JONES DAY | STATE TAX RETURN NEWSLETTER

Volume 18 Number 1 March 2011

NEXUS: UPDATE ON RECENT DEVELOPMENTS FOR FOURTH QUARTER 2010

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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 fourth quarter of 2010. Organized by the kind of activity that tends to give out-of-state entities nexus-planning and litigation difficulties, the items covered include the following: several rulings on the scope of P.L. 86-272's protections, "fly-by nexus" in Illinois, two more decisions imposing income tax on an intangible holding company based on economic nexus alone, and a pair of cases that show how using third parties in the state always raises tricky nexus issues. This update also has some cases with good "practical" advice: A Michigan appellate court decision provides an important reminder to take care when responding to nexus questionnaires, and a Virginia ruling highlights the importance of apportionment as an equally effective way to limit state tax liabilities. Finally, web nexus remains on the cutting edge in the news, as a New York appellate court issues its long-awaited decision on its "web affiliate" statute.

DOING BUSINESS IN THE STATE

NEW YORK

Can you follow the trail? Passive ownership in a limited liability company that ultimately held an indirect 0.01 percent general partnership interest in an entity doing business in New York created nexus.

***Shell Gas Gathering Corp. #2, et. al. v. N.Y. Div. of Tax App.*, CCH ¶ 406-422 (N.Y. Div. Tax App., ALJ Unit June 11, 2009), *aff'd*, Nos. 821569 and 821570, CCH ¶ 406-993 (N.Y. Div. Tax App., Tax App. Tribunal Sept. 23, 2010).**

1. Taxpayers Shell Gas Gathering Corp. #2 and Shell Gas Pipeline Corp. #2 were holding companies that held a membership interest in a third entity, "SUSGP." SUSGP was a Delaware limited liability

company that held an indirect 0.01 percent general partnership interest in Coral Energy Resources, L.P. ("CER"). CER was a seller and marketer of natural resources that conducts business, owns property, and makes sales in New York.

2. During the years in question, Taxpayers and SUSGP did not conduct any business in New York, employ anyone in New York, or own or lease any property in New York. SUSGP, however, did file a partnership return in New York because it held a 99 percent limited partnership interest (and indirectly held a 0.01 percent general partnership interest) in CER, the company that had business operations in New York.

3. Taxpayers did not have the right to participate in the management of SUSGP, nor were they able to act on behalf of SUSGP.

4. The administrative law judge ("ALJ") held that Taxpayers' passive ownership in SUSGP was enough to create nexus for franchise tax purposes, even though neither Taxpayers nor SUSGP had any New York business activities, and the general partnership interest in the entity that did business in New York was both slight and several layers removed. The ALJ held that Taxpayers had sufficient nexus with New York because New York has accorded privileges and immunities that led to CER's capital appreciation, which created benefit for its shareholders, ultimately including Taxpayers.

5. On appeal, Taxpayers argued that taxing them for mere passive investment in another entity violated the Due Process and Commerce Clauses of the United States Constitution as enunciated in *Quill* and violated the four-part test articulated by the U.S. Supreme Court in *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977). The New York Tax Appeals Tribunal rejected these arguments and upheld the ALJ's decision. The tribunal noted that 20 NCYRR 1-3.2(a)(5) requires that if a partnership is doing business in New York, then all of the corporate general partners are subject to tax under Article 9-A of the Tax Law. According to the tribunal, this provision withstands constitutional scrutiny because the relevant inquiry is whether "New York has given something for which it may impose a tax in return." New York "satisfied this standard because it [] accorded privileges and immunities that led to CER's income, which inured to the benefit of its shareholders, including [Taxpayers]."

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TEMPORARY IN-STATE PRESENCE

COLORADO

In this case, store fixtures were subject to local sales tax, even though the taxpayer did not do business within the city and the fixtures were to be used at stores in other Colorado locations.

***Leggett & Platt, Inc. v. Ostrom*, CCH ¶ 200-989 (Colo. Ct. App. Sept. 30, 2010).**

1. Taxpayer The Gap operates retail stores throughout Colorado but does not own or operate any retail stores in the City of Thornton (the "City"). The Gap purchased store fixtures from Taxpayer Leggett & Platt, which operated a manufacturing facility in the City.

2. The City imposes a sales tax on certain transactions taking place within the City: "Sales taxes are required to be imposed and collected from the purchaser or consumer on behalf of the City by any person engaged in business in the City and making a taxable retail sale or completing any other taxable transaction within the City."

3. Leggett & Platt agreed to manufacture store fixtures for The Gap for use in its retail stores outside the City. In order to transport the fixtures to The Gap's Colorado stores, Leggett & Platt loaded the fixtures at its facility in the City into vehicles either owned or hired and paid for by The Gap. The fixtures were then delivered to Gap stores located outside the City.

4. Leggett & Platt and The Gap paid sales tax to the City and then later requested a refund, arguing, among other things, that the transactions were exempt from tax because the items were delivered for use outside the City and that the imposition of the sales tax violated the Commerce Clause. The court rejected these claims, affirming the district court's denial of the refund claim.

5. Section 26-390 of the Thornton City Tax Code exempts sales of tangible personal property to persons who reside or do business outside the City if the *seller* delivers the goods to the purchaser outside the City via common, contract, or commercial carrier. Here, the court found that the exemption did not apply because it was the purchaser, not the seller, that delivered the goods. The sales took place within the City because the fixtures were placed on trucks hired and paid for by The Gap at Leggett & Platt's manufacturing facility within the City. Because possession transferred to the Gap within the City, it was "immaterial" that the goods "were eventually delivered elsewhere in Colorado."

6. The court applied this same reasoning to conclude that there was no Commerce or Due Process Clause violation. Noting that the "threshold inquiry" in Commerce Clause analysis is whether interstate commerce is even at issue, the court held that since the sale took place within the City, interstate commerce and the Commerce Clause were not implicated. In this case, there was no Commerce or Due Process Clause violation because the taxable event (the sale) took place within the City. The court further noted that the City tax code explicitly exempts from sales tax those sales transactions that are consummated out of state, avoiding Commerce Clause issues.

ILLINOIS

Another "airplane nexus" case shows just how easy it is to create use tax nexus. The Illinois Supreme Court finds that frequent take-offs and landings in Illinois were enough to impose Illinois use tax on the purchase price of a corporate jet regularly used to transport Illinois-based officers.

***Irwin Indus. Tool Co. v. Ill. Dep't of Revenue*, CCH ¶ 402-198, 2010 Ill. LEXIS 1065 (Ill. Sept. 23, 2010).**

1. Taxpayer was headquartered in Nebraska but also had a corporate office in Illinois. Taxpayer's chief executive officer, chief operating officer, chief financial officer, and general counsel—plus four directors—had their offices in Illinois. A former wholly owned subsidiary of Taxpayer bought an airplane and did not pay any sales tax on the purchase. The purchase agreement was signed in Kansas, but the bill of sale and FAA documents initially listed the Illinois office address as the registered address. The plane was hangared and maintained in Nebraska. On 49.3 percent of the airplane's total flying days, the plane flew to and/or from Illinois, and the plane was present overnight at an Illinois airport on 25 occasions.

2. Taxpayer challenged the Illinois Department of Revenue's levy of a use tax on the airplane's purchase price. Taxpayer argued, among other things, that the use tax violated the Commerce Clause because the airplane did not have substantial nexus with Illinois. The trial court granted summary judgment to the Department of Revenue, rejecting Taxpayer's Commerce Clause claim, and the appellate court affirmed.

3. The Illinois Supreme Court held that the corporation was liable for Illinois use tax on the purchase of the airplane and that Illinois's imposition of use tax did not violate the Commerce Clause because both the airplane and the corporation had substantial nexus with

Illinois. The court noted that the airplane had more than a "slight" physical presence in Illinois and met *Complete Auto's* substantial nexus requirement.

4. The court reaffirmed that *Quill* was controlling. It found that sufficient physical-presence nexus existed, even though the plane was rarely in Illinois longer than was necessary to pick up/drop off passengers. According to the court, "The airplane's frequent physical presence in Illinois, through the many take-offs and landings from Illinois runways, as well as the nights spent in Illinois, was not coincidental, but was inherent in its basic purpose and function in this state."

IN-STATE PERSONNEL: INDEPENDENT CONTRACTORS, SALES REPRESENTATIVES, AND MANUFACTURING REPRESENTATIVES

FLORIDA

This administrative ruling serves as an important reminder that P.L. 86-272's protections do not apply if an in-state employee performs administrative or other non-sales-related functions.

***Florida Dep't of Rev., Technical Assistance Advisement*, No. 10C1-009, CCH ¶ 205-566 (Sept. 1, 2010).**

1. Taxpayer has an employee present in the state who performs functions other than the solicitation of sales within Florida. The employee's activities involve the performance of online administrative duties for Taxpayer's operations and are not limited to soliciting sales of tangible personal property to customers in Florida.

2. The Florida Department of Revenue advised that Taxpayer's employee conducted activities which exceeded the solicitation of orders protected by P.L. 86-272, and thus Taxpayer had nexus with Florida and must file a corporate income tax return with the state.

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MICHIGAN

More than two days of sales solicitation creates nexus.

Be careful of how you respond to nexus questionnaires! Form-letter responses may trigger enforcement and cause problems in overcoming evidentiary burdens.

***Barr Laboratories v. Michigan Dep't of Treasury*, No. 291968, CCH ¶ 401-532 (Mich. Ct. App. Oct. 21, 2010).**

1. Taxpayer Barr Laboratories ("Barr") was an out-of-state corporation that maintained no property or employees in Michigan. During the audit period, Barr did have two employees who infrequently came to the state to maintain relationships with its customers (pharmaceutical distributors). Barr asserted that it lacked nexus in Michigan.

2. Barr's responses to the state's nexus questionnaires stated that it made "[p]hysical contact within Michigan soliciting sales through employees, agents, representatives[,] independent contractors or others acting on [its] behalf" between two and nine times per year. It checked the box on the nexus questionnaire for "2–9 days" of physical contact each year soliciting sales through employees, agents, representatives, or independent contractors. In subsequent affidavits, however, Barr attested that its employees made fewer than two visits to Michigan per year and that these visits were not to solicit sales, but to visit distributors and gather information.

3. The trial court granted summary judgment in Barr's favor, but the Michigan court of appeals reversed. Noting "conflicting evidence" resulting from the responses on the nexus questionnaire, the court of appeals held that the factual question of nexus could not be resolved as a matter of law. Instead, under Michigan law, the evidence showed "the possibility that [Barr] engaged in taxable business activity" since it had checked the box for 2–9 days of sales solicitation activity on its nexus questionnaire. The case was remanded for further proceedings consistent with the appellate decision.

Independent registered representatives soliciting requests for securities transactions created nexus for an out-of-state securities broker-dealer.

***Vestax Securities Corp. v. Michigan Dep't of Treasury*, No. 292062, CCH ¶ 401-537 (Mich. Ct. App. Oct. 28, 2010).**

1. Taxpayer Vestax Securities Corporation ("Vestax") was an out-of-state securities broker-dealer. It had a contractual relationship with

independent registered representatives ("IRRs") in Michigan that used Vestax to facilitate securities transactions. Customers of an IRR would request securities transactions from the IRR, and the IRR in turn would rely on Vestax to make the transaction on a national securities exchange. IRRs could access a national securities exchange—and thus complete the transaction—only through a registered broker-dealer such as Vestax. Vestax and the IRRs were not commonly owned. The IRRs ran their own offices and offered services other than securities transactions.

2. The Michigan Department of Treasury assessed single business tax, claiming that Vestax had agents in the state acting on its behalf to solicit sales of securities transactions. The court of claims ruled that Vestax did not have a nexus sufficient to subject Vestax to Michigan's taxing jurisdiction. The court of claims relied on *Scholastic Book Clubs, Inc. v. Michigan Department of Treasury*, 567 N.W.2d 692 (Mich. Ct. App. 1997), which held that Scholastic's relationship with local teachers did not create the physical-presence nexus required by the Commerce Clause.

3. Rejecting the court of claims' analysis, the court of appeals found *Scholastic Book Clubs* inapplicable: "[T]he instant case involves a contractual relationship between [Vestax] and the IRRs that is specific to the IRRs' utilization of [Vestax]'s services. Moreover, the IRRs were required to use a broker-dealer, such as [Vestax], to conduct their customers' transactions. The contractual relationship between [Vestax] and the IRRs was more formal, direct, and specific than the *Scholastic Book Clubs*' arrangement. Additionally, the IRRs were [Vestax]'s agents."

4. The court of appeals held that the activity of the IRRs permanently located in Michigan to negotiate sales for Vestax amounted to "'conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf.'" The label given to the relationship was not controlling and the "IRRs certainly created business for [Vestax] in the state because the IRRs were required to use a securities broker-dealer, such as [Vestax], in order to process the orders for the IRRs' customers."

5. Here, the "IRRs were acting on their own behalf and on behalf of the broker-dealer they chose pursuant to contract to receive a commission for executing the securities transactions." Thus, Vestax's activities resulted in a physical presence that satisfied the constitutional substantial nexus requirements and made it subject to the (former) single business tax.

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VIRGINIA

Sales of services on behalf of an unrelated third party do not create nexus for a corporation otherwise protected by P.L. 86-272, so long as the third party is an "independent contractor" within the meaning of P.L. 86-272.

Ruling of Commissioner, P.D. 10-252 (Va. Dep't of Tax., Nov. 10, 2010).

1. Taxpayer is an out-of-state company that arranges for repair and maintenance services for its customers. Taxpayer does not own or lease real or tangible property in Virginia, has no employees in the state, and performs no marketing there. Taxpayer does make approximately $2 million each year in revenue from third-party service providers in Virginia.

2. When a customer calls Taxpayer to procure services, Taxpayer contacts an unrelated independent contractor who provides service to the customer. The contractor bills Taxpayer for the services performed, and Taxpayer bills the customer for the service call. Taxpayer sought a ruling as to whether the services provided by independent third-party service providers would subject it to corporate income tax in Virginia.

3. Although P.L. 86-272 applies only to the sale of tangible personal property and not to services, Virginia applies the same test to business activities involving sales of intangible personal property.

4. Maintenance and repair services are not protected by P.L. 86-272. Therefore, Taxpayer would be subject to tax if it provided on-site repair or maintenance services with its own employees. In this case, however, Taxpayer purchases the services from an unrelated third party and resells them to its customers. "Under such circumstances, sales of services on behalf of an unrelated third party would not create nexus for a corporation that is otherwise protected under P.L. 86-272."

5. The Commissioner did not expressly resolve whether or not Taxpayer is subject to tax. The key will be whether or not the third-party providers are independent contractors within the meaning of P.L. 86-272, since the "Department attributes unprotected activities performed by an entity that is not independent to a business entity for purposes of determining whether or not the entity has nexus with Virginia." A third party that is not independent is considered to be providing services on behalf of Taxpayer to Taxpayer's customers.

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6. In order to be independent, the contractors must represent two or more principals and must, in fact, be independent of the principals. In this case, Taxpayer did not provide detailed information regarding its third-party service providers. The Commissioner therefore indicated that Taxpayer must "evaluate its relationship with each of its Virginia third-party service providers in order to determine if they meet the definition of an independent contractor under P.L. 86-272." If the contractors meet this test, Taxpayer is not required to pay Virginia corporate income tax.

WEB NEXUS

NEW YORK

1. ***Amazon.com LLC v. New York State Dep't of Taxation and Finance*, No. 601247/08, CCH ¶ 406-287 (N.Y. Sup. Ct. Jan. 12, 2009), *rev'd in part*, No. 07823, ¶ 407-041 (N.Y. App. Div. Nov. 4, 2010).**

   a. Amazon sought to declare N.Y. Tax Law § 1101(b)(8)(vi) unconstitutional. Amazon alleged that the New York statute violates the Commerce and Due Process Clauses of the U.S. Constitution because it imposes tax obligations on companies that have no "substantial nexus" in New York.

   b. The New York Supreme Court rejected Amazon's facial challenge to the statute, and the Appellate Division affirmed the court's decision to reject the facial challenges, noting with regard to the Commerce Clause challenge that the statute imposes an obligation on an out-of-state vendor "only where the vendor enters into a business-referral agreement with a New York State resident, and only when that resident receives a commission based on a sale in New York."

   c. Amazon also attacked the statute under an "as applied" challenge relating to assertion of nexus stemming from an Amazon program that allows participants ("Associates") to be compensated based on a percentage of sale proceeds from click-through ads. The lower court dismissed this challenge as well, suggesting that Amazon's use of Associates was similar to an out-of-state company's hiring an in-state salesperson to solicit sales, which is sufficient to create nexus under the United States Constitution.

   d. The Appellate Division reversed the lower court, concluding that Amazon should be given the opportunity on Commerce and Due Process Clause grounds to develop the record that

its Associates engaged only in advertising, as opposed to solicitation. Thus, the case was remanded to develop the record.

2. ***Overstock.com, Inc. v. New York State Dep't of Taxation and Finance*, No. 107581/08, CCH ¶ 406-294 (N.Y. Sup. Ct. Jan. 12, 2009), *rev'd in part*, No. 07823, ¶ 407-041 (N.Y. App. Div. Nov. 4, 2010).**

   a. Overstock is a Delaware corporation that has no offices, employees, representatives, or agents in New York. Nor does it own or rent property in the state. Its retail web site offers brand-name items that it ships to customers across the country.

   b. Overstock adopted an affiliate program through which approved web-site owners and operators ("Affiliates") enter into a master agreement with Overstock and are authorized to place a link on their own web sites to Overstock's site. Affiliates receive a commission for sales made directly through those links. Overstock has thousands of Affiliates across the U.S. and thousands of Affiliates with New York addresses.

   c. Overstock sought a declaratory judgment that N.Y. Tax Law § 1101(b)(8)(vi) is invalid and unconstitutional on the grounds that it violates both the Commerce and Due Process Clauses. Overstock contended that the statute is invalid because, as applied, it would force Overstock to collect and pay New York sales and use taxes on receipts from sales to New York customers despite the fact that it lacks any physical presence in New York and does not actively solicit business there.

   d. The New York Supreme Court granted the state's motion to dismiss Overstock's complaint for the reasons stated in *Amazon.com LLC v. New York State Dep't of Taxation and Finance*, *supra*. The court noted that there were no allegations in Overstock's complaint that made the action materially different from Amazon's: "Though Overstock does not directly ask or directly encourage Affiliates to solicit business for its benefit, it is aware that such solicitation may take place and provides incentives for its Affiliates to encourage their customers to purchase from Overstock through their own sites."

e. In an opinion consolidated with the *Amazon.com* decision discussed *supra*, the Appellate Division affirmed regarding Overstock's facial challenges but reversed regarding its as-applied challenges and remanded the case for additional discovery.

"INTANGIBLE" NEXUS

MARYLAND

Another intangible holding company loss—"economic realities" support taxation when the parent company's activities in Maryland produce income for the IHC.

***W.L. Gore v. Maryland Comptroller of Treasury*, No. 07-IN-OO-0084; No. 07-IN-OO-0085; No. 07-IN-OO-0086, CCH ¶ 201-923 (Md. Tax Ct. Nov. 9, 2010).**

1. Two Delaware intangible holding company ("IHC") subsidiaries held intellectual property and funds for a parent corporation located in Maryland. One of the IHCs, Gore Enterprises, Inc. ("GEH"), earned license income generated by the parent's manufacturing operations in Maryland and sale of goods to Maryland customers. The other IHC, Future Value, Inc. ("FVI"), earned interest income that was directly connected to the parent's operations. The IHCs had no physical presence in Maryland and argued that the imposition of income tax in Maryland violated the Commerce Clause.

2. Each IHC was formed for valid business purposes, was a separate legal entity, incurred significant business expenses, and engaged in significant business activities. Taxpayers assert that GEH manages patents worldwide, invests in patent applications, enforces its patents through litigation, etc. It was also noted that the parent company did not transfer its trademarks to GEH because there was no business reason to do so, even though such a transfer would have provided significant state tax benefits. FVI was created to invest and manage excess funds not needed for working capital. Taxpayers assert that FVI actively manages its investment portfolio, makes substantive investment decisions, and exercises independent judgment in making these decisions.

3. The Comptroller rejected claims that the IHCs had sufficient economic substance for nexus purposes, finding that they were instead passive entities inextricably connected to their parent. According to the Comptroller, there was an "economic inter-dependence of the W.L. Gore family of companies." The Comptroller found that the subsidiaries "depended" on the parent

company for their existence and that there was a circular flow of money through royalties, dividends, and loans. In addition, the IHCs relied on the parent for personnel, office space, and corporate services. The Comptroller also asserted that "functional integration and control through stock ownership, as well as common employees, directors and officers of [the subsidiaries] and [the parent company]" support its nexus determination.

4. The Comptroller noted that "Maryland courts have consistently concluded that the basis of a nexus sufficient to justify taxation is the economic reality of the fact that that parent's business in Maryland was what produced the income of the subsidiary."

5. Citing the notable reliance on and integration with the Maryland parent company, the tax court held that "substantial nexus exist[ed] between [the subsidiaries] with the State of Maryland, and that the Comptroller ha[d] fairly apportioned the tax on income through its apportionment formula." The tax court concluded that the Due Process and Commerce Clauses did not prevent the Comptroller from taxing these entities.

IOWA

Can an out-of-state business that lacks any in-state physical presence under *Quill* be subject to state income taxation based upon its licensing of intangible property to unrelated in-state third parties?

***KFC Corporation v. Iowa Department of Revenue,* No. 09-1032, 792 N.W.2d 308 (Iowa Dec. 30, 2010) (appeal pending).**

1. Taxpayer KFC Corporation, a Delaware corporation with its principal place of business in Kentucky, had no tangible property or employees in Iowa. The Iowa Department of Revenue (IDOR) asserted income tax because KFC licensed the KFC trademark and related system to independent franchisees in Iowa.

2. The ALJ upheld the IDOR's assessment, concluding that "physical presence" under *Quill* is not required to assess an income tax when a franchisor licenses intangible property that generates income from the state.

3. The Iowa Supreme Court began its discussion with a survey of the dormant Commerce Clause cases, focusing on "the struggle between formalistic approaches and approaches that emphasize the economic substance in the context of both sales and use and state income taxes."

4. Although the Iowa Supreme Court "recognize[d] that a counterargument could be made that aggressive judicial intervention is required to prevent states from shifting tax burdens onto out-of-state parties who lack political power in the taxing jurisdiction," the Court questioned "whether out-of-state entities are as powerless in the halls of state legislatures as they once were in light of the growth of national advocacy groups . . . and the involvement of national political parties in state political affairs."

5. The Iowa Supreme Court affirmed the ALJ ruling, holding that "a physical presence is not required under the dormant Commerce Clause of the United States Constitution in order for the Iowa legislature to impose an income tax on revenue earned by an out-of-state corporation arising from the use of its intangibles by franchisees located within the State of Iowa." As justification, the Court stated, "we think taxation of the income here is most consistent with the now prevailing substance-over-form approach embraced in most modern cases decided by the Supreme Court under the dormant Commerce Clause."

6. At the time of publication, the *KFC* decision remained subject to appeal.

MISCELLANEOUS

WASHINGTON

A federal district court in Washington rules that Amazon.com is not required to turn over customer names and other transaction-specific information to the North Carolina Department of Revenue in connection with a sales tax audit.

***Amazon.com LLC v. Lay*, No. C10-664, CCH ¶ 202-480 (W.D. Wash. Oct. 25, 2010).**

1. As part of a sales tax audit of Amazon.com ("Amazon"), the North Carolina Department of Revenue (the "Department") sought customer and transactional information, including purchase specifics and customer contact data, related to Amazon's online sales to North Carolina residents. Although Amazon provided detailed transactional information to the Department (including order ID number; ship-to city, county, and postal code; a detailed description of the product; and the total amount paid), it objected to the Department's requests for personally identifiable customer information, as well as information that would reveal the content-specific nature of books, videos, and music purchased by that customer. Amazon therefore filed suit in federal district court in its

home state of Washington, seeking declaratory and injunctive relief to challenge the Department's requests for more information.

2. Amazon sought a ruling that would exempt it from turning over the names, addresses, or other personal information of its customers, alleging: "(1) that the First Amendment [of the United States Constitution] and Article 1, Sections 4 and 5 of the Washington State Constitution bar the revelation of the identities of its customers' purchases and any specifics as to the content of the purchases; and (2) that the Video Privacy Protection Act, 18 U.S.C. § 2710, bars compliance with the [Department]'s March 2010 request." The ACLU also represented several intervenors in the case who added claims relating to the "personal information regarding purchases they have made on Amazon" and alleging "fears they have that the government may track their purchases and their fear of buying more materials online."

3. The Department challenged the complaint for ripeness, for violation of the Tax Injunction Act, and for want of jurisdiction under the Video Privacy Protection Act, but the court rejected these arguments. Specifically, the federal district court held that the Tax Injunction Act was not a bar to federal court jurisdiction because Amazon was not asking the court to "enjoin, suspend, or restrain the assessment, levy or collection of tax." Indeed, the Department expressly acknowledged that the lack of customer names does not impede a tax assessment against Amazon. The court further held that the Tax Injunction Act was not a bar to the federal action because there was no "plain" remedy in North Carolina if a tax summons were issued.

4. Regarding the First Amendment challenge, the court granted Amazon's motion for declaratory judgment. Looking to other First Amendment jurisprudence, the court held that "Amazon and the Intervenors [] established that the First Amendment protects the disclosure of individual's reading, listening, and viewing habits." Disclosure of such information would have a "chilling effect" on the First Amendment, and the Department could not show a "substantial relation between the information sought and a subject of overriding and compelling state interest."

5. The court similarly found that the Department's requests violated the federal Video Privacy Protection Act because Amazon could disclose the customer information only "pursuant to a court order, in a civil proceeding upon a showing of compelling need for the information that cannot be accommodated by any other means[.]" The court did not address relief under the Washington State

Constitution because the Department did not adequately brief on those grounds.

6. Noting the unconstitutionality of the Department's requests, the court issued the following declaratory relief: "[T]o the extent the March Information Request demands that Amazon disclose its customers' names, addresses or any other personal information, it violates the First Amendment and 18 U.S.C. § 2710, only as long as the [Department] continues to have access to or possession of detailed purchase records obtained from Amazon (including ASIN numbers)."

VIRGINIA

The Commissioner's ruling serves as an important reminder that apportionment rules can be just as important as nexus in limiting state income tax obligations.

Ruling of Commissioner, PD 10-217 (Dep't of Tax., Sept. 16, 2010).

1. Taxpayer is an out-of-state company that provides communication infrastructure and other services that allow third-party marketers and mobile network providers (mobile or cellular phone companies) to sell mobile content to end users. Taxpayer's primary responsibility is to provide marketers with connectivity to the mobile network providers and the end-user mobile phone customers. Taxpayer does not own or lease property in Virginia, has no employees in the state, and does not believe it should pay Virginia corporate income tax.

2. Although P.L. 86-272 applies only to the sale of tangible personal property and not to services, Virginia applies the same test to business activities involving sales of intangible personal property.

3. The Commissioner found that Taxpayer's primary connection with Virginia would be providing marketers with access to end users in Virginia. Because these services take place electronically, the Department of Taxation concluded that "it is likely impossible to determine exactly where the services occur." For this reason, there was not enough information to determine whether Taxpayer owed corporate income tax, according to P.L. 86-272, or otherwise had nexus in Virginia.

4. The Commissioner concluded, however, that nexus was irrelevant since even if nexus existed, Taxpayer did not have any Virginia source income. Clearly, it had no property or payroll in Virginia. It also lacked sales in Virginia since Virginia has a "cost of performance" rule for attributing sales of intangible property to

Virginia. *Virginia Code* § 58.1-416 sets forth a cost-of-performance test that requires income-producing activity to be performed in Virginia, or at least a greater proportion of the income-producing activity to be performed in Virginia than in another state, before sales are attributed to Virginia. Since none of Taxpayer's employees who perform income-producing functions live or work in Virginia, Taxpayer did not meet this test.

5. The Commissioner concluded that because Taxpayer would have no property, payroll, or sales in Virginia, it would not have Virginia taxable income and would not be subject to Virginia income tax.

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