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## Department of Revenue

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### Legal - Public Hearing, August 24, 2017

#### THE COMMONWEALTH OF MASSACHUSETTS DEPARTMENT OF REVENUE

##### NOTICE OF PUBLIC HEARING

Pursuant to the provisions of General Laws Chapter 14, Section 6(1), Chapter 30A, Section 2, and Chapter 62C, Section 3, the Commissioner will hold a public hearing on the following proposed regulation:

##### **830 CMR 64H.1.7: Vendors Making Internet Sales**

##### Scheduled Hearing Date:

Thursday, August 24, 2017 at 10:00 a.m.  
 100 Cambridge Street, 2<sup>nd</sup> Floor, Room C  
 Boston, Massachusetts 02114

##### Subject Matter:

830 CMR 64H.1.7 explains how the general sales and use tax jurisdictional standard set forth in General Laws Chapter 64H and 64I applies to vendors making Internet sales, taking into consideration the relevant provisions of the U.S. Constitution and federal law. The proposed regulation includes an explanation of the circumstances under which certain Internet vendors with a principal place of business located outside the state are required to register, collect and remit Massachusetts sales or use tax as set forth in General Laws Chapter 64H and 64I.

A vendor that is engaged in making taxable sales in the commonwealth or that sells taxable tangible personal property or services or a combination of both for use in the commonwealth is subject to a sales or use tax collection duty when it is "engaged in business in the commonwealth" within the meaning of M.G.L. c. 64H, § 1 and it meets the constitutional requirements as discussed in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). The provisions of M.G.L. c. 64H, § 1 are to be "enforced to the extent allowed under [the] constitutional limits."

The provisions of the proposed regulation are substantially based on the analysis detailed in DOR Directive 17-1, which was rescinded in anticipation of this proposed regulation. See DOR Directive 17-2. That analysis included the following explanation of some of the contacts Internet vendors invariably have that satisfy the "physical presence" dormant Commerce Clause standard as set forth in *Quill* (note that footnotes relied upon for the analysis in the Directive have been omitted here):

##### (1) In-state software and "cookies"

Large Internet vendors almost invariably own software that is downloaded and used by in-state customers on their computers and communications devices ("in-state software") that functions to facilitate or enhance the vendor's in-state sales. This software may be affirmatively downloaded, as in the case of "native" or "mobile" apps, or may be downloaded as the result of the user's general exploration of the vendor's website, as in the case of "browser" or "web" apps. Among other things, Internet vendors use "apps" to implement web-based shopping carts, to permit customers to compare products and evaluate product reviews, and to track their customers' preferences and locations.

Software is generally considered to be tangible personal property. Specifically, software is generally considered to be tangible personal property under this term's common law definition and under the sales tax law of most states, including Massachusetts. As noted by one state supreme court, "When stored on magnetic tape, disc, or computer chip, this software, or set of instructions, is physically manifested in machine readable form by arranging electrons, by use of an electric current, to create either a magnetized or unmagnetized space." *South Cent. Bell Tel. Co. v. Barthelemy*, 643 So. 1240, 1246 (La. 1994). Software "is not merely knowledge, but rather is knowledge recorded on physical form which has physical existence, takes up space on the tape, disc, or hard drive, makes physical things happen and can be perceived by the senses." *Id.*

Further, the ownership of in-state software by large Internet vendors would apparently constitute an in-state physical presence within the meaning of *Quill*. *Quill* recognized that "title to a few floppy diskettes present in a State might constitute some minimal nexus" but concluded that "the existence in [a state] of a few floppy diskettes to which [the vendor] holds title" does not result in nexus because it would represent a mere de minimis or "slightest presence." See 504 U.S. at 315 n.8. In contrast, large Internet vendors own software that exists on the computers or other devices of all or substantially all of their in-state customers – software that is instrumental in the creation of the vendor's in-state sales. A vendor's in-state software is often the means itself of significant in-state business activity on the part of the vendor, which is also a stark difference from the facts of *Quill*.

As in the case of software, large Internet vendors also enhance their customer sales through the complementary use of text data files, or "cookies." Cookies are not software but as in the case of software are present in the state and serve to facilitate such vendor's in-state sales. Large Internet vendors store cookies on their customers' computers and communication devices when the customers visit the vendor's website. These files are stored locally on the

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customer's computer or device the first time he or she visits the site and identify the customer on each subsequent visit. These files include "session cookies," which are erased when a browser is closed, and "persistent cookies," which are preserved across multiple browser sessions. Cookies facilitate sales by customizing the shopping experience and allowing each customer to readily log into his or her account, store items in a shopping cart, etc. Cookies also enable a vendor to track their customers' behavior over time and to deliver ads that are specific to each customer. Vendors own the proprietary cookies that they place on their customers' computers and devices. As in the case of in-state vendor software, the ownership and use of these in-state cookies results in in-state business activity by such vendor that distinguishes such vendors from the mail order vendors that were evaluated by *Quill*.

(2) Content distribution networks

Large Internet vendors routinely contract with providers of content distribution networks ("CDNs") to use local servers to accelerate the delivery of their web pages to their customers. CDN servers are computer hardware that is housed in geographically distributed data centers. A CDN is an organized network of such servers that are generally placed in close proximity to Internet users. CDNs operate to hasten the delivery of Internet vendors' web pages to nearby customers. By allowing Internet vendors to deliver web page content to their local customers more quickly and efficiently, CDNs ensure that the vendors' customers are less likely to exit the vendors' web pages without making a purchase and increase the likelihood that the customers will return for future business. Consequently, the CDNs perform local activities "on behalf of the [vendor that] are significantly associated with the [vendor's] ability to establish and maintain a market" for its sales. See *Tyler Pipe Industries v. Washington Dep't of Revenue*, 483 U.S. 232, 251 (1987). When that activity takes place in Massachusetts it establishes an in-state physical presence on behalf of such vendor. See *id.*

(3) Other representative contacts

Large Internet vendors may also utilize other persons as in-state representatives that result in the creation of an in-state physical presence. For example, large Internet vendors commonly sell goods through third-party agreements with companies that are often referred to as "online marketplaces." These online marketplaces, which offer a range of potential services through employees or other contract personnel, benefit the client-vendor by, among other things, enhancing its name recognition and creating consumer confidence with respect to its products. These arrangements may vary in form. Many of these agreements allow the Internet vendor to post goods for sale on a website operated by the online marketplace, with orders and payment then processed through that website (with subsequent order fulfillment completed by the individual Internet vendor). Other agreements may provide for increased services by the employees or other personnel of the online marketplace, which may include order fulfillment, return processing, access to the online marketplace's customer service team, and the preparation of sales reports or other analytics. In either instance, although the website maintained by the online marketplace on which the vendor's products are sold is "virtual," some of the various services provided by the online marketplace in connection with the sale of the vendor's products will be physical in nature. Because these latter, physical services operate to establish and maintain the Internet vendor's market, these services, when performed in the state, will result in an in-state physical presence on the part of such vendor. See *Tyler Pipe*, 483 US at 251.

Also, large Internet vendors may utilize delivery services that exceed the type of delivery services that were evaluated by *Quill*. *Quill* held that a state could not impose a sales or use tax collection duty on vendors that limit their contacts with the state to the contacts of mail and common carrier. In contrast, large Internet vendors may utilize delivery services that provide not merely product delivery, but additional services that may include logistics, order fulfillment, storage, return processing and order management. In general, these additional services operate to enhance the vendor's sales. Therefore, these services, when performed in the state, will result in an in-state physical presence on the part of such vendor. See *Tyler Pipe*, 483 US at 251.

The Department seeks comments on all aspects of the proposed regulation, and in particular, the analysis above.

Information:

Copies of the proposed regulations will be sent electronically via e-mail to practitioners who are on the Rulings and Regulations Bureau's e-mail list. In addition the proposed regulations are posted on the Department of Revenue's Web site at: <http://www.mass.gov/dor/businesses/help-and-resources/legal-library/regulations/proposedregulations.html>. Hard copies of the proposed regulations may be obtained from the Rulings and Regulations Bureau, Post Office Box 9566, Boston, Massachusetts 02114-9566.

Written comments in advance of the hearing are encouraged and should be sent to the Rulings and Regulations Bureau. Alternatively, comments may be emailed to [RulesandRegs@dor.state.ma.us](mailto:RulesandRegs@dor.state.ma.us) or faxed to 617-626-3290. All persons desiring to be heard on this matter should appear at the designated time and place.

/s/Michael J. Heffernan

Michael J. Heffernan  
 Commissioner of Revenue

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