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Presentation

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Lemonade from Lemons? Applying Economic Nexus Standards

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Table of Contents

Page

I. NEXUS: DEFINING THE ISSUE 2

A. A person's connection with a state 2

B. Natural tension exists 2

II. FEDERAL CONSTITUTIONAL FRAMEWORK 2

A. Tenth Amendment 2

B. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). 3

III. DUE PROCESS CLAUSE 3

A. Fundamental Principles 3

B. Transactional Nexus 3

C. Presence Nexus 4

IV. INTERSTATE COMMERCE CLAUSE. 7

A. Fundamental Principles 7

B. Transactional Nexus 7

C. Presence Nexus ... 8

D. Attributional Nexus ... 26

V. LOCAL NEXUS ... 42

A. Alabama ... 42

B. Arizona ... 42

C. Colorado ... 43

VI. BUSINESS ACTIVITY TAX SIMPLIFICATION ACT ("BATSA") LEGISLATION ... 43

VII. MTC PROPOSAL ... 50

VIII. GENERAL STATUTORY ECONOMIC NEXUS ... 50

A. Ohio Commercial Activity Tax. ... 50

B. Michigan Business Tax ... 51

C. New Hampshire Business Tax ... 51

D. Oregon Economic Nexus ... 51

E. South Carolina Nexus Creating Activities ... 52

I. Nexus: Defining the Issue

A. A person's connection with a state; prerequisite for a state's ability to tax or impose tax collection obligations on an out-of-state business.

B. Natural tension exists between (1) states desiring to obtain as much revenue as possible and imposing as much of the tax burden on those outside the state and (2) businesses not wanting to pay or administer cumbersome taxes that inhibit their growth and expansion, especially in the context of jurisdictions where they conduct little or no business.

II. Federal Constitutional Framework

A. Tenth Amendment

"The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. Const. amend. X.

B. *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992). The Due Process and Commerce Clauses are motivated by different national concerns and, accordingly, each mandates a different connection between a state and a tax imposition for the imposition to be sustained. Both Clauses' requirements must be met.

III. Due Process Clause

A. Fundamental Principles

1. "[Nor] shall any state deprive any person of life, liberty, or property, without due process of law . . . ." U.S. Const. amend. XIV, § 1.

2. Both transactional nexus and presence nexus are required by the Due Process Clause.

3. *Mobil Oil Corp. v. Comm'r of Taxes*, 245 U.S. 425 (1980). The Court held that in order for an application of state tax jurisdiction to be constitutional under the Due Process Clause, there must be

a. Nexus or some minimum connection between the taxing state and the activity from which the income is derived (*transactional nexus*) and

b. A rational relationship between the income attributed to the taxing state and the interstate values of the enterprise (*presence nexus*).

c. *Also see Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980) (citing *Mobil Oil Corp*.) and *Wisconsin v. J.C. Penney Co*., 311 U.S. 435, 444 (1940).

B. Transactional Nexus

1. *Connecticut General Life Insurance Co. v. Johnson, Treasurer of California*, 303 U.S. 77 (1938). Appellant insurer claimed that a tax on its receipt in its home state, Connecticut, of reinsurance premiums from insurance companies operating in California on policies reinsuring them against loss on policies they issued in California to California residents violated the due process clause. Apart from the fact that appellant was privileged to do business in California, and that risks reinsured were originally insured against in that state by companies also authorized to do business there, California had no relationship to appellant or the contracts. The Supreme Court reversed the dismissal of appellant insurer's actions to recover state taxes paid under protest, finding a due process violation and that California had no relationship to appellant or to reinsurance contracts.

2. *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768 (1992) - "[I]n the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax." Investment income which was not operationally related to the taxpayer's New Jersey activities could not be taxed by New Jersey because the investment activity occurred only at the taxpayer's headquarters in Michigan.

3. *Norton v. Illinois*, 340 U.S. 534 (1975) – The taxpayer was able to dissociate the sales of its national accounts – made directly by Illinois customers to taxpayer's out of state home office and shipped directly to the customers – from the activities of its branch office within the state.

    a. *But see* Washington State Department of Revenue Determination Nos. 00-098, 22 WTD 151 (2003) and 04-208, 24 WTD 217 (2005). Distinguishing *Norton*, the ALJ ruled in both cases that a taxpayer seeking to dissociate sales from its nexus creating activities in Washington must prove that those select sales are not significantly associated in any way with the taxpayer's in-state activities that establish or maintain a market for its products.

4. *Danov Corp. v. Alabama Dep't of Revenue*, No. 97-283 (Dec. 22, 2000). ALJ held that the State could not tax the dividend income of a nonresident corporation whose only contact with the State was 21% interest in a limited partnership that was not unitary with the taxpayer. The ALJ stated that the income could not be taxed under the operational test of *Allied-Signal* because there was "no connection between the out-of-state operational functions for which the dividends were used and Danov's activity in Alabama."

5. *Cent. National-Gattesman, Inc. v. Dir., Div. of Taxation*, 146 N.J. 569; 683 A.2d 1164 (1996). The corporation conducted two different businesses through distinct divisions: a forest products business and an investment business. Inasmuch as the investment business was conducted solely in New York, and because there was no economies of scale, functional integration, or centralized management, the investment activity (and the results of that activity) could not be taxed by New Jersey.

C. Presence Nexus

1. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

    a. The Due Process Clause requires only that a corporation have "minimum contacts" with the taxing state. The intent of the Due Process Clause is to ensure fairness and notice to the corporation that its contacts with the State cause it to be subject to tax.

    b. The presence in a state necessary to satisfy the Due Process Clause is comparable to that needed to support a state court's jurisdiction over a defendant in a civil matter; is met if the entity purposefully directs its activity into a jurisdiction. The Due Process Clause does not require physical presence in the taxing state.

2. *Int'l Harvester Co. v. Dep't of Treasury*, 322 U.S. 435 (1944) – "We think that Wisconsin may constitutionally tax the Wisconsin earnings distributed as dividends to the stockholders. It has afforded protection and benefits to appellants' corporate activities and transactions within the state. These activities have given rise to the dividend income of appellants' stockholders and this

income fairly measures the benefits they have derived from these Wisconsin activities." The Court determined that such a tax was merely a deferred tax on the corporation's income.

3. *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 298 (1980) (plurality opinion) - A corporation can be sued in a state, under the Due Process Clause, when the corporation "delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum state," because the defendant's conduct and connection with the forum state are such that it should "reasonably anticipate being hauled into court there."

4. *Asahi Metal Indus. Co. v. Superior Court of California*, 480 U.S. 102, 112 (1987) (plurality opinion). "The placement of a product into the stream of commerce, without more, is not an act of the defendant purposefully directed toward the forum State . . . . [A] defendant's awareness that the stream of commerce may or will sweep the product into the forum State does not convert the mere act of placing the product into the stream into an act purposefully directed toward the forum State."

5. *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 313 S.C. 15, 437 S.E.2d 13, cert. denied, 510 U.S. 992 (1993).

   a. Geoffrey, Inc. was a wholly owned Delaware corporation and a second tier subsidiary of Toys R Us to which several valuable trademarks and trade names were transferred. Geoffrey licensed intangibles to Toys R Us in exchange for a royalty of one percent of the net sales revenues. Toys R Us deducted the amount of the royalty payments from income in computing the amount of its tax obligation in South Carolina. South Carolina initially disallowed the deduction but then allowed the deduction and took the position that Geoffrey was taxable in the state.

   b. Due Process nexus: "The real source of Geoffrey's income is not a paper agreement, but South Carolina's Toys R Us customers. By providing an orderly society in which Toys R Us conducts business, South Carolina has made it possible for Geoffrey to earn income pursuant to the royalty agreement. That Geoffrey has received protection, benefits, and opportunities from South Carolina is manifested by the fact that it earns income in the state."

6. *Geoffrey, Inc. v. Oklahoma Tax Comm'n*, (Case No. 99,938) (Dec 23, 2005). The Oklahoma Court of Civil Appeals held that the state may constitutionally impose corporate income tax on royalty income derived by an out-of-state intellectual property company under a licensing agreement that based the royalty on sales generated within the state. By licensing intangibles for use in Oklahoma and receiving income in exchange for their use, the court found that the taxpayer purposefully directed its activities toward state residents and had the necessary connection with required by due process.

7. *Bridges v. Autozone*, 900 So.2d 784 (March 24, 2005), reh'g denied (May 13, 2005). The Louisiana Supreme Court provided an unusual twist to Due Process case law. All seven of the court's justices held that due process protections did not prevent the state from taxing an out of state entity that owned intangible property arguably used in the state (an interest in an affiliated real estate investment trust). The taxpayer filed a petition for rehearing, which the court declined to hear due to procedural issues. However, the court's Chief Justice filed a concurring opinion arguing strenuously that the court misunderstood the issue. He argued that the due process personal jurisdiction issue involved principles distinct from the question of a state's ability to impose an income tax on an out of state business. In his Autozone concurrence, the Chief Justice was not joined by any of his colleagues. However, less than two months later, he was joined by two other justices in voting to accept a case that might have overturned Autozone.

8. *Associated Elec. & Gas Ins. Servs., Ltd. v. Clark*, 676 A.2d 1357 (R.I. Sup. Ct. 1996). The taxpayer collected premiums from four natural gas companies located in Rhode Island. The taxpayer had no physical presence in the state and received all insurance contracts directly from the insured by mail. The taxpayer argued that subjecting it to the gross insurance premiums tax violated the Due Process Clause of the U.S. Constitution. The Rhode Island Supreme Court upheld imposition of the tax. Based on *Quill*, the court determined that the taxpayer had "purposefully availed" itself of the benefits of an economic market in Rhode Island and, thus, was subject to tax in Rhode Island.

9. *Town Crier, Inc. v. Dep't of Revenue*, 733 N.E.2d 780 (Ill. Ct. App. 2000). An out-of-state retailer, whose only physical contact with Illinois during a twenty-six month audit period were thirty deliveries into the state using its own vehicles, and installation of window dressings on five occasions, was determined to have nexus. Taxpayer argued it did not "purposefully avail" itself of the Illinois market because it did not actively solicit customers from Illinois and that all contacts with the state were at the request of customers in the state. The Court found that although the taxpayer's contacts did not rise to the level of contacts in the Illinois Supreme Court's decision in *Brown's Furniture*, the number of deliveries would have satisfied the statutes cited in that decision and the frequency of the taxpayer's presence in Illinois was approximately equal to that of the taxpayer in the New York court of Appeal's decision in *Orvis*. The court did not fully address the fact that the customers requested the visits.

10. *Thomas Pub'g Co. v. Indus. Quick Search, Inc.*, No. 02 CIV 3307 (RO) (S.D.N.Y. 2002). In a copyright infringement case, defendant's solicitation through an interactive website that listed New York entities and carried advertisements from New York business was sufficient to establish personal jurisdiction in New York.

11. *Bensusan Rest. Corp. v. King*, 937 F. Supp. 295, (S.D.N.Y. 1996). New York did not have personal jurisdiction over a defendant, for purposes of the Due Process Clause, when the defendant's only connection with New York was the establishment of a Web site that could be accessed from anywhere, including from New York. While this decision was affirmed by the Court of Appeals, the

Court of Appeals did not reach this Due Process argument because it decided that New York did not have jurisdiction over the defendant under New York's long arm statute.

12. *Lanzi v. Alabama Dep't of Revenue*, 2006 Ala. Civ. App. LEXIS 406 (Ala. Civ. App. 2006). The Alabama Court of Appeals held that a non-resident limited partner did not have nexus with the state for state income tax purposes. The LLP's principal purposes was to manage and preserve the taxpayer's family assets. The LLP's general partners managed the business and conducted affairs in Alabama and other states. The record indicated that, aside from the limited partnership in the LLP, the taxpayer had no property, business, or economic ties to Alabama. The court compared this situation to that of a nonresident owner of stock in an Alabama corporation and held that, similarly, the minimum contacts requirement was not satisfied and no nexus existed for tax purposes.

IV. Interstate Commerce Clause.

A. Fundamental Principles

1. "The Congress shall have the power . . . to regulate commerce . . . among the several States . . . ." U.S. Const. Art. I, § 8, cl. 3.

2. The U.S. Supreme Court has held that the Commerce Clause not only gives the authority to Congress to regulate interstate commerce, but also prohibits the states from enacting laws that discriminate against or interfere with interstate commerce. *Gibbons v. Ogden*, 9 Wheat. 1 (1894).

3. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), articulated a four-part test that must be met in order to satisfy the interstate Commerce Clause.

a. The tax must be applied to an activity with a ***substantial nexus*** with the taxing state;

b. The tax must be fairly apportioned;

c. The tax must not discriminate against interstate commerce; and

d. The tax must be fairly related to the services provided by the state.

B. Transactional Nexus

1. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977): "[T]he transaction being taxed must have substantial nexus with the taxing state."

2. *Goldberg v. Sweet*, 488 U.S. 252 (1989). Commerce Clause challenge to the Illinois tax on telecommunications, imposed on calls originated or terminated in the state and charged to an Illinois service address. The tax was held to have met the four prong *Complete Auto* Commerce Clause test for state tax impositions since all parties agreed that the termination/origination requirement

meant that the taxed calls had substantial nexus with Illinois; the credit mechanism ensured that there would be no multiple impositions of tax if every state adopted the Illinois scheme; the tax was imposed in the same manner on intrastate and interstate calls so it did not discriminate against interstate commerce; the test "fairly related to the presence and activities of the taxpayer within the state" under Complete Auto, since the taxpayers were afforded the use of roads, police, and fire protection.

3. *In re Moran Towing Corp. v. Comm'r, New York State Dep't of Taxation and Finance*, 99 N.Y.2d 443 (N.Y. 2003). The Court implied that transactional nexus may not be a separate requirement if presence nexus is met.

C. Presence Nexus

1. Framework

a. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

The interstate Commerce Clause requires that a corporate taxpayer (or tax collector, in the case of use taxes) have "substantial nexus" with the taxing state. A corporation "may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause."

b. *Nat'l Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551 (1977).

(1) The taxpayer was held to have use tax collection responsibility on its interstate mail order sales of maps because of the physical presence of its advertising sales offices for its magazine division in the taxing state.

(2) The Court held it to be irrelevant that the mail order sales activity being taxed did not have a physical presence in state where taxpayer had otherwise established physical presence in the state through its magazine publication activity.

(3) The Court noted that an activity with only the "slightest presence" in the state would not be sufficient to establish taxable nexus in the state.

2. Sales Tax

a. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

In the area of use tax collection, a corporation must be physically present in a state for that state to constitutionally impose collection responsibilities upon the corporation. The degree of presence in a state

necessary to satisfy the Commerce Clause is uncertain with respect to the imposition of gross receipts, income, and franchise taxes. (*See Nat'l Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551 (1977) and *Felt & Tarrant Manufacturing Co. v. Gallagher*, 306 U.S. 62 (1939) regarding support for the argument that a greater nexus standard is appropriate when a tax is being imposed, rather than merely a tax collection responsibility.)

b. The New York Court of Appeals has held that the test is substantial nexus, not substantial presence.

(1) *Orvis Co., Inc. v. Tax Appeals Tribunal*, 86 N.Y. 2d 165, 654 N.E.2d 954, cert. denied, 516 U.S. 989 (1995). "We do not read *Quill Corp. v. North Dakota* to make a substantial physical presence of an out-of-state vendor in New York a prerequisite to imposing the duty upon the vendor to collect the use tax from its New York clientele." *Orvis*, 86 N.Y. 2d at 70, 654 N.E. 2d at 956.

(2) "[A]cceptance of the thesis urged by Orvis . . . that *Quill* made the substantial nexus prong of the *Complete Auto* test an in-State substantial physical presence requirement - would destroy the bright-line rule the Supreme Court in *Quill* thought it was preserving in declining completely to overrule *Bellas Hess*. Inevitably, a substantial physical presence test would require a 'case-by-case, evaluation of the actual burden imposed' on the individual vendor involving a weighing of factors such as number of local visits, size of local sales offices, intensity of direct solicitations, etc., rather than the clear-cut line of demarcation the Supreme Court sought to keep intact by its decision in *Quill*." *Orvis*, 86 N.Y.2d at 177, 654 N.E.2d at 960.

(3) "While a physical presence of the vendor is required, it need not be substantial. Rather, it must be demonstrably more than a 'slightest presence.' And it may be manifested by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf." *Orvis*, 86 N.Y.2d at 178, citing *Nat'l Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551, 556 (1977)).

c. *Cole Bros. Circus, Inc. v. Huddleston*, No. 01-A-01-9301-CH-00004, 1993 Tenn. App. LEXIS 386 (Tenn. Ct. App. 1993) - The taxpayer provided circus performances in various eastern states. During the 3 ½ year audit period, the corporation was physically present in Tennessee for between four and thirteen days each year. Its presence consisted of substantial equipment, which was hauled on 27 trucks, and its 209 full-time employees. The court determined that Tennessee could assess use tax on the taxpayer for the use of its equipment in Tennessee.

d. *Dep't of Revenue v. Share Int'l, Inc*., 676 So. 2d 1362 (Fla. 1996). *cert. denied*, 117 S. Ct. 685 (1997). The taxpayer manufactured and distributed chiropractic supplies and sold its product through direct mail. For three days every year, the taxpayer's president and vice president were speakers and coordinators at a national seminar in Florida. During the seminar, the taxpayer's products were displayed and sold. The taxpayer collected and remitted sales tax on these sales. The Department of Revenue determined that the taxpayer should be collecting sales tax on all sales, including mail-order sales, to Florida. The Florida Supreme Court held that the taxpayer did not have substantial nexus with Florida and, thus, could not be compelled to collect and remit use tax on the mail-order sales.

e. *Arizona Dep't of Revenue v. Care Computer Systems*, No. 1 CA-TX 98-0003 (Ariz. Ct. App. 2000). The Arizona Court of Appeals, reversing the Board of Tax Appeals and the Superior Court, concluded that Care Computer systems had sufficient nexus for the state to impose its retail transaction privilege tax. Care did not own or` lease any real property in the state, maintain a business address there, or have any employees or agents residing in the state. One salesperson who lived in California made seven business trips (one or two days each) during the seven-year audit period to solicit business or follow up on business prospects. The Court of Appeals decision relied heavily on the "establishing and maintaining a commercial market" test for nexus.

f. *In the Matter of Intercard, Inc*., 14 P.3d 1111 (Kan. 2000). Eleven installations of card readers by an out-of-state company did not create nexus because such contacts were isolated and sporadic based solely on customer requests.

g. *Yvonne Greenberg (Advisory Opinion)*, TSB-A-02(49)S, N.Y.S. Comm'r of Tax'n and Fin. (Sept. 24, 2002). The Department of Taxation and Finance ruled that a company based in Canada that produced golf course maintenance products had sufficient nexus with New York requiring it to register and collect New York sales tax on all its sales to New York customers because the company had more than the slightest presence in New York as a result of its solicitation of activities in New York. While participation in a trade show in New York (for which the ruling was sought) alone did not necessarily establish nexus, the company also sent salespersons into New York to solicit sales from potential or existing customers two to three times. Whether the one-time transaction where the company's product was installed at the site of an international volleyball event in New York was sufficient presence for nexus was not pivotal according to the Department since the company had sufficient nexus with New York through its other activities. It was, however, another instance of the company's connection with and presence in New York.

h. Alabama Rev. Rul. No. 02-006 (Dec. 10, 2002). The Department ruled that the solicitation and installation activities conducted by an out-of-state seller of electrical illuminated signs created nexus for Alabama sales and use tax purposes when the seller's representatives visited Alabama for solicitation of sales and when the seller's contractors or subcontractors installed the signs to realty in Alabama. Transactions subject to tax included the sale of signs at retail through sales representatives in Alabama and freight charges for signs sold at retail without installation and delivered on the seller's conveyances. Sales and use tax did not apply to sales made without sales representatives in Alabama and without a contract for installation, separately billed installation charges, freight charges for delivery on a conveyance owned by a common carrier, or installation permits.

i. *Educational Resources, Inc. v. Tolson*, Nos. 00CVS14723 and 14724, N.C. Superior Ct. (Feb. 20, 2003). The court held that an out-of-state corporation was not liable for income and sales tax as a result of renting and selling videotapes to N.C. customers. The company advertised to customers through catalogs. Orders were fulfilled through common carrier. The Department, relying on its regulation, asserted that ownership of the rented property in the state established sufficient nexus to impose sales and use tax collection obligations. The Department also asserted that the company owed income taxes based on a state statute that provided that renting tangible personal property in the state constitutes being engaged in business in the state. According to the court, *Quill* precluded a finding of substantial nexus, despite the statute and Department's regulation.

j. *In re Buehner Block Co*., No. 2003-161 (April 27, 2005). The Wyoming Board of Equalization affirmed the Department of Revenue assessment of tax on the basis that when the corporate taxpayer voluntarily applied for a license to collect Wyoming sales and use taxes, it was subject to the sales tax statutes. Specifically, despite the fact that the taxpayer did not have any facilities or employees in Wyoming and it did not advertise in the state, the taxpayer could not argue that it lacked substantial nexus with the state and that therefore, it could not be taxed under the Commerce Clause per *Quill*. The Board stated that by voluntarily applying for a sales tax license and collecting sales tax, "a vendor establishes substantial nexus with the state."

k. Idaho Tax Comm'n, Dkt. No. 10706 (Sept. 10, 1996). The Idaho Tax Commission asserts that a company that provides seminars in Idaho is obligated to collect sales tax on materials it sells to clients. According to the decision, the firm has more than the slightest presence in Idaho because its employees conducted "dedicated colleges" in the state.

l. Va. Dep't of Tax'n, Ruling of Comm'r, P.D. #98-147 (Oct. 9, 1998). The Virginia Department of Taxation ruled that an out-of-state interior decorating firm whose only contacts with the state are periodic services

for Virginia customers is not liable for sales and use tax collection duties. The ruling does not provide the frequency of such contacts but emphasized that the firm did not maintain any offices or employees/agents in Virginia.

m. Trade Show Attendance

(1) Kansas - Ltr. 0-2000-006 (Mar. 24, 2000) provides that any trade show activity may create nexus for use tax purposes.

(2) Maine - Section 1754-B provides that attending trade shows, seminars, or conventions in the state does not constitute "substantial physical presence."

(3) Massachusetts - Directive 91-3 holds that a vendor that solicits sales at trade shows for three days or more is subject to use tax collection obligations.

(4) Minnesota - Revenue Notice 2000-1 (Nov. 6, 2000) holds that a company has sufficient nexus when it conducts business activity in the state on at least four days during a 12-month period. Business activity includes trade show attendance.

(5) New York - *In re NADA Serv. Corp*. No. 810592 (N.Y.S. Div. Tax App. 1996), a non-precedential Administrative Law Judge decision, holds that attendance at educational seminars will not give rise to sales and use tax obligations.

3. Business Activity Taxes – General

In contrast to the "physical presence" standard, under an "economic nexus" standard, an out-of-state business is deemed to have nexus with a jurisdiction merely by having intangibles assets or customers in the state. The doctrine first arose in situations involving alleged "abusive" out-of-state passive investment companies, but is now being applied in many other situations, including ordinary third-party licensing arrangements and provision of intangible property to customers, and is been used to describe relationships traditionally thought of as the provision of services.

a. *FIA Card Services, N.A. f/k/a MBNA America Bank, N.A.* v. West Virginia, 640 S.E. 2d 226 (W. Va. 2006) *cert denied*, Dkt. No. 06-1228 (June 18, 2007)

(1) West Virginia's statute imposes tax on financial institutions based on the amount of the financial institutions' economic activity with respect to West Virginia customers.

(2) The Administrative Law Judge for the West Virginia Office of Tax Appeals determined that to meet the "substantial nexus"

requirement of the Commerce Clause, there must be "a finding of a physical presence in the taxing state, not merely an economic exploitation of the market."

The ALJ then ruled that MBNA's use of the services of in-state lawyers and West Virginia courts for a *de minimis* number of credit card debt collection actions (three actions over a two year period) was insufficient to create nexus in West Virginia because it was merely the "slightest presence" and was not significantly associated with MBNA's ability to establish and maintain a market in West Virginia.

(3) The Circuit Court reversed the decision of the Office of Tax of Appeals and held that the corporate net income and business franchise taxes had been properly imposed on MBNA.

The Court found that MBNA's gross receipts attributable to a West Virginia source far exceeded the statutory threshold for nexus and concluded that MBNA had substantial nexus with the state for the years in question such that imposition of the corporate income and business franchise taxes was proper.

The Court rejected the "bright-line physical presence test" established in *Bellas Hess* and adhered to in *Quill* because the taxes at issue in this case were not sales and use taxes. Specifically, the Court found as a matter of law that physical presence was not required to establish substantial nexus to satisfy the Commerce Clause when imposing corporate net income and business franchise taxes.

In reaching its decision, the Court focused on the many benefits MBNA was deemed to receive from the state, such as the banking and consumer credit laws and access to the state's courts, all of which enabled MBNA to generate income from West Virginia customers. The Court noted in particular that because MBNA extends substantial unsecured credit to citizens of West Virginia, the fact that MBNA had access to West Virginia courts was essential to its business operations.

(4) The West Virginia Supreme Court of Appeal affirmed the circuit court decision and introduced a "significant economic presence test" to hold MBNA liable for business franchise and corporate income taxes.

The court began its analysis by determining that *Quill* applies only to sales and use taxes. It based this conclusion on four grounds. First, the *Quill* decision was primarily based on stare decisis and the need for a continuing bright-line standard for sales tax imposition. The court pointed to language in *Quill*

stating that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today." Second, the West Virginia court read Quill so as to limit its decision to sales and use taxes. Third, the court cited *Quill's* foundation that without the *Quill* rule, compliance with the myriad of state and local sales tax rules and rates would be unduly difficult and burdensome on business. The court felt that because income taxes are remitted less frequently and to fewer jurisdictions, the compliance burden for income taxes was not as significant. Finally, the court cited changes in communication technology and electronic commerce leading to the declining viability of *Quill's* physical presence test in today's world.

After refusing to apply *Quill* to income taxes, the court introduced a "significant economic presence test" as an indicator of whether businesses have nexus for Commerce Clause purposes. The court described the test as one that incorporates the due process requirements of purposeful direction towards a state while at the same time examining the degree of those directed contacts. That degree is measured by "the frequency, quantity, and systematic nature of a taxpayer's economic contacts with a state." In applying this standard to MBNA, the court pointed to the systematic and continuous nature of the direct mail and telephone solicitation performed in West Virginia. Furthermore, MBNA's gross receipts of over $8,000,000 and $10,000,000 in 1998 and 1999 respectively were sizable and "attributable" to West Virginia, thus satisfying the significant economic presence test.

In his dissenting opinion, Justice Benjamin argued that the majority opinion missed the mark by analyzing what type of tax this was rather than the effects imposition of the tax would have on interstate commerce. "Absent precedential support for differentiating 'substantial nexus' standards based upon tax types, this Court should resist the State's invitation for us to speculate based on semantics and, instead, focus on the effect which the state tax has on interstate commerce - here, attempting to levy an income tax on an out-of-state corporation with no property, tangible or intangible, in West Virginia where the income in question was generated from credit accounts held outside of this state." Justice Benjamin contended that policy considerations such as undue burden on companies and the need for a bright-line standard are equally as valid for income taxes as for sales taxes. Under this framework, he concluded that for the same reasons that sale tax imposition requires physical presence, imposition of an income tax also should require physical presence.

b. *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999), cert. denied (2000). The Tennessee Court of Appeals reversed a franchise and excise tax assessment on JCPNB relating to its Tennessee credit card solicitation and activities. Tennessee's Commissioner of Revenue argued:

(1) that the assessment was within *Complete Auto Transit's* Commerce Clause constraints because "the substantial privilege of carrying on business" created a substantial nexus with Tennessee – even with no physical presence; and

(2) that credit cards owned by JCPNB in the State created a substantial nexus and that nexus could be attributed to JCPNB by contractors within Tennessee who aided in the solicitation of credit card customers.

(a) The Court of Appeals rejected each of the Commissioner's arguments. Most significantly, the court refused to hold that an "economic presence" established a substantial nexus.

The court rejected the Commissioner's attempt to distinguish *Quill's* physical presence requirement for use tax from the nexus requirement for franchise and excise tax because the Commissioner offered no precedent to support treating the nexus requirements differently.

The court rejected the argument that the credit cards created nexus by noting that the value of the cards is in the intangible account the card represents.

The court also rejected the Commissioner's attributional nexus theories because the contractors did not have a physical presence in Tennessee. The court noted that the use of Tennessee collection agencies to collect money owed to JCPNB was close to physical presence but was far too attenuated to create the physical presence required by *Quill*.

c. *Capital One Bank and Capital One FSB v. Commissioner of Revenue*, Nos. C262391 and C262598 (Mass. App. Tax Bd. June 22, 2007). The Appellate Tax Board determined that two credit card banks with no physical presence in the Commonwealth were subject to the financial institution excise tax ("FIET").

(1) Under the FIET, a bank is presumed to be regularly engaging in activities in the Commonwealth if it conducts transactions with 100 or more residents of the Commonwealth, or has

$10,000,000 or more of assets attributable to sources in the Commonwealth, or has in excess of $500,000 in receipts attributable to sources in the Commonwealth. As the banks conducted transactions with more than 100 residents and had more than $500,000 in receipts attributable to Massachusetts customers, the banks were deemed to be engaged in business in the Commonwealth and subject to the FIET.

(2) Addressing the banks' Commerce Clause challenges, the Board concluded that *Quill*'s physical presence test did not apply to an income-based tax such as the FIET and that the banks had a substantial nexus with Massachusetts under the *Complete Auto* test because the banks: (i) purposefully targeted their credit card business to Commonwealth residents; (ii) filed quarterly Credit Card Issuer's Reports with the Massachusetts Division of Banks; (iii) used the Massachusetts courts and Attorney General's Office to collect delinquent accounts and resolve disputes with Commonwealth residents; (iv) used a sophisticated network, including Visa and MasterCard as well as Massachusetts acquiring banks, which linked the banks with Massachusetts customers; and (v) derived hundreds of millions of dollars in income from millions of transactions involving Massachusetts customers and merchants. The Board also noted that the use of Capital One's intangible property (the Capital One trademark on the credit cards) in the Commonwealth to generate substantial revenue further supported its ruling that there was substantial nexus.

d. *Matter of the Petition of Wascana Energy Mktg. (U.S.), Inc.*, N.Y.S. Div. of Tax App., ALJ Div., DTA 817866 (Aug. 8, 2002. The foreign corporation was a purchaser and seller of oil and natural gas imported from Canada to customers in the United States. Under contracts with its customers, title to the product passed at an interconnect to the pipeline at the U.S./Canada border. During the period at issue, sales to customers taking possession in New York accounted for 3.91 to 18.43% of total sales. The company did not maintain any real or tangible property or employees in New York. All activities connected with its business (including marketing and negotiations) occurred in Canada. The NYS Department of Taxation asserted gross receipts tax deficiencies on the basis that the company was doing business in New York. Before the ALJ, the company asserted that its activities did not constitute doing business under the Tax Law and in addition failed to satisfy the constitutional threshold for imposing a tax on a foreign company. The ALJ agreed with the company on both points. First, relying on the Department's regulations under an analogous taxing provision, the ALJ determined that the company was not "carrying on business" in New York. Second, with respect to the constitutional argument, the ALJ relied on the Court of Appeals decision in Orvis (interpreting *Quill*). Although the company's connection satisfied the due

process considerations because of its “economic presence” in New York, the ALJ concluded that “*Quill* requires physical presence within the taxing state irrespective of the degree to which the vendor engages in exploitation of the consumer market of the taxing state.” However, presence was not found on the basis of the company’s activities and the ALJ specifically refused to hold that the momentary transfer of title at the pipeline border (a common carrier for these purposes) without more provided the requisite physical presence. The decision was not appealed.

e. *Enterprise Leasing Co. of Chicago v. Indiana Dep’t of Revenue*, No. 49T10-9807-TA-74 (Dec. 18, 2002). The Indiana Tax Court ruled that a non-resident company that did not maintain employees or an office in the state was not liable for the state’s gross income tax. The company leased vehicles to state residents. At the lessees’ direction, the vehicles were delivered to Indiana and subsequently titled and registered by the lessees. Reversing the determination of the Department, the court held that under state law a “business situs” in the state is not established by these activities.

f. *U-Haul Co. of Indiana, Inc. v. Indiana Dep’t of State Revenue*, No. 49T10-9801-TA-1 (Dec. 20, 2002). The court held that a rental company in the business of renting moving equipment for use throughout the country was subject to Indiana gross income tax on the amount of rental amounts derived from Indiana that they actually received. The rental companies were part of a system under which fleet companies, the rental companies, and rental dealers who rented the equipment to consumers, all received a percentage of the rentals collected and funneled through a service company formed to administer the system. The Department of Revenue imposed gross income tax on the rental companies on the basis of 100% of the amount of rentals collected by the rental dealers, but the rental companies successfully argued that it was acting as an agent of the service company, serving as a conduit for the rentals paid by the rental dealers to the service company for distribution to system members. The rental dealers did not have any right or interest in the amounts collected beyond their contractually specified percentage, and therefore, it was that amount that was subject to gross income tax.

g. *Rayovac Corp. v. Dept. of Treasury*, No. 251283, 2004 Mich. App. LEXIS 3190 (Mich. Ct. App. November 23, 2004). The Court of Appeals overturned the trial court and found that an out-of-state seller’s four-member Michigan sales staff conducting business activities within the Michigan established nexus with the state under the Commerce Clause and met the “bright-line test” for nexus set out in *Quill*. The Court specifically cited to *MagneTek Controls, Inc. v. Dep’t of Treasury*, which interpreted *Quill* as preserving the “bright-line rule” by not giving any consideration to the substantiality of the physical presence of the sales force and instead finding that the presence of any sales force at all

provides “more than a ‘slightest presence’ in a state, so that substantial nexus will be found.” *MagneTek Controls, Inc. v. Dep’t of Treasury*, 221 Mich. App. 400, 562 N.W.2d 219 (1997), citing *In re Orvis*.

h. *Navistar Financial Corp. v. Tolson*, 625 N.E.2d 852 (N.C. App. 2006). The North Carolina Court of Appeals affirmed the Superior Court’s granting of summary judgment holding that Navistar had sufficient nexus with North Carolina for taxation under N.C. Gen. Stat. § 105-83. This statute imposes a tax on persons “dealing in, buying, or discounting paper, notes, bonds, contracts, or evidence of debt for which…a lien is reserved or taken upon personal property located in this State to secure the payment of the obligations.” N.C. Gen. Stat. § 105-83. Navistar was a finance company that bought installment paper secured by personal property in North Carolina from North Carolina wholesalers, retailers and individuals. The court held that working with dealers in state and securing the notes with property located in North Carolina established nexus.

i. *General Motors v. Seattle*, 25 P.3d 1022 (Wash. Ct. App. 2001) – The court held that substantial nexus existed because the taxpayer’s in-city advertising, sales/service calls, and marketing/service of warranties significantly impacted ability to maintain their market within Seattle. “[T]he automakers certainly exploit the market in the City, regardless of where they are physically located. We decline to extend *Quill’s* physical presence requirement in this context.

j. *In Re BP Oil Supply Co. v. City of Tacoma*, Tacoma Hearing Examiner No. T-97964 (2003). The Hearing Examiner concluded that substantial nexus did not exist between BP Oil and the city of Tacoma based on the following activities:

(1) An arrangement, made outside of Tacoma, of shipping by a company affiliated with BP Oil to use a common carrier to carry crude oil to the buyer’s Tacoma refinery did not constitute nexus with Tacoma under the test in *Tyler Pipe*.

(2) Services provided by a jointly hired independent oil inspection firm to verify the quantity and quality of crude oil delivered by BP Oil to the buyer’s Tacoma dock were not significantly associated with BP’s ability to establish and maintain the market for BP’s products in Tacoma.

(3) Two visits in seven years by BP Oil employees to buyer’s Tacoma offices provided no evidence of significance in establishing or maintaining BP Oil’s market for crude oil in Tacoma.

k. *Kaiser Optical Systems, Inc. v. Michigan Dep’t of Treasury*, No. 226661 (Mich. Ct. App. 2002). The court found that a Michigan corporation had

sufficient nexus with California to avoid the throwback of sales to its parent corporation to Michigan. The corporation's accounting and financial functions were performed in California by its parent. It also leased office space in California for the storage of financial books and records. According to the court, these contacts were sufficient under Michigan law to establish the corporation's presence in California.

l. *Annox v. Kentucky Revenue Cabinet*, Dkt. No. K-19039, KY Bd. of Tax App. (December 23, 2003), *aff'd*, No. 03-CI-1605, Franklin County Cir. Ct. (February 17,2005). Annox was a telecommunications services reseller with Kentucky customers. The Kentucky Board of Tax Appeals found nexus, even though Annox did not have any property or payroll in Kentucky. Consequently, the Board held that Annox was liable for the public service corporation property tax. Several different theories drove the Board's decision: First, the Board determined that Annox had voluntarily accepted jurisdiction by the state, because it was a utility regulated by Kentucky's Public Service Commission and only operated in the state with permission of the state authority. Second, the Board held that by passing a federal telecommunication act that granted the state utility commission authority over telecommunications services in the state, Congress had consented to state nexus over telecommunications resellers. Finally, notwithstanding the fact that a finding of "*Quill*" physical presence was not required outside of the context of the sales and use tax, the Board ruled that Annox had a "physical presence" due to its use of the local telecommunications companies' networks.

m. *In re Goldome Capital Invs., Inc*., 1991 N.Y. Tax LEXIS 360 (N.Y.S. Div. Tax App., June 27, 1991). Taxpayer was a Delaware passive investment holding company. The majority of its income was interest from inter-company loans to its New York parent. The taxpayer maintained a statutory office in Delaware and had no office or address in New York. It generally had no activities anywhere. All of the taxpayer's officers were in New York; most of the taxpayer's income was from interest on loans to its New York parent; and all of its books and records were located in New York. The N.Y.S. Division of Tax Appeals, in a non-precedential decision, determined that the taxpayer was "doing business" in New York state and thus subject to tax in the state.

n. *In the Matter of U.S. Trust Corp*., TAT(H)93-204(BT) (N.Y.C. Tax App. Trib. Dec. 14, 1995). A bank holding company was required to include a Delaware subsidiary in its combined New York City return. During the years at issue, the parent company, through its New York subsidiary, made all of the significant business decisions and most of the investment decisions of the Delaware subsidiary. As a result, the Delaware company was deemed to be doing business in New York City.

o. Fla. Admin. Code R. 12C-1.011.

(1) The Florida Department of Revenue has issued a regulation that provides that a corporation will be considered to be conducting business in Florida if it has "corporate officers who have permanent or extended temporary residency (3 months in the aggregate of a 12 month period) within the state who make management decisions while residing in the state. If the only officer of the corporation or a key officer of the corporation is residing within the state, management of the corporation is presumed to be occurring within the state."

(2) In interpreting this regulation, the Department issued Technical Assistance Advisement No. 96(C)l- 001 (May 1, 1996), in which the Department found that a corporation had nexus to Florida because eight of the company's fifteen officers resided in Florida, including its president, chief operating officer, controller, vice president of human resources, vice president of international affairs and another general vice president. The Department advised that the mere presence of a corporate officer in Florida is not sufficient to create nexus for Florida corporate income tax purposes. Instead, nexus is created when the corporation is deemed to be conducting business by having corporate officers in Florida who are involved in conducting the corporation's business. Furthermore, while the mere presence of a corporate officer is not sufficient to create nexus, the mere presence of a key officer creates a presumption that business is being conducted.

p. *Kevin Assocs., LLC v. Crawford* 865 So. 2d 34 (La. 2004). The Louisiana Supreme Court held that Kevin Associates, an out-of-state holding company, was subject to Louisiana corporate income and franchise taxes. The company was part of a closely held group of corporations all of whose directors (except for the Delaware-based nexus provider) were Louisiana residents, and the company earned dividends and received interest from Louisiana subsidiaries and a Louisiana corporation, respectively. On these grounds, the Court found the company was commercially domiciled in Louisiana, managed from Louisiana, and its Delaware presence was merely a paper domicile. The Court also held the company had physical presence in Louisiana because its principal business was in Louisiana, and it was managed from Louisiana.

q. Ruling of Commissioner, P.D. 05-90, Virginia Department of Taxation (June 9, 2005). Nexus with Virginia found where out-of-state holding company's officers conducted the company's affairs from wholly owned subsidiary's office located in Virginia. The holding company was required to join in the combined income tax return that the affiliated companies filed.

r. Trade Show Attendance

(1) California - Cal. Tax Code § 23104 provides that an out-of-state corporation will not be deemed doing business within the state if it does not engage in convention and trade show activities for more than 7 days and does not derive more than $10,000 from such activities.

(2) Florida - In Tech. Assist. Advisement No. 84(M)-004 (Aug. 24, 1984), the Department of Revenue determined that attendance alone would not subject a corporation to tax. However, sufficient nexus would exist if sales were made, if sales persons made credit investigations, or if sales were accepted.

(3) Illinois - Two rulings issued by the Department of Revenue indicate that mere short-term attendance or display at a trade show will not create taxable nexus. However, filling orders or attendance greater than 14 days may create nexus. A newly adopted regulation provides for the same result. ON the other hand, a General Information Letter (94-0373-GIL 09/01/1994) stated: “The Department believes that a single appearance by a retailer at a trade show in Illinois, if due process was otherwise satisfied, would qualify under the bright line test set out in Quill.”

(4) Indiana - A ruling indicates that attendance and even sales at a trade show will not create nexus for income tax purposes. DRAC 79-2 (Mar. 23, 1979).

(5) Maine - Rule 808 provides that companies that exhibit products for 2 weeks or less will not be subject to tax, provided that no sales are made.

(6) Michigan - An administrative bulletin provides that attendance at a trade show for less than 10 days does not create nexus provided that no sales are made

(7) New Jersey – A corporation will not be subject to corporation business tax if trade show activities are limited solely to 1) speech or conduct that invites an order, and 2) ancillary activities that involve maintaining a display at a single location for less than two weeks during the tax year.

(8) New York - The Department of Taxation ruled that participation at two five-day trade shows did not create nexus, where the taxpayer did not sell any of its products. TSB-A-97(6)C, N.Y.S. Comm’r of Tax’n and Fin. (Mar. 24, 1997). In 2004, the Department ruled that taking orders and receiving payment at trade shows created tax nexus. TSB-A-04(12)C, N.Y.S. Comm’r of Tax’n and Fin. (July 21, 2004).

4. Business Activity Taxes - Licensing Intangibles

a. *Cerro Copper Prods., Inc. v. Ala. Dep't of Revenue*, No. F-94444, 1995 Ala. Tax LEXIS 211, at * 13 (Dec. 11, 1995). The taxpayer sells copper products to Alabama customers but maintains no employees or facilities in Alabama. The Department of Revenue argued that the existence of an account receivable arising from the sales in the state created nexus for the taxpayer. The ALJ determined that Quill bright-line, physical presence test should apply to other taxes as well, and further determined that accounts receivable do not, by themselves, create substantial nexus for Commerce Clause purposes. The ALJ characterized the decision as a respectful dissent from *Geoffrey*. However, in *dicta* in *Alabama Dep't of Rev. v. Lanzi*, No. CV-2003-2795 (Cir. Ct. Montgomery County Nov. 17, 2004), ALJ Thompson took the opportunity to note that he was "no longer convinced that the Supreme Court intended the *Quill* physical presence test to apply beyond sales and use tax."

b. *Rylander v. Bandag Licensing Corp*., Tex. App. Ct., No. 03-99-004217-CV May 11, 2000). The Texas Court of Appeals rejected the Comptroller's *Geoffrey* type approach to nexus by holding that the possession of a certificate of authority and receipt of royalties without any physical presence, does not give rise to substantial nexus.

c. *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 313 S.C. 15, 437 S.E.2d 13, cert. denied, 510 U.S. 992 (1993) - Delaware holding company that licenses its trademarks and trade names for use by its parent corporation, Toys 'R Us, in South Carolina has sufficient nexus under the Commerce Clause to subject it to the state's corporate income tax and corporate license fee.

d. *SYL, Inc. v. Comptroller; Crown, Cork & Seal Co. (Del.), Inc. v. Comptroller*, 825 A.2d 399 (Md. 2003) – The Maryland Supreme Court held that two intangible holding companies that did not conduct business in Maryland, nor owned any business in Maryland, nonetheless had nexus with Maryland. The Court stated in dicta that the entities had no economic substance and that the predominate purpose for their existence was to shelter income.

e. *Lanco, Inc. v. Dir., Div. of Taxation*, 980 A.2d 176 (N.J. 2006), *cert denied*, Dkt. No 06-1235 (June, 18, 2007). Lanco was a Delaware corporation with no officers, employees, or real or tangible personal property in New Jersey. However, Lanco owned and licensed intangibles to its affiliate in New Jersey.

(1) The New Jersey Tax Court held that New Jersey's corporation business tax did not apply to Lanco, because it did not have physical presence in the state and thus, did not satisfy the "substantial nexus" requirement of the Commerce Clause. The

Court stated that under *Quill*, physical presence was a necessary element of nexus for taxing income.

(2) Reversing the decision of the New Jersey Tax Court, the Appellate Division of the Superior Court held that *Quill's* physical presence nexus requirement is not applicable to income tax and that the New Jersey Corporation Business Tax may be constitutionally applied to income derived by plaintiff from licensing fees attributable to New Jersey.

(3) In reversing the Tax Court, the Appellate Division looked to recent state cases adopting the holding of the South Carolina Supreme Court in *Geoffrey*, namely North Carolina in its *A&F Trademark* decision and Louisiana in its *Gap (Apparel)* decision), although the Louisiana decision dealt only with Due Process and not the Commerce Clause. After examining these cases, Appellate Division was "satisfied" that the physical presence requirement applicable to sales and use taxes is not applicable to income tax. As a result, it concluded that New Jersey corporation business tax may be constitutionally applied to income derived by Lanco from licensing fees attributable to New Jersey.

(4) The New Jersey Supreme Court upheld the Appellate Division's decision and referred to that decision for a substantive analysis of the issue instead of issuing its own detailed analysis. The Court briefly analyzed the *Quill* decision and ruled that *Quill's* nexus application was limited to sales tax.

(5) The U.S. Supreme Court denied cert. on June 18, 2007.

f. *Praxair Technology, Inc., v Director, Division of Taxation*, Tax Court Dkt. No. 007445-05 (June 18, 2007). The taxpayer, an intangibles holding company, owned various patents, trade secrets, and know-how. It was incorporated outside of New Jersey and conducted none of its business there. The taxpayer had no employees in the state. The taxpayer's parent licensed its intangible property for use in New Jersey. Nevertheless, the Tax Court determined that Praxair was subject to tax in New Jersey because it derived income from property used in the state. Three unique elements arise in this opinion.

(1) First, even though the taxpayer in *Lanco Inc. v. Division of Taxation*, 980 A.2d 176 (N.J. 2006), *cert denied*, Dkt. No 06-1235 (June, 18, 2007), owned trademarks (and not patents, trade secrets, or know-how) the Tax Court followed the decision in *Lanco,* ruling that "a taxpayer need not have a tangible physical presence in a state for income to be taxed there. The presence of intangible property is sufficient to establish nexus." The Tax Court made no attempt to reconcile the different

factual circumstances of these cases. It appears, therefore, that *Lanco* will be broadly applied, beyond its precise facts. The Court also stated, "the Supreme Court's continuous…refusal to grant certiorari in income tax nexus matters…signals to this court that a line has been drawn in reasoning between sales and use tax cases [requiring physical presence] and income tax cases [which seem not to require physical presence]."

(2) Second, the taxpayer did not file returns in New Jersey in the years in question and claimed it had reasonable cause not to do so due to its contention that it lacked nexus with the State. In upholding the failure to file penalty (i.e., finding that reasonable cause did not exist) the Tax Court determined that a sophisticated taxpayer, such as Praxair, should have recognized the "distinction between established law regarding sales tax from *Quill,* and before, and the established law regarding income tax from the New Jersey statute…" The Court did not address the fact that the Tax Court itself had previously opined that physical presence was required (see Tax Court opinion in *Lanco*, which was reversed on appeal).

(3) Finally, the Tax Court held that the 1996 amendments to the nexus regulations did not "alter the law or create new law" because the statue, and not the 1996 regulations, exposes the taxpayer to taxation. Intangibles holding companies should expect the New Jersey Division of Taxation to assert nexus in tax years before 1996.

g. *Bridges v. Autozone Props., Inc*., 2004 La. App. LEXIS 400 (La. Ct. App., 1st Cir. Jan. 5, 2004), *rev'd & remanded*, No. 2004-C-814 (La. S. Ct. March 24, 2005) – A Nevada corporation received dividends from a real estate investment trust that received rental income from subsidiary retail stores, some of which were located in Louisiana.

(1) The Court of Appeals held that the Louisiana Department of Revenue could not tax the dividends because the Nevada corporation had insufficient contacts with Louisiana for purposes of the Due Process Clause. The Court ruled that the dividends did not have economic presence in the state and the state could not claim a Louisiana business situs for the dividends. In a footnote, the Court stated that *Quill* requires physical presence to establish Commerce Clause nexus (although this was not at issue) (contrast with *Kevin Associates*, discussed on page 26.).

(2) The Supreme Court of Louisiana reversed the decision of the lower courts finding that the nexus requirement of the Due Process Clause had been met such that Louisiana could exert jurisdiction over the Nevada corporation. The Court reasoned

that the state had provided protections and benefits to the retail stores that had generated the rental income which was passed through to the Nevada corporation in the form of dividends. The Court held that "Louisiana has personal jurisdiction over a nonresident shareholder when Louisiana has provided benefits, opportunities and protections that helped to generate that income." The Court did not address whether the nexus requirement of the Commerce Clause had been met because this issue was not raised on appeal.

(3) In a concurring opinion, Chief Justice Calogero of the Louisiana Supreme Court noted that the Court may have incorrectly decided the case. In particular, the Chief Justice distinguished between the standard necessary for a state to have taxing jurisdiction over a non-resident and the standard necessary for a state to have personal jurisdiction over a non-resident and took issue with the Court for conflating these two standards. The Chief Justice noted that the opinion, which concluded that the state had taxing jurisdiction only cited to cases that focused on a state's authority to impose taxes, as opposed to a state court's personal jurisdiction over a nonresident defendant. (*Int'l Harvester Co. v. Wisconsin Dept. of Taxation; Quill v. N. Dakota; Geoffrey, Inc. v. South Carolina Tax Comm'n*) The Chief Justice noted in particular that the Supreme Court had failed to cite to any of the leading cases on personal jurisdiction, such as *Int'l Shoe v. State of Washington*, in reaching its conclusion.

(4) Principles.

When a non-resident tax payer has minimum contacts with a state and these minimum contacts are sufficient to allow the state's courts to exercise personal jurisdiction over that taxpayer, the state probably has authority to tax that income.

However, when a state has authority to tax income because it has provided benefits, opportunities and protections that contributed to the profitability of the enterprise providing that income, that does not necessarily mean that the nonresident prospective taxpayer, who receives dividend income derived from a corporation doing business in that state, has minimum contacts with the state sufficient to support personal jurisdiction over that taxpayer.

h. *A & F Trademark, Inc. v. Tolson*, 605 S.E.2d 187 (N.C. Ct. App. 2004), *cert. denied* 126 S. Ct. 353 (2005). The Court affirmed the decision of a lower court, which in turn had affirmed the decision of the North Carolina Tax Review Board. The Board had held that several Delaware holding companies that licensed trademarks to affiliates operating in North

Carolina were subject to the corporate income tax. The Board had found that the holding companies were “doing business” in the state because they owned intangible property with a business situs in the state, they rented property to in-state businesses, and they operated a business enterprise in the state.

i. *Geoffrey, Inc. v. Oklahoma Tax Comm’n*, (Case No. 99,938) (Dec 23, 2005). The court held that physical presence was not necessary to satisfy the substantial nexus requirement of the Commerce Clause because the bright-line physical presence test established by *Bellas Hess* and applied in *Quill* does not apply to taxes other than sales and use taxes. The tax was rationally related to the income generated by Geoffrey from the protection, benefits and opportunities provided by Oklahoma.

j. *Kmart Corp. v. Taxation and Revenue Dep’t*, N.M. Sup. Ct. Docket No. 27,269 (Dec. 29, 2005) – The New Mexico Supreme Court unanimously held that New Mexico’s gross receipts tax does not apply to receipts from granting a license to use intangible personal property when the grant occurs outside New Mexico. However, the court declined to rule on the constitutional nexus and corporate income tax issues. Instead, the court quashed its writ of certiorari on these issues and ordered that the Court of Appeals’ decision be published, making the appeals court’s holdings the current law of New Mexico.

(1) The Court of Appeals had held that the royalties flowing from the sale of a license that occurred wholly outside of the state could nonetheless be taxed because trademarks resulted in the use of the license in New Mexico.

(2) The Court of Appeals had also held that the Michigan affiliate could be taxed because its relationship with an in-state operating company created the functional equivalent of physical nexus.

D. Attributional Nexus

1. Foundation of Attributional Nexus Assertions

a. *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). The use of salespersons to solicit orders was attributed to the principal for purposes of determining an obligation to collect *sales tax*. A company may not avoid sales tax nexus by labeling its salespersons "independent contractors." The physical presence of the contractors constituted sufficient nexus.

b. *Tyler Pipe Indus. v. Washington State Dep’t of Revenue*, 483 U.S. 232 (1987)

(i) The U.S. Supreme Court determined that Washington could impose its *business and occupation tax* on an out-of-state wholesaler that had no office, property or employees in Washington based solely on the solicitation of business by an independent contractor that was in Seattle.

(ii) The Supreme Court affirmed the Washington Supreme Court's holding that the "crucial factor governing nexus" is whether the activities performed by the independent contractor on behalf of the out-of-state company are "significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales."

(iii) The Supreme Court has noted that the attribution it had allowed in *Scripto v. Carson*, 362 U.S. 207 (1960), where an out-of-state corporation was held to be subject to a state's sales and use tax jurisdiction solely because it had an in-state sales force consisting exclusively of independent contractors, as being "the furthest extension" of state tax jurisdiction it has ever condoned. *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992).

2. Attributional Nexus Developments

a. *Graduate Supply House v. Alabama Department of Revenue*, Alabama Law Division Dkt. No. S. 05-751 (Nov. 20, 2007). An out-of-state cap and gown rental company was found to have nexus for *sales and use tax* collection purposes based both on the presence of in-state representatives and the presence of the actual income-producing property (the caps and gowns). Even though there was no written agency agreement between the company and the in-state third party representatives, they were de facto agents based on their activities, which included measuring students for caps and gowns and providing and collecting order forms. These activities, according to the ALJ, were sufficient to enable the taxpayer to establish and maintain a market in the state. Furthermore, the presence of the caps and gowns—the income-producing property—constituted a sufficient physical nexus.

b. *Barnesandnoble.com v. State Bd. of Equalization*, No. CGC-06-456465, (Superior Court, San Francisco County, Sept. 7, 2007). An out-of-state corporation that sells books, music, and movies in the state via the Internet does not engage in business in the state, for *use tax* collection purposes, even though limited marketing was done through brick-and-mortar stores in the state. The California Rev. & Tax. Cd. § 6203 definition of a retailer engaged in business in the state includes a retailer having an agent within the state. The Superior Court ruled that Barnes & Noble, which owned brick-and-mortar stores in California, was not the agent of Barnesandnoble.com when the brick-and-mortar stores inserted the online retailer's coupons into its shopping bags and printed the name of the online retailer on one side of its shopping bags. The Superior

Court distinguished the present case from that in the previous *Borders* case in that Barnesandnoble.com was not fully controlled by Barnes & Noble. Also, Barnes & Noble had no authority to bind Barnesandnoble.com, and Barnes & Noble owned only 40% of Barnesandnoble.com, whereas in *Borders*, the subsidiary was wholly owned by the parent.

c. *St. Tammany Parish Tax Collector v. BarnesandNoble.com*, Dkt. No. 05-5695 (E.D. La. 2007).

(i) The nature of the activities performed by the in-state retailer on behalf of the online retailer were insufficient to create nexus, for the purpose of requiring the online retailer to collect *sales and use taxes*. Membership in a savings club that provided savings to purchases made either in the stores or online did not result in either earning revenue from the sales of the other and the revenue was distributed pro rata. Gift cards redeemable in either the store or online did not result in either earning revenue from the sales of the other because it was the sales of the gift cards themselves – and not the redemptions – that generated the revenue. Commissions on in-store sales of online products did not generate cross-revenue as the retail store was charged a wholesale price for the books and then collected sales tax on its sale. There was a very limited amount of in-store advertising for the online entity, most of which related to the gift cards and membership. The in-store acceptance of returns policy indicated that the retailer would accept an in-store return from the online retailer or from any competitor. The acceptance of returns is not "comparable to the level of sales or sales support activity undertaken by in-state agents in other cases in which courts have found nexus."

(ii) An appeal by the St. Tammany Parish Tax Collector is currently pending (May 2007).

(iii) Compare with *In re Barnes & Noble.com,* SC OHB 97-732835 (Cal. State Bd. of Equalization, Sept. 24, 2002) where the SBE determined that taxable nexus existed.

d. Virginia Pub. Doc. Rul., No. 07-181 (Nov. 21, 2007). An energy service company that assists customers in selling their unused electricity back to the energy grid hired an employee in Virginia to promote and sell the company's services in Virginia. The taxpayer requested a ruling as to whether it had nexus for corporate and sales and use tax obligations. The Commissioner determined that the taxpayer was not a "dealer" within the definition of Va. Code § 58.1-612 "because it does not offer tangible personal property for sale at retail," and thus "does not have a sales tax collection obligation." It does however have an obligation to pay use tax on "tangible personal property used in the performance of its

services in Virginia." The Commissioner also determined that the "mere presence of a salesman in Virginia is not a sufficient basis to establish [income tax] nexus where no other activities are present."

e. Virginia Pub. Doc. Rul., No. 07-138 (Sept. 5, 2007). An out-of-state manufacturing company that makes CDs, DVDs and replication equipment for sale to musicians planned to hire an employee to work from home in Virginia. The employee would receive sales calls via an out-of-state contact center. The company would maintain no office in Virginia and all orders would continue to be received and accepted from its out-of-state location, with products being shipped by common carrier. The Commissioner determined that the "employee creates nexus with the Commonwealth for retail sales and use tax purposes." However, since the employee will only be responsible for soliciting sales, the company's in-state activities fall within the protection of P.L. 86-272 and thus it will not be subject to the corporate income tax.

f. Virginia Pub. Doc. Rul., No. 07-24 (March 27, 2007). The operator of a retail website (the "Retailer") without any stores in Virginia considered entering into an a contractual relationship with a Distribution Center ("Center") located in Virginia whereby the Center, like all other distribution centers with which the Retailer contracts, purchases products from unrelated vendors and provides labeling, packaging, shipping and other related services for the company on a cost plus basis in addition to a per unit handling fee. When customers place orders through the company's website, the order is passed-on to a distribution center where the above-enumerated services are performed and the product is shipped via common carrier to the customer on behalf of the Retailer. The Commissioner determined that entering into a relationship with the Center in Virginia would not create nexus for purposes of the Commonwealth's income or sales and use taxes. The Retailer is protected under P.L. 86-272 from income tax liability because its activities are limited to "solicitation of orders for sales of tangible personal property," the "Center would not be an affiliated representative or independent contractor acting on behalf of the Retailer in Virginia," and the Retailer would not own inventory in the Commonwealth. The Commissioner also determined that the Retailer's activity within Virginia was not sufficient to establish nexus under Va. Code § 58.1-612C for imposing a sales and use tax collection obligation. Furthermore, there would be no agency relationship between the Retailer and the Center, which would have been sufficient to establish nexus, because the Retailer does not control the work to be done or the manner in which it is to be done.

g. *Matter of Robert L. Reynolds and Donald R. Reynolds*, California State Board of Equalization, No. 208940 (JH) (May 31, 2007). The Petitioner-partnership, which makes sales to California customers, has facilities in Oregon from which it manufactures fruit bins. It did not have any permanent business location in California in its own name. While some

of the sales were shipped directly from Oregon to California by common carrier, certain other sales involved shipping the component parts to a company located in California that was owned by one of the partners, where the parts were assembled and shipped to or held for pick-up by the California customers. The SBE determined that the use tax assessment was proper. The partnership was a "retailer engaged in business in" California under Rev. & Tax Code § 6203 on three separate grounds. First, under § 6203(c)(1) it was deemed to have a "place of business" in California as a result of the tangible personal property located in the state prior to delivery and the assembly activity performed on its behalf. Second, the partnership was found to have a "representative operating in [California] under its authority" because the partner's other company was an "in-state person… doing something at the out-of-state retailer's specific or constructive request." While neither delivery by common carrier or assembly alone would be sufficient, in combination with "some other activity related to selling" they are. Finally, the partnership held a "seller's permit" which is only available to a retailer that represents that it is engaged in business in California.

h. Missouri Letter Ruling No. LR 3189 (April 11, 2007). The DOR considered whether the activities of an in-state vendor (data storage, manipulation, processing, and assembly of products for delivery outside of the state) creates franchise, income or sales and use tax nexus for the vendor's out-of-state customers. The DOR determined that as to the first three services, provided the customer had no employees, property or usage of intangible data in the state, the activities of the in-state vendor did not create nexus for the customer. However, it determined that with respect to the assembly of products for delivery out of state, the presence of tangible personal property in the state would create nexus for all taxes for the out-of-state customer. It further stated that for sales and use taxes, nexus between the out-of-state customer and the state may depend upon the extent of intangibles and activities in Missouri.

3. Additional Attributional Nexus Materials

a. *Arco Building Systems, Inc. v. Chumley*, M2004-01872-COA-R3-CV, 2005 Tenn. App. Lexis 395 (Tenn. Ct. App. 2006). Arco, a Delaware Corporation doing business out of Georgia, sold single story metal buildings in several states including Tennessee. Arco did not build the structures itself but contracted with four companies located in Tennessee, Georgia, Louisiana, and Texas for their construction. Typically, customers contacted Arco about a building, who then arranged with the various builders for the best price. When a customer decided to purchase, the builder prepared the plans and sent them directly to the customer for approval. The manufacturers were authorized to accept final payment for the structures.

Approximately 15% of Arco's sales were to customers in Tennessee. Although, it filed a tax return in Tennessee, Arco did not report any of its

sales to Tennessee customers on the return. Upon audit, Tennessee assessed tax and penalties for Arco's sales to Tennessee customers. The trial court upheld the assessment and the appellate court affirmed that decision. The court relied on *Tyler Pipe* and its own decisions regarding nexus created by non-employee representatives, affiliates, and independent contractors. The in-state contractors business activities were imputed to Arco to establish nexus, and *sales and use tax* collection liability, because Arco used the Tennessee contractor "as a *de facto* representative and extensive participant" in its business.

b. *Lanzi v. Alabama Dep't of Revenue*, 2006 Ala. Civ. App. LEXIS 406 (Ala. Civ. App. 2006). The Alabama Court of Appeals held that a non-resident limited partner did not have nexus with the state for state *income tax* purposes. The LLP's principal purposes was to manage and preserve the taxpayer's family assets. The LLP's general partners managed the business and conducted affairs in Alabama and other states. The record indicated that, aside from the limited partnership in the LLP, the taxpayer had no property, business, or economic ties to Alabama. The court compared this situation to that of a nonresident owner of stock in an Alabama corporation and held that, similarly, no nexus existed for tax purposes.

c. *State of Louisiana and Secretary of the Dep't of Revenue and Taxation v. Dell Int'l, Inc. et. al.*, State of Louisiana Court of Appeal, First Circuit, Number 2004 CA 1702 (February 15, 2006) – The Court of Appeal reversed the summary judgment granted in Dell's favor, finding that the Louisiana Department of Revenue and Taxation might be able to establish "substantial nexus" with the state and thereby justify the state's claim against Dell for unpaid *use taxes* relating to its failure to collect taxes on sales made to residents. A full trial on the nexus issue was ordered by the appeals court. *State of Louisiana and Secretary of the Dep't of Revenue and Taxation v. Dell Catalog Sales*, State of Louisiana 19th Judicial District Court, Parish of East Baton Rouge, Dkt. No. 456,807 (May 25, 2004) – BancTec served as an independent contractor to Dell, a remote catalog vendor that was selling computer repair service contracts to its customers. BancTec provided Dell's customers with computer repairs under the service contracts, and the Louisiana Department of Revenue sought to impose a sales and use tax collection obligation on Dell based on BancTec's activities in Louisiana. The court granted summary judgment to Dell Catalog Sales on the basis that the sales of optional services contracts administered by BancTec in Louisiana were not sufficient to subject Dell to a Louisiana use tax collection responsibility. The court first determined that Dell did not have a physical presence in Louisiana and that Dell was not performing services in Louisiana. The court also determined that BancTec was not performing services on behalf of Dell, but on behalf of Dell's customers and, thus, its activities did not create nexus for Dell.

d. *Borders Online, LLC v. State Board of Equalization,* 129 Cal. App. 4th 1179 (Cal. Ct. App. 2005)*, aff'g, In re Borders Online, Inc.*, SC OHA 97-638364 56270 (Cal. State Bd. of Equalization, Sept. 26, 2001) - Borders Online, Inc. sells books and other items to customers in California and elsewhere. Customers access the company's website and place orders there. Orders are fulfilled by common carrier. Borders Online had no physical presence in California. Customers who had purchased items from Borders Online could return those items to Borders Stores maintained by Borders, Inc., an affiliate of Borders Online, and receive a full refund of the purchase price.

(i) The California State Board of Equalization (SBE) concluded that the availability of the return-for-refund policy at California stores was a significant selling advantage for Borders Online; thus, Borders Stores was performing "selling" activities in California on behalf of Borders Online. The SBE found that this activity created a substantial physical presence for Borders Online in California and thus it had a duty to collect "use taxes on all sales to California purchasers."

(ii) The District Court upheld the Board's decision, granting summary judgment for the Government.

(iii) The Court of Appeals affirmed both decisions. The Court first rejected the idea that in order to meet the substantial nexus requirement, the in-state representative must actually conduct sales transactions as was the case in *Scripto*, *Tyler Pipe* and *Scholastic*. Instead, the Court cited *Orvis*, where it was held that physical presence "need not be substantial" and that it may be "manifested by the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf."

In particular, the Court stressed the "cross selling synergy" between the online store and the brick and mortar store evidenced by the fact that the Borders' receipts were sometimes imprinted with advertising for Borders Online, the fact that the link on the Borders' store website led to Borders Online website and that the two companies shared some market and financial data. Also, it was noted that Online generated more than $1.5 million in sales in California in 18 months. Therefore, the Court found that "Online had a representative with a physical presence in the State" and that "the representative's activities in the State were significantly associated with Online's ability to establish and maintain a market in the state for the sales." (Citing *Tyler Pipe*).

e. *Kmart Corp. v. Taxation and Revenue Dep't*, (N.M. Sup. Ct. Docket No. 27,269 (Dec. 29, 2005), *aff'g*, *Matter of Kmart Props., Inc.*, No. 21140 (N.M. Ct. App. 2001), Although holding that the Michigan holding

company was subject to tax based on attributional contacts with the state, the Court of Appeals had court recognized a distinction in the substantial nexus requirements for purposes of imposing a duty to collect tax. “Unlike an income tax, a *sales and use tax* can make the taxpayer an agent of the state, obligated to collect the tax from the consumer at the point of sale and then pay it over to the taxing entity. Whereas, a state income tax is usually paid once a year, to one taxing jurisdiction and at one rate, a sales and use tax can be due periodically to more than one taxing jurisdiction within a state and at varying rates. Thus, collecting and paying a sales and use tax can impose additional burdens on commerce that the Supreme Court has repeatedly identified in prior opinions.”

f. Ltr. Rul. 05-08, Massachusetts Department of Revenue (November 21, 2005) – The Department announced that a Massachusetts commodity advisor acting as an independent contractor on behalf of a foreign portfolio company will qualify for the independent contractor exception and will not create nexus in the state under the state’s *corporation excise tax*.

g. Ltr. Rul. No. CRP-05-003, Pa. Dept. of Rev., (August 8, 2005) – The ruling held that a foreign liability company would have taxable nexus for purposes of the Pennsylvania *franchise tax* if its affiliate solicited sales in the state on its behalf.

h. Virginia Tax Bulletin, No. 05-3, Virginia Department of Taxation (April 18, 2005). The Department announced that, for purposes of the state’s *corporate income tax*, it will not assert nexus over a financial corporation solely because of services performed in Virginia by an independent contractor or the existence of an independent contractor’s office in Virginia.

(i) This bulletin was promulgated in response to *General Motors Corp. v. Virginia*, 268 Va. 289 (2004). The Virginia Supreme Court invalidated the Department’s regulation that limited the costs of performances used to apportion a financial corporation’s income to direct costs, excluding costs of independent contractors.

i. Decision of the Comptroller of Public Accounts, Hearing No. 44,735 (April 6, 2005) – A direct sales and network marketing company that sold a variety of products and services to marketing professionals had substantial nexus with Texas for the Texas *franchise tax*. The company sold memberships that allowed Texas customers to purchase products and become affiliate independent contractors who solicited sales of company memberships, goods, and services in Texas. Substantial nexus was found because the activities of the affiliates exceeded the mere solicitation of orders for tangible goods.

j. *Ion Technologies, Inc. (Advisory Opinion)*, TSB-A-05(6)C), N.Y.S. Comm'r of Tax'n and Fin. (March 10, 2005). A foreign corporation that has an employee performing research in New York is considered to be "doing business" in the state for purposes of the *franchise tax*. The opinion noted that even a single employee working for the foreign corporation constitutes "doing business" under New York tax regulations. If the individual performing the research were an independent contractor, the foreign corporation would not be subject to the tax because the research activities of that individual in New York would not constitute "doing business" on the part of the foreign corporation.

k. *Boat American Corp. and BoatU.S. (Advisory Opinion)*, TSB-A-04(3)S, N.Y.S. Comm'r of Tax'n and Fin. (Feb. 24, 2004) – The New York State Department of Taxation and Finance found nexus for *sales and use tax* purposes in the case of an association for boaters (an out-of-state non-profit membership organization) that had no physical presence in New York. The Department based its decision on the New York activities of two unrelated independent contractors. First, the Department ruled that where retail stores carried the boaters' association's name and sold association memberships, the stores acted as independent representatives who created nexus through their sales. Second, the Department found that the association's agreement with local towing companies regarding emergency towing services created nexus.

l. *Dillard Nat'l Bank, N.A., v. Johnson*, Tennessee Chancery Court, 20th Jud. Dist., Davidson County, No. 96-545-III (June 22, 2004) – Dillard National Bank ("DNB") was a subsidiary of Dillard Department Stores. DNB issued proprietary credit cards that could only be used at Dillard stores. The Court held that nexus existed for Tennessee *corporate tax* purposes based on a conglomerate of activities conducted by Dillard Department Store employees in Tennessee on behalf of DNB. The activities included distributing and soliciting applications in the stores, placing ads in local newspapers, taking applications, issuing temporary charge cards, and answering questions about DNB accounts. The Court found the sporadic presence of DNB employees, DNB's collection activities and the "minimal" use of third party contractors to be immaterial to the nexus determination.

m. *Home Impressions, Inc. v. Dir., Div. of Taxation*, No. 000099-2003, 2004 N.J. Tax LEXIS 14 (Tax Ct. June 7, 2004) – Home Impression, a manufacturer and seller of mailboxes and mailbox posts is incorporated under the laws of North Carolina, which is also its principal place of business. The company solicits orders of its products in New Jersey through independent contractors in New Jersey and otherwise has no other contact with the state. The sole activity of its independent contractors was the solicitation of orders for sales of tangible property. The orders were sent outside New Jersey for approval or rejection and were filled by shipment or delivery from outside New Jersey. The court

found that the activities of the independent contractors in New Jersey were sufficient to create nexus between Home Impression and New Jersey under both the Due Process Clause and the Commerce Clause, as required by *Quill*.

(i) In finding substantial nexus for purposes of the Commerce Clause, the court specifically made no distinction between independent contractors and traditional employees, stating that such a distinction had no "constitutional significance."

(ii) In reaching this conclusion, the court cited *Scripto, Inc. v. Carson* that held that an out of state vendor must collect a *use tax* based upon the fact that the seller's in-state solicitation was performed by independent contractors who had a physical presence within the State. *Scripto, Inc. v. Carson* 362 U.S. 207 (1960).

n. Texas Comptroller of Public Accounts, Decision Hearing No. 39,829 (Feb. 24, 2004) – Nexus, as required to impose *sales and use tax* liability, was created in Texas based on physical presence, where a debt collection service company employed at least six contract salesmen to solicit business in Texas for the company. The sales of the debt collection services constituted "doing business" in Texas. Additionally, the contracts of the debt collection service company specifically provided for debt collection services in Texas, and one such contract required the company to provide internal staff for client-related activities.

o. *Dell Catalog Sales v. Comm'r of Revenue Servs.*, 48 Conn. Supp. 170 (Ct. Superior Ct. 2003) – BancTec served as an independent contractor to Dell, a remote catalog vendor that was selling computer repair service contracts to its customers. BancTec provided Dell's customers with computer repairs under the service contracts, and the Connecticut Department of Revenue Services sought to impose a *sales and use tax* collection obligation on Dell based on BancTec's activities in Connecticut. Although the Court did not outright reject the notion that BancTec's activities could create nexus for Dell, it nonetheless held that there was insufficient evidence of BancTec's Connecticut activities to allow a finding of nexus.

p. *Matter of Family of Eagles*, 275 Kan 479 (April 18, 2003) - A Texas company selling products nationwide through independent sales representatives was liable for Kansas *use tax* for the products sold in Kansas. The products were sold through word-of-mouth or person-to-person contact by the independent sales representatives without the use of advertising or sales aids provided by the company. The independent sales representatives completed order forms and submitted them to the company for approval but did not accept orders, distribute merchandise, or perform any services after the sale. The court relying on *Scripto* held these contacts to be sufficient to establish nexus.

q. *In re Barnes & Noble.com,* SC OHB 97-732835 (Cal. State Bd. of Equalization, Sept. 24, 2002) - Barnes & Noble.com acquired a taxable nexus with California and was required to collect *use tax* on purchases made on its website and delivered to California customers. The distribution of coupons redeemable on Barnes & Noble.com's website by Barnes & Noble Booksellers, Inc., an affiliated corporation that sells similar goods in "brick and mortar" stores throughout the country, including California, constitutes a selling activity by Barnes & Noble.com.

r. *America OnLine v. Johnson*, TN Ct. of App., No. 97-3786-III (July 30, 2002). In reviewing a decision on a motion for summary judgment granted, the Court of Appeals held that certain activities in the state that facilitated the operations of AOL precluded a judgment that it did not have nexus with the state. The lower court, relying in part on the Court of Appeal's decision in *J.C. Penney* determined that AOL was not subject to tax merely because it had customers in the state, sent software and advertisements into the state, and leased modems in the state. In a retreat from its earlier decision in *J.C. Penney*, the Court of Appeals determined that physical presence was not the only criterion for determining substantial nexus where a state seeks to impose an *income tax* on a foreign corporation. The court stated (in explaining its departure from the physical presence standard in *J.C. Penney*) that "[p]erhaps it would have been more accurate to say that the Supreme Court had rejected state taxes on interstate commerce where no activities had been carried on in the taxing state on the taxpayer's behalf." The court suggested that an evaluation of the activities of certain of AOL's network service providers in the state was crucial to the determination of whether nexus was established.

s. *Comm'r of Revenue v. Jafra Cosmetics*, 433 Mass. 255 (Jan. 25, 2001). Company with in-state consultants demonstrating and selling its cosmetics line had representatives in the state and, thus, had substantial nexus for *sales and use tax* purposes. Taxpayer had argued that consultants were representing their own, independent business, and were not acting on behalf of the out-of-state company. The "representatives" were not merely sales agents, they were "retailers" who purchased inventory from Jafra. *Cf. Shaklee Corp. v. Comm'r of Revenue*, Mass. App. Tax Bd., Nos. F245496, F24597 (Feb, 7, 2000) (A manufacturer of household products was not subject to Massachusetts excise tax or sales and use tax collection based on the sales activities of local independent contractors or a single sales convention in the state. The board found the local sales representatives operated independent businesses, and thus did not create nexus subjecting Shaklee to *sales/use tax* collection obligations in the state.)

t. *JS&A Group, Inc. v. State Bd. of Equalization*, No. 1075021 (Cal. Ct. App. 1997). A company whose only contacts with California consisted of entering into advertising contracts with California broadcast and cable television companies, soliciting sales through mailings, and shipping

goods via common carriers was not liable for collection of *use tax*. The court rejected the SBE's argument that the contracts converted the television operators into the company's representatives, thus establishing a physical presence in the state.

u. *In re Scholastic Book Clubs, Inc.*, 920 P.2d 947 (Kan. 1996) - The taxpayer was a mail-order seller of children's books. The taxpayer sent catalogs to schoolteachers who distributed the catalogs to their students and collected and submitted the orders to the taxpayer. Teachers received bonus merchandise in proportion to student purchases. Kansas asserted that the taxpayer was subject to *use tax* liability in Kansas because the teachers were acting as sales agents of the taxpayer and, thus, created physical presence for the taxpayer in the state. The Kansas Supreme Court determined that the teachers were the taxpayer's implied agents because the teachers acted under the taxpayer's authority once they chose to sell the books. The court determined that the taxpayer's use of the teachers created substantial nexus with Kansas and, thus, the taxpayer was required to collect sales tax on the book orders. The state courts that have addressed the issue have come to widely divergent results. *Cf.* (A) *Scholastic Book Clubs, Inc. v. State Bd. of Equalization*, 207 Cal. App. 3d 734, 255 Cal. Rptr. 77 (1989) (once publisher accepted an order from a teacher, publisher ratified teacher's authority to act on its behalf, thus creating an agency relationship), (B) *Pledger v. Troll Book Clubs, Inc.*, 871 S.W.2d 389 (Ark. 1994) (no agency relationship existed because of lack of requisite control, thus, no nexus), (C) *Troll Book Clubs v. Tracy*, Case No. 92-Z-590, 1994 Ohio Tax LEXIS 1374 (Aug. 19, 1994) (Ohio teachers not controlled by publishing company, thus, no nexus).

v. *Serv. Merchandise Co., Inc. v. Arizona Dep't of Revenue*, 937 P.2d 336, 341 (Ariz. 1996) - Arizona could impose *use tax* on the taxpayer due to catalogs that were sent into Arizona by an out-of-state printer because the taxpayer had sufficient nexus with Arizona to satisfy Commerce Clause principles. The taxpayer "determined that Arizona households would receive the catalogs and fliers and directed that they be sent into Arizona. The purpose of sending the catalogs into Arizona was to encourage Arizona residents either to shop in one of the two [taxpayer's] stores in Arizona or to order goods by mail. Although it only has two stores in Arizona, its presence is not so minimal that the nexus between Arizona and (the taxpayer's] efforts to distribute catalogs and fliers in [Arizona] is insubstantial." The court implicitly found that the postal service, when conducting its activities in Arizona, was the agent of the out-of-state shipper and thus attributed those in-state activities to the out-of-state shipper. Although this was a finding that the out-of-state shipper conducted activities in the state for purposes of determining whether it used the property in the state, it is not dissimilar from attributing nexus.

w. Vermont Ruling 96-14 (October 14, 1996) - A California company engaged in support and maintenance of an “electronic mall” accessible through the internet sought a ruling on its liability for the collection of *sales tax*. The company maintained a server in California and rendered all services in California. The Department of Taxes ruled that as an agent for its client retailers, the company was responsible for collecting sales tax on transactions with a retailer’s customers in Vermont.

x. *SFA Folio Collections, Inc. v. Comm’r*, 73 Ohio St. 3d 119, 652 N.E. 2d 693 (Ohio 1995) -The taxpayer sold clothes to Ohio customers through catalogs. An affiliate of the taxpayer, Saks Fifth Avenue of Ohio (“Saks-Ohio”) operated stores in Ohio. Saks-Ohio stores received copies of the taxpayer’s mail order catalogs and made copies available for store customers to review. Saks-Ohio stores also accepted returns of the taxpayer’s mail order merchandise. The Ohio Tax Commissioner assessed the taxpayer *use tax* on its Ohio sales claiming that the taxpayer had substantial nexus with Ohio through its unitary relationship with Saks-Ohio. The Ohio Supreme Court determined that under *Quill*, the vendor itself must have physical presence in Ohio. Inasmuch as the taxpayer and Saks-Ohio were different legal entities and the retail stores did not conduct activities in Ohio on behalf of the taxpayer, the stores’ physical presence in Ohio did not establish nexus.

y. *Current, Inc. v. California State Bd. of Equalization*, 24 Cal. App. 4th 382, (Cal. App. 1994) – Current, an out-of-state company with no property or payroll in California, which sold and shipped its novelty printed items to California resident individuals and fund-raising groups, was purchased by a company with plants and personnel in California that engaged in the sale of printed items, such as checks, through financial institutions. The California State Board of Equalization thereafter asserted a *use tax* collection responsibility on Current under Code § 6203(g), as a “retailer owned or controlled by the same interests which own or control any retailer engaged in business in the same or similar line of business,” in California. Noting that the two companies “were organized and operated as separate and distinct corporate entities,” and were not the “alter ego or agent of the other for any purpose,” the Court of Appeals found that Current did not have sufficient nexus with California to “justify the imposition of a use tax,” collection responsibility upon it. The court also found the statute as applied to Current to violate the Commerce Clause. The court alternatively found that the SBE’s interpretation of the statute’s scope was too broad, because the common reproduction by printing was “too common a denominator to constitute a meaningful distinction,” and that the common production of checks, which was a small portion of Current’s business, was insufficient to constitute “the same or similar line of business,” as required by § 6203(g).

z. *Bloomingdale’s By Mail, Ltd. v. Pennsylvania Dep’t of Revenue*, 130 Pa. Commw. 190, 198, 567 A.2d 773, 778 (1989) *aff’d*, 527 Pa. Commw.

347, 591 A.2d 1047 (1991) - A corporation whose only connection with Pennsylvania was the solicitation of sales through catalogs mailed into Pennsylvania from outside of the state and the shipment of goods into Pennsylvania from outside of the state did not have an obligation to collect *use tax* on shipments of goods into Pennsylvania. Substantial nexus was not established through the presence of an affiliate's retail stores in Pennsylvania because the stores "do not solicit orders on [the catalog company's] behalf nor act as its agents in any fashion and [the catalog company] does not solicit orders for [the in-state stores]." The only connections between the catalog company and the stores were two documented instances where a catalog item was returned to a store in Pennsylvania – even though the catalog specified that items should be returned only by mail - and the fact that the catalogs and the stores used the same advertising themes.

aa. *SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666 (Conn. 1991) The taxpayer, a brother/sister corporation of a corporation that operated a retail store in Connecticut, operated a mail order merchandise business outside of Connecticut and sent merchandise to Connecticut customers by mail and common carrier. The taxpayer was not licensed to do business in Connecticut and did not maintain tangible personal property, personnel, telephone listings or bank accounts in the state or conduct credit investigations or collections in the state. The taxpayer did mail catalogs to Connecticut residents and place advertisements in magazines that reached Connecticut residents. The taxpayer did not operate retail stores and did not maintain any physical location in Connecticut. Orders were received by mail or telephone in New York, where the orders were filled and delivered to the U.S.P.S. or other common carrier. The taxpayer and its parent shared sales and financial data although their management groups were separate and operated autonomously. The taxpayer provided, by common carrier, extra catalogs to the affiliated corporation for employee training and the taxpayer's customers could use the affiliated corporation's tailoring services, which were available to anyone. Also, the taxpayer and the affiliated corporation sold some of the same items, which were also available at other retail stores throughout the country. The Court found no greater nexus between Connecticut and the taxpayer than existed between Connecticut and the out-of-state corporation in *Cally Curtis Co. v. Groppo*, an earlier Connecticut Supreme Court decision applying *National Bellas Hess, Inc. v. Dep't of Revenue,* 386 U.S. 753 (1967), to a corporation operating under similar circumstances. The taxpayer's operations, viewed independently, did not have a constitutionally sufficient nexus with Connecticut to support the imposition of *sales and use taxes*. Moreover, the taxpayer was a distinct corporate entity and there was no basis to disregard its separate corporate existence for purposes of imposing sales and use taxes.

bb. West Virginia Tax Department, Technical Assistance Advisory, TAA 2005-02 (August 24, 2005) – Provision of customer support services by

a West Virginia subsidiary to out-of-state entities, including related corporations and third parties with no physical presence, would not cause nexus to be imputed to the out-of-state entities for purposes of the state's *sales and use taxes*.

cc. *ReveNews*, Maryland Comptroller of the Treasury, Fall 2005 – The Comptroller stated Maryland's position that out-of-state vendors have nexus for *sales and use tax* purposes if they have offices, distribution, storage or other facilities for the sale of tangible personal property or a taxable service in Maryland or have an agent, salesperson, repairman, or other representative in the State or that enters the State on a regular basis.

In particular, out-of-state internet or catalog businesses that allow "brick and mortar" retailers to place orders, take returns or provide other services on their behalf are required to collect the Maryland sales and use tax on all taxable sales and services delivered to Maryland customers, even though these businesses are separate legal entities.

dd. Ltr. Rul. 05-7, Massachusetts Department of Revenue (November 8, 2005) – The Commissioner of Revenue ruled that there was no *sales and use tax* nexus for a corporation that opens a retail store in the state and whose foreign parent corporation and other wholly owned subsidiaries sell similar tangible personal property by mail order or the Internet to in-state residents. The corporation does not conduct in-store advertising for affiliated companies and no website addresses, telephone or other contact information appear on the corporation's shopping bags, store receipts or in store displays. However, the corporation has a "repurchase" policy to repurchase or replace products they normally carry even if the item was not originally purchased at that store. Catalogs for the affiliates companies are available to customers upon request but are primarily used by store employees.

(i) The commissioner concluded that there must be some additional connection between related corporations beyond a related company name and similar inventory to constitutionally require an out-of-state affiliate to collect sales or use tax.

(ii) The corporation's "repurchase" policy was distinguished from other return policies that encourage in-store return of items bought on-line or from a catalog. The activity was not found to meaningfully benefit the affiliate companies.

(iii) Use of catalogs and a common gift certificate were found to only incidentally benefit the affiliated companies.

(iv) On July 30, 2007 the Department revoked Ltr. Rul. 05-7.

ee. Several states have legislation or regulations addressing affiliate nexus. These acts consider an out-of-state retailer with an in-state affiliate to have nexus with the state when certain conditions are met. For example:

(i) Minnesota Chap. 377 defines retailer maintaining "a place of business in the state" as a person with an affiliated entity that has a place of business in Minnesota.

(ii) Washington Rev. Code §§ 82.08.050(7) (2003), and 82.12.040(5) (2005). Section 82.08.050(7) sunsets July 1, 2008 an is reincorporated as 82.08.050(11) (2008) taking effect July 1, 2008. The Washington Sales and Use Taxes provide that a person making sales in Washington is not subject to sales and use tax requirements if the person's activities are limited to:

(a) The storage, dissemination or display of advertising;

(b) The taking of orders;

(c) The processing of payment; or

(d) When the activities are conducted electronically via a website or a server or other computer equipment located in Washington that is not owned or operated by the person making sales into this state nor owned or operated by an affiliated person.

(iii) The Alabama legislature added Section 40-23-190 to the Alabama Code in 2003, which creates conditions for "remote entity nexus." The first condition is that an out-of-state vendor and in-state vendor must maintain one or more location in Alabama and be related parties. If this threshold condition is met, the out-of-state vendor will be deemed to have substantial nexus with Alabama for sales and use tax collection purposes if one of the following is true:

(a) The out-of-state vendor and the in-state business use an identical or substantially similar name, trade name, trademark, or goodwill to develop, promote, or maintain sales;

(b) The in-state business and the out-of-state vendor pay for each other's services in whole or in part contingent upon the volume or value of sales;

(c) The in-state and the out-of-state vendor share a common business plan or substantially coordinate their business plans; or

(d) The in-state business provides services to, or that inure to the benefit of, the out-of-state business related to developing, promoting, or maintaining the in-state market.

The main target of this bill appears to be out-of-state Internet vendors that are related to “brick and mortar” business located in Alabama.

(iv) Kentucky Rev. Stat. 139.340(2)(f) (2005). The Kentucky legislature amended the definition of a “retailer engaged in business in this state” for purposes of sales tax nexus to include any retailer located outside Kentucky that uses a representative in Kentucky, either full-time or part-time, if the representative performs any activities that help establish or maintain a marketplace for the retailer, including receiving or exchanging returned merchandise.

(v) New York has proposed an amendment to the definition of “vendor” in Tax Law § 1101(b)(8)(i)(C)(I), to include a purportedly rebuttable presumption that out-of-state sellers who receive direct or indirect referrals from New York residents who solicit the sales in the State through their own websites are “vendors” and are therefore responsible for collecting sales and use taxes. This presumption applies where the aggregate gross receipts from sales attributable to New York resident referrals exceed $10,000 for the previous four quarterly periods. This amendment, S.B. 6810, Part X (Jan 23, 2008), would be effective January 1, 2008.

V. Local Nexus

A. Alabama

1. Under an Alabama regulation and several rulings, a business must have either a physical location or a salesperson present in the locality in order for the business to be subject to sales or use tax in the locality. Ala. Admin. Code § 810-6-3-.51(2); *Yelverton’s v. Jefferson County, Alabama,* 742 So.2d 1216 (Ala. Civ. App. 1997), *aff’d per curiam* 742 So. 2d 1224 (ala. 1999); *Diversified Sales, Inc. v. Dep’t of Rev*., Dkt. No. S06-937 (Sept. 4, 2007).

2. *Crown Housing Group, Inc. v. Department of Revenue*, Ala. Admin. Law Div., No. S. 06-399 (July 26, 2007). A retailer of mobile homes and modular buildings that only collected local sales tax on sales into jurisdictions where it had outlets, was assessed a deficiency for sales tax on sales delivered into local jurisdictions where it did not have a physical presence. Though the local tax portion of the assessment was not at issue on appeal, the ALJ stated that for intrastate commerce, local use tax collection responsibility turned solely on due process nexus requirements, not the Commerce Clause, and criticized the *Yelverton’s*

Court for ignoring *Quill* in interpreting the due process nexus standard for intrastate sales in § 810-6-3-.51(2) to require physical presence.

B. Arizona

1. Under the Arizona Model City Tax Code, a business is not subject to sales or use tax or excise tax in a jurisdiction unless that business is deemed to be "engaged in or continuing in business" within the jurisdiction. Model City Tax Code Reg. 301.(a).

2. A business generally is found to be engaged in or continuing in business if it maintains a place of business or warehouse within the jurisdiction, is engaged in business activity in the jurisdiction or has salespeople in the jurisdiction. An Arizona Court of Appeals decision held that a business was subject to local sales and use tax in a jurisdiction where it had a physical presence in that jurisdiction. *Centric-Jones Co. v. Town of Marana,* 937 P.2d 654 (Ariz. Ct. App. 1996).

C. Colorado

Colorado's Supreme Court has interpreted the Colorado Constitution to include due process limitations similar to those provided in the federal Constitution. *Associated Dry Goods Corp. v. City of Arvada*, 593 P.2d 1375 (Colo. 1979). The court has relied on those due process limitations in holding that a city could not impose a use tax on a business that had no fixed or transitory situs in the taxing jurisdiction. The business in the case delivered goods to persons throughout the state by its own trucks and by common carrier.

VI. Business Activity Tax Simplification Act ("BATSA") legislation

A. Supporters of federal BAT nexus legislation are asking Congress to enact S. 1726. United States Senators Mike Crapo (R,-Idaho) and Charles E. Schumer (D-New York) introduced the Business Activity Tax Simplification Act for the 110th Congress on June 28, 2007

1. What does BATSA do?

a. Modernizes P.L. 86-272.

(1) Deletes "tangible personal property" language and adds the term "transactions." This ensures that the protection for solicitation activities extends to all sales, which recognizes the increased focus in the American economy on intangibles and services.

(2) Adds the concept of "fulfillment" to acknowledge that not all sales or transactions are "shipped or delivered"

(3) Adds "business activity taxes" in addition to "net income taxes." This ensures that protections of P.L. 86-272 extend to all business activity taxes, which recognizes the proliferation on

business activity taxes not based on income (gross receipts taxes, capital taxes, etc.).

(4) Implements a physical presence standard for all business activity taxes.

(a) Provides qualitative and quantitative de minimis standards.

(i) Quantitative: Employees in a state for less than 21 days.

(ii) Qualitative: Acting as a customer in the state, e.g., visiting vendors, attending conferences, media events, etc.

(5) Clarifies that certain situations subject a person to tax.

(a) Entertainers and athletes.

(b) Off-the-truck/over-the-counter sales; itinerate handymen

(c) Maintaining an office and storing inventory (this is property in a state).

(6) Addresses those situations when attribution of nexus to other persons is appropriate.

2. Why is Congress Being Asked to Act?

a. Problems that the Federal Legislation seeks to Address

(1) Uncertainty

(a) There is no clear standard governing when a state or locality may impose its business activity taxes on an out-of-state business.

(b) The Supreme Court has declined to rule on the nexus standard as applied to business activity taxes, apparently preferring to leave the matter for resolution by Congress.

(c) The existing federal statute addresses only a subset of the issue.

(2) Controversy

(a) The lack of a clear standard has engendered contentious tension between the state taxing authorities and businesses.

(b) Many states and localities are trying to impose tax on businesses that merely have customers in the taxing jurisdiction (“economic nexus”).

(c) Businesses want to pay their fair share of tax where they receive the benefits and protections of the state government (“physical presence nexus”).

(3) Wasted resources

(a) Compliance with increasingly complex and divergent state and local tax laws and rules places a large burden on interstate commerce.

(b) Litigation absorbs resources (management attention and expenses) that could be used to strengthen the economy.

(4) Chilling effect on interstate commerce

(a) Businesses are hesitant to expand their activities that may cross an invisible “threshold” and make them taxable in other states.

(b) Businesses are forced to construct inefficient business structures.

(5) International ramifications

(a) There is a dramatic, antithetical “disconnect” between the permanent establishment concept used by the U.S. in international tax treaties and the economic nexus standard favored by some state and local tax jurisdictions

(b) If economic nexus becomes an acceptable standard for state and local taxation:

(1) U.S. businesses would be competitively disadvantaged because they will be subject to a greater tax burden than foreign businesses.

(2) The strength of the U.S. in treaty negotiations with countries that favor eliminating the permanent establishment standard would be significantly weakened.

b. How the Proposed Legislation Addresses the Problems

(1) Benefits and Protections.

(a) A physical presence nexus standard ensures that businesses are taxed only where they receive protections and benefits (fire, police, etc.) of the state.

(b) The argument that states "contribute to nation as a whole" is not a justification for taxing businesses that do not have a physical presence in a state.

(2) Bright-line Standard. A physical presence nexus standard is fair and administrable.

(a) Eases compliance burdens created by current complex and divergent state and local tax laws.

(b) Minimizes litigation, thereby freeing resources (management attention and expenses) that can otherwise be used to strengthen the economy.

(3) International Harmony.

(a) Ensures consistency with the permanent establishment concept used by the U.S. in international tax treaties.

(i) Protects the strength of the U.S. in treaty negotiations with countries that favor eliminating the permanent establishment standard would be significantly weakened.

(b) Creates a level playing field for U.S. and foreign businesses.

c. Other Considerations

(1) No Effect on Federalism or Infringement on States' Rights

(a) U.S. Constitution grants Congress the authority to regulate interstate commerce.

(b) This is an issue of when a state can tax, not *what or how* a state can tax. State legislatures remain free to, among other things:

(i) Decide the type of tax(es) imposed, *e.g.*, an income tax, a gross receipts tax, a value added tax, or a capital stock tax.

(ii) Determine how to apportion the income that is taxed in the state, be it a single- or three-factor formula based on property, payroll and/or sales.

(iii) Set the rate at which the tax chosen will be imposed.

(iv) Determine whether to follow federal taxable income, e.g., to choose whether to decouple from federal bonus depreciation.

(v) To provide credits or deductions for certain types of expenses.

(2) No Material Effect on Revenue

(a) Businesses that have a facility and/or inventory in the state remain subject to tax

(b) Consensus is that few businesses that do not have a facility are actually paying tax

(c) Result is that businesses will continue to pay their fair share because they will be paying tax where income is earned.

(3) Not a Vehicle For Promoting Tax Shelters.

(a) Opponents of a physical presence nexus standard argue that economic nexus is required to combat “abusive” tax shelters, such as passive investment companies.

(b) States have many other methods of attacking such perceived tax shelters.

(i) Combined reporting. *See, e.g., Matter of Sherwin-Williams Co*., N.Y.S. Div. of Tax App., Tax. App. Trib., DTA No. 816712 (June 5,

2003); Va. Dep't of Tax'n, Ruling of Comm'r, P.D. 05-139 (Aug. 23, 2005).

(ii) Statutory addbacks, deduction denial. *See, e.g.*, Ala. Code § 40-18-35(b); Ark. Code Ann. § 26-51-423(g)(1); Conn. Gen. Stat. § 12-218c; Ga. Code Ann. § 48-7-28.3; Ky. Rev. Stat. Ann. § 141.205; Md. Code Ann., Tax § 10-306.1; Mass Gen. Laws ch. 63, §§ 31I, 31J, 31K; Miss. Code Ann. § 27-7-17(2); N.J. Stat. Ann. § 54:10A-4.4; N.Y. Tax Law § 208(9)(o); N.C. Gen. Stat. § 105-130.7A; Ohio Rev. Code Ann. § 5733.042; and Va. Code Ann. § 58.1-402B. *See also* Multistate Tax Commission Model Statute Requiring the Add-back of Certain Intangible and Interests Expenses, Multistate Tax Commission (Adopted August 17, 2006).

(iii) Common law principles, such as economic substance, sham transaction, lack of valid non-tax business purpose, and alter ego. *Syms Corp. v. Commissioner of Revenue*, 765 N.E.2d 758 (Mass. 2002); *Comptroller of the Treasury v. SYL, Inc.*; *Crown Cork & Seal Co. (Del.), Inc.*, 825 A.2d 399 (Md. 2003), *cert. denied*, 540 U.S. 9 and 540 U.S. 1090 (2003).

(iv) I.R.C. § 482-type authority to make adjustments to properly reflect income.

d. Who are the Stakeholders?

(1) For. Many American businesses, some state government officials (mostly from the legislative branch), and economists believe that states should not be able to impose tax on an out-of-state business unless that business has a physical presence in the taxing state.

(a) American Legislative Exchange Council:

(i) ALEC has adopted a resolution supporting enactment of federal legislation implementing a physical presence standard.

(ii) ALEC has crafted model legislation enacting a physical presence standard, similar to the proposed federal legislation.

(2) Against. Some state government officials take the opposite position and assert that a state may impose tax on any business that has customers in the state. Opponents of such legislation argue that federal BAT nexus legislation is an infringement on state sovereignty, would reduce state tax revenue, and would facilitate “tax shelters.”

(a) Multistate Tax Commission “factor-presence” nexus standard:

(i) The MTC states that it objects to codification of the physical presence nexus standard for business activity taxes. Multistate Tax Commission Resolutions Committee Policy Statement 02-02, “Ensuring the Equity, Integrity and Viability of State Income Tax Systems,” as amended October 17, 2002.

(b) The Federation of Tax Administrators approved a resolution to oppose federal efforts to establish nexus standards for state business activity taxes, such as H.R. 1956, at its annual business meeting on June 15, 2005.

(i) At the meeting, FTA Executive Director Harley Duncan specifically noted that one major concern that states had with such legislation was that it would create significant opportunities to engage in a variety of tax planning activities.

(ii) Also, the Executive Director criticized the bill for being internally inconsistent. “If a clear definition of physical presence is good, then there should be no need to carve out all sorts of activities that don’t constitute physical presence. But the bill does just that.”

(c) Montana resolution (S.J. 32) supported by the Commissioner of Revenue, Dan Bucks, opposed introduction of federal legislation implementing a physical presence standard for business activity taxes. The measure died in the House committee

(ii) More information on this issue can be found at www.batsa.org.

VII. MTC Proposal

MTC Factor Presence Nexus: Multi-state Tax Commission Resolutions Committee Policy Statement 02-02, “Ensuring the Equity, Integrity and Viability of State Income Tax Systems,” as amended October 17, 2002. The MTC states that it objects to codification of the physical presence nexus standard for business activity taxes. Rather, the MTC proposes an economic nexus standard for business activity taxes based on the “factors” of a business assignable to a state, as in the standard apportionment formula of the Uniform Division of Income for Tax Purposes Act (“UDITPA”):

A. Like the UDITPA formula, the MTC standard is based on the three factors of property, payroll, and sales.

B. Under the MTC standard, a state could impose a business activity tax on any business whose factors in a state exceed certain threshold amounts, namely $50,000 for property, $50,000 for payroll, and $500,000 for sales.

VIII. General Statutory Economic Nexus

A. Ohio Commercial Activity Tax.

1. Effective July 1, 2005, Ohio imposes a commercial activity tax (“CAT”), which is an annual privilege tax that is measured by gross receipts from business activities in Ohio.

2. A taxpayer is deemed to have “substantial nexus” for purposes of the CAT if:

a. the taxpayer owns or uses a part or all of its capital in Ohio;

(1) the taxpayer holds a certificate of compliance to do business in Ohio;

(2) the taxpayer has “bright-line presence” with Ohio; or

(3) the taxpayer otherwise has nexus pursuant to the U.S. Constitution.

b. For purposes of the CAT, “bright-line presence” is defined to include any taxpayer that meets any of the following:

(1) Is domiciled in Ohio.

(2) Has at least 25% of its total property, payroll and sales in Ohio; or

(3) Has at least $500,000 in taxable gross receipts in Ohio;

(4) Has at least $50,000 in real or personal property in Ohio;

(5) Expends more than $50,000 in payroll for work in Ohio.

B. Michigan Business Tax

1. Michigan has a new business tax, replacing the Single Business Tax, that will be effective beginning on January 1, 2008. The new tax involves both an income tax and a modified gross receipts tax.

2. The income tax is applicable to every taxpayer with “business activity” within the state unless prohibited by Pub. L. No. 86-272. The modified gross receipts tax is imposed on all taxpayers with gross receipts sourced to the state in excess of $300,000 that have physical presence in the state for one or more days or that solicit sales in the state.

C. New Hampshire Business Tax

1. New Hampshire's recent budget bill amends the definition of "business activity" for purposes of the business profits tax. The amendment is effective July 1, 2007.

2. Under the amendment, a business is conducting "business activity" in New Hampshire, such that it can be subject to the business profits tax, if the business has a "significant economic presence" in New Hampshire, as evidenced by a purposeful direction of business toward the state examined in light of the frequency, quantity and systematic nature of a business's economic contacts with New Hampshire. The "significant economic presence" standard is the Commerce Clause substantial nexus standard endorsed by the West Virginia Supreme Court in its MBNA decision.

D. Oregon Economic Nexus

1. S.B. 177, 74th Or. Leg. Assem., Reg. Sess, (2007). This bill specifies that nonresident individuals and business entities will have substantial nexus with Oregon if certain levels of payroll, property, or sales are exceeded in state.

a. These levels are as follows:

(i) $50,000 in payroll

(ii) $50,000 in real and tangible personal property owned or rented in state.

(iii) $500,000 in gross sales in state.

b. Alternatively, if persons or entities have more than 25% of payroll, property, or sales in the state, that person or entity has substantial nexus with Oregon even though its total figures do not exceed those listed above.

c. This statute also provides for an aggregation approach for commonly owned enterprises. This aggregation approach calls for the aggregation of all commonly-held enterprises whose payroll, property, and sales exceed $5,000 in Oregon. Enterprises that independently meet the nexus tests are included in this aggregate determination.

2. Oregon Administrative Rule 150-318.020

The Oregon Department of Revenue has issued a proposed rule on treatment of intangible property in Oregon with respect to nexus for out-of-state corporations for corporate income and/or excise tax purposes. The proposed rule would cause an out-of-state corporation to have a minimum connection for income tax purposes if it maintained tangible or intangible property in Oregon, entered into franchising or licensing agreements for use of a franchise or license in Oregon, received franchise fees or royalties form Oregon sources, sold or otherwise disposed of a franchise or license used in Oregon, or sold or otherwise transferred tangible personal property to a franchisee or licensee in the state. Additionally, corporations with receipts from royalties, franchise fees, or the sale or transfer of tangible personal property pursuant to a franchise or license agreement might be subject to the corporate excise tax if they were found to be “doing business” in Oregon. Activities such as inspecting a franchisee’s businesses or records would subject a corporation to the corporate excise tax, but not to the corporate income tax.

E. South Carolina Nexus Creating Activities

On December 3, 2007 the South Carolina Department of Revenue issued a Draft Revenue Ruling (Rev. Rul. 07-Draft), clarifying Revenue Ruling 98-3, in which it enumerated specific activities that do not create income tax nexus for out-of-state companies. A number of the activities listed in the draft are detailed to a degree that may signal a shift in the interpretation of nexus-creating activities. For example, nexus will not be imputed as a result of a subsidiary conducting “unrelated, non-unitary business” activities. Rev. Rul. 98-3 was less specific about the type of business that could be transacted. Similarly, whereas Rev. Rul. 98-3 indicated that “using” the South Carolina court system would not create nexus, the current draft specifies that “defending” a lawsuit in the state will not create nexus. The draft also clarifies that presence in South Carolina for the purpose of purchasing raw materials and inventory will not create nexus when it is for less than five days, whereas the previous Ruling did not specify a day limitation. Finally, employee visits for training seminars, conventions, retreats, and board of director meetings, that last for fourteen or fewer days, are still not considered nexus-creating but now have the additional limitation that the employee may not conduct or solicit any business in person with anyone outside of the company while attending an event in South Carolina. Moreover, attendance at trade shows was previously included in this event list but has been removed.

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