



State & Local Tax Advisory ■

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Cookies Crumble in Massachusetts

The Massachusetts Supreme Judicial Court (SJC) unanimously affirmed a decision by the Appellate Tax Board and rejected the Department of Revenue's pre-*Wayfair* "cookie nexus" regulation. The SJC refused to retroactively apply *Wayfair*, relying on representations made by the commonwealth and other states in amici briefing in *Wayfair* that they would not "upset settled expectations" by imposing a use tax collection for periods before *Wayfair* on vendors lacking an in-state physical presence. The court also ruled that using virtual connections, such as cookies, "does not constitute physical presence."

U.S. Auto Parts Network Inc. v. Commissioner of Revenue involved a California retailer that sold after-market automobile parts via the internet, mobile applications, and catalogs. The company lacked any physical presence in Massachusetts, but its websites were hosted on third-party servers, some of which were located in the commonwealth, and it used cookies (data received on a user's hard drive when a website is accessed) that resided on customers' hard drives in Massachusetts.

This is not the first time the commonwealth has jumped the gun in trying to impose use tax collection obligations on remote vendors. In 1988, the legislature revised the sales and use tax imposition provision, but the department issued Technical Information Release 88-13 stating that the expanded imposition provision that covered remote vendors would not be enforced until federal statutory or case law was changed to allow a state to impose a collection requirement on out-of-state remote vendors. TIR 88-13 was revoked after *Quill* was decided, and the department again assured the public in TIR 96-8 that it would only enforce the 1988 amendment "to the extent allowed under constitutional limitations." Despite its assurances, the department adopted Revenue Directive 17-1, which was revoked after being the subject of challenges. The department then opted to promulgate the "cookie nexus" regulation, 830 CMR § 64H.1.7. The regulation provided that remote vendors with sales volume exceeding \$500,000 in 100 or more transactions "invariably" had in-state physical presence from the use of vendors' apps, cookies, and content delivery networks (CDNs).

In holding that *Wayfair* could not be applied to retroactively validate the cookie nexus regulation, in addition to the commonwealth's assurances to the U.S. Supreme Court that it would not retroactively apply a change to physical presence jurisprudence, the SJC considered the fact that in *Wayfair* the U.S. Supreme Court favorably commented on the South Dakota statute's prospective application and that the regulation itself "cabined its enforcement to the parameters of *Quill*." Finally, the SJC concluded that apps, cookies, and CDNs do not establish

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a physical presence to satisfy the *Quill* standard, relying on both *Quill*, which found that substantial nexus was not triggered even though customers were using the vendor's software, and *Wayfair*'s suggestion that any "physical aspects" of technologies such as the use of apps, cookies, and CDNs would not satisfy the *Quill* standard."

Takeaways

The SJC's decision got it right, and we hope that Massachusetts will not further burden U.S. Auto Parts Network and other similarly situated vendors by requesting U.S. Supreme Court review. With *Wayfair* and the elimination of the physical presence requirement for substantial nexus, states obtained a substantial victory, and seeking its retroactive application is punitive and unwarranted since the burden for retroactive collection will mean in most states and for most vendors that the vendors become taxpayers and not just tax collectors since they will be unable to collect the tax from customers. Although the SJC noted that it did not need to reach the issue of whether the regulation raised a potential due process violation, it nonetheless suggested that the regulation might well transgress due process protections.

Online retailers that complied with the cookie nexus regulation may have a refund opportunity and should review their pre-*Wayfair* tax filings in Massachusetts.

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