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State Tax Return

NEXUS: UPDATE ON RECENT DEVELOPMENTS

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We keep track of nexus developments on a regular basis - legislation, administrative interpretations, the passage of rules and regulations, and court cases. This issue of our newsletter updates important nexus developments during the Second Quarter 2008. It is organized by the kind of activity that tends to give out-of-state entities nexus planning and litigation difficulties, such as sales personnel who travel in and out of states, affiliate nexus, intangible nexus, doing business in the state, and whether P.L. 86-272 immunizes certain non-sales activities. The State of New York was especially active – an adverse P.L. 86-272 decision was issued and the legislature passed the "web affiliate" nexus law, as well as expanding the Bank Franchise Act to cover foreign credit card companies that solicit in-state. We hope you find it helpful in your planning and compliance work.

IN-STATE PERSONNEL

As always, in-state solicitation is a problematical nexus area. Almost every state takes the position now that traveling into a state to solicit sales from current customers, or to find new customers for the company's products, create nexus. This Missouri ruling reached that conclusion, especially because "most" of the products were delivered to customers in company-owned trucks.

MISSOURI

Missouri Department of Revenue Letter Ruling No. LR4643, CCH ¶202-891 (Apr. 1, 2008).

1. Applicant manufactures hardwood molding at a facility located outside Missouri. Applicant has no property in Missouri. However, a salesman based out-of-state travels into Missouri to generate sales. Some repeat sales are ordered directly via phone, fax, or email without salesman intervention. Some sales are delivered by common carrier, but most are delivered by Applicant's employees

in trucks owned by Applicant. Applicant asked for a letter ruling addressing whether: (1) Applicant is required to collect and remit sales or use tax on the sales to customers in Missouri; (2) Applicant is subject to Missouri corporate income or franchise tax.

2. The Department of Revenue found that Applicant is required to collect and remit use tax on the sales to customers in Missouri. Missouri's use tax law provides: "A seller has no place of business in Missouri. A sales representative who works from a non-Missouri location visits Missouri customers. All orders are accepted outside Missouri and goods are shipped to Missouri customers from outside the state. The seller must collect and remit use tax." 12 CSR 10-113.200(4)(G).

3. The Department also found that Applicant is subject to Missouri corporate income and franchise taxes because Applicant is a foreign corporation engaged in business in Missouri and deriving income from Missouri sources.

NEW YORK

Much media attention has been paid to New York's new law that creates "web site nexus," for out-of-state internet vendors that "affiliate" with in-state persons or entities. As noted in this summary, the New York Department of Taxation and Finance has issued an extensive administrative explanation of the new legislation. However, Amazon.com filed a lawsuit against the "web site nexus" legislation, claiming that it violates the Commerce Clause.

New York Senate Bill 6807, Part OO-1 of Chapter 57 of the Laws of 2008, effective Apr. 23, 2008.

1. As written, New York Tax Law 1101(b)(8) provides that every New York seller of tangible personal property or services must register as a vendor and collect sales tax. The tax law provides that any person who solicits New York business by employees, independent contractors, agents, or other representatives is a vendor.

2. New York Senate Bill 6807 amended the tax law to provide a rebuttable presumption that any person making taxable sales of tangible personal property or services is a vendor subject to New York sales and compensating use tax when the seller enters into an agreement with a New York resident to directly or indirectly refer customers to the seller, whether by a link on an Internet website or otherwise, for a commission or other consideration and the agreement generates sales of over $10,000 in the prior four quarterly reporting periods. In that situation, the person is

presumed to be soliciting business in New York through an independent contractor or other representative and will have to charge sales tax on all sales into the state.

3. The presumption may be rebutted by proof that the resident did not engage in any solicitation activities in New York on behalf of the seller that would satisfy the nexus requirements under the U.S. Constitution.

New York State Dep't of Taxation and Finance Admin. Ruling, CCH ¶406-047 (May 8, 2008).

1. Under amended Tax Law § 1101(b)(8), a seller that makes tangible sales of personal property or services in New York is presumed to be a vendor required to register for sales tax purposes and collect sales tax if both of the following conditions are met:

    a. The seller enters into an agreement with a New York resident under which, for commission or other consideration, the resident representative directly or indirectly refers potential customers to the seller, whether by link on an Internet website or otherwise.

        (i) A resident representative would be indirectly referring potential customers to the seller where, for example, the resident representative refers potential customers to its own website or to another party's website which then directs the potential customer to the seller's website.

    b. The cumulative gross receipts from sales by the seller to customers in New York as a result of referrals to the seller by all of the seller's resident representatives totals more than $10,000 during the four preceding quarterly sales tax periods.

2. For purposes of the presumption, a seller is also considered to have met the condition of having an agreement with a New York resident where the seller enters into an agreement with a third party under which the third party enters into an agreement with a New York resident to act as the seller's representative.

3. An agreement to place an advertisement does not give rise to the presumption. Placing an advertisement does not include the placement of a link on a website as described above.

4. Presumption examples:

   a. CAB company manufactures and also sells fitness equipment. CAB is located in Arizona. CAB has no retail outlets in New York. CAB's only connection with New York is that it enters into agreements with health and fitness clubs in New York where the clubs refer members to CAB's products. When a club member purchases a CAB product, the club is given a 5% commission on the sale. From 3/1/07 to 2/29/08, CAB's gross receipts from sales made through club referrals totaled $38,000. CAB is presumed to be making taxable sales in New York.

   b. XYZ is an internet-based retailer of sporting goods. XYZ is located in Vermont, but makes sales throughout the U.S. Merchandise is delivered by the Postal Service or other common carrier. As part of its marketing plan, XYZ has entered into agreements with New York ski clubs where the clubs will maintain links to XYZ's retail website on their own websites. XYZ will pay a commission to the ski clubs based on the sales XYZ makes that originate from the links. From 3/1/07 to 2/28/08, XYZ has gross receipts from the links totaling $78,000. XYZ is presumed to be making taxable sales in New York.

   c. T sells small tools nationwide over the Internet. T is located in Arkansas. T's only connection with New York is that it enters into a contract with S, a service provider. Under the contract, S enters into agreements with New York residents on behalf of T, whereby New York residents agree to refer potential customers to T's website by placing a link to T's website on their own websites. Under the contract, S tracks T's sales as a result of the referrals and distributes commissions to New York resident representatives based on referral sales. From 3/1/07 to 2/28/08, T's gross receipts from these referrals totaled $68,000. T is presumed to be soliciting taxable sales in New York.

   d. G is an Internet-based retailer of gardening supplies. G is located in North Carolina. G sells products nationwide and then ships them via common carrier. As a part of its marketing plan, G enters into agreements with several garden clubs to place advertisements on their websites for G's products. When clicked, the advertisements lead the website user to G's website. In exchange for placing the advertisements, the clubs receive a set fee based on the number of clicks, not sales. G's agreement with the clubs is

merely to place advertisements on their websites. Therefore, G is not presumed to be a vendor making sales in New York.

5. A seller may rebut the presumption that it is soliciting sales in New York through resident representatives. The presumption is deemed rebutted where the seller is able to establish that the only activity the resident representatives perform is to include a link on the representatives' websites to the seller's website. It must be demonstrated that the resident representatives do not engage in any solicitation on behalf of the seller.

6. Rebuttal examples:

   a. See example b. above. At least one of the ski clubs refers potential customers to XYZ's website by distributing fliers that provide the link to XYZ's website. XYZ cannot rebut the presumption that it is making taxable sales in New York.

   b. See example b. above. However, none of the clubs refer members to XYZ through fliers, newsletters, telephone calls, emails, or any other means of solicitation. XYZ may successfully rebut the presumption that it is making taxable sales in New York.

7. For sales tax quarterly periods beginning before 6/1/08, the Tax Department may not assess sales tax required to be collected against a business that is covered by the presumption if the business meets the following conditions:

   a. The business is not required to register as a vendor for any other reason.

   b. The business was not registered as of 4/28/08 and was not registered at the time it made the sales that gave rise to the presumption.

   c. The business registers for sales tax purposes and begins to collect sales tax from New York customers by 6/1/08.

***Amazon.com, LLC v. New York Dept. of Taxation and Finance*, No. 08601247 (Compl. filed Apr. 25, 2008).**

1. Amazon.com has filed suit in the New York Supreme Court, New York County, challenging the constitutionality of the newly enacted New York Senate Bill 6807 Part OO-1, which requires out-of-state Internet retailers with no physical presence in New York to collect New York sales and use tax.

2. In its complaint, Amazon.com alleges that because some independently operated New York-based websites post advertisements with links to Amazon.com and are compensated for these advertisements, Amazon will be presumed to have solicited taxable New York sales. As a result, Amazon.com states that it will have to collect New York sales tax on all of its sales to New York residents or face civil and criminal penalties despite the fact that it lacks a physical presence in New York and does not actually solicit business in New York.

3. Amazon.com seeks a declaratory judgment on the grounds that the new statutory provision:

    a. Violates the Commerce Clause because it imposes tax-collection obligations on out-of-state businesses like Amazon.com that have no nexus with New York;

    b. Violates the Due Process clauses because it effectively creates an irrebuttable presumption of solicitation and is overly broad and vague;

    c. Violates the Equal Protection Clause because it intentionally targets Amazon.com and has even been referred to as the "Amazon Tax."

AFFILIATE NEXUS

It's always beneficial to out-of-state companies when a state tax department sets forth its understanding of how the law is being applied on an administrative basis. The Idaho Commission has done so in a Guide that covers numerous circumstances that may or may not create nexus.

IDAHO

Idaho State Tax Commission Guide to Combined Reporting, CCH ¶400-573 (April 1, 2008).

1. The Idaho State Tax Commission has released a Guide to Combined Reporting that seeks to explain how Idaho taxable income is determined for a unitary business operating through more than one corporation and in more than one taxing jurisdiction.

2. In pertinent part, the Guide offers an example regarding when a subsidiary of an Idaho business would have nexus with the State sufficient for required income tax filing. In the example, where the Parent transacts business in Idaho and leases property in Idaho, "Sub[sidiary] 3 makes some sales into Idaho. The orders are taken by phone at a sales office outside of Idaho and goods are shipped

into Idaho by common carrier. Sub[sidiary] 3 has no other contact with Idaho such as sales of services, owned or rented property in the state, nor has it filed with the Idaho Secretary of State. Mere solicitation of sales in Idaho is insufficient to give Sub[sidiary] 3 nexus in Idaho under Public Law 86-272. Consequently, Sub[sidiary] 3 is not required to file an income tax return. Sub[sidiary] 3's sales are not included in the sales factor numerator, and Sub[sidiary] does not owe the $20 minimum income tax, nor the $10 permanent building fund tax."

INDIANA

This is one of those circumstances when an out-of-state company thinks it established nexus and filed a consolidated return, but the state concludes that the out-of-state affiliates should not be included. Wonder if there was a tax refund situation here?

Indiana Department of Revenue Letter of Finding No. 07-0327, Ind. Tax Reporter ¶20080505019 (April 30, 2008).

1. Taxpayer manufactures automobile parts, and included two of its subsidiaries on its Indiana income tax return in 2003. The two subsidiaries have their principal place of business outside of Indiana, and the Department of Revenue therefore excluded the subsidiaries from the Taxpayer's income tax returns.

2. Taxpayer objected on the grounds that the subsidiaries had established nexus with the state of Indiana by virtue of their visits to Taxpayer's customers' facilities in Indiana, and ownership of inventory and tooling residing in third party vendors' and suppliers' facilities in Indiana.

3. Indiana law allows an affiliated group to file a consolidated income tax return, but requires that each entity have "adjusted gross income derived from sources within the state" to be included in the affiliated group. 45 IAC 3.1-1-111.

4. Because the Taxpayer had not established that its two at-issue subsidiaries generated an income stream in Indiana, or had an Indiana business activity associated with the tooling or raw materials located in third party facilities there, Taxpayer had failed to establish a nontrivial connection with the State. The subsidiaries were therefore properly excluded from Taxpayer's consolidated income tax return.

LOUISIANA

In this circumstances, the Louisiana Department of Revenue determined that the out-of-state companies were not subject to tax because they were only involved in debt financing and were not registered with the Louisiana Secretary of State to do business in the state.

> ***Louisiana Department of Revenue Private Letter Ruling No. 08-007, CCH ¶202-128 (March 12, 2008).***

1. Taxpayers are a part of a group of affiliated entities. Two of the group's substantial affiliates are Company A, Inc. (Co. A), which distributes tangible personal property in Louisiana, and B Corporation (B Corp.), which finances wholesale and retail purchases in Louisiana. Taxpayers, subsidiaries of B Corp., are organized for the sole purpose of facilitating structured debt financing of B Corp.'s consumer and wholesale lending activities.

2. Co. A and B Corp. believe that they have a taxable nexus with Louisiana and, therefore, file Louisiana Corporate Income and Franchise Tax returns. Taxpayers have historically asserted that they do not have nexus with Louisiana and have not filed those same returns. Given the uncertain nature of nexus determinations, Taxpayers requested a private letter ruling from the Louisiana Department of Revenue regarding their nexus status.

3. The Department found that Taxpayers do not have any employees or property located in Louisiana and do not conduct any business activities in Louisiana. With respect to the Corporate Income Tax, Taxpayers' sole income source is interest on the loans they purchase from B Corp. Interest income is exempt from taxation in Louisiana. With respect to the Corporate Franchise Tax, Taxpayers are merely buying and selling commercial paper that might have originated in Louisiana. According to the Department, that activity does not rise to the level of doing business in the state. The Department concluded by pointing out that Taxpayers must not be qualified to do business in the state. As long as they have not registered with the Secretary of State, that requirement should also be met. Based on all of its findings, the Department concluded that Taxpayers did not owe any Louisiana Corporate Income or Franchise taxes.

NEW YORK

This opinion illustrates why it is so difficult to make nexus determinations. The out-of-state entity made investments in a limited partnership and the Commissioner determined that the ownership interest was sufficient to

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give rise to franchise tax liability, unless the limited partnership could prove that it was an exempt "portfolio investment partnership."

Advisory Opinion, Petition No. C080122A, CCH ¶406-050 (N.Y. Dept. of Tax. & Fin. Apr. 29, 2008).

1. Petitioner Service Life and Casualty is a life insurance corporation domiciled in Texas. It is not licensed to do insurance work in New York and has never generated any premiums allocable to New York. In order to achieve higher returns on investments, Petitioner made an initial investment in a limited partnership (LP) and plans to make additional investments in the LP in the future. The LP is an investment-driven partnership that invests with underlying hedge fund managers who often operate in New York. Many of the underlying hedge fund managers invest in stocks and bonds that generate passive income in the form of dividends, interest, and capital gains. However, some of the underlying hedge fund managers participate in lending and loan origination, which generates New York income. The income is allocated to the funds and ultimately to the partners of these funds.

2. Under New York law, every foreign corporation must pay a franchise tax for the privilege of doing business, employing capital, or owning or leasing property in New York in a corporate or organized capacity. Insurance companies have previously been subject to the franchise tax through an ownership interest in a partnership or LLC that conducts business in New York.

3. The Commissioner of Taxation and Finance found that Petitioner is deemed to be doing business, employing capital, owning or leasing property, or owning or maintaining an office in New York through its ownership interest in the LP provided the LP is not a portfolio investment partnership under Regulations § 1-3.2(a)(6)(iii). Therefore, Petitioner will be required to pay franchise taxes under New York Tax Law § 1501 unless the LP is a portfolio investment partnership. The Commissioner found that he could not determine within the scope of his Advisory Opinion whether the LP is a portfolio investment partnership.

PUBLIC LAW 86-272

This is an extremely complex and interesting determination about the immunities granted by Public Law 86-272. The New York State Department of Taxation and Finance's forced combination against Buena Vista Home Video was sustained by the Court of Appeals.

***Disney Enterprises, Inc. v. Tax Appeals Tribunal of New York*, DTA No. 818378, CCH ¶406-016 (N.Y. Mar. 25, 2008).**

1. Petitioner Disney Enterprises, Inc. (Disney), is an entertainment conglomerate with hundreds of parents, subsidiaries, and affiliates. For corporate franchise tax purposes, New York law permits related corporations to report their income on a combined basis where there are substantial intercorporate transactions. See NYCR 6-2.3. The combined reporting is based on the theory that if the members of the group filed separately, the financial activities of the group would be distorted. During the relevant years, Disney filed combined reports in New York for certain of its corporate subsidiaries, including Buena Vista Home Video (Video). Disney, however, reported only a fixed dollar minimum tax of $1,500 for Video instead of reporting its millions of dollars worth of gross receipts from videos shipped to New York for the years at issue. In omitting the video destination sales in New York from its combined receipts calculation, Disney relied on PL 86-272.

2. The New York Department of Taxation and Finance increased Disney's receipts to include Video's destination sales, which resulted in an additional tax liability. Disney argued that Video was not subject to taxation because its New York activities were nothing more than solicitation of business, which is protected by PL 86-272. Disney argued that Video only permitted Disney salespeople to solicit business—the salespeople could not take orders, collect money, or accept returns. Further, Video did not own or rent any property in New York. The Department disagreed and issued a notice of deficiency. The Division found that "it simply cannot be concluded that the only business activities within New York . . . by or on behalf of [Video] was the solicitation of orders for sales of tangible personal property." To hold otherwise would be to ignore the "extraordinary synergies" among members of the Disney group involved in consumer products. The Tax Appeals Tribunal affirmed.

3. The Court of Appeals agreed with the Tax Appeals Tribunal, finding that Disney's synergies are historical and well-documented. The Court found that "this is a far cry from the limited object of PL 86-272. We cannot agree that the statute was intended to prevent inclusion of New York income generated by the unified activities of this corporate giant in the state's franchise tax apportionment scheme."

VOLUNTARY REGISTRATION OR INCORPORATION

This very sensible legislation provided that registration under SSTP did not constitute a concession that municipal business and occupation tax nexus

arose. This is an area that needs increased attention because agreeing to have nexus on an entire state basis does not mean that the out-of-state entity has established nexus, or conceded nexus, for local use tax or gross receipts tax purposes.

WASHINGTON

H.B. 3126, 60th Leg., 2nd Sess. (WA 2008), effective June 12, 2008.

1. Type of Tax: Business and Occupation Tax (B&O Tax)

2. The Washington legislature amended WASH. REV. CODE § 35.102.050, the municipal B&O Tax nexus provision, to specify that mere registration under or compliance with the Streamlined Sales and Use Tax Agreement does not constitute nexus for the purposes of the B&O Tax.

IN-STATE ADVERTISING/SOLICITATION

A non-nexus vendor did not get nexus because it advertised its products in Missouri, as long as it did not have any physical presence nexus and used U.S. Mail to deliver products to Missouri customers.

MISSOURI

Missouri Department of Revenue Letter Ruling No. LR4702, CCH ¶202-895 (Apr. 21, 2008).

1. Applicant is a non-Missouri company that sells non-prescription medical supplies. Applicant has no property, employees, or other presence in the state. However, Applicant does advertise its medical supplies in Missouri and ship those same supplies to Missouri via the U.S. Postal Service. Applicant asked the Missouri Department of Revenue to determine whether it is required to file a Missouri use tax return and remit use tax on its sales to Missouri customers.

2. Under Missouri's use tax law, "a vendor does not have sufficient nexus if the only contact with the state is delivery of goods by common carrier or mail, advertising in state through media, or occasionally attending trade shows at which no orders for goods are taken and no sales are made." 12 CSR 10-114.100(3)(B).

3. Based on the above language, the Department found that Applicant lacks sufficient nexus with Missouri and is, therefore, not required to file a Missouri use tax return and remit use tax on its sales to Missouri customers.

VIRGINIA

A traveling sales person again created nexus for a manufacturer of modular homes which solicited sales in Virginia. Additionally, the out-of-state manufacturer had voluntarily registered to collect Virginia sales tax in February, 2005, but without a voluntary disclosure agreement. Because the in-state solicitations had occurred since October, 2003, the Virginia Department assessed the period between registration and actual solicitation.

Ruling of Commissioner, P.D. 08-42 (Va. Dep't of Taxation, April 17, 2008).

1. Taxpayer was an out-of-state modular home manufacturer. Taxpayer voluntarily registered to collect Virginia retail sales tax beginning in February, 2005. However, an audit revealed that the Taxpayer had been actively soliciting in Virginia and making retail sales to Virginia customers since October, 2003. Thus, Taxpayer was assessed sales tax on sales made before its registration.

2. Virginia requires collection of retail sales tax if the entity is a dealer and has sufficient contact with Virginia. A dealer has sufficient contact with Virginia if it "solicits business in [the] Commonwealth by employees, independent contractors, agents or other representatives."

3. Under Virginia law and the controlling nexus cases, the Commissioner upheld the tax assessment because Taxpayer had at least one salesperson actively traveling through the state to set up accounts; and, one of the salespersons lived in Virginia and called on Virginia businesses during the period in question.

4. Although the Commissioner upheld the tax, she allowed a credit against the sales tax if the Taxpayer could provide proof that the customers remitted consumer use tax to the Virginia Department of Taxation or that the customers resold the modular sections without installation.

"INTANGIBLE" NEXUS

What more can be said about intangible holding company nexus? Here, in short, the Arizona Department determined that income tax nexus existed.

ARIZONA

In the matter of [REDACTED] F.E.I.N. [REDACTED], Decision of Hearing Officer, No. 200700083-C (May 15, 2008).

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1. The Taxpayer, an out-of-state franchisor that received license and royalty fees from Arizona franchisees, argued that the Supreme Court's decision in Quill Corp. v. North Dakota, 504 U.S. 298 (1992), required that the Taxpayer be physically present in the state in order to meet the substantial nexus requirement.

2. The Arizona Department of Revenue first determined that the relevance of physical presence in such a case was less significant than a taxpayer's receipt of income from the use of the taxpayer's property in the state by another party. In this regard, the Department found the South Carolina Supreme Court decision in Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E.2d 13 (1993), to be directly on point and highly persuasive. Just as in that case, the Taxpayer licensed intangibles for use in the state and derived income from their use in the state. Furthermore, the Taxpayer had significant control over its franchisees—although the Department was careful to note that "control" is not a key factor in the nexus determination in such cases. Finally, the Taxpayer contemplated and purposefully sought the benefit of economic contact with Arizona. For these reasons, the Taxpayer had substantial income tax nexus with Arizona.

LOUISIANA

Bridges v. Geoffrey, Inc., No. 2007 CA 1063, CCH ¶ 202-118 (La. App. Ct. Feb. 8, 2008), petition for cert. denied, No. 2008-C-0547, Apr. 25, 2008.

1. On April 25, 2008, the Louisiana Supreme Court declined to review the appellate court's decision.

MARYLAND

Even if nothing more can be said about "intangible holding company nexus," this is Maryland's application of the rule to the retailer Talbots.

The Classic Chicago, Inc. v. Comptroller of the Treasury; The Talbots, Inc. v. Comptroller of the Treasury, Tax Appeal No. 06-IN-OO-0226, 06-IN-OO-0227, CCH ¶201-815 (Md. Tax Apr. 11, 2008).

1. The Talbots (Talbots) is a Delaware Corporation with its principal place of business and commercial domicile in Massachusetts. Talbots conducted a women's retail clothing business by catalog and through retail stores located in many states, including Maryland. In 1973, Talbots was acquired by General Mills, Inc. In 1988, General Mills sold its interest in Talbots to Jusco USA, Inc. (Jusco USA), a subsidiary of Jusco Co. Ltd. (Jusco), a Japanese corporation. At the same time, Talbots sold all of its trademarks,

trade names, and related intellectual property (trademarks) to Jusco Europe BV (Jusco BV), a Dutch subsidiary of Jusco. Jusco BV and Talbots entered into a license agreement pursuant to which Jusco BV licensed to Talbots the right to use the Talbots trademarks in exchange for a royalty fee. Incident to an initial public offering of a minority portion of its interest in Talbots, Jusco USA incorporated The Chicago Classic (Classic), a Delaware wholly owned subsidiary of Talbots. Classic purchased all of the Talbots trademarks. Classic and Talbots then entered into a license agreement similar to the agreement between Jusco BV and Talbots.

2. Petitioners filed suit seeking an order reversing assessments against Classic and Talbots for back corporate income tax due on royalty income. Petitioners argued that the transfer of the trademarks from the parent to a foreign holding company, Jusco BV, was done to take advantage of favorable Dutch accounting rules. The transfer to Classic was then executed for numerous business reasons, including greater growth flexibility. Since the trademark transactions were not structured to avoid state taxation, Petitioners asserted, nexus with Maryland did not exist and the assessments were improper.

3. The Maryland Court of Tax Appeals noted that the test to be applied is whether the out-of-state affiliates had "real economic substance as separate business entities." The court then went on to find that Classic had minimal operating expenses. In addition, all of the transactions that generated the income were inter-company. Classic's royalty income resulted from transactions by its parent, Talbots, and Classic relied entirely on Talbots to generate enough revenue for business operations. Based on those facts, the court concluded that Classic lacked real economic substance as a separate business entity. Thus, Classic's activities in Maryland are those of its parent, Talbots. As such, Classic has substantial nexus with Maryland and the assessments were affirmed.

AD VALOREM TAX AFFIRMED ON NEXUS GROUNDS

Loading and unloading oil at the Valdez terminal created property tax nexus for a shipping company. The tax also survived a "fair apportionment" challenge.

ALASKA

Valdez v. Polar Tankers, Inc., No. 6254, CCH ¶200-503 (Alaska Sup. Ct. April 25, 2008).

1. Before addressing the constitutionality of an ad valorem tax on certain large vessels that docked in the City of Valdez under the Due Process Clause and the Commerce Clause, the Alaska Supreme Court first had to determine whether there was sufficient nexus between Taxpayer's vessels and the City. The Court determined that there was substantial nexus.

2. First, most of Taxpayer's business involved the oil it loads at a terminal in the City. Second, the Taxpayer's vessels spent an average of 42 days per year in the City. Next, the City provided many services to Taxpayer, including the regulation of tanker traffic, assistance in financing construction of the City terminal, involvement in oil spill contingency plans and cleanup efforts, and provision of regular city services. Finally, the Taxpayer had at least one employee permanently located in the City.

3. The court applied the four-part nexus test for mobile property set forth in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

4. The Taxpayer also challenged the tax's apportionment formula based on the days the vessel spent in the Port of Valdez. The court upheld the formula, after finding it was "fairly apporting" the tax.

NEBRASKA

While interstate trucking companies are not protected by Public Law 86-272 from the imposition of Nebraska income tax, there are certain exemptions and exceptions which were fairly applied by the Nebraska Department in this ruling.

Nebraska Department of Revenue Ruling 24-08-1, CCH ¶ 200-884 (Apr. 9, 2008).

1. The Department of Revenue concluded that for-hire trucking companies that transport goods over Nebraska roads are subject to corporate income tax. Such companies are doing business within Nebraska because they are physically present in the state and taking advantage of Nebraska's roads to generate income. They also enjoy police and fire protection while in the state. Such services are not protected by PL 86-272.

2. However, trucking companies are not required to apportion income to Nebraska if their activities within Nebraska are de minimis. A trucking company need not apportion income to Nebraska where it neither:

    a. Owns nor rents any real or personal property in the state except motor vehicles; nor

b. Makes any pick-ups or deliveries within the state; nor

c. Travels more than 25,000 miles within the state provided that total miles in the state do not exceed 3% of total miles traveled; nor

d. Makes more than 12 trips to the state.

NEW JERSEY

Nexus applies to all kinds of taxes. Here, the New Jersey court of appeals found that a Connecticut wholesale cigar and tobacco dealer did not have the requisite physical presence in New Jersey necessary for the imposition of the Tobacco Products Wholesale Tax.

Davidoff of Geneva, Inc. v. Division of Taxation, No. A-4181-06T3, CCH ¶401-343 (N.J. Super. Ct. Mar. 18, 2008).

1. Davidoff is a nationwide wholesale cigar and tobacco dealer based in Connecticut. Davidoff owns no property in New Jersey and has no office in the state. The parties agree, however, that Davidoff products are regularly sold by third-party retailers and consumed in New Jersey. In April 2000, Davidoff obtained a Certificate of Authority to collect the New Jersey Tobacco Products Wholesale Sales and Use Tax (TPT). Despite having the authorization, Davidoff did not collect or pay the TPT because it believed the nature of its operations did not trigger any liability under the TPT. Also in 2000, the Director of the Division of Taxation audited Davidoff and found that Davidoff had New Jersey independent contractors that solicited orders from tobacco wholesalers and retailers, which was sufficient to subject Davidoff to the TPT. Pursuant to the audit, the Department issued an assessment. Davidoff sought administrative review with the Division's Conference and Appeals Branch, which affirmed.

2. Davidoff filed a complaint in 2005. The judge granted Davidoff's motion for summary judgment, concluding that Davidoff was not a "distributor" under the TPT because it did not receive, sell, store, or otherwise dispose of tobacco products in New Jersey. See N.J.S.A. 54:40B-2. Instead, the most that Davidoff did was use independent contractors to solicit orders, which does not make Davidoff a distributor under the TBT.

3. The court of appeals agreed, finding that even if the Director could prove that Davidoff relied upon independent contractors to sell its tobacco products in New Jersey, such reliance is not sufficient evidence that Davidoff was distributing tobacco in New Jersey under the TBT. Because Davidoff was not a distributor of tobacco

products, it lacked the physical presence necessary for imposition of the TBT.

NEW YORK

New York Senate Bill 6807, Part EE-1 of Chapter 57 of the Laws of 2008, effective Apr. 23, 2008.

1. The legislation amends the New York Bank Franchise Act to provide that a banking corporation is doing business in New York in a corporate or organized capacity if:

    a. It has issued credit cards to 1,000 or more customers with New York mailing addresses;

    b. It has merchant customer contracts with merchants and the total number of locations covered by those contracts equals 1,000 or more locations in New York to which the banking corporation remitted payments for credit card transactions during the taxable year;

    c. It has receipts of $1 million or more arising from merchant customer contracts with merchants relating to locations in New York; or

    d. The sum of the number of customers described in (a) plus the number of locations covered by its contracts described in (b) equals 1,000 or more or the amount of its receipts described in (c) and (d) equals $1 million or more.

AIRCRAFT TAX

There are hundreds, if not thousands, of aircraft use tax cases reported through the years. Here is one in which the aircraft owner won! It was a special purpose World War II fighter plane, it was not used to generate income, and the owner sold it for a loss.

Advisory Opinion, Petition No. 821342, CCH ¶406-033 (N.Y. Dept. of Tax & Fin. Apr. 18, 2008).

1. Petitioner Rochester Amphibian Airways, Inc. was a Delaware Corporation. Mark Rudeckwald, its sole shareholder, officer, and director was a New York resident. Petitioner was formed for the primary purpose of shielding Rudeckwald from liability arising from the ownership and operation of an aircraft. The aircraft that Petitioner owned was a “one seater” World War II fighter plane that was not suitable for transporting passengers or for other commercial purposes. Petitioner never received any income from

appearances in air shows. When Petitioner sold the aircraft, he received a price lower than what he had paid.

2. The Division of Taxation received information from Aero Fax, a private company that monitors registration of aircraft with the FAA, that Petitioner had registered the aircraft with a New York address. Because the Division had no record of sales or use tax paid, it sought information from Petitioner. Although Petitioner admitted the plane had been in New York, it claimed it was entitled to an exemption from tax as a foreign corporation not doing business in New York. The Division disagreed and issued a Notice of Determination that asserted use tax due.

3. The Division of Tax Appeals noted that New York law provides a use tax exemption for the use of property by non-residents of the State as long as the non-resident is not engaged in any employment, trade, business, or profession in New York. The Division of Tax Appeals then found that the aircraft was purchased in Illinois, transferred in Wisconsin, and only stored in New York for 5 out of 17 months of ownership. Furthermore, Petitioner did not maintain a place of business in New York and did not operate a business of collecting appreciating assets which provided a revenue stream in New York. To the contrary, the aircraft was sold at a loss. For all of those reasons, The Division of Tax Appeals held that Petitioner was entitled to the use tax exemption.

OREGON

Your authors have always thought that Oregon has a very expansive view of tax nexus. Believe it or not, this administrative ruling attempts to further liberalize it!

OR. ADMIN. R. 150-317.010 (2008).

1. The Oregon Department of Revenue revised its nexus rule to clarify that substantial nexus for corporate excise and income tax purposes does not require physical presence within the state. Rather, substantial nexus exists when a taxpayer regularly takes advantage of Oregon's economy to produce income for the taxpayer. Factors to determine whether nexus exists, include:

    - Whether taxpayer maintains continuous and systemic contacts with the state's economy or market.

    - Whether taxpayer conducts deliberate marketing to or solicitation of the state's customers.

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- Whether taxpayer files or is required to file reports or returns with the state's regulatory bodies.
- Whether taxpayer receives significant gross receipts attributable to customers in the state or attributable to the use of the taxpayer's intangible property in the state.
- Whether taxpayer receives benefits provided by the state.

WEST VIRGINIA

Growing timber is a business excepted from the imposition of the state franchise tax.

West Virginia Office of Tax Appeals, WV, 06-098 FN, 06-099 FN, 06-100 FN, 06-101 FN, CCH ¶ 400-527, March 18, 2008.

1. Type of Tax: Business Franchise Tax
2. Each of the Petitioners is a foreign limited partnership and qualified to do business in West Virginia. Each Petitioner holds commercial woodlands and the primary product of the woodlands is standing saw timber. The Petitioners do not harvest the timber, but convey the right to cut the timber to unrelated third parties.
3. The field auditing division of the West Virginia State Tax Commissioner's Office conducted an examination of the books of Petitioner and assessed a business franchise tax against the Petitioners for the business of growing and managing the timber. The issue is whether the growing and managing of the timber falls within the agricultural and farming exception to "doing business" for purposes of the tax.
4. Under the West Virginia business franchise tax statute, the activity of "agriculture and farming" is excepted from the meaning of "doing business." The court held that growing and managing standing timber, without any severing activity, is agriculture and farming for the purpose of the exemption from "doing business" under the business franchise tax. Therefore, the business and franchise tax assessments against the Petitioners were vacated.

This sensible legislation includes activities that do not constitute "doing business" for purposes of foreign corporations and foreign limited liability companies.

H.B. 4464, 78th Leg., 2nd Sess. (WV 2008), effective June 4, 2008.

1. Provisions regarding foreign corporations and foreign limited liability companies were amended to include new activities that do not constitute transacting business in the state for purposes of the foreign corporations and foreign limited liability company statutes. The new exemptions include: applying for withholding tax on an employee who resides in the state but works for the foreign entity in another state; holding all, or a portion of, the outstanding stock of a corporation authorized to do business in the state, provided the foreign entity does not produce goods, services or otherwise conduct business in the state.

2. The new exemptions only apply to nexus for tax purposes insofar as the exemptions relieve a corporation or limited liability company from registering as a foreign entity within the state. The listed activities are not necessarily exemptions from "doing business" for general tax purposes.

SETTLEMENT PROCEEDS

UTAH

Mandell v. Auditing Division of the Utah State Tax Commission, 2008 UT 24 (May 23, 2008).

1. Petitioners were residents of Utah and 20% shareholders of a mobile home company. The mobile home company was sold and the sale was treated as a "deemed asset sale." The proceeds of the sale were apportioned 100% to Utah. Petitioners subsequently moved to Nevada and discovered the buyer of the company had defrauded the company. Petitioners filed suit in Nevada against the buyer. The suit settled and the issue is whether the proceeds of the settlement are taxable by Utah. Petitioners claim that because they were not residents of Utah at the time of the settlement, Utah lacked jurisdiction to tax the settlement proceeds and the taxation violated the Due Process Clause and Commerce Clause of the U.S. Constitution.

2. The Utah Supreme Court held that the Commission had appropriately adopted and applied the "in lieu of" test to determine that the proceeds of the settlement were paid "in lieu of" the funds that Petitioners would have received on the asset sale. The proceeds of the settlement were taxable by Utah because Utah had authority to tax the original asset sale as income sourced to Utah. The proceeds are taxable by Utah regardless of whether or not shareholders are residents of Utah.

3. Regarding the Due Process and Commerce Clause claims, the court held that no violation occurred. Under the Due Process Clause, a minimum connection was found because the proceeds of the settlement were for the underlying "deemed asset sale," and the asset sale was of a corporation that did all of its business within Utah. In addition, there was no Commerce Clause violation because the underlying asset sale created substantial nexus with the taxing state. Since the state had a minimum connection and nexus to tax the underlying transaction, it also had minimum connection and nexus to tax the settlement proceeds.

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