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NEXUS: Update On Recent Developments – New Jersey Distinguishes Selling Prewritten Software from Licensing IP; Washington Finds Mere License of Trademark Not "Doing Business"

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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 Third and Fourth Quarter of 2009 and the First Quarter of 2010. It is organized by the kind of activity that tends to give out-of-state entities nexus planning and litigation difficulties, such as attendance at trade shows or seminars, sales personnel who travel in and out of states, affiliate nexus, intangible nexus, and doing business in the state if you are a non-resident shareholder in an S Corporation, and a "drop shipment" ruling from the New Mexico Taxation & Revenue Department that is sensible. It also highlights Wisconsin's new "affiliate nexus" statute (effective July 1, 2009) and Connecticut's "economic nexus" statute (effective for taxable year on and after January 1, 2010).

Decisions from New Jersey and the City of Seattle deserve special attention. The New Jersey Tax Court made a careful and correct distinction between *selling* prewritten software and *licensing* intellectual property in the AccuZIP case. In Blistex Bracken, a Seattle B&O assessment on royalty income was reversed on Due Process grounds because there was insufficient nexus between a limited partnership that received the royalties and the B&O tax.

EMPLOYEE VISITS

ILLINOIS

An agreement by which a company promoted the sale of drugs manufactured by another created income tax nexus – the Department determined that P.L. 86-272 did not apply to income generated by "distribution rights."

General Information Letter IT 09-0023-GIL, Illinois Dept. of Rev., CCH T 402-002 (Aug. 14, 2009).

1. Taxpayer is an out-of-state company in the business of researching and developing pharmaceutical products. Taxpayer entered into a contract with an unrelated third party to develop, use, sell, promote, offer for sale, import and distribute pharmaceutical drugs. Taxpayer's employees occasionally visited with the third party's representatives in Illinois to coordinate efforts to sell their products. Neither Taxpayer nor its employees had an office in Illinois. Taxpayer also employed account executives, who met with doctors to promote the use of Taxpayer's products. Account executives did not deliver the product or take orders, but generated "pull through" sales. These sales generated revenue to taxpayer.

2. The Illinois Department of Revenue determined that Taxpayer's activities were related to the sale of intangible property and, thus were not protected under P.L. 86-272 (U.S.C. § 381-84) from tax. Due to taxpayer's employees activities, which the Department characterized as "activities related to a distribution right," the Department determined Taxpayer likely had sufficient nexus with Illinois and was subject to corporate income tax.

3. The Department was unable to respond to the Taxpayer's questions about apportionment due to lack of facts.

As it always does, the Illinois Department of Revenue noted that nexus determinations were highly fact specific. Whether sales from a retailer's mobile unit created nexus went unanswered.

Illinois Dep't of Rev., General Information Letter ST09-0130-GIL, ¶20091027016

1. Taxpayer received less than one percent of its business from Illinois. Eight percent of its Illinois sales were made from a mobile unit that traveled to Illinois twice per year, while the remaining 92% of sales were accepted and rejected outside the state. Taxpayer had no property or payroll in Illinois and sought to avoid the imposition of Retailer's Occupation Tax.

2. The Department of Revenue responded that a vendor is only liable for Illinois tax if it has sufficient nexus with Illinois and determinations regarding nexus are very fact specific. The Department would not provide a determination as to whether the company had nexus with Illinois, but provided guidelines regarding nexus. For instance, any type of physical presence in Illinois,

including the presence of any agent or representative of the seller in Illinois, constituted sufficient nexus.

WASHINGTON

In-person customer visits created B&O tax nexus, even though the New Jersey manufacturer had no employees, property, or inventory in Washington. The "economic nexus" standard was applied.

Lamtec Corp. v. Washington Department of Revenue, No. 35716-811 (Wash. Ct. App. Div. II, Aug. 4, 2009).

1. The Washington Court of Appeals found that the activities in Washington of an out-of-state manufacturer established nexus for business and occupation ("B&O") tax purposes for the audit period 1997 through June 30, 2004, even though the company did not have an office in the state and made no direct sales. The B&O tax is an excise tax levied for "the privilege of doing business." Ford Motor Co. v. City of Seattle, 156 P.3d 185 (2007). The court found nexus because company employees visited customers to establish and maintain a market for sales in the state. Affirming the trial court, the Court of Appeals also held that the company's customers received its products in Washington.

2. Lamtec (the taxpayer) manufactured vapor barriers and insulation facings. Lamtec wholesaled these and related products to customers on a nationwide basis. Among other things, Lamtec claimed that its activities within Washington did not satisfy the statutory nexus requirement under WAC 458-20-193(7), which parallels the rule for determining nexus under federal commerce clause analysis. Lamtec's primary argument was that it did not have substantial nexus with Washington because it did not maintain a physical presence in the state. Relying on Quill Corp. v. North Dakota, 504 U.S. 274 (1977), it contended that to show substantial nexus, the Department must establish that Lamtec had a physical presence akin to "a small sales force, plant or office" within the taxing state. The Washington Court of Appeals noted, however, that since Quill, courts have developed a split in authority as to whether the Supreme Court's holding was limited to sales and use taxes. The Washington court concluded that "[a] close reading of Quill reveals that its language supports those courts that have limited Quill to cases involving sales and use taxes." The Quill Court did not attempt to equate the substantial nexus requirement with a universal physical presence requirement.

3. The Washington court then concluded that Lamtec's business activities in Washington significantly contributed to its ability to

establish and maintain its market in the state. Given Lamtec's business strategy - maintaining long-term relationships with a small number of customers - its in-person customer visits were critical to maintaining its existing Washington customers. While in Washington, Lamtec employees provided information, listened to concerns about and answered questions concerning Lamtec products, participated in telephone calls that the customers placed to Lamtec's technical and customer service departments in New Jersey, fielded questions concerning potential price increases and new products, and maintained general client relations.

4. The court rejected Lamtec's distinction that its employees solicited no sales during their visits to Washington, holding that the test is whether Lamtec's in-state activities were significantly associated with its ability to establish and maintain its market in Washington, not whether it employed people within the state. The court repeatedly cited Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue, 483 U.S. (1987), and Gen. Motors Corp. v. Washington, 377 U.S. 436 (1964), in support of its reasoning, two cases with expansive readings of nexus in the B&O context. In sum, the court found that Lamtec had substantial nexus with Washington. Its employees' activities within the state were significantly associated with its ability to establish and maintain its market, particularly in light of Lamtec's business model that entailed maintaining a small number of high-volume customers long-term.

OTHER SPORADIC PHYSICAL CONTACTS

ALABAMA

Commerce Clause and Due Process Nexus Found – Alabama successfully assessed personal income tax against a Mississippi resident who was a shareholder in an Alabama "S Corporation." The Mississippi resident was an investor and did not engage in day-to-day management of the S Corporation's business.

Prince v. State Dep't of Revenue, ___So.3d___, No. 2080634, 2010 WL 245578 (Ala. Ct. Civ. App. Jan. 22, 2010).

1. Taxpayer, an individual, owned 1/3 shares of Zebra.Net, an S corporation organized and doing business in Alabama. Taxpayer was a resident of Mississippi. Taxpayer did not engage in the operation or management of the corporation.

2. In 1999, the shareholders of Zebra.Net entered into a merger agreement. As part of the merger agreement, the shareholders

agreed to have the acquisition of Zebra.Net treated as an asset acquisition pursuant to 26 U.S.C. § 338(h)(10).

3. Taxpayer paid income tax on his proportional distribution from the asset sale of Zebra.Net in Mississippi, his state of residence. He did not pay income tax. The Alabama Department of Revenue assessed income tax with penalties and interest against Taxpayer. Taxpayer appealed, arguing he lacked both minimum contacts and a substantial nexus with Alabama.

4. The Alabama Court of Civil Appeals held that nonresident shareholders of S corporations that conduct business activities in Alabama are subject to income tax on their distributive share of an asset sale of the S corporation. The Court concluded that both due process and commerce clause nexus existed.

TRADE SHOWS OR SEMINARS

KANSAS

No trade show nexus exists if the retailer does not accept purchase orders or negotiate sales at the Kansas trade show.

1. On August 28, 2009, the Kansas Department of Revenue issued an Opinion Letter (0-2009011) confirming that when an out-of-state retailer attends a trade show in Kansas and takes orders, negotiates sales, or otherwise engages in sales activities, nexus is created. However, the Letter stated that if the retailer does not receive purchase orders or negotiate sales, then nexus is not created. An out-of-state retailer is considered to be engaging in sales at a trade show when it: 1) accepts orders and processes them after it leaves Kansas; 2) forwards orders taken in Kansas to an out-of-state office for final approval; or 3) provides the means for trade-show attendees to place purchase orders over the Internet or by other electronic means.

MINNESOTA

If sales are made by an out-of-state vendor at craft shows, art fairs, flea markets and other Minnesota venues, sales tax must be collected.

1. In July, 2009, the Minnesota Department of Revenue issued Sales Tax Fact Sheet No. 154, stating that out-of-state businesses must collect Minnesota tax on all taxable sales of arts and crafts made while in Minnesota. The Department noted that this included sales at “craft shows, art fairs, flea markets and similar events, private homes or nonprofit events such as church bazaars. The Fact Sheet pointed out that sales to Minnesota residents after the

taxpayer leaves the state of Minnesota, or orders taken for future direct mailings, are sales that may be subject to Minnesota tax. It went on to say, "If you come into Minnesota for a selling event you are subject to income tax if you meet the minimum filing requirements."

IN-STATE PERSONNEL

INDEPENDENT CONTRACTORS, SALES REPRESENTATIVES, AND MANUFACTURING REPRESENTATIVES

FLORIDA

An independent contractor in Florida, who had no contacts with the out-of-state company's vendors and customers, did <u>not</u> create nexus in Florida.

Florida Dep't of Rev., Technical Assistance Advisement, No. 09A-058 (Nov. 9, 2009).

1. Taxpayer makes interstate sales of goods through the mail to customers located in Florida. It previously leased a building in Florida but terminated the lease and vacated the building. It utilizes the services of an independent contractor consultant who provides process improvement services while working out of her home in Florida, but presents her advice to Taxpayer personnel outside Florida. Consultant has no contact with Taxpayer's customers or vendors. Taxpayer does not maintain an office or other place of business in Florida, nor does not store inventory in Florida or have any employees in Florida.

2. Under such circumstances, the former sublease and the use of the independent consultant who has no contact with Florida customers does not create sales and use tax nexus with the State of Florida.

WEB NEXUS

ILLINOIS

The Illinois Department of Revenue reminded everyone that in-state representatives can create nexus, depending on the particular facts and circumstances.

General Information Letter No. ST 09-0098-GIL, Illinois Dept. of Rev., CCH 120090825037 (July 30, 2009).

1. A company annually collects information regarding the application of state tax laws. Such information is compiled into a "publication"

which is used as a reference tool for state tax departments, attorneys, CPAs, and corporate tax departments. It sought information as to whether a retailer has a use tax collection obligation when it enters into an agreement with Illinois residents in which it agrees to pay commissions to the resident for directly or indirectly referring potential customers to the retailer through a link on that resident's website.

2. The Illinois Department of Revenue explained that Illinois is considering the promulgation of a regulation that addresses the issue but has not yet done so. Thus, according to the Department, the Department's regulation at 86 Ill. Adm. Code 150.201 identifies when a retailer is "maintaining a place of business in Illinois" and makes it clear that representatives, including independent contractors, can create nexus for a retailer.

RHODE ISLAND

"Web nexus" was created effective June 30, 2009.

R.I. Gen. Laws § 44-15-15 (enacted 2009 H.B. 5983).

1. This new bill was signed into law by the Governor of Rhode Island on or around July 2, 2009. The new provision establishes a rebuttable presumption for Rhode Island sales and use tax purposes that a seller is soliciting business in the state through an agent if the seller enters into an agreement with a state resident under which the resident refers potential customers to the seller through a website link or otherwise. The bill includes a $5,000 threshold before the tax will be imposed. The new law became effective June 30, 2009.

INCIDENTAL OWNERSHIP OF PROPERTY

COLORADO

An out-of-state company that stores inventory in Colorado has income tax nexus.

General Information Letter No. GIL-2009-012, Colorado Dept. of Rev., CCH T 200-903 (July 7, 2009).

1. This letter dealt with corporate income tax nexus. The taxpayer is an out-of-state company that sells glassware and shipped approximately .35% of its 2007 sales to Colorado destinations by common carrier. The company used a public warehouse located in Colorado for storage of its inventory for subsequent shipment to its customers in the Northwest.

2. The Colorado Department of Revenue determined that P.L. 86-272 did not prohibit the state from imposing income tax liability on the taxpayer because it maintained a warehouse and inventory in Colorado.

WASHINGTON

Vonage had nexus in Seattle because it purchased the right to use telephone lines in Seattle through an affiliate.

***Vonage America, Inc. v. City of Seattle*, No. 63234-5-1 (unpublished opinion), Washington Court of Appeals, Division One (July 6, 2009).**

1. Vonage, the taxpayer, provided VoIP service to its customers, including residents of Seattle. VoIP technology enables consumers to conduct voice communications (calls) via a high-speed (broadband) Internet connection. To use Vonage's VoIP service, customers were required to purchase special software through Vonage's website or were required to acquire a "plug-and-play" device (VoIP device), which they could purchase from third party retail stores or obtain from Vonage's website at no cost.

2. When a customer initiates a call, the software or VoIP device converts the customer's outgoing analog audio signal into digital data packets. If the call recipient is also a Vonage customer, the digital data is transmitted directly over the Internet through the recipient's broadband connection to the recipient's computer (similar to the way in which e-mail communications are sent and received). The recipient's VoIP device or software then converts the incoming digital data into an analog audio signal, enabling the recipient to hear the call.

3. However, if the recipient is not a Vonage customer, the digital data is processed through one of several regional data centers. These centers convert the digital data into an analog audio signal, which is then directed to the Public Switched Telephone Network (PSTN). Vonage contracts with its affiliate, Vonage Networks, Inc., which provides services that allow for VoIP-to-PSTN and PSTN-to-VoIP calls. In turn, Vonage Networks purchases telephone communication services from traditional telephone companies that complete the communication to the recipient. In Seattle, WilTel Communications and Global Crossing provided these services during the disputed period. When a non-Vonage customer calls a Vonage customer, the process occurs in reverse order.

4. In December 2002, Vonage began selling VoIP service to Seattle residents. Acting through advertising agencies, Vonage purchased promotional materials that were broadcast or circulated in Seattle through television, radio or newspapers. Vonage, however, did not own or lease any property or employ any employees in Seattle during this period. When the City audited Vonage for the period between December 1, 2002 and December 31, 2005, it determined that Vonage was subject to the City's telephone utility tax. Vonage appealed the assessment.

5. One of the grounds on which Vonage appealed the assessment was that the federal commerce clause bars the City's tax because Vonage's contacts with Seattle were insufficient to establish "substantial nexus" with the City. Specifically, Vonage argued under Quill Corp. v. North Dakota, 504 U.S. 274 (1977), that it lacked substantial nexus with Seattle because it had no physical presence in the City. The court noted, however, that it was not clear whether a physical presence requirement for nexus applies beyond sales and use taxes.

6. In any event, the court concluded that Vonage had sufficient contacts to establish the requisite nexus. In so finding, the court relied on General Motors Corp. v. City of Seattle, 25 P.3d 1022 (2001), a post-Quill decision in which the Washington Supreme Court declined "to extend Quill's physical presence requirement" beyond traditional sales and use taxes. While there was no evidence that Vonage owned or leased property in Seattle or that it had employees in Seattle during the audit, it obtained a sufficient physical presence in the city by purchasing the right to use telephone lines in Seattle through its affiliate, Vonage Networks, Inc. In addition, Vonage advertised its VoIP service in Seattle to "establish and maintain a market" in the City. Vonage sold its services to Seattle customers with Seattle billing addresses. According to the court, this was sufficient to establish the requisite nexus.

AFFILIATE NEXUS

UTAH

This very detailed advisory from the Commission reminds retailers of Utah's basic "doing business" standards. Importantly, it concluded that out-of-Utah business activity did not create nexus for a non-Utah business, including affiliates.

Private Letter Ruling, Opinion No. 09-008 (Utah State Tax Commission, March 4, 2009 (published Sept. 3, 2009).

1. The Utah State Tax Commission found that an out-of-state related seller ("Retailer") of an out-of-state nexus seller ("Nexus Seller") was not required to register to collect and remit Utah sales and use tax. Nexus Seller was a web-based provider of e-commerce services and had Utah customers. Nexus Seller wanted to send two or three employees to Utah to visit a potential customer, with the purpose of the visit being to discuss the services that Nexus Seller provided and how the services could be used by the customer. Nexus Seller also wanted to open an office in Utah to support and service its Utah customers and it was anticipated that Nexus Seller would have employees working from its Utah office.

2. Nexus Seller was affiliated with other entities, including Retailer. Retailer was an internet seller of tangible personal property and digital goods to customers around the world, including customers in Utah. Retailer was located outside of Utah and did not operate any retail stores, engage in any Utah activities, or own or lease any real property in Utah, and was not registered as a retail merchant in Utah. Retailer also had no employees in Utah. Nexus Seller did not provide advertising, marketing or sales services for Retailer, nor would Nexus Seller provide these activities from its proposed Utah office. Nexus Seller would potentially provide Retailer with certain business services for its back-end infrastructure, including content delivery network and storage services. However, these services would not be provided from Utah.

3. The question presented to the Commission was: Assuming Nexus Seller would be required to collect and remit Utah sales and use tax based on its proposed visits to Utah, would Retailer be required to register to collect and remit Utah sales and use tax? The Commission found that Nexus Seller's out-of-state business activities could not create nexus for Retailer, regardless of whether Nexus Seller had a Utah presence. Retailer did not meet any of Utah's statutory "doing business" requirements that would trigger a duty to register in that it did not have a physical facility in Utah, did not maintain tangible personal property or inventory in the state, and did not maintain personnel in the state to solicit orders. In addition, in order to create Utah nexus for a related seller, the services needed to be provided from a place of business within Utah, which was not the case.

4. The Commission specially stated that it "does not believe that business activity provided in a state outside of Utah can create

5. Additionally, Retailer satisfied the requirements of the statutory Affiliate Nexus Exception, which provides that if a seller is a related seller and the seller to which the related seller is related does not engage in certain activities on behalf of the related seller (advertising, marketing, sales, or other services), then the related seller is not required to register to collect and remit Utah sales tax. Thus, Retailer also did not have affiliate nexus because Nexus Seller did not provide advertising, sales services, or marketing for it.

WISCONSIN

Wisconsin passed an affiliate nexus statute which is like most state statutes of this nature, generally incorporating an agency nexus standard.

2009 Act 28, create sec. 77.51(13g)(d), effective July 1, 2009 (Tax Bulletin No. 162, Wisconsin Department of Revenue, July 2009).

1. This provision, effective July 1, 2009, expands the definition of "retailer engaged in business in this state" to specifically include any person who has an affiliate in Wisconsin, if the person is related to the affiliate and if the affiliate uses facilities or employees in Wisconsin to advertise, promote, or facilitate the establishment of or market for sales of items by the related person to purchasers in Wisconsin or for providing services to the related person's purchasers in Wisconsin, including accepting returns of purchases or resolving customer complaints.

2. For purposes of this provision, two persons are "related" if any of the following apply:

    a. One person, or each person, is a corporation and one person and any person related to that person in a manner that would require a stock attribution from the corporation to the person or from the person to the corporation under section 318 of the Internal Revenue Code owns directly, indirectly, beneficially, or constructively at least 50% of the corporation's outstanding stock value;

    b. One person, or each person, is a partnership, estate, or trust and any partner or beneficiary; and the partnership, estate, or trust and its partners or beneficiaries; own directly, indirectly, or beneficially, or constructively, in the aggregate, at least 50% of the profits, capital stock, or value of the other person or both persons;

c. An individual stockholder and the members of the stockholder's family, as defined in section 318 of the Internal Revenue Code, owns directly, indirectly, beneficially, or constructively, in the aggregate, at least 50% of both persons' outstanding stock value.

IN-STATE ADVERTISING/SOLICITATION

VIRGINIA

Here, based on additional evidence, the Virginia Department of Taxation reversed its July, 2008, decision that the Virginia activities of a District Sales Manager and an employee veterinarian exceeded sales solicitation under P.L. 86-272.

Ruling of Commissioner, P.D. 09-172, Virginia Dep't of Taxation, October 23, 2009 (CCH ¶205-102).

1. In P.D. 08-142, the Virginia Department of Taxation ruled on July 30, 2008, that certain activities performed by the district manager and the veterinarian of a foreign corporation exceeded the protection afforded by Public Law (P.L.) 86-272 (15 U.S.C. § 381), and upheld assessments issued for the taxable years ended October 31, 2002 through 2005. The Taxpayer asked the Department to reconsider its decision, contending that the facts were misstated or inaccurately interpreted in P.D. 08-142. The taxpayer was a manufacturer of animal medications which it sold through sales representatives.

2. Based on additional evidence and testimony, the Department determined that while the district manager does recruit, hire, train, and assign responsibilities of the sales representatives who report to him, his responsibilities do not include many of the activities that were attributed to his position in P.D. 08-142, including providing sales forecasts, making budget recommendations, evaluating costs, tracking expenditures, and providing market input on pricing, positioning, and competitive activities.

3. Additionally, the Taxpayer presented evidence that its employee, a veterinarian, demonstrated products and explained technical training prior to the sale in order to encourage other veterinarians to order the products. All post-sale technical support was performed outside of Virginia. Distinguishing the current facts from P.D. 01-70 (5/25/2001), the Department determined that technical information provided prior to a sale would be ancillary to sale solicitation

because such activity would not occur but for the solicitation of sales. However, any post-sale technical training or support provided to customers would create nexus with Virginia.

4. Based on the subsequent evidence provided by the Taxpayer, the Department found that the activities of the district manager and the veterinarian did, in fact, constitute solicitation of sales, were ancillary to sales solicitation, or provided a de minimis connection with Virginia. Accordingly, the Taxpayer did not have nexus with Virginia for the taxable years at issue and the assessments for the taxable years ended October 31, 2002 through 2005 were abated.

TEMPORARY NEXUS

The Illinois Department of Revenue concluded that machine part sales made to Illinois customers do not create nexus for an out-of-state vendor that used common carriers to make deliveries.

Illinois Dep't of Revenue General Information Letter, IT 09-0045-GIL, CCH ¶ 402-070, 2009 WL 5407993(Dec. 10, 2009).

1. Taxpayer company is incorporated and has its principal place of business outside Illinois. Taxpayer imports machinery from foreign countries for sale in North America. The machines are very large, so when they are sold, they are shipped directly from point of entry to the customer. Taxpayer installs the machines with its own personnel. Taxpayer also stocks parts at its principal place of business for sale to customers that bought machines. Parts are shipped via interstate commerce. Taxpayer does not own its own trucks. Taxpayer may only sell five machines per year in North America. Taxpayer frequently sells parts to Illinois customers. Sales are generated by telephone, and Taxpayer may visit a customer from time to time to secure a sale.

2. The Department of Revenue advised that under these facts, whether or not Taxpayer has the requisite nexus with Illinois for a taxable year likely depends on whether or not it has machine sales to Illinois customers during that year. Installation of machines sold to Illinois customers is an unprotected activity under Public Law 86-272 and subject to state taxation. However, in taxable years in which Taxpayer has no machine sales in Illinois, it may be exempt from Illinois income tax because the parts it ships from its office for delivery to customers are ordered via telephone and delivered by third party carriers.

“INTANGIBLE” NEXUS

MARYLAND

Another intangible holding company loss -- the Maryland Court of Special Appeals affirmed the assessment against the holding company that owned and licensed intangible property to an affiliated entity that operated retail stores in Maryland.

The Classics Chicago, Inc. v. Comptroller of the Treasury, Tax Appeal No. 06-IN-OO-0226, CCH ¶ 201-815 (Md. Tax Apr. 11, 2008), aff’d, CCH ¶ 201-856 (Cir. Ct. Balt. City Oct. 8, 2008), aff’d, CCH ¶ 201-897, 985 A.2d 593 (Md. Ct. Special App. Jan. 4, 2010).

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, General Mills, Inc. acquired Talbots. In 1988, General Mills sold its interests 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 Classics Chicago (Classics), a Delaware wholly-owned subsidiary of Talbots with its principal place of business in Illinois. Classics purchased all of the Talbots trademarks. Classic and Talbots then entered into a license agreement similar to the agreement between Jusco BV and Talbots. Classics maintained and preserved the Talbot trademarks. Classics rented office space from Talbots for its offices in Chicago.

2. Classics and Talbots appealed from a judgment entered by the Circuit Court for Baltimore City affirming a Maryland Tax Court decision which approved income tax assessments against Classics and Talbots. The basis of the assessments was that during the taxable period, Talbots filed Maryland income tax returns and deducted royalty payments to Classics, but Classics did not file Maryland state income tax returns and did not report the royalty payments as taxable income to Maryland. Classics and Talbots argued that Classics lacked a substantial nexus to the state of Maryland. As support for this argument, Classics and Talbots

pointed to the fact that the transfer to Classics was executed for numerous business reasons and not structured to avoid state taxation.

3. The Court of Special Appeals held that Classics had a substantial nexus with Maryland by virtue of Talbots' royalty payments. The Court applied an economic reality test and determined that because Talbots' business in Maryland was what produced the sole income of its subsidiary, Classics, a sufficient nexus existed. In so holding, the Court also noted that the motivation behind the transaction is not dispositive when assessing economic reality.

NEW JERSEY

Another round in the extended battle between a Delaware Holding Company that licensed patents, trade secrets and technology to corporate affiliates that did business in New Jersey. The Delaware Holding Company lost in the New Jersey Tax Court, won on appeal, but ultimately lost in the New Jersey Supreme Court.

Praxair Technology, Inc. v. Director, Division of Taxation, No. 007445-05 (N.J. Tax Ct.), rev'd 961 A.2d 738 (N.J. Sup. Ct. App. Div. 2008), rev'd, No. A-91-92/08, 2009 N.J. LEXIS 1406 (N.J. Dec. 15, 2009).

1. Praxair Technology, Inc. ("Praxair Technology"), a Delaware corporation with its principle place of business in Connecticut, engaged in the sole business of owning intellectual property in the form of patents, trade secrets and technology. Praxair Technology formed a subsidiary, Praxair, Inc., which was engaged in the business of manufacturing and selling industrial gases throughout the United States and New Jersey ("Parent"). In exchange for fees, Praxair Technology entered into a license agreement with its Parent, whereby the Parent used Praxair Technology's intellectual property in the manufacture of industrial gases.

2. In 2002, the Director of the Division of Taxation made an assessment against Praxair Technology for New Jersey's corporation business tax (CBT), including interest and late filing penalties, for each of the 1994 to 1999 tax years. Praxair Technology filed a complaint before the Tax Court, arguing that it was not "doing business" in New Jersey for the taxable years 1994 to 1996 because the regulation promulgated to implement the CBT did not include a subsidiary trademark example until 1996. Praxair Technology did not contest the fact that it was subject to the business tax following the addition of the 1996 example to the regulation.

3. The Tax Court relied on the plain language of the CBT statute to find Praxair Technology liable for the tax because the law itself "clearly applie[d] to [Praxair Technology] without the assistance of regulation." Thus, because the Parent had facilities in New Jersey, Praxair Technology had a sufficient nexus with the state.

4. Citing Lanco, Inc. v. Director, Division of Taxation, 21 N.J. Tax 200 (N.J. Tax Ct. 2003), rev'd, 879 A.2d 1234 (N.J. Sup. Ct. App. Div. 2005), aff'd, 908 A.2d 176 (N.J. 2006), petition for cert. denied, 2007 U.S. LEXIS 7736 (June 17, 2007) (§ III.J.9.a of this outline), the Appellate Division agreed that New Jersey can tax income generated by intangible property even where the assessed corporation lacks a physical presence in the state. The Appellate Division reversed, however, concluding that the 1996 addition of the trademark example to the regulation indicated that, prior to that point, doubt existed regarding the Director's ability to tax subsidiary trademark entities such as Praxair Technology.

5. The New Jersey Supreme Court subsequently reversed the Appellate Division, describing the Tax Court's interpretation of the plain language of the CBT statute as "unassailable." Further, the New Jersey Supreme Court noted that Praxair Technology's arrangement with its Parent corporation was designed to minimize or evade taxes. This corporate form, however, did "not trump substance," and therefore, Praxair Technology was "doing business" in New Jersey in a manner sufficient for taxation nexus.

WEST VIRGINIA

A third loss! Another out-of-state intangible holding company, which received royalty payments from its corporate affiliates for the use of licensed trademarks and trade names, was subject to West Virginia corporation net income tax.

Redacted Decision, West Virginia Office of Tax Appeals, Nos. 06-544N & 06-545, ¶20100208005, Jan. 6, 2010.

1. Petitioner, a Nebraska corporation, licensed trademarks and trade names to other entities, including affiliated companies, which then sold trade-named products to West Virginia customers.

2. In a thorough analysis of law and fact, the Administrative Law Judge ("ALJ") determined that Petitioner was subject to both the State's corporate franchise tax and its net income tax, justifying the application of each of these taxes on nexus and minimum contacts considerations.

3. Due Process Nexus

   a. Under a Quill analysis, the ALJ found that Petitioner had the requisite minimum contacts with West Virginia and that the tax was rationally related to activities conducted in West Virginia.

   b. Looking to minimum contacts, the ALJ found that Petitioner licensed trademarks and trade names to entities that manufactured goods bearing those names for sale in West Virginia. Because Petitioner benefited from the sale of these licensed products in the state, it necessarily availed itself of West Virginia's economic market.

   c. Also, basing its findings on precedent from other jurisdictions, the ALJ found that the taxes were rationally related to the trademark activity being taxed.

   d. Commerce Clause Nexus

      (i) The ALJ also found that the Petitioner had sufficient nexus with West Virginia under Complete Auto, and the ALJ further affirmed that the tax was fairly apportioned, did not discriminate against interstate commerce, and that it was fairly related to the benefits provided by West Virginia.

      (ii) Noting that several jurisdictions including West Virginia have limited Quill's physical presence requirement to sales and use taxes, the ALJ instead relied on a "substantial economic presence" standard considering the frequency, quantity and systematic nature of Petitioner's contacts with the state.

      (iii) The ALJ found substantial economic presence by looking to the heavy penetration of Petitioner's trademarks into the West Virginia marketplace. The ALJ emphasized that "[p]roducts bearing its trademarks and trade names can be found in many, perhaps most, retail stores in West Virginia that sell food products." This finding was supported by consideration of various redacted sales and royalty figures.

      (iv) The ALJ also rejected Petitioner's attempt to "compartmentalize the transactions" to individual license sales, noting that Petitioner's aggregate sales, and specifically its sales to affiliated companies, produce a substantial economic impact.

e. Of note, the ALJ dismissed the Tax Commissioner's assertion that the sales of trademarks and trade names to affiliate entities were "sham" transactions solely for tax evasion purposes. This face was "irrelevant," according to the ALJ, and the real issue was whether the Petitioner could be constitutionally subjected to taxation by West Virginia.

DOING BUSINESS IN THE STATE

ARIZONA

The Arizona Department of Revenue refused to apply P.L. 86-272 to one entity in a consolidated return. Nexus was dependent on the principal taxpayer and it had nexus in Arizona.

Arizona Dep't of Rev. v. Central Newspapers, Inc., 218 P.3d 1083 (2009).

1. A subsidiary of taxpayer conducted no business activities in Arizona beyond the solicitation of orders. It did not have employees or maintain a sales office or store in Arizona. Taxpayer argued that under P.L. 86-272 (15 U.S.C. § 381), its subsidiary's income should not be included in Taxpayer's consolidated return.

2. The Court rejected taxpayer's argument because the taxpayer had chosen to file a consolidated return, so it had to include its subsidiaries. Moreover, "the primary trigger for the application of [15 U.S.C. § 381] is not the receipt of income from interstate commerce, but the lack of contacts by the taxpayer with the taxing state." Because the taxpayer itself had sufficient contacts, its subsidiary's lack of contacts were immaterial.

COLORADO

This advisory applies P.L. 86-272 to situations in which in-state employees solicit sales. If the vendor has no employees or merchandise in Colorado, it is not subject to income tax liability.

Colorado Dep't of Rev., FYI Income 58, ¶200-926, October 2009.

1. A corporation must file a Colorado corporate income tax return if it does business in Colorado or derives business from Colorado sources. If a corporation's only activity in Colorado is soliciting sales of tangible personal property, and the sales orders are sent

out of Colorado for acceptance and fulfillment, the corporation does not have a filing obligation with Colorado.

2. Corporations that do not have employees nor stocks of goods in Colorado and do not engage in activities in the state, other than the shipping of goods to customers in Colorado pursuant to orders received by mail, telephone, or the Internet, are not "doing business" in Colorado and are not subject to Colorado income tax. Likewise, if sales are made to customers in Colorado pursuant to orders taken by independent brokers or dealers, if such corporations have neither employees nor stocks of goods in Colorado and engage in no other activities in the state, a corporation is not subject to Colorado income tax.

CONNECTICUT

Regardless of physical presence, "substantial economic nexus" will create income tax nexus in Connecticut for out-of-state corporations and S corporations.

HB 6802 (2009).

1. On August 31, 2009, the Connecticut General Assembly passed a bill which established an "economic nexus" standard for determining whether an out-of-state corporation is subject to the corporation business tax. The bill became law on September 8, 2009.

2. Effective for taxable years beginning on or after January 1, 2010, the bill states that, to the extent allowed by the U.S. Constitution, an out-of-state corporation and certain partnerships and S corporations with "substantial economic presence" in Connecticut are subject to the corporation business tax, regardless of a physical presence, if there is substantial economic presence in Connecticut or derived income from sources in the state. A "substantial economic presence" in Connecticut means purposefully directing business towards the state. Such "purpose" is determined by the frequency, quantity and systematic nature of economic contacts with the state.

3. The same kind of "economic presence" standard was also enacted for S corporations. The test is evidence of "a purposeful direction of business" toward Connecticut.

INDIANA

Sometimes nexus is a good thing. This taxpayer was allowed to apportion its income to non-Indiana jurisdictions.

Letter of Findings No. 08-0583, Indiana Department of Revenue (July 29, 2009).

1. Taxpayer's sales force operated out of their homes and used their own vehicles, solicited orders in other states and forwarded the orders to taxpayer's Indiana offices, which then shipped the goods to the out-of-state customers. Taxpayer sought to apportion its income so Indiana could not tax it all for a given year. The Department's initial audit determined that taxpayer was not entitled to apportion its income because it did not establish nexus in any other state except Indiana. Taxpayer challenged the audit and the Department reversed.

2. When a taxpayer proved that it filed and paid net income tax in other states, it could apportion its income to avoid double taxation. In addition, when a taxpayer established that it was subject to taxes in other states, sales to customers in those states would not be "thrown back" to Indiana for income tax purposes.

An Illinois auto dealer had nexus in Indiana because it had an Indiana office. It was immaterial that the dealer's customers registered cars in states other than Indiana.

Indiana Dep't of Rev., Letter of Findings No. 09-0154, ¶20091030012 (Oct. 28, 2009).

1. Taxpayer is an Illinois car dealership renting an office and selling cars in Indiana. Taxpayer protested assessments of income tax. Taxpayer argued that customers from out of state and cars sold to them were registered in states other than Indiana, so sales were not generated from Indiana. The Department rejected Taxpayer's arguments, explaining that Taxpayer still was "doing business in Indiana" because Taxpayer maintained an office in Indiana and the sales forms were generated by Taxpayer's Indiana office.

KANSAS

This is an excellent summary of nexus creating activities in Kansas.

Information Guide No. KS-1510, CCH ¶ 201-270 (Oct. 2009); Information Guide No. KS-1520 CCH ¶ 201-265 (Oct. 2009).

1. Two Kansas Department of Revenue publications explain "nexus," for purposes of the Kansas retailers' compensating use tax as a "'means of connection' or a 'link'" that varies from situation to situation. The publications set forth the following as "some of the areas the department looks for" in nexus determinations:

   a. Business location in Kansas, including an office;

   b. The presence in Kansas of sales or service representatives;

   c. Operation of mobile stores in Kansas (example: trucks with a driver salesperson);

   d. Stocking inventory in a Kansas warehouse or on consignment;

   e. Providing tangible personal property for lease or rental in Kansas;

   f. Delivering merchandise to Kansas customers using company vehicles or contract carriers, other than interstate common carriers; and

   g. Providing or contracting for installation, construction, repair, or other services in Kansas (such as maintenance contracts).

KENTUCKY

Kentucky passed a new law that creates a "doing business" rule for ownership interests in a Kentucky general partnership, for tax years on and after January 1, 2005.

Ky. Rev. Stat. § 141.040.

1. On March 18, 2005, the Kentucky Legislature amended Ky. Rev. Stat. §141.040 (effective January 1, 2005) eliminating the physical presence standard relied on by the Board in Ashworth Corp. v. Kentucky Revenue Cabinet, 2006 Ky. Tax LEXIS 63 (Ky. BTA Jan. 27, 2006), rev'd, Kentucky Revenue Cabinet v. Ashworth Corp., No. 06-CI-00288 (Ky. Cir. Ct. Dec. 4, 2007), aff'd in part, Kentucky Revenue Cabinet v. Ashworth Corp., 2009 Ky. App. LEXIS 229 (Ky. Ct. App. Nov. 20, 2009). Effective for tax years beginning on or after January 1, 2005, the amended statute instead adopts a "doing business" nexus standard. Under this new standard, every corporation doing business in Kentucky is subject to the corporate income tax. "Doing business" is defined for this purpose as including, among other things, "maintaining an interest

in a general partnership doing business in [Kentucky]," and "deriving income from or attributable to sources within [Kentucky]." Ky. Rev. Stat. §141.010(25)(e) and (f). Accordingly, the Board's decision in Ashworth should not be solely relied on for tax years beginning on or after January 1, 2005.

MASSACHUSETTS

While the use tax audit had Commerce Clause issues, the Supreme Judicial Court reversed the assessment on burden of proof grounds and lack of audit evidence.

Town Fair Tire Centers, Inc. v. Commissioner, No. SJC-10360, CCH T 401-256 (Mass. 2009).

1. Taxpayer is a Connecticut corporation with the principal business of the retail sale and installation of automobile tires. During the period at issue in this matter, Taxpayer operated 60 stores in New England, including 18 stores in Massachusetts and three stores in New Hampshire. Taxpayer collected and remitted Massachusetts sales tax on tire sales at its Massachusetts stores, but it did not collect Massachusetts use tax in connection with the sale of tires at its stores outside Massachusetts.

2. An auditor with the Massachusetts Department of Revenue, using a single month as a sample, discovered that Taxpayer's three New Hampshire stores had 313 invoices that listed a Massachusetts address beneath the name of the purchaser. The auditor determined that Taxpayer should have collected and remitted Massachusetts use tax for the 313 sales. Taxpayer appealed and the Appellate Tax Board found that the sales at issue were sales of tangible personal property to be used in Massachusetts and held that the assessment of use tax was proper.

3. The Court reversed the Board's decision, pointing out that there was no evidence that the tires were actually used in Massachusetts. The Court said it was particularly significant that there is no statutory presumption that a vendor's knowledge that a purchaser is a resident of Massachusetts will permit a finding that the goods purchased out-of-state were purchased for use in Massachusetts.

4. The Court did not rule on the Commerce Clause issues raised by the taxpayer.

NEW JERSEY

These very interesting cases hold that, in and of itself, licensing computer software does not create nexus – and that the New Jersey Tax Court does not blindly apply Lanco.

AccuZIP, Inc. v. Division of Taxation; CCH 91 401-462 (N.J. Tax Ct. Aug. 13, 2009).

1. AccuZIP, Inc. and Quark, Inc. are two computer software corporations that were domiciled out of state and appealed from final determinations issued by the Division of Taxation finding the corporations liable for the Corporation Business Tax ("CBT"). Nexus assessments against them were overruled by the Tax Court, although Quark was found to be doing business in New Jersey because of a resident sales person, P.L. 86-272 prohibited the CBT assessment.

2. AccuZIP is a Nevada corporation with offices in California. It has no agents, officers, or employees in New Jersey, and its management, offices, and other places of business are not located in New Jersey. Furthermore, it did not own or rent any real property in New Jersey. AccuZIP develops and sells computer mailing programs to customers nationwide. It marketed its products by placing advertisements in national trade magazines and maintaining a website. Customers placed orders via telephone, e-mail, or fax with an AccuZIP employee in California. The products were then shipped to customers from the California office.

3. Between 1999 and 2001, AccuZIP had 93 customers in New Jersey who generated 2% of the company's total gross income. In 2002, AccuZIP completed a Nexus Survey at the request of the Director of the Division of Taxation. The Director found that AccuZIP was "doing business" in New Jersey for CBT purposes because it retained title to licensed software in New Jersey.

4. The Tax Court, however, found that the nature and extent of AccuZIP's activities in New Jersey, as well as the continuity, frequency and regularity of those activities, were de minimus. Importantly, the Court found that AccuZIP was selling tangible personal property - prewritten software - and not licensing intellectual property to New Jersey customers. Accordingly, the Court held that AccuZIP was not "doing business" in New Jersey, as there was no substantial nexus between AccuZIP and New Jersey.

5. Quark is a privately held Colorado corporation with its principal offices and headquarters in Denver, Colorado. Quark does not own property in New Jersey, but it employed a regional sales representative in New Jersey that sold Quark's products and held educational sessions. Quark developed and copyrighted a desktop publishing computer program. Its products, the disks containing the program, were shipped from a fulfillment center to locations around the world.

6. The Director found that Quark's licensing of software to New Jersey customers, while retaining title to such software, constituted "doing business" in New Jersey. The Tax Court also held that Quark sold tangible personal property and did not license intellectual property to New Jersey customers. However, because Quark's regional sales representative in New Jersey traveled to stores in New Jersey that sold Quark's products, Quark was "doing business" in New Jersey for CBT purposes at the minimum tax because P.L. 86-272 otherwise prohibited taxation of Quark.

BIS LP, Inc. v. Division of Taxation,
CCH 91 401-457 (N.J. Tax Ct. July 30, 2009).

1. BISYS Group, Inc. provides information processing and technology outsourcing services for its clients. It reorganized its banking information solutions division, creating a limited partnership, known as BISYS Information Solutions ("Solutions"), which was in the data processing business. BISYS, a wholly owned subsidiary of BISYS Group, transferred the assets and liabilities of its data processing business to Solutions. BISYS and BIS LP, Inc., the plaintiff in this case and a wholly owned subsidiary of BISYS, entered into a limited partnership agreement, whereby BISYS was the general partner of Solutions with a 1% interest and BIS was the limited partner with a 99% interest.

2. BIS did not have a place of business in New Jersey; it did not have employees, agents, or representatives; and did not own property in New Jersey. BIS' sole interest in New Jersey was its limited partnership interest in Solutions, a New Jersey partnership. However, the Division of Taxation issued a corporation business tax (CBT) assessment of $1,008,537 to BIS on the basis that it had a unitary relationship with the business conducted by Solutions, giving BIS enough of a constitutional presence in New Jersey to subject it CBT.

3. The Tax Court, on the other hand, found that Solutions and BIS were not integrally related. Rather, BIS was a passive investor in Solutions, and BIS had no control or potential for control in the

limited partnership. It was not in the same line of business. A foreign corporation that simply holds a limited partnership interest in a New Jersey partnership and is not part of the unitary business of the partnership is not subject to CBT.

NEW MEXICO

An out-of-state drop shipper was declared immune from New Mexico's gross receipts tax because it had no physical presence nexus in New Mexico. The Department of Revenue deemed it critical that the drop shipper never had physical possession of its customers' merchandise – it had gross receipts but no nexus.

1. Administrative Ruling, No. 401-09-05, CCH ¶ 401-258 (N.M. Taxation and Revenue Dept. Dec. 3, 2009).

2. The New Mexico Taxation and Revenue Department considered a set of hypothetical facts to determine whether a out-of-state taxpayer would be liable under the gross receipts tax and/or the compensating tax for sales to New Mexico customers. In the hypothetical, an out-of-state "Company X" sells property to New Mexico customers by drop shipment. In such transactions, the customers order merchandise from Company X. Company X then purchases the property from vendors and has the property delivered to New Mexico customers by common carrier without Company X ever taking physical possession of the property.

3. Company X has no equipment, offices, warehouses, employees, advertising or other contacts with New Mexico. It contracts with customers in a way that Company X retains title in the property from the point in time when customers order the property to the time when the customer receives the property from Company X via common carrier. Based on these facts, Company X asked the New Mexico Taxation and Revenue Department whether it or its vendors were subject to New Mexico's gross receipts tax and/or the state compensating tax.

4. The Revenue Department determined that Company X was not subject to the gross receipts tax because it lacked a nexus with New Mexico. In its analysis, the Department first determined that the drop shipments to customers in New Mexico were gross receipts from the selling of property in New Mexico. However, the brief ownership by Company X of the property, without ever taking physical possession, was not sufficient ownership to establish nexus. Without other physical ties — equipment, offices, warehouses, etc. — Company X did not have sufficient tax nexus with New Mexico.

5. The Department did not thoroughly analyze nexus considerations regarding the vendors, but noted that the vendors were eligible for certain deductions under state law should nexus be found.

6. For statutory reasons, such as the resale exemption, the Department found Company X and the vendors could be exempt from the compensating tax if the statutory requirements were satisfied by Company X and the vendors.

NEW YORK

Every decade or so, a taxpayer wins a use tax case on an aircraft. Here, unusual facts about a World War II P-51 Mustang fighter plane resulted in a finding that mere ownership of the P-51 Mustang did not constitute "doing business" in New York for tax purposes.

Advisory Opinion, Petition No. 821342, CCH ¶406033 (N.Y. Dept. of Tax & Fin. Apr. 18, 2008) aff'd In re Rochester Amphibian Airways, Inc., CCH T 406-484 (N.Y. Tax App. Trib. Aug. 6, 2009).

1. On appeal, the Tax Appeals Tribunal affirmed the Division of Tax Appeals' decision involving a use tax assessment against a Delaware corporation that owned two vintage World War II aircraft. The Tribunal held that the corporation's ownership and maintenance of the aircraft, purchased in another state, did not constitute doing or carrying on a business in New York.

The method and location of the ultimate delivery of asphalt controlled the New York sales tax consequences of initial railcar delivery in Albany. This is a good reminder of basic nexus rules.

Advisory Opinion, Petition No. S090206A, CCH T 406-471 (N.Y. Dep't of Tax & Fin. July 14, 2009).

1. Petitioner is one of the largest asphalt refiners and marketers in the United States. Petitioner's product comes into the railway terminal in Albany, New York in railroad cars in a "heated" and "wet" condition. The asphalt is delivered to customers at the terminal by loading it into tractor-trailer (tanker) combinations or tank trucks. These vehicles may be owned by the customer or may be owned and operated by a third-party carrier contracted and paid directly by the customer.

2. Many of Petitioner's customers are out-of-state entities that are not doing business in New York. The customers may subject the asphalt to further processing and either resell the asphalt or use it in fulfillment of construction projects. These customers all assert

that the asphalt is not for use in New York. Petitioner requested an advisory opinion as to whether its asphalt sales are subject to sales tax.

3. The Opinion stated that if Petitioner relinquishes possession of the asphalt directly to the custody of a common carrier, Petitioner is required to collect New York sales tax only on deliveries made to locations in New York, unless otherwise exempt. However, any delivery of the asphalt to an agent, representative, or employee of the customer was a taxable transfer of the possession of the asphalt to the customer in New York.

SOUTH CAROLINA

This extensive guidance includes nexus creating activities and is a useful reference to those planning to do business with South Carolina customers.

Revenue Ruling 09-9, South Carolina Department of Revenue, CCH ¶400-488 (June 16, 2009).

1. The South Carolina Department of Revenue released a notice that explains when a retailer with Commerce Clause nexus in South Carolina has sufficient minimal connection with a jurisdiction in order to subject it to sales and use taxation.

2. If a retailer with Commerce Clause nexus purposefully avails itself of a jurisdiction's economic market or has purposefully directed its efforts towards the jurisdiction's residents, it may be subject to the authority of that jurisdiction and will be required to submit taxes on deliveries into that jurisdiction. A retailer's physical presence within a jurisdiction is not necessary. A retailer with nexus in South Carolina must remit a jurisdiction's sales and use tax when it delivers property into a jurisdiction using its own vehicles or a contract carrier. A retailer is also subject to a jurisdiction's taxes when it uses a common carrier for deliveries and Due Process nexus has been established with the jurisdiction. Examples of Due Process nexus include advertising using media located in the jurisdiction, maintenance of property within the jurisdiction, and placing agents or employees within the jurisdiction.

VIRGINIA

Sometimes a state removes an affiliate from a consolidated return on a "no nexus" basis.

Ruling of Commissioner, P.D. 09-121, CCH ¶205-049 (Virginia Department of Taxation, August 7, 2009).

1. Taxpayer was the lead corporation in an affiliated group (the “Group”) that filed a consolidated Virginia corporate income tax return for the 2003 taxable year. Under audit, the Department removed one of the entities, “X”, from the consolidated return, finding that X lacked income from Virginia sources and lacked nexus to the state.

2. X was a construction contractor based outside Virginia and had no payroll or property in the state. For the 2003 taxable year, X’s sole revenue resulted from a final progress billing invoice for a contract completed in a previous taxable year. In addition, X had out-of-state personnel traveling into Virginia soliciting additional contract work. The Taxpayer contested the assessment, asserting that X had nexus with Virginia for the 2003 taxable year and was properly included in the Group’s consolidated return because it was actively pursuing additional work in Virginia.

3. Generally, a corporation not organized under Virginia law is subject to Virginia income tax if the corporation receives income from Virginia sources, unless exempted by Va. Code § 58.1-401 or Public Law (P.L.) 86-272. P.L. 86-272 prohibits a state from imposing a net income tax where the only contacts with a state are a narrowly defined set of activities constituting solicitation of orders for sales of tangible personal property. The Department limits the scope of P.L. 86-272 to only those activities that constitute solicitation, are ancillary to solicitation, or are de minimis in nature.

4. The Tax Commissioner concluded that X did not have nexus with Virginia for the 2003 taxable year. X did not provide contracting services in Virginia in 2003. X did have personnel traveling into Virginia to pursue potential contracts; these activities involved a bidding process that extended several months involving multiple visits to potential construction sites. The bid work was primarily conducted by a project superintendent who traveled into Virginia in a company owned truck. X was eventually granted a contract set to begin in 2004, but lack of funding caused the contract to be cancelled.

5. The Tax Commissioner found that actively pursuing business in Virginia generally includes activities included in the solicitation of orders. According to the Commissioner, “[s]uch activities cannot create nexus pursuant to P.L. 86-272.” The Taxpayer provided no evidence that the project superintendent conducted any activities in Virginia that exceeded the protection afforded under P.L. 86-272. Therefore, X did not have nexus with Virginia.

After an analysis of the rules about licensing and selling software, the Tax Commissioner concluded that the out-of-state company was leasing servers in Virginia with licensed prewritten software in a sufficient quantity to create nexus.

Ruling of Commissioner, P.D. 09-169, CCH ¶205-099 (Virginia Department of Taxation, October 23, 2009).

1. The Ruling of the Commissioner discuses the application of retail sales and use tax to an out-of-state company that licenses software installed on servers shipped to customers in Virginia. The Company has an office located outside Virginia and all employees work at this office. There are no traveling salespersons, installers, service people, subcontractors, independent contractors, agents, affiliates, or similar individuals entering Virginia on behalf of the Company. According to the Company, it creates and sells canned software, which the Company installs, configures and tests on computer servers at its office. This characterization of the Company's business was disputed by the Commissioner in this ruling. Once operating correctly, servers with installed software are shipped to customers in Virginia via common carrier. The Company pays sales or use tax on the cost of these servers in the state where its office is located. The software installed on these servers functions and receives software fixes, upgrades and patches through a link to a network with an Internet connection.

2. The facts also revealed that although the Company states that it sells a canned software product, the company actually licenses the software without passing title to the software to another person. Also, the Company treats itself as a user or consumer of the servers as it pays the sales tax on the cost price of such servers to its home state. Generally, a person engaged in personal or professional service transactions is the user or consumer of the tangible personal property used in the performance of such services. <u>See</u> Title 23 of the Virginia Administrative Code 10-210-4040 E and Va. Code § 58.1-609.5 1. In an attempt to respond to the issue presented, the Commissioner addresses the application of the tax using two likely scenarios.

3. <u>(1) Service Provider</u>. If the Company is a service provider in Virginia, then it is generally liable for the tax on all servers, software and any other tangible personal property used in Virginia for its provision of services. An exception to this rule would be for servers and software owned or leased by an Internet service provider to enable users to access proprietary and other content, information, electronic mail, and the Internet as part of a package of services sold to end-user subscribers.

4. (2) Lessor or Renter. If the Company is engaged in transactions for the lease or rental of tangible personal property in Virginia and does not use the servers, software and other tangible personal property in the provision of exempt information services, then it is engaged as a dealer in Virginia, pursuant to Va. Code §58.1-612 B 5. Under these circumstances, an examination of the Company's activities in Virginia is required to determine whether the Company has sufficient activity in Virginia pursuant to Va. Code § 58.1-612 C 9 to require it to register for use tax collection duties.

5. According to the Commissioner, the facts presented suggest that the Company satisfies the criteria of Va. Code § 58.1-612 C 9 as a "dealer." When the Company engages in the retail or lease of servers with licensed prewritten software to Virginia customers, it maintains a continuous physical presence in Virginia that regularly and intentionally makes use of the Virginia marketplace. The software and server fees are also not incidental nor of immaterial value. Moreover, the Company's physical and economic presence on an ongoing basis in Virginia is not a de minimis presence in Virginia but a significant one. Thus, the Commissioner found that the Company's leasing presence in Virginia from 2002 through 2006 is sufficient to require registration for the collection of the sales or use tax on the server and software charges imposed on Virginia customers.

WASHINGTON

It's hard to defeat a Seattle B&O tax assessment, but this Limited Partnership prevailed. Its office in Seattle and the passive receipt of royalty income from 1947 trademarks and other intangibles was not "doing business" for B&O tax purposes.

Blistex Bracken v. City of Seattle, No. 62006-1-I (unpublished opinion), Washington Court of Appeals, Division One (September 21, 2009).

1. The minimal business activities of a family's limited partnership in Seattle were insufficient to justify the city's assessment of business and occupation ("B&O") tax on the royalty income the family received from licensing trademarks. Affirming the trial court, the Washington Court of Appeals held that the city's imposition of B&O tax violated Due Process.

2. Since 1947, the family had licensed the trademarks it owned for lip balm and skin care products to an Illinois corporation. To avoid probate and re-registering the trademarks each time an heir died, the family formed a limited partnership ("LP") to hold the

trademarks the family owned and to receive the royalty payments from the Illinois corporation. A family member who was the general partner rented an office in downtown Seattle to store the LP's records and receive mail. Royalty payments the LP received were either mailed or sent by wire transfer to a banking account in Seattle, and an accounting firm prepared the federal tax return.

3. Although the city conceded the LP was an estate planning mechanism, the city contended that under its municipal code, the LP was engaged in business activities by owning, managing, and maintaining the trademarks. The court found, however, that the fact that the LP received royalties did not make that income taxable; the LP had to be engaged in business activities that generated the sales and royalty income. The corporation, not the LP, developed, manufactured, marketed, licensed, and sold products using the trademarks, and generated the royalty income. The LP's maintenance of an office, use of banking services, and hiring of accountants to prepare federal tax returns were not a determining factor in deciding the tax issue.

WISCONSIN

"Doing business" in Wisconsin now includes new "economic nexus" activities like solicitation of Wisconsin customers.

Wis. Stat. § 71.255 (2009).

1. Wisconsin passed this new legislation, which will be effective for tax years beginning on or after January 1, 2009. Under the new legislation, the definition of "doing business in this state" has been expanded to incorporate a variety of economic nexus concepts. Activities considered to constitute doing business in Wisconsin, and hence, subject corporations to the Wisconsin corporation income tax, will now include: (1) regularly selling products or services of any kind or nature to in-state customers that receive the product or service in Wisconsin; (2) regularly soliciting business from potential customers in Wisconsin; (3) regularly performing services outside Wisconsin for which the benefits are received in Wisconsin; (4) regularly engaging in transactions with in-state customers involving intangible property and resulting in receipts flowing to the taxpayer from within Wisconsin; and (5) holding loans secured by real or tangible personal property located in Wisconsin.