

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF ALBANY

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AMERICAN CATALOG MAILERS	:
ASSOCIATION,	:
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Plaintiff,	:
	:
	:
v.	:
	:
DEPARTMENT OF TAXATION AND FINANCE :	:
and AMANDA HILLER in her capacity as the :	:
ACTING COMMISSIONER OF TAXATION :	:
AND FINANCE,	:
	:
Defendants.	:
	:
-----X	

Index No.:

VERIFIED COMPLAINT

Plaintiff American Catalog Mailers Association (“ACMA”) as and for its complaint for declaratory relief against Defendants Department of Taxation and Finance and Amanda Hiller (“Commissioner”) in her capacity as the Acting Commissioner of Taxation and Finance (collectively, “Defendants” or the “Department”) alleges as follows:

Introduction

1. This is an action by the ACMA, the nation’s leading industry trade association advocating specifically for catalog, online, direct mail, and other remote-selling merchants and their suppliers, seeking an Order declaring that certain regulations promulgated by the Department that purport to interpret and apply the Interstate Income Tax Act of 1959, codified as 15 U.S.C. §§ 381-384, commonly referred to as Public Law 86-272 (“P.L. 86-272”), are invalid and issuing a declaratory judgment. As described in greater detail below, under the guise of interpreting and applying P.L. 86-272, certain portions of the challenged regulations, 20 N.Y.C.R.R. § 1-2.10 (“Section 1-2.10” or the “Rule”), effectively erase longstanding federal protections against overreach by state tax agencies, such as the Department. The ACMA’s merchant members—and

countless other retailers throughout the United States—have relied for over sixty years and continue to rely on the federal statutory protections afforded them by P.L. 86-272. Only Congress, not the Department, has the power to amend or repeal this federal statute. Because the Department’s Rule regarding P.L. 86-272 as applied to “activities engaged in via the Internet” (Internet Activities) directly conflicts with the controlling federal statute, and so is invalid. 20 N.Y.C.R.R. § 1-2.10(d).

Parties

2. The ACMA is a Washington D.C.-based not-for-profit organization, organized under Section 501(c)(6) of the Internal Revenue Code of 1986, with a principal place of business at 1800 Diagonal Road, Suite 600, Alexandria, Virginia, 22314. Founded in 2007, the ACMA 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 ACMA merchant members currently have no property or payroll in New York and conduct no business activities within the physical boundaries of New York. These members will be directly affected by the Rule because it purports to redefine and expand what constitutes business activities in New York for purposes of P.L. 86-272 to include “activities engaged in via the Internet”.

3. The Department is a New York state agency responsible for the administration and enforcement of the New York tax laws, including specifically the Business Corporation Franchise Tax. The Department promulgated the challenged Rule, which was published on or about December 27, 2023.

Jurisdiction and Venue

4. The Court has jurisdiction over this action under C.P.L.R. §§ 301 and 3001. *See Watergate II Apartments v. Buffalo Sewer Auth.*, 46 N.Y.2d 52, 57 (1978); *Matter of Building*

Constrs. Ass'n v. Tully, 65 A.D.2d 199, 201 (3d Dep't 1978); *Matter of City of New York v. Blum*, 98 Misc.2d 373, 378 (Sup. Ct. 1979).

5. Venue is proper in this Court under C.P.L.R. §§ 505 and 506(b)(2).

Standing

6. The ACMA may bring this action on behalf of its affected merchant members pursuant to the standards for associational standing established by the U.S. Supreme Court in *Hunt v. Washington Apple Advertising Commission*, 432 U.S. 333 (1977), and applied by New York courts. *See, e.g., Tax Equity Now NY LLC v. City of New York*, 182 A.D.3d 148, 156 (1st Dep't 2020). ACMA merchant members that have no business presence in New York and conduct no business activities within the physical boundaries of New York are at risk of illegal assessment by the Department on the basis of the legally erroneous Rule. These members would have standing to sue in their own right; their interests, which the ACMA is asserting, are germane to the ACMA's purpose as a trade association; and neither the claims asserted nor the relief requested requires any individual member to participate in the litigation.

Background

Congress Passes Public Law 86-272 In 1959.

7. In 1959, Congress exercised its affirmative authority to regulate interstate commerce to enact P.L. 86-272. This federal statute exempts an out-of-state company from state taxes on net income, so long as the company does not engage in activities within the state beyond the solicitation of orders for sales of tangible personal property, which are approved or rejected out of state and fulfilled by shipment or delivery from a point outside of the state. *See* 15 U.S.C. § 381(a). By defining a clear lower limit for the exercise of a state's power to tax interstate commerce, P.L. 86-272 represents a careful balancing of local and national interests.

8. P.L. 86-272 provides, in relevant part:
- (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, 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 U.S.C. §381(a).

9. Congress has neither repealed nor amended P.L. 86-272 since its passage in 1959.
10. P.L. 86-272 provides crucial predictability for remote retailers, such as the ACMA's merchant members, by clearly defining the lower limit of a state's power to tax. As the U.S. Supreme Court recognized in *Heublein Inc. v. South Carolina Tax Commission*, 409 U.S. 275, 281 (1972), Congress's passage of P.L. 86-272 was an "accommodation of local and national interests," which is "a delicate matter."
11. Striking the balance between local and national interests in the regulation of interstate commerce is a core function of the federal government, committed to Congress through the Commerce Clause of the U.S. Constitution. *See* U.S. Const. art. I, § 8, cl. 3.
12. Some of the U.S. Supreme Court's Commerce Clause jurisprudence concerns the so-called "dormant Commerce Clause," the doctrine that, in addition to being a positive grant of power to Congress, the Commerce Clause itself prohibits state laws that unduly restrict interstate

commerce. Prior to the U.S. Supreme Court's decision in *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018), long-standing precedent under the dormant Commerce Clause had held that states could not compel out-of-state retailers to collect and remit the state's sales tax from customers located in the state, unless the retailer had a physical presence in the state. See, e.g., *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); *National Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753 (1967).

13. The physical presence rule for sales tax collection, articulated in *Quill* and *Bellas Hess* and overruled in *Wayfair*, was a court-made rule grounded in the dormant Commerce Clause and specific to the sales tax context. In the *Wayfair* decision, the Supreme Court announced a change to a constitutional standard it had previously articulated in the absence of controlling federal legislation.

14. Unlike the judge-made rule of *Quill* and *Bellas Hess*, created by the Court in those cases and later changed by the Court in *Wayfair*, P.L. 86-272 is a federal statute, the result of an affirmative exercise by Congress of its positive authority to legislate under the Commerce Clause. Only Congress, not the Supreme Court nor any branch of a state government, can amend a federal statute.

15. Accordingly, as a duly enacted federal law, P.L. 86-272 is binding on the states under the Supremacy Clause of the U.S. Constitution, U.S. Const. art. VI, c. 2.

The Department Promulgates New Tax Regulations In December 2023.

16. On or about December 11, 2023, the Department published notice of the repeal of Parts 1 through 9 of Subchapter A of Chapter I of Title 20 of the Codes, Rules and Regulations of New York, and the addition of new Parts 1 through 9, specifically including Section 1.2-10, over the Commissioner's signature. A true and correct copy is attached as Exhibit A.

17. Upon information and belief, as the Department announced, these new rules were submitted for publication in the December 27, 2023, edition of the State Register.

18. With this publication, the Department posted a summary of the substance of the proposed rule, a true and correct copy of which is attached as Exhibit B.

19. With this publication, the Department posted an assessment of public comment, a true and correct copy of which is attached as Exhibit C.

20. With this publication, the Department posted a regulatory impact statement, a true and correct copy of which is attached as Exhibit D.

The Rule Rewrites P.L. 86-272.

21. Section 1.2-10 of these regulations is entitled, “Foreign corporations—Public Law 86-272.” *See* Ex. A at 24.

22. Section 1.2-10 begins with a general statement of the role of P.L. 86-272 in limiting state tax obligations on non-New York corporations: “Pursuant to Public Law 86-272 (15 U.S.C.A. sections 381-384), a foreign corporation is exempt from the tax imposed by article 9-A if its activities are limited to those described in that law.” Section 1.2-10(a).

23. Section 1.2-10 goes on to correctly identify certain activities protected by P.L. 86-272, including the solicitation of orders by employees or representatives of a foreign corporation in New York State for sales of tangible personal property if the orders are approved and fulfilled outside the state for delivery inside the state. Section 1.2-10(a)(1)-(3).

24. Section 1.2-10 further recognizes that the same solicitation activities performed by New York-based independent contractors are also protected by P.L. 86-272. Section 1.2-10(b)-(c).

25. In subsection (d), the Department states as follows: “In 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.” Section 1.2-10(d) (emphasis added).

26. In this language, the Department identifies two distinct categories of “business activities” covered by the regulation’s interpretation of P.L. 86-272: (a) “the activities in New York state of employees or representatives;” and (b) “activities engaged in via the Internet.” *Id.* The ACMA refers to this second category as “Internet activities.”

27. According to the text of the Rule, a business that engages in Internet activities, regardless where they occur, is not protected by P.L. 86-272 unless those activities are “limited to the solicitation of orders for the sale of tangible personal property.” *Id.*

28. In subsection (f), the Rule states, “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...engage in via the Internet, including interacting with customers or potential customers through the corporation’s website or computer application.” Subsection 1.2-10(f).

29. Subsection (i), provides examples of activities that, according to the Department, are or are not protected by P.L. 86-272. Among those are included the following examples of the Internet activities of a foreign corporation, *i.e.*, a non-New York business, that the Department deems unprotected.

30. Example 7 provides: “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.” Section 1.2-10(i).

31. Example 8 provides: “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.” *Id.*

32. Example 9 provides: “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.” *Id.*

33. Example 10 provides: “A foreign corporation places Internet “cookies” onto the computers or other electronic devices of its 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.” *Id.*

34. Example 12 provides: “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.” *Id.*

35. Example 13 provides: “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.” *Id.*

36. In sum, through its use of the term “Internet activities” and the examples of unprotected Internet activities just recited, Section 1.2-10 effectively rewrites P.L. 86-272 to include within the definition of “business activities within such State,” 35 U.S.C. § 381(a), activities performed by employees or agents located outside New York using computer equipment located outside New York. Under these rules, if a Virginia-based employee of a Virginia retailer using computer equipment in Virginia receives and responds to an email or electronic chat; a credit card application; a job application; or a request for technical assistance, that employee has engaged in a business activity *in New York* without ever leaving their desk in Virginia. It is the validity of these provisions, which the ACMA will refer to as the “Internet Activities Rule,” that the ACMA challenges as in conflict with and violative of federal law.

37. As promulgated by the Department, the Internet Activities Rule effectively rewrites P.L. 86-272. Only Congress, not the Department, is empowered to amend a federal statute in this way.

The Department Ignores The ACMA’s Concerns.

38. In or about April 2022, the Department first proposed the draft regulations that included the initial public draft of the Internet Activities Rule.

39. On October 10, 2023, during the rule-making process, the ACMA submitted comments to the Department challenging the Internet Activities Rule. A true and correct copy of the ACMA's comments is attached as Exhibit E.

40. The ACMA plainly laid out its concerns: "Unless and until a business has its own employees, agents, inventory, or equipment in a state, it is not engaged in business activities within that state just because it receives U.S. mail, long-distance telephone calls, or online communications from that state." *Id.* at 2.

41. The ACMA explicated the text, legislative history, and judicial interpretation of P.L. 86-272, all of which confirm that only Congress, not the Department, can effect the change the Department has sought to implement through the Internet Activities Rule. *Id.* at 2-5.

42. In its published response, the Department acknowledged and rejected the public comments of the ACMA and others. *See* Ex C.

43. In defense of the Internet Activities Rule, the Department conclusorily described its provisions as a "rational interpretation of law," but offered no considered support for this assertion. Ex. C at 3. As authority, the Department cited neither a Congressional action nor a federal judicial interpretation of the statute, but rather "positions taken by the Multistate Tax Commission [(MTC)] and several other states." Ex. C at 3. Unless and until the MTC or the states successfully lobby Congress to amend P.L. 86-272, however, their policy views, whether rational or otherwise, cannot override the Supremacy Clause.

The Department Announces Retroactive Application.

44. The Department has publicly announced that, over the objections of public commenters, it believes it has the authority to apply *all* of these new regulations (adopted in

December 2023), including specifically the Internet Activities Rule, retroactively to *January 1, 2015*. See Ex. C at 19-20.

45. Despite the fact that the tax reform legislation that led to the development of these regulations did not and could not authorize the amendment of a federal statute, itself unchanged since 1959, the Department considers its own redefinition of “business activities within such State” to include the Internet Activities Rule, adopted in December 2023, to have been effective for the nine years prior.

46. The only relief the Department “*may choose*” to offer is “not to apply penalties” to taxpayers who learned for the first time in December 2023 that the Department now may believe they were required to file tax returns as early as 2015, on the basis of a novel re-interpretation of a decades-old federal law unsupported by the text of that law. Ex. C at 20.

47. ACMA members that have relied in good faith on the plain text of P.L. 86-272, not to mention decades of settled law and practice, could suddenly find themselves at risk of audits by the Department stretching back nearly a decade, and ultimately imposing taxes, penalties and interest.

48. The Department’s new enforcement policy regarding P.L. 86-272, articulated in the Internet Activities Rule and accompanying notices, and its stated intention to apply this new policy retroactively, amount to a refusal by the Department to respect federal law, and a violation of the rights of businesses, including ACMA members, to due process.

**First Cause of Action
(Declaratory Judgment)**

49. The ACMA repeats the allegations set forth in paragraphs 1-48 as if fully set forth herein.

50. A party may bring an action to determine the validity of a state agency rule. Further, this Court is empowered to declare the respective rights of parties to one another.

51. The Internet Activities Rule announces a new state-level policy and legal interpretation of an existing federal law that is inconsistent with a federal statute, P.L. 86-272, and the previous policy and practice of the Department.

52. As described in detail above, the Internet Activities Rule characterizes conduct performed by persons outside New York using equipment outside New York as unprotected business activities occurring inside New York in direct contravention of P.L. 86-272 and the U.S. Constitution.

53. A justiciable controversy exists because the Internet Activities Rule directly conflicts with a federal statute, P.L. 86-272, which will harm merchant members of the ACMA. Accordingly the ACMA is entitled to a judgment declaring the Internet Activities Rule invalid under the Supremacy Clause.

54. No adequate remedy exists at law.

**Second Cause of Action
(Declaratory Judgment)**

55. The ACMA repeats the allegations set forth in paragraphs 1-54 as if fully set forth herein.

56. A party may bring an action to determine the validity of a state agency rule. Further, this Court is empowered to declare the respective rights of parties to one another.

57. Section 1 of the Fourteenth Amendment to the United States Constitution and Article I, Section 6 of the New York Constitution prohibit the Department and the State of New York from depriving any person of property without due process of law.

58. The Internet Activities Rule announces a new state-level policy and legal interpretation of an existing federal law, P.L. 86-272, that is inconsistent with both the federal statute and the previous policy and practice of the Department.

59. The MTC did not issue the policy statement on which the Department based the Internet Activities Rule until August 2021, over six-and-one-half years after January 1, 2015.

60. The Department did not publish its draft regulations until April 2022, over seven years after January 1, 2015.

61. Each iteration of the draft regulations was published with a public notice that “these draft regulations are not yet final and should not be relied upon.”

62. The Internet Activities Rule in its final form was not published until December 2023, nearly nine years after January 1, 2015.

63. In sum, until December 2023, the Department provided no notice to potentially affected parties, including ACMA’s potentially affected merchant members, that they would be deemed to have been bound by the provisions of the newly announced Internet Activities Rule in all tax periods dating back to January 1, 2015.

64. As a result, a justiciable controversy exists as to the application of the interpretation contained in the Internet Activities Rule to any time periods prior to its actual publication would deprive businesses, including ACMA merchant members who engaged in no activities within the physical boundaries of New York, of their right to due process of law.

65. To the extent the Internet Activities Rule is not declared invalid in whole or in part under count one of the ACMA’s complaint, the Court should declare that the Internet Activities Rule is invalid to the extent the Department seeks to apply it to any time period prior to its date of publication.

66. No adequate remedy exists at law.

WHEREFORE, the ACMA respectfully requests the following relief:

A. With respect to the First Cause of Action, entry of a judgment declaring that the Internet Activities Rule is invalid because it conflicts with P.L. 86-272 as applied to remote retailers with no property or payroll in New York and other affected businesses;

B. In the alternative, with respect to the Second Cause of Action, entry of a judgment declaring that the Internet Activities Rule as applied to any time period before its publication date violates the rights of such remote retailers and other taxpayers to due process of law;

C. An award of the ACMA's attorney fees, costs, and expenses to the extent authorized by law; and

D. Such other and further relief as the Court deems just and proper.

Dated: April 5, 2024

Respectfully submitted,

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Attorneys for Plaintiff

Attorney Certification

To the best of my knowledge, information and belief, formed after an inquiry reasonable under the circumstances, the presentation and filing of the papers herein are not frivolous, as defined in subsection (c) of section 130-1.1 of NYCRR.

Dated: Albany, New York
April 5, 2024

David Gise

David Gise

VERIFICATION

STATE OF NEW YORK)
) ss.:
COUNTY OF NASSAU)

David Gise, Esq., an attorney admitted to practice in the Courts of the State of New York, affirms that the following statements are true under penalties of perjury:

Deponent is the attorney of record for the American Catalog Mailers Association, the Plaintiff in the within action. Deponent has read the foregoing Verified Complaint, knows the contents thereof, and that the same is true to deponent’s own knowledge, except as to the matters therein stated to be alleged upon information and belief, and that those matters deponent believes it to be true.

This verification is made by deponent and not by the Plaintiff because Plaintiff does not maintain its place of business in the County wherein your deponent maintains an office.

The grounds of deponent’s belief as to all matters not stated upon deponent’s knowledge are based upon deponent’s general investigation into the facts of this case.

Dated: Uniondale, New York
April 5, 2024

David Gise
David Gise