

CATALOG S U C C E S S

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Catalogers' Legal Challenges '07 (and Beyond)

An extensive overview of tax and legal matters you need to know
By George S. Isaacson

Beginning with our January 2008 issue, veteran direct marketing tax attorney George Isaacson will join our distinguished panel of columnists with a periodic column devoted primarily to tax issues affecting catalogers and multichannel marketers. To lay the groundwork for his column, in this issue he offers an overview of key legal issues affecting catalogers and other direct marketers. His columns next year will delve more deeply into the specific issues.

Sales & Use Tax (Nexus)

State revenue departments have stepped up their efforts to require catalog companies and Internet merchants to collect state sales and use taxes. To impose such collection obligations, state tax auditors must be able to prove that a retailer has some form of physical presence in the taxing state — what lawyers refer to as “nexus.”

Increasingly, states are relying upon so-called “agency nexus” theories, claiming that presale promotional programs and after-sale customer services performed by a third party (such as in-state distribution of advertising materials, acceptance of customer returns and performing on-site repairs) are a sufficient connection with the out-of-state seller to establish nexus.

States also are pursuing “clicks and mortar” retailers. These are companies whose common parent corporations have both a retail store subsidiary, which collects sales tax in all states where it has stores, and a catalog/direct marketing subsidiary, which collects sales tax only in its headquarters state.

Auditors have attacked these multicorporation structures, arguing the commonly owned companies are so financially and operationally integrated that the nexus created by the retail stores should apply to the direct marketing entity as well.

Finally, keep an eye on Congress. There's proposed legislation that would require most direct marketers to collect state taxes.

Escheat (Abandoned Property)

The word “escheat” may sound like a new brand of perfume, but it's actually a long since established legal doctrine entitling states to take over property that has been abandoned by its owner. All states have laws requiring holders of unclaimed property to report and pay over money that has remained unclaimed for a specific number of years (usually three to five years, depending on the state and the type of property).

Most catalog/direct marketers hold unclaimed property in the form of unredeemed gift certificates or gift cards; customer overpayments; and un-cashed refund, payroll and vendor accounts-payable checks. Many catalogers aren't compliant with state escheat laws, which generally require that unclaimed property must be paid over to the state of the owner's last-known address as shown on the holder's books and records. And if there's no record of the owner's last-known address, then the property must be paid to the holder's state of incorporation.

States are becoming increasingly aggressive, often hiring private contractors, sometimes referred to as “bounty hunters,” who conduct an audit of a single company on behalf of several states simultaneously. A marketer could find itself on the receiving end of an unclaimed property assessment going back decades, along with accrued interest and penalties for having failed to report and turn over property to the states on a timely basis.

In order to limit their exposure, catalogers/multichannel marketers that haven’t been targeted for audit should consider entering into voluntary disclosure agreements (VDAs). Where available, VDAs usually permit companies to avoid interest and penalties and to limit the number of years they must “look back” in reporting unclaimed property. Generally, however, in order to qualify for a VDA, a company must approach the state before it receives a notice of audit.

S&H Class Action Lawsuits

Here’s one that caught a number of direct marketers by surprise: class action lawsuits regarding shipping and handling (S&H) charges, in which the plaintiffs claim that customers are charged excessive and deceptive fees.

These lawsuits maintain that (1) S&H fees are implicitly represented to the public as simply a direct pass-through of the actual costs of delivering products, and (2) consumers aren’t informed that these surcharges include a hidden profit component.

In addition to the economic ramifications (some companies have agreed to multimillion-dollar settlements), being named as a defendant in a highly publicized, consumer-fraud class action can have a serious, adverse impact on a company’s brand reputation and customer relations.

Cost-justification for delivery charges, based on a documented cost study, is an excellent defense to allegations of a “secret profit center.” In addition, improved disclosure practices are a direct marketer’s best protection against these kinds of class action lawsuits.

Privacy and Security

Because of fragmentary federal regulations and inconsistent state laws, compliance in the area of privacy and security can seem overwhelming to direct marketers. Security violations often are splashed across newspapers, and the impact on customer loyalty can be quick and severe.

Greater uniformity in this area of law is slowly evolving, however. For example, California privacy laws provide a relatively straightforward set of rules regarding the content of privacy policies and the use of opt-out provisions. If a direct marketer follows these standards, it will be well on its way to compliance with most other state privacy laws.

In addition, the federal CAN-SPAM legislation provides uniform standards governing e-mail promotion. This law governs the following:

- * It bans false or misleading e-mail header information (“from” and “to” entries);
- * Prohibits deceptive subject lines;
- * Requires that recipients of commercial e-mail messages have an opt-out method; and
- * Mandates that commercial e-mails be identified as advertisements.

It’s of critical importance that every direct marketer develops a set of CAN-SPAM compliance procedures.

Cybersquatting

Cybersquatting occurs when a person registers an Internet domain name that incorporates a famous trademark and then “squats” on it until an opportunity arises to profit from ownership. Until the late ’90s, it was unclear whether existing U.S. trademark law prohibited this practice.

But in 1999, ICANN, the organization that functions as the de facto governing body of Internet infrastructure, rolled out a contractual method for resolving disputes over ownership of domain names. One of the current requirements for registering a domain name is that the registrant agrees to submit to an alternative dispute resolution process to determine whether it's entitled to maintain a domain name that includes, or plays off, another company's trademark. This process has greatly benefited trademark owners and provides a relatively quick (six to eight weeks) and affordable (\$5,000 or less) means of recovering domain names.

Also that year, Congress enacted the Anti-cybersquatting Consumer Protection Act of 1999, which enables trademark owners to sue in federal court to recover domain names, including the right to bring an action against the domain name itself, even if the registrant is beyond the jurisdictional reach of the federal courts.

Consumer Product Safety

The federal Consumer Product Safety Act requires catalogers and other retailers to report to the Consumer Product Safety Commission (CPSC) any product defect that "could create a substantial product hazard." This regulatory scheme heavily relies on self-reporting with large penalties for failure to do so. Many catalog merchants are unaware of the act's record-keeping requirements, what events trigger a reporting obligation to the CPSC, the extent to which a company can negotiate with the staff of the CPSC the terms of a consumer recall notice, or the possibility of offsetting recall responsibilities onto the manufacturer or supplier.

Establishing a formal and closely monitored compliance program is critical to assuring that your company meets the requirements of the law. In addition, the very existence of a documented compliance program may be helpful in avoiding or reducing penalties in the event of an inadvertent failure to report a substantial product hazard to the CPSC.

International Trademark Protection

In this era of global e-commerce, the opportunities for widespread, low-cost promotion of a valuable brand have never been greater. Ensure your brand has appropriate protection in each of the jurisdictions where it's likely to receive exposure. In many countries, trademark rights are available for the asking, regardless of whether applicants make any actual use of the marks in question.

The result can be perilous for U.S. trademark owners who fail to seek timely registration in foreign countries. They could find themselves infringing the rights of trademark pirates who are clever enough to obtain a prior registration of the same marks. U.S. companies may be forced to repurchase their own trademarks or, even worse, not be able to use their trademarks in overseas markets.

Such a scenario is notably possible in such high-growth economies as China and other Southeast Asian countries. The key to avoiding this dilemma is developing a plan for managing valuable trademarks. Protection should be obtained not only in countries where you're engaged in marketing activities, but also in those countries where you source product. U.S. retailers can take advantage of opportunities for multijurisdictional registrations, such as the Community trade mark, which covers all the nations in the European Union. In addition, the U.S. is now party to a treaty that enables U.S. trademark registrations to be filed simultaneously, for an additional fee, in a number of other jurisdictions.

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