (1)"

(15 USC 381[a]).

PL 86–272 "prohibits a State from taxing the income of a corporation whose only business activities within the State consist of 'solicitation of orders' for tangible goods, provided that the orders are sent outside the State for approval and the goods are delivered from out of state" (Wisconsin Dept of Revenue v William Wrigley, Jr., Co., 505 US 214, 216 [1992], quoting PL 86-272).

20 NYCRR 1.2-10

In response to the Legislature's amendments to New York's corporate tax laws effective January 1, 2015, defendants adopted amendments to Chapter I of Title 20 of the Official Compilation of Codes, Rules and Regulations of the State of New York (NYCRR). The record reflects that, in April 2022, defendants published draft regulations that included the Internet Activities Rule, which provided that "these draft regulations are not yet final and should not be relied upon" (NYSCEF No. 2, ¶ 61, No. 13, ¶61). The final regulations were published in December 2023.

As is applicable to this action, 20 NYCRR 1.2-10, entitled "Foreign corporations – Public Law 86-272," was added. That section provided that "a foreign corporation is exempt from the tax imposed by article 9-A [of the Tax Law] if its activities are limited to those described in [PL-86-272]. Thus, to be exempt under Public Law 86-272, the activities of the corporation in New York State must be limited to one or more of the following:

> (1) the solicitation of orders by employees or representatives in New York State for sales of tangible personal property, if the orders are sent outside New York State for approval or rejection and, if approved, are filled by shipment or delivery from a point outside New York State;
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> (2) the solicitation of orders for sales of tangible personal property by employees or representatives in New York State in the name of or for the benefit of a prospective customer of such corporation, if the customer's orders to the corporation are sent outside New York State for approval or rejection and, if approved, are filled by

shipment or delivery from a point outside New York State; and

(3) the solicitation of orders via the Internet in New York State for sales of tangible personal property, if the orders are sent outside New York State for approval or rejection and, if approved, are filled by shipment or delivery from a point outside New York State.

(20 NYCRR 1.2-10 [a]).[4]

In New York State,

"[f]or purposes of exemption, a corporation will not be considered to have engaged in taxable activities in New York State during the taxable year merely by reason of sales in New York State or the solicitation of orders for sales in New York State, of tangible personal property on behalf of the corporation by one or more independent contractors. A corporation will not be considered to have engaged in taxable activities in New York State by reason of maintaining an office in New York State by one or more independent contractors whose activities on behalf of the corporation in New York State consist solely of making sales, or soliciting orders for sales, of tangible personal property"

(20 NYCRR 1.2-10 [b]).

Furthermore, pursuant to 20 NYCRR 1-2.10 (d), (e), and (f),

"[i]n order to be exempt by virtue of Public Law 86-272, the activities in New York State of employees or representatives, *or activities engaged in via the Internet*, must be limited to the solicitation of orders for the sale of tangible personal property. The solicitation of orders includes offering tangible personal property for sale or pursuing offers for the purchase of tangible personal property and those ancillary activities, other than maintaining an office, that serve no independent business function apart from their connection to the solicitation of orders. Examples of activities performed by such employees or representatives in New York State, or that are engaged in via the Internet, that are entirely ancillary to the solicitation of orders include:

(1) the use of free samples and other promotional materials in connection with the solicitation of orders;

(2) passing product inquiries and complaints to the corporation's home office;

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[4] The regulations were revised in response to the Supreme Court Decision in South Dakota v Wayfair, Inc., (585 US 162 [2018]), which held that in order to establish a seller's "substantial nexus" so as to impose taxes on the seller, as is required by the Commerce Clause of the United States Constitution, an out-of-state seller's physical presence in a taxing state is not necessary. Rather, substantial nexus can be established through economic and virtual contacts, and "a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term" (id., at 163, 181, and 188).

(3) using autos furnished by the corporation;

(4) advising customers on the display of the corporation's products and furnishing and setting up display racks;

(5) recruitment, training and evaluation of sales representatives;

(6) use of hotels and homes for sales-related meetings;

(7) intervention in credit disputes;

(8) use of space at the salesperson's home solely for the salesperson's convenience. (However, see subdivision (g) of this section as to loss of immunity for maintaining an office.);

(9) participating in a trade show or shows, provided that participation is for not more than 14 days, or part thereof, in the aggregate during the corporation's taxable year for Federal income tax purposes. (However, see subdivision (g) of this section as to loss of immunity for maintaining an office.)"

(e) The exemption under the provisions of Public Law 86-272 is limited to the solicitation of orders for the sale of tangible personal property and does not include the solicitation of orders for the sale of services or intangible property.

(f) Activities in New York State beyond the solicitation of orders will subject a corporation to tax in New York State unless such activities are de minimis. Activities will not be considered de minimis if such activities establish a nontrivial additional connection with New York State. Solicitation activities do not include those activities that the corporation would have reason to engage in apart from the solicitation of orders, but chooses to allocate to its New York State sales force, *or to engage in via the Internet,* including interacting with customers or potential customers through the corporation's website or computer application. However, a corporation will not be made taxable solely by presenting static text or images on its website. In determining whether a corporation's activities exceed the solicitation of orders, all of the corporation's activities in New York State will be considered. Examples of activities that go beyond the solicitation of orders include:

(1) making repairs to or installing the corporation's products;

(2) making credit investigations;

(3) collecting delinquent accounts;

(4) taking inventory of the corporation's products for customers or prospective customers;

(5) replacing the corporation's stale or damaged products;

(6) giving technical advice on the use of the corporation's products after the products have been delivered to the customer"

(20 NYCRR 1-2.10[d-f][emphasis added]).

20 NYCRR 1-2.10 (i) provides the following examples of certain internet activity that may subject the foreign corporation to taxation, together with examples of activity that is considered de minimis, and, therefore, exempt:

"Example 6: A foreign corporation solicits sales of tangible personal property on its website and provides assistance to customers by posting a list of static frequently asked questions ("FAQs") and answers on the corporation's website. Since this activity is de minimis under this section, the corporation is exempt from tax under article 9-A.

Example 7: A foreign corporation regularly provides assistance to its customers after its products have been delivered, either by email or electronic "chat" that customers initiate by clicking on an icon on the corporation's website. For example, the corporation regularly advises customers on how to use products after the products have been delivered. Since this activity does not constitute, and is not entirely ancillary to, the solicitation of orders for sales of tangible personal property, the corporation is not exempt from tax under this section.

Example 8: A foreign corporation solicits and receives online applications for its branded credit card via the corporation's website. The issued cards will generate interest income and fees for the corporation. Since this activity does not constitute, and is not entirely ancillary to, the solicitation of orders for sales of tangible personal property, the corporation is not exempt from tax under this section.

Example 9: A foreign corporation's website invites viewers in New York State to apply for non-sales positions with the corporation. The website enables viewers to fill out and submit an electronic application, as well as to upload a cover letter and résumé. Since this activity does not constitute, and is not entirely ancillary to, the solicitation of orders for sales of tangible personal property, the corporation is not exempt from tax under this section.

Example 10: A foreign corporation places Internet "cookies" onto the computers or other electronic devices of is customers. These cookies gather customer search

information that will be used to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale. Since this activity does not constitute, and is not entirely ancillary to, the solicitation of orders for sales of tangible personal property, the corporation is not exempt from tax under this section.

Example 11: The same facts as example 10 except that the cookies gather customer information that is used only for purposes entirely ancillary to the solicitation of orders for tangible personal property, such as: to remember items that customers have placed in their shopping cart during a current web session, to store personal information customers have provided to avoid the need for the customers to re-input the information when they return to the corporation's website, and to remind customers what products they have considered during previous sessions. The cookies perform no other function, and these are the only types of cookies delivered by the corporation to the computers or other devices of its customers. Since this activity is entirely ancillary to the solicitation of orders for sales of tangible personal property, the corporation, under the facts of this example, is exempt from tax under this section.

Example 12: A foreign corporation remotely fixes or upgrades products previously purchased by its customers by transmitting code or other electronic instructions to those products via the Internet. Since this does not constitute, and is not entirely ancillary to, the solicitation of orders for sales of tangible personal property, the corporation is not exempt from tax under this section.

Example 13: A foreign corporation offers and sells extended warranty plans through its website to New York State customers who purchase the corporation's products. Since this activity involves selling, or offering to sell, a service that is not entirely ancillary to the solicitation of orders for sales of tangible personal property, the corporation is not exempt from tax under this section.

Example 14: A foreign corporation contracts with a marketplace provider that facilitates the sale of the corporation's products on the provider's online marketplace. The marketplace provider maintains inventory, including some of the corporation's products, at fulfillment centers in New York State. Since this activity involves the maintenance of the corporation's products in New York State, the corporation is not exempt from tax under this section.

Example 15: A foreign corporation that sells tangible personal property via the Internet also contracts with New York State customers to stream videos and music to electronic devices for a fee. Since this activity involves streaming, which does not constitute the sale of tangible personal property, the corporation is not exempt from tax under this section.

Example 16: A foreign corporation offers for sale only items of tangible personal property on its website. The website enables customers to search for items, read product descriptions, select items for purchase, choose among delivery options, and

> pay for the items. The corporation does not engage in any activities in New York State that are not described in this example. Since the corporation engages exclusively in activities in New York State that either constitute solicitation of orders for sales of tangible personal property or are entirely ancillary to solicitation, the corporation is exempt from tax under this section"

(20 NYCRR 1-2.10 [i]).

New York's corporation tax reform, effective January 1, 2015, provides that the reforms apply to "taxable years commencing on or after such date" (L 2014, ch 59, pt A, § 113; https://tinyurl.com/4zdv4ywd, accessed April 22, 2025). In December 2023, defendants published the Internet Activities rule in its final form, which announced that 20 NYCRR 1-2.10 would be applied retroactive to the effective date of the underlying legislation.[5]

Plaintiff's Motion

Plaintiff takes issue with the language in the regulations regarding "activities engaged in via the Internet," contending that the regulations impermissibly exclude its members from the protections of PL 86-272, even if the activities are engaged in outside of New York.

Plaintiff presents, among other things, the affidavit of its Executive Vice President & Managing Director, Paul Miller (see NYSCEF No. 21), who attests that plaintiff is the "voice of the direct and remote marketing industry. It is the only organization advocating specifically for policy and legislation that benefits catalog, online, direct mail, and other remote marketers, as well as their suppliers" (id., at ¶ 4). Mr. Miller states that plaintiff's members are located across the country and include companies with no property or payroll in New York State. According to Mr. Miller, Crutchfield Corporation (CC) and Crutchfield New Media (Crutchfield NM) (collectively

[5]A December 2023 assessment of public comments related to 20 NYCRR 1-2.10, provides that "the department, based on a totality of the circumstances, may choose not to apply penalties in cases where taxpayers took a position in their tax filings prior to adoption of the proposed rule in reliance upon prior article 9-A regulations or prior drafts of the proposed rule" (NYSCEF No. 26, page 21).

Crutchfield) is one such case, and that defendants' implementation of the challenged regulations will impermissibly expand the State's right to collect income taxes from sellers that do not engage in business activities in New York, despite the Federal limitations on state taxation of income derived from interstate commerce provided under PL 86-272.

Plaintiff also presents the affidavit of Nathan Hayes, the General Counsel of Crutchfield, which has been a member of plaintiff since 2013. Mr. Hayes attests that CC is a family owned business, operating since 1974, and Crutchfield NM has managed CC's website since 1995. CC began as a mail-order business specializing in car stereos in 1974, and issued its first catalog in 1975. Since that time, CC has accepted direct written mail and telephone orders from customers. In 1995, CC has accepted direct orders from customers through its website. Crutchfield employees, who design and run the website, are based in the Commonwealth of Virginia.

Mr. Hayes attests that "[f]rom 1995 to 2022, Crutchfield followed a policy of not engaging in any business activities outside of the Commonwealth of Virginia, its state of residence" (NYSCEF No. 22, ¶12). In 2022, Crutchfield expanded its business activities to South Carolina. Mr. Hayes states that Crutchfield has no employees, agents, or offices in the State of New York, and does not employ or contract with persons outside of Virginia or South Carolina.

As for its internet site, Mr. Hayes attests that Crutchfield "uses cookies for various business purposes, which are accurately described in Crutchfield's Privacy Policy, available [on its website - https://tinyurl.com/67xp2je9] and linked in the footer of each page of the Website" (NYSCEF No. 22, ¶ 21). Pursuant to its website, Crutchfield collects from visitors personal identifying information, including any information entered by the consumer on the site, which is described as "information [that] is normally provided when you search, buy, participate in a contest, sweepstakes or on-line survey, or when you communicate with any of our departments such as customer service, sales or

technical services through our Website, telephone, mail or fax" (https://tinyurl.com/67xp2je9, accessed Aril 7, 2025). Crutchfield also collects and stores 'cookies' "which remember information about a visitor from one page to the next and from one visit to the next" (id.), as well a consumer's IP address, login, password, computer and connection information, purchase history, confirmation that an e-mail from Crutchfield has been opened, URLs that led the consumer to Crutchfield's website, and the pages and or products viewed or searched, among other things. Furthermore, "[a]t certain times [Crutchfield] offer[s] financing options with or without third party participation" (id.). "Crutchfield's web pages may contain action tags set by third party firms [ ] for the purpose of collecting anonymous information about the usage of our site," to compile statistics regarding the effectiveness of the site (id.). The website, through the use of third parties, provides services such as "sending e-mail, providing Social Question & Answer functionality, providing click to call telephone calling services, analyzing customer lists and data, providing marketing assistance, or consulting services" (id.). Crutchfield's vendors may also be provided with customer information for product support and, if a customer visits the website via a third-party site, that third-party site may be able to access customer information. Finally, Crutchfield may use a marketing platform to display adds, and run surveys and promotions on its site.

Plaintiff, first, argues that the challenged regulations conflict with PL 86-272 because the Federal statue bars a state from imposing state income tax on an out-of-state company that (1) engages in all of its business activities outside New York, or (2) engages in all of its business activities outside New York except for the solicitation of orders for tangible goods. Plaintiff contends that all out-of-state activities are protected by PL 86-272, and submits that the State may impose income tax only if the out-of-state company engages in in-state, non-solicitation activities. In noting that PL 86-272 does not require that out-of-state businesses limit their out-of-state activities to the solicitation of orders

for the sale of tangible personal property, plaintiff concludes that that the challenged regulations, insofar as they provide that internet activities conducted out-of-state are not exempt from taxation, is contrary to PL 86-272.

Plaintiff also argues that defendant's determination to apply the challenged regulations, promulgated in December 2023, retroactively to 2015, violates plaintiff's members' due process rights. Plaintiff notes a business, that relied on the exemptions set forth in PL 86-272 in organizing its business operations, could be stripped of the statute's protections for the past nine years without notice.

Defendants' Cross-Motion

In support of their cross-motion, defendants present the affirmation of David Markey, Esq., as Associate Attorney in the Office of Counsel at the DOTF, who provides a background on New York State's 2015 tax reform and the amendments to DOTF regulations adopted in 2023 to implement that tax reform (see NYSCEF No. 39). According to Attorney Markey, "the corporation tax regulations include amendments to reflect [ ] changes in the Tax Law; to codify departmental policy; and to update the Tax Law to more accurately reflect transformations in business models since the last time the regulations were updated. The revised regulations provide regulated parties with detailed direction regarding the computation of tax under Article 9-A, pursuant to tax reform" (id., ¶9).

Attorney Markey states that PL 86-272 exempts out-of-state sellers from state taxation if their business activities in New York are limited to solicitation of orders for such tangible personal property that is then shipped into New York. However, according to Attorney Markey, that protection is lost if the seller's activity goes beyond solicitation. The DOTF promulgated 20 NYCRR 1-2.10 to address the scope of PL 86-272 and its exemptions.

In 2018, the United States Supreme Court issued its decision in South Dakota v Wayfair, Inc. (585 US 162 [2018]), which held that with respect to taxation, an out-of-state seller may have a nexus with a state without violating the Commerce Clause, even without having a physical presence in the state. The DOTF interpreted South Dakota v Wayfair, Inc. to mean that a corporation may lose PL 86-272 protection when, except for *de minimus* activity or activity ancillary to solicitation, the internet activity exceeds solicitation. Accordingly, in 2023, the DOTF revised 20 NYCRR 1-2.10 to conform to that interpretation and defined specific internet activities that are deemed *de minimus* or ancillary to solicitation, as well certain internet activities that go beyond solicitation, which would subject a corporation to tax in New York State (see 20 NYCRR 1-2.10 [d], [f]). The DOTF made its 2023 revisions retroactive to 2015, thus providing defendants with the ability to assess back taxes to 2015 - when New York's corporate tax reform became effective. Finally, Attorney Markey affirms that "upon information and belief, although the Department may lawfully seek to assess any tax due back to January 1, 2015, when corporation tax reform became effective, no such action has taken place" (NYSCEF No. 39, ¶ 26).

Based on the forgoing, defendants argue that the challenged regulations, which simply update the rule to account for business activities engaged in via the internet, neither conflict with PL 86-272 nor violate either the Supremacy Clause of the United States Constitution, or Article 1, Section 6 of the New York Constitution, and their retroactive application does not violate plaintiff's right to due process. Accordingly, defendants request summary judgment, pursuant to CPLR 3212, granting them a declaratory judgment that 20 NYCRR 1-2.10 is lawful in all respects.

LAW

The Due Process Clause

The Due Process Clause of the Fourteenth Amendment of the United States Constitution,

prohibits any State from "depriv[ing] any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws" (US Const, amend XIV, § 1). The Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property, or transaction that the state seeks to tax" (Miller Bros. Co. v. Maryland, 347 US 340, 344-345 [1954]; accord South Dakota v Wayfair, Inc., 585 US at 177).[6]

The Commerce Clause

The United States Constitution also grants Congress the power "[t]o regulate Commerce ... among the several States" (US Const, art I, § 8, cl 3). "The Commerce Clause forbids the States to levy taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation" (MeadWestvaco Corp. v Illinois Dept of Revenue, 553 US 16, 24 [2008]). "Although phrased as a grant of regulatory power to Congress, the Commerce Clause has also been interpreted as effecting a negative aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce [], including prohibiting certain state taxation even when Congress has failed to legislate on the subject" (Matter of Walt Disney Co. & Consol. Subsidiaries v Tax Appeals Trib. of the State of N.Y., 42 NY3d 538, 550-551 [2024], cert denied sub nom Walt Disney Co. v New York Tax Appeals Tribunal, __ NY3d__, 2025 WL 247450 [2025], cert denied sub nom International Business Machines Corp. & Combined Affiliates v New York Tax Appeals Tribunal, __ NY3d __, 2025 WL 247453 [2025] [internal quotation marks and citations omitted]). "Indeed, the dormant Commerce Clause precludes states from discriminating between transactions on the basis of some interstate element [ ], meaning that states may not tax a transaction or incident more heavily when it crosses state lines than when it

[6] "The New York State constitution's guarantees of equal protection and due process are virtually coextensive with those of the federal Constitution" (Febres v City of New York, 238 FRD 377, 392 [SDNY 2006]; see Oneida Indian Nation of N.Y. v Madison County, 665 F3d 408, 427 n13 [2d Cir 2011], cert dismissed 572 US 1031 [2014]).

occurs entirely within the State [ ] or impose a tax which. . . provid[es] a direct commercial advantage to local business, or . . . subject[s] interstate commerce to the burden of multiple taxation" (id., at 550-551[internal quotation marks and citations omitted]).

Federal Preemption and the Supremacy Clause

"Federal preemption is based on the U.S. Constitution's Supremacy Clause" (Malerba v New York City Transit Auth., 232 AD3d 91, 96 [1st Dept 2024]). "Article VI, cl [] 2, of the Constitution provides that the laws of the United States 'shall be the supreme Law of the Land; ...[anything] in the Constitution or Laws of any state to the Contrary notwithstanding' "(Altria Group, Inc. v Good, 555 US 70, 76 [2008], quoting US Const, art VI cl 2). "Consistent with that command, [the Supreme Court of the United States has] long recognized that state laws that conflict with federal law are without effect" (id. [internal quotation marks and citation omitted]). "Congress may indicate pre-emptive intent through a statute's express language or through its structure and purpose [ ]. If a federal law contains an express pre-emption clause, it does not immediately end the inquiry because the question of the substance and scope of Congress' displacement of state law still remains. Pre-emptive intent may also be inferred if the scope of the statute indicates that Congress intended federal law to occupy the legislative field, or if there is an actual conflict between state and federal law" (id. at 76-77 [internal citations omitted]; see Jackson-Mau v Walgreen Co., 115 F4th 121, 125 [2d Cir 2024]).

"Three general types of preemption exist: '(1) express preemption, where Congress has expressly preempted local law; (2) field preemption, where Congress has legislated so comprehensively that federal law occupies an entire field of regulation and leaves no room for state law; and (3) conflict preemption, where local law conflicts with federal law such that it is impossible for a party to comply with both or the local law is an obstacle to the achievement of federal objectives'" (Bates v Abbott Labs, 727 F Supp3d 194, 217 [NDNY 2004], quoting New York SMSA

Ltd. Partnership v Town of Clarkstown, 612 F3d 97, 104 [2d Cir 2010]). "Traditionally, there has been a presumption against preemption with respect to areas where states have historically exercised their police powers" (New York SMSA Ltd. Partnership v Town of Clarkstown, 612 F3d at 104; see Wachovia Bank, N.A. v Burke, 414 F3d 305, 314 [2d Cir 2005], cert denied 550 US 913 [2007]["There is typically a presumption against preemption in areas of regulation that are traditionally allocated to states and are of particular local concern."]). In the instant matter, it is clear that the provisions of PL 86-272 only preempt state law to the extent that there is a conflict. Such a conflict exists when "compliance with both federal and state law is a physical impossibility, or where the state law at issue .... stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" (Matter of Quigley v Village of E. Aurora, 193 AD3d 207, 211 [3d Dept 2021], lv denied 37 NY3d 908 [2021]).

Conflict Preemption and PL 86-272

PL 86-272 "prohibits a State from taxing the income of a corporation whose only business activities within the State consist of 'solicitation of orders' for tangible goods, provided that the orders are sent outside the State for approval and the goods are delivered from out of state" (Wisconsin Dept of Revenue v William Wrigley, Jr., Co., 505 US 214, 216 [1992], quoting 15 USC 381 [a][1]). Through PL 86-272, Congress established " 'minimum standards' for [the] imposition of a state net-income tax based on solicitation of interstate sales" (id., at 222; quoting 15 USC 381[a]), and legislated that

> "[n]o State . . . .shall have power to impose . . . .a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
>
> (1) the solicitation of orders .... in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved,

are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders . . . . in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)"

(15 USC 381 [a] [1], [2]).

Neither the sales of tangible personal property in a state, the solicitation of orders in a state, nor the maintenance of an office within a state by independent contractors, whose activities are limited to making sales or soliciting orders for sales, are considered business activities within a state that would subject to income tax (see 15 USC 381 [c]). "The 'rather limited' purpose of Public Law 86–272 was to set a 'lower limit' on state taxation (*Heublein, Inc. v South Carolina Tax Comm'n*, 409 US 275, 279, 280 [1972]), to establish a 'minimum standard' for imposition of a state net-income tax based on solicitation of interstate sales (*Wisconsin Dept of Revenue v William Wrigley, Jr., Co.*, 505 US 214, 222 [1992]). Congressional concern was for small- and medium-sized businesses that might have to file a return in every state where they solicited a sales order" (Matter of Disney Enters., Inc. v Tax Appeals Trib. of State of N.Y., 10 NY3d 392, 404 [2008]).[7]

DISCUSSION

Plaintiff's First Cause of Action seeking declaratory relief that the challenged regulations are invalid.

In this instance and, in noting that the Internet Activities Rule set forth in 20 NYCRR 1-2.10 does not broadly tax any and all internet sales, but rather identifies, for taxation purposes, those

[7] " '[T]his legislation is not broad in its effect. It is very narrow, indeed. It covers only the single and simple area where a corporation does nothing more within a State than solicit orders. . . . This is important to small business. Large corporations can afford the attorneys and the accountants necessary to keep books for the payment of some 34 different State taxes computed on 34 different State taxing provisions. But, small business engaged in interstate commerce who do nothing more, perhaps than solicit orders either by a salesman within a State or even just through the mail, have always thought that they would not be subject to multiple State taxation' " (id., at page 404, quoting 105 Cong Rec 17771 [1959]).

internet activities that establish a substantial nexus between an out-of-state seller and New York, the Court finds that the Internet Activities Rule does not subject out-of-state sellers who engage in more than solicitation within the State, to duplicative or unfair taxation. Rather, 20 NYCRR 1-2.10 treats the internet activities out-of-state sellers similarly and, when those sellers do more than solicit orders, they will be subject to tax collection.

The Court also finds that PL 86-272 does not preempt the State's adoption of the Internet Activities Rule, which was amended in response to the Supreme Court Decision in South Dakota v Wayfair, Inc., (585 US 162 [2018]). South Dakota v Wayfair, Inc. specifically held that a substantial nexus for taxing can be established through, instead of a mere physical presence within the state, a party's economic and virtual contacts. Since PL 86-272 does not prohibit the State from identifying and regulating which internet activities are construed to constitute more than solicitation of orders for taxation purposes, in this evolving virtual world, the challenged regulations do not conflict with the tax exemptions set forth in the Federal law. Finally, the Internet Activities Rule does not impermissibly expand on the exemptions provided for in PL 86-272. Any internet activity that is deemed to be ancillary to solicitation is exempt from taxation. Accordingly, the Court finds that no conflict exists between the PL 86-272 and 20 NYCRR 1-2.10 and that PL 86-272 does not preempt the implementation of the regulations challenged by plaintiff. Thus, defendants are entitled to summary judgment dismissing plaintiff's first cause of action, together with a declaration that the Internet Activities Rule set forth in 20 NYCRR 1-2.10 is not preempted by PL 86-272, and is not violative of either the Supremacy Clause of the United States Constitution or Article 1, Section 6 of the New York Constitution.

Plaintiff's Second Cause of Action challenging the retroactive application of the challenged regulations.

The Court reaches a different conclusion with respect to plaintiff's motion seeking summary judgment on its second cause of action - seeking a declaration that retroactive application of the challenged regulations results in a violation of the due process clauses of the Fourteenth Amendment of the United States Constitution and Article I, Section 6 of the New York Constitution.

" '[F]or centuries our law has harbored a singular distrust of retroactive statutes'" (James Sq. Assoc. LP v Mullen, 21 NY3d 233, 246 [2013], quoting Eastern Enterprises v Apfel, 524 US 498, 547 [1998], Kennedy, J., concurring in part]). "[E]lementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted" (id. [internal quotation marks and citations omitted]). "However, the retroactivity provisions of a tax statute are not necessarily unconstitutional and are generally tolerated and considered valid if for a short period . . . because taxation is 'but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens' " (id., quoting Welch v Henry, 305 US 134, 146 [1938]). "[A] retroactive tax violates due process only if it is 'so harsh and oppressive as to transgress the constitutional limitation' " (Caprio v New York State Dept. of Taxation & Fin., 25 NY3d 744, 752 [2015], quoting Matter of Replan Dev. v Department of Hous. Preserv. & Dev. of City of N.Y., 70 NY2d 451, 455 [1987]). The harsh and oppressive test is akin to the prohibition against arbitrary and irrational legislation, requiring a plaintiff to establish that the retroactive application of a tax is arbitrary and irrational (see Caprio v New York State Dept. of Taxation & Fin., 25 NY3d at 752).

"When assessing the constitutionality of a retroactive tax, the important factors to consider

are (1) the taxpayer's forewarning of a change in the legislation and the reasonableness of reliance on the old law, (2) the length of the retroactive period, and (3) the public purpose for retroactive application[ ].The focus of the three-pronged test is fairness [ ]. Defendants need not prevail on all three factors to establish that retroactivity is rational" (AmerisourceBergen Drug Corp. v New York State Dept. of Health, 227 AD3d 1286, 1292 [3d Dept 2024], appeal dismissed 42 NY3d 1023 [2024] [internal quotation marks and citations omitted]). "[W]hether a retroactive statute comports with due process principles is a question of degree that turns on the length of the retroactivity period, the taxpayer's forewarning of a change in legislation as relevant to reliance interests and the public purpose for retroactive application" (id., at 1291 [internal quotation marks and citations omitted]).

The record reflects that, in April 2022, defendants published draft regulations that included the Internet Activities Rule, which provided that "these draft regulations are not yet final and should not be relied upon" (NYSCEF No. 2, ¶ 61, No. 13, ¶61). The Internet Activities Rule, in its final form, was published in December 2023, and was made retroactive to January 2015. These final regulations provided, for the first time, their retroactive application.

The Court finds that plaintiff was not forewarned of this retroactive application, which exposes it members to New York income tax liability for time periods during which their activities were thought to be exempt from taxation. Plaintiff's members had no opportunity to "alter their behavior in anticipation of the impact of the [retroactive application of the challenged regulations]" (James Sq. Assoc. LP v Mullen, 21 NY3d at 248). And, the length of the retroactive period - nearly nine years – is excessive, since "the period of retroactivity was long enough [ ] so that plaintiffs gained a reasonable expectation that they would secure repose in the existing tax scheme" (id., at page 249; see Matter of Replan Dev. v Department of Hous. Preserv. & Dev. of City of N.Y., 70 NY2d at 456 ["Additionally, the length of the retroactive period often has been a crucial factor, and

excessive periods have been held to unconstitutionally deprive taxpayers of a reasonable expectation that they 'will secure repose from the taxation of transactions which have, in all probability, been long forgotten'" quoting Matter of Neuner v Weyant, 63 AD2d 290, 302 [2d Dept 1978], appeal dismissed 48 NY2d 975 [1979]; see Matter of Lacidem Realty Corp. v Graves, 288 NY 354, 357 [1942], rearg denied 289 NY 675 [1942] [four-year retroactivity period excessive]; People ex rel. Beck v Graves, 280 NY 405, 409-410 [1939] [16-year retroactivity period excessive]). Finally, defendants have failed "to set forth a valid public purpose for the retroactive application of the [challenged regulations]" (James Sq. Assoc. LP v Mullen, 21 NY3d at 249). Indeed, defendants aver that they have not made any attempt to assess any back taxes.

Accordingly, based on the foregoing, plaintiff is entitled to summary judgment on its second cause of action, and declares that the retroactive application of the Internet Activities Rule, as applied to any time period before its December 2023 publication date, violates plaintiff's due process of law.

Accordingly, it is hereby

ORDERED that plaintiff's motion, made pursuant to CPLR 3212, is granted only insofar as the Court grants summary judgment to plaintiff on its second cause of action, and declares that the retroactive application of the Internet Activities Rule (20 NYCRR 1-2.10), as applied to any time period before its December 2023 publication date, violates plaintiff's due process of law, and plaintiff's motion is otherwise denied; and it is further

ORDERED that defendants' cross-motion, made pursuant to CPLR 3212, is granted only insofar as the Court grants summary judgment to defendant dismissing plaintiff's first cause of action, and declares that the Internet Activities Rule (20 NYCRR 1-2.10) is not preempted by PL 86-272, and is not violative of either the Supremacy Clause of the United States Constitution or Article 1, Section 6 of the New York Constitution, and defendants' motion is otherwise denied.

This constitutes the Decision and Order of the Court, which will be uploaded to the New York State Court's Electronic Filing System (NYSCEF). Counsel is advised of 22 NYCRR 202.5-b (h) (2) relating to notice of entry.

SO ORDERED AND ADJUDGED

ENTER.

Dated: Albany, New York
April 25 2025

Hon. James H. Ferreira
Acting Justice of the Supreme Court

Papers Considered:

NYSCEF Documents Numbered 1-56.

04/28/2025