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Services

New York appellate division upholds regulation interpreting P.L. 86-272

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In brief

What happened?

The New York Supreme Court, Appellate Division affirmed the trial court's decision that New York's regulation applying Public Law (P.L.) 86-272 is not preempted. Because the plaintiff trade association brought a "facial" challenge to the regulation, the court limited its review to whether the regulation "as written" revokes franchise tax immunity where P.L. 86-272 requires it or obstructs Congress's purposes in enacting the federal law. The court stated that "whether the Department can, in practice, administer the regulation in accord with Public Law 86-272's in-state activity requirement...will need to be assessed on a factual record, not the text of the regulation itself."

[*American Catalog Mailers Ass'n v. Dep't of Tax'n and Fin.*, N.Y. App. Div. (3d Dep't), No. CV-25-0865, 5/7/2026]

Why is it relevant?

The decision represents a setback in efforts to obtain judicial guidance on an expansive interpretation of P.L. 86-272 and its application to out-of-state businesses' internet activities. This interpretation, first adopted by the Multistate Tax Commission (MTC) in 2021 and since adopted by California, Massachusetts, and New Jersey as well as New York, has the potential to recast many common internet-enabled customer interactions as constituting "in-state" business activities and nullifying P.L. 86-272's protections. It remains to be seen whether this decision is appealed. However, it is important to note that the Department did not appeal the trial court's order that the regulation could not be applied retroactively, and therefore that portion of the ruling is now binding.

Actions to consider

Taxpayers engaging in sales of tangible personal property that avail themselves of P.L. 86-272's protections against the imposition of state net income taxes should monitor this litigation and actions in other states to determine the potential impact on their multistate tax liability. The application of P.L. 86-272 can impact both direct tax imposition and apportionment calculations (e.g., throwback sales).

In detail

The MTC in August 2021 adopted a revised policy statement addressing activities conducted via the internet and protections under P.L. 86-272. The MTC stated that “as a general rule, when a business interacts with a customer via the business's website or app, the business engages in a business activity within the customer’s state.” However, the MTC recognized that “when a business presents static text or photos on its website, that presentation does not in itself constitute a business activity within those states where the business’s customers are located.”

New York draft and final regulation

In April 2022, the New York Department of Taxation and Finance issued a draft regulation amending its interpretation of P.L. 86-272 protection to largely align with the MTC’s policy changes. For example, where a company has a website that invites New York viewers to apply for non-sales positions and enables viewers to fill out and submit an electronic application and upload a cover letter and resume, the company would lose P.L. 86-272 protection. This result is because the activity does not constitute and is not ancillary to solicitation of orders for sales of tangible personal property, the Department asserted.

In another example, a company places internet cookies onto the computers or other electronic devices of its customers. These cookies gather customer search information used to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale. Under the draft regulation, the company would lose P.L. 86-272 protection because the activity does not constitute and is not ancillary to solicitation of orders for sales of tangible personal property. Click here for more on the draft regulation.

This draft regulation was officially proposed in August 2023 as part of the Department’s long-awaited implementation of 2014 corporate tax reform legislation and went final in December 2023 with minor, non-substantial changes. (See 20 NYCRR 1-2.10.)

Lawsuit and trial court decision

In April 2024, the American Catalog Mailers Association (ACMA) filed suit in the New York Supreme Court, Albany County, seeking summary judgment and a declaration that the regulation was invalid because it was preempted by P.L. 86-272. Specifically, the ACMA argued that the regulation impermissibly exposes out-of-state businesses to franchise tax liability without regard to whether their activities occur within New York.

The court cited the US Supreme Court’s *Wayfair* decision as holding “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.” The court concluded that since P.L. 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.”

The ACMA also argued that the Department violated its members' due process rights by seeking to apply its regulation retroactively to 2015. In evaluating this argument, the court applied a three-factor test focused on "fairness": (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 court found that the December 2023 publication of the final regulation made clear the Department's retroactive intent for the first time. The court also noted that the Department's draft regulations provided that "these draft regulations are not yet final and should not be relied upon." ACMA members had no opportunity to alter their behavior in anticipation of the impact of the retroactive application of the challenged regulations, the court found. Further, the court found that a retroactive period of "nearly nine years" was excessive, and that the Department failed to set forth a valid public purpose for retroactive application. "Indeed, defendants aver that they have not made any attempt to assess any back taxes," the court noted. Click here for more on the court's decision.

Observation: The trial court declared that the retroactive application of the Department's regulation, as applied to any time period before its December 2023 publication date, violated due process of law. The Department did not appeal this ruling, and the appellate division affirmed the trial court's order, thereby leaving its decision barring retroactivity in place.

Appellate decision rejects "facial" challenge to New York's regulation

The Appellate Division noted that ACMA's federal preemption challenge to New York's regulation is "solely facial," and therefore the court must confine its analysis to the regulation's alleged textual defects. "Applied questions – including whether a particular corporation's activities fall within or outside the immunity conferred by Public Law 86-272 – are not before us." Because New York's regulation represents the Department's interpretation of a federal statute, the ACMA's challenge represents a "pure question of law" for the court to revolve.

Rather than consider whether *Wayfair* supports the Department's regulatory interpretation, the court limited its legal review to "whether the regulation, as written, stands as an obstacle to the accomplishment and execution of Congress' objectives in enacting Public Law 86-272." The court concluded that the regulatory text "expressly and repeatedly cabins its scope to a corporation's activities 'in New York State'...We therefore agree with the Department that 20 NYCRR 1-2.10 is reasonably understood as immunizing a foreign corporation from franchise tax liability when all of its in-state business activities – however conducted – are confined to solicitation, activities ancillary thereto or de minimis, and as withholding immunity when any of its in-state business activities – however conducted – exceed those bounds (see *Wisconsin Dept. of Revenue v William Wrigley, Jr., Co*., 505 US at 232)."

Observation: The trial court's holding appeared to equate "virtual contacts" for state sales tax nexus purposes with in-state "business activity" for purposes of qualifying for P.L. 86-272 protection. However, the appellate division declined to engage in this analysis, instead taking at face value the regulation's assertion that internet activities can take place both inside and outside the state.

In rejecting the ACMA's facial challenge to the regulation, the court acknowledged what it saw as the ACMA's underlying concern. "If a corporation that sells tangible personal property into New York does not or cannot isolate its Internet activities occurring in this state, the regulation may operate to impose franchise tax liability on that corporation based upon its Internet-based activity in general – activity that may, or may not, have a demonstrably sufficient nexus with this state...That said, because imposition of the franchise tax under 20 NYCRR 1-2.10 is predicated on in-state activity, plaintiff's concern reduces to

whether the Department can, in practice, administer the regulation in accord with Public Law 86-272's in-state activity requirement – a concern that will need to be assessed on a factual record, not the text of the regulation itself.”

Finally, the court rejected ACMA’s arguments that internet activity was not anticipated by Congress when enacting P.L. 86-272 and that the regulation obstructs Congress' objective to provide a clear rule of immunity for small businesses engaged in interstate commerce. P.L. 86-272 “is framed in functional terms, requiring consideration of the nature or purpose of the business activity, not the means through which that activity is conducted,” the court found. Further, “the details and examples the Department wrote into the challenged regulation...promote rather than inhibit Congress' original goal of clarity by providing guidance to foreign corporations for which, if any, of their Internet-based activities will, and will not, be considered solicitation, activities entirely ancillary thereto or de minimis in New York State (see 20 NYCRR 1-2.10 [i]). Whether 20 NYCRR 1-2.10 draws the right line between Internet-based solicitation and other activities, and whether certain Internet-based business functions are entirely ancillary to solicitation or de minimis, are not matters that are before us.”

Let’s talk

For a discussion of the potential impact of this decision on your business, please contact:

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