Volume 18 Number 3 October 2011

NEXUS: UPDATE ON RECENT DEVELOPMENTS FOR THE SECOND QUARTER 2011

Charolette Noel
Dallas
1.214.969.4538
cfnoel@jonesday.com

Karen H. Currie
Dallas
1.214.969.5285
kcurrie@jonesday.com

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 reports on important nexus developments during the second quarter of 2011. It is organized by state and type of activity—focusing on those types of activities that tend to give out-of-state entities nexus-planning and litigation difficulties, such as representatives in the state, affiliate activities, web nexus, and drop-shipment transactions.

In numerous state legislative sessions, nexus legislation reigned as king this quarter, particularly in the affiliate and "click-through" nexus areas. Affiliate nexus was addressed through legislation in Arkansas and administrative guidance in New Mexico and Wisconsin. "Click-through" nexus legislation continued to be passed in spite of significant push-back from taxpayers. Both Connecticut and Vermont passed "click-through" nexus legislation in the second quarter—though Vermont's legislation will not take effect until at least 15 other states enact similar rules. On the bright side, however, both South Carolina and Wisconsin passed legislation establishing safe harbors pursuant to which a taxpayer can have activity in the state without having nexus. And the Michigan Supreme Court recognized that independent contractors who act on their own behalf do not create third party contract nexus by their in-state actions.

ARKANSAS

Affiliate and "Click-Through" Nexus Bill: S.B. 738, 88th Gen. Assem. (2011) (enacted at Ark. Code Ann. § 26-52-117) (the "Act"). Arkansas enacted a law making certain remote sellers responsible for the collection of Arkansas sales and use tax when selling tangible personal property or taxable services for use in Arkansas.

i. The law creates a rebuttable presumption that a remote seller must collect sales and use tax if an affiliate of the seller is also subject to the Arkansas sales and use tax and if one or more of the following conditions apply:

(a) The seller sells a similar line of products under a name that is the same as or similar to the affiliate's name;

(b) The affiliate uses its in-state employees or facilities to advertise, promote, or facilitate sales by the seller to consumers;

(c) The affiliate maintains an office, distribution facility, warehouse or storage place, or similar place of business to facilitate the delivery of property or services sold by the seller;

(d) The affiliate uses trademarks, service marks, or trade names in the state that are the same as or substantially similar to those used by the seller; or

(e) The affiliate delivers, installs, assembles, or performs maintenance services for the seller's purchasers within the state.

ii. "Affiliate," for purposes of the Act, is defined as an entity that is a member of the same controlled group of corporations as the seller or another entity that, notwithstanding its form of organization, bears the same ownership relationship to the seller as a corporation which is a member of the same controlled group of corporations.

iii. The law creates an additional rebuttable presumption that a remote seller must collect sales and use tax if it enters into an agreement with resident(s) of Arkansas under which the resident(s), for a commission or other consideration, directly or indirectly refer potential purchasers to the seller. A referral for purposes of the Act will take place if a resident refers potential purchasers to the remote seller through a link on a web site or otherwise. In order for this presumption to apply, however, the remote seller's cumulative gross receipts from sales to purchasers in Arkansas resulting from such referrals must exceed $10,000 during a 12-month period.

CONNECTICUT

"Click-Through" Nexus Bill: S.B. 1239, 2011 Reg. Session (May 4, 2011).

i. The Connecticut budget bill for the biennium ending on June 30, 2013, signed by the governor on May 4, 2011, included a click-through nexus provision.

ii. The law amended the definition of "retailer" to include retailers making sales through Connecticut residents when the retailer enters into an agreement under which the resident, directly or indirectly, refers potential customers to the retailer using Internet web site links or other referral methods, in exchange for a commission or other consideration.

iii. The statute creates a presumption that the retailer is soliciting business in the state when the retailer has at least $2,000 in cumulative gross receipts from sales to customers in Connecticut who are referred to the retailer by Connecticut residents during the preceding four quarterly periods.

iv. The retailer may rebut the presumption of nexus by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the state on behalf of the retailer that would satisfy constitutional nexus requirements.

GEORGIA

Streamlined Sales Tax: Georgia Department of Revenue, Emergency Rule 560-12-1-0.21-.38 (August 30, 2011).

i. Effective August 30, Georgia re-adopted an emergency rule that establishes, among other actions, that if Georgia is expelled or withdraws from the Streamlined Sales and Use Tax Agreement, it will not use a seller's registration with the central system to determine whether the seller has nexus with the state.

ii. The rule was originally adopted on May 3, 2011 as a replacement for Emergency Rule 560-12-1-0.21-.37.

ILLINOIS

Nexus Guidelines: General Information Letter IT 11-0006-GIL (Mar. 11, 2011).

i. The Illinois Department of Revenue held that the fact-specific nature of nexus inquiries prohibits letter rulings on whether an entity has nexus with the state. However, the state issued a letter ruling providing general nexus guidelines.

ii. Unless shielded by Public Law 86-272, an out-of-state corporation may be subject to income tax if any part of its income is allocated to the state.

iii. Public Law 86-272 prohibits Illinois from imposing income tax on an out-of-state company if the company's only activities within the state consist of soliciting the sale of tangible goods.

iv. If an activity of an out-of-state company is not protected by Public Law 86-272, the activity may still be immune if it is *de minimis*. Found in Regulations § 100.9720(c)(2)(D), the test for whether activities are *de minimis* is that "when taken together, [the activities] establish only a trivial additional connection with [Illinois]."

MICHIGAN

Representatives in State: *Vestax Securities Corp. v. Department of Treasury*, No. 142535 (Mich. June 1, 2011).

i. The Michigan Supreme Court ruled that independent registered representatives ("IRRs") who contracted with an out-of-state corporation to facilitate securities transactions did not subject the out-of-state corporation to the Single Business Tax.

ii. Customers of the in-state IRRs would request a securities transaction from the IRR, and the IRR would rely upon the out-of-state corporation to make the transaction.

iii. The appellate court had found a substantial nexus because the contractual relationship between the IRRs and the out-of-state corporation resulted in a physical presence in the state of a person doing business on behalf of the out-of-state corporation.

iv. The Supreme Court reversed and remanded so that summary judgment in favor of the taxpayer could be reinstated because the evidentiary record did not support the appellate court's finding of a substantial nexus.

NEW MEXICO

Affiliate Nexus: *In the Matter of the Protest of Barnesandnoble.com LLC.*, N.M. Taxation and Revenue Dep't, No. 11-10 (Apr. 11, 2011).

i. The New Mexico Taxation and Revenue Department ruled that an online bookseller did not have sufficient contacts with the state to establish a substantial nexus.

ii. The online bookseller was an out-of-state company that sold books, movies, and music on the internet to customers in the United States, including residents of New Mexico. An affiliate of the online bookseller owned and operated bookstores located in New Mexico.

iii. According to the Taxation and Revenue Department, the following activities were insufficient to create nexus: (1) the close corporate relationship between the online bookseller and the in-state affiliate; (2) the cross-marketing employed by the online bookseller and the in-state affiliate; (3) the in-state affiliate's book-return policy; (4) the online bookseller's participation in a multi-retailer gift-card program and customer-loyalty program; (5) the sharing of customer email addresses by the online bookseller and the in-state affiliate; and (6) the system through which the in-state affiliate's local stores ordered books from the online bookseller for shipment to customers.

NEW YORK

Nonresident Partner Nexus: *In re Tosti,* New York Div. Tax App., N.Y. Tax App. Trib. Opinion No. 822915 (May 12, 2011).

i. The New York Tax Appeals Tribunal (the "Tribunal") upheld the decision of the administrative law judge that the income of Tosti, a nonequity partner in a New York law firm, was subject to New York state income tax, despite the fact that Tosti resided and practiced solely in New Jersey. Tosti had argued on appeal that he was not a partner in the firm for tax purposes, because he received salary payments rather than sharing in partnership profits and losses. In addition, he lacked many of the powers and obligations of a true partner, such as liability for obligations incurred by the firm, the right to participate in management, and the right to demand an accounting or dissolution of the firm.

ii. The Tribunal relied upon *In re Heffron v. Chu*, 144 A.D.2d 729 (1988), and *In re Heller v. N.Y. State Tax Comm'n*, 116 A.D.2d 901 (1986), both of which involved nonresident attorneys who were designated as partners by their respective law firms but did not share in partnership profits or losses. The court noted that both decisions hinged on the important fact that *the partners were able to hold themselves out as partners, thereby enhancing their reputations* and attracting clients more effectively. Similarly, Tosti received "the firm's resources, backing, and support," the Tribunal indicated, including his designation as a partner for purposes of client development.

iii. The court noted that Tosti had signed an agreement with the firm that designated him as a partner; the firm had designated Tosti as a partner on its partnership tax filings; and Tosti exerted at least de facto *management* within the firm, because one or more associates worked for him and he provided their performance reviews.

OKLAHOMA

Use Tax Notice Law: Okla. Stat. tit. 68, § 1406.1 (eff. Oct. 1, 2010); Okla. Admin. Code § 710:65-21-8 (eff. Oct. 1, 2010).

i. Oklahoma passed a use tax notice law and an emergency regulation that went into effect on October 1, 2010. The emergency regulation was later replaced with a permanent regulation that made only nonsubstantive, technical changes.

ii. A retailer that sells merchandise for use in Oklahoma but does not collect tax must provide a visible notice—on its web site, in its catalogs, and on its invoices—that Oklahoma use tax is imposed and must be paid to the state. Okla. Stat. tit. 68, § 1406.1; Okla. Admin. Code § 710:65-21-8.

iii. Retailers that have less than $100,000 in total gross sales in Oklahoma in the previous year and reasonably expect the same in the current year are considered *de minimis* and need not comply with the notice law.

iv. Web Site and Catalog Notices

(a) The web site notice must appear on "a page necessary to facilitating the applicable transaction," although it shall be sufficient if the retailer provides a prominent linking notice that reads: "See important Oklahoma sales tax information regarding the tax you may owe directly to the State of Oklahoma."

(b) For catalogs, the notice must be included on the order form, although a linking notice using the language set forth above may be used.

v. Invoice Notices

(a) For online orders, the notice must be on the electronic order confirmation sent to the consumer. This requirement can be met through the use of a linking notice as described above. If no electronic order confirmation is provided, the full text of the notice must appear "on the purchase order, bill, receipt, sales slip, order form, or packing statement." Alternatively, internet retailers can place the notice on the "checkout" page of their web sites. This fulfills both the web site and the invoice notice requirements.

(b) For catalog orders, the full text of the notice must appear "on the purchase order, bill, receipt, sales slip, order form, or packing statement."

(c) At this time, there are no penalties imposed for noncompliance under either Okla. Stat. tit. 68, § 1406.1, or the regulation.

PENNSYLVANIA

Nexus Guidelines and Voluntary Disclosure Program: *Nexus Project,* Philadelphia Revenue Dep't (May 13, 2011), http://www.phila.gov/revenue/pdfs/Rev%20PDFs/nexusproject.pdf.

i. The Philadelphia Department of Revenue announced on May 13, 2011, that its Audit Department is currently working to find nonresident businesses having a nexus with the city for business tax purposes.

ii. Businesses having a nexus with the city that have not filed business taxes may contact the Audit Department to enter the Voluntary Disclosure Program whereby the business may be eligible to have all penalties waived.

iii. If the Audit Department contacts a business regarding its nexus with the city prior to its enrollment in the Program, however, it will be ineligible for the Program.

SOUTH CAROLINA

Distribution Facility Safe Harbor: S.B. 36, 119th Gen. Assem. (June 8, 2011). South Carolina has enacted a bill that establishes a safe harbor from nexus for distribution facilities without the governor's signature. The safe harbor expires on January 1, 2016. To be exempt from sales and use tax in South Carolina, a distribution center must meet the following requirements:

i. It must be placed into service after December 31, 2010, and before January 1, 2013;

ii. The business must make, or cause to be made, a capital investment of at least $125 million after December 31, 2010, and before December 31, 2013;

iii. The business must create at least 2,000 full-time jobs and must have a comprehensive health plan for those employees after December 31, 2010, and before December 31, 2013; and

iv. After meeting the initial job-related requirements, the business must maintain at least 1,500 full-time jobs until January 1, 2016.

TEXAS

Website / Server Nexus: Texas Comptroller of Public Accounts, Letter No. 201103016L (Mar. 24, 2011).

i. The Texas Comptroller of Public Accounts held that an out-of-state entity is not subject to use tax if its presence and activity in Texas involves only having a web site on a server owned and operated by a third party in Texas and delivering goods into Texas through a third-party carrier.

ii. The agency noted in its letter that it is currently determining what type of digital content would be sufficient to require an out-of-state entity to acquire a sales and use tax permit. The agency plans to amend Rule 3.286 to make such circumstances clear.

VERMONT

"Click-Through" Nexus Bill: H.B. 436 , 2011-2012 Reg. Sess. (May 24, 2011). Vermont recently enacted "click-through" nexus legislation; however, the legislation will not become effective until at least 15 other states enact or adopt comparable rules or legislation, as determined by the Vermont attorney general.

i. Vermont enacted a "click-through" nexus law pursuant to which a person is presumed to be soliciting business through an independent contractor, agent, or other representative if the person enters into an agreement with a Vermont resident under which the resident, for compensation, refers potential customers by a link on a web site or otherwise.

ii. This presumption makes such sales subject to sales and use tax but applies only if the person had cumulative gross sales to Vermont customers exceeding $10,000 during the prior tax year.

iii. A person may rebut the presumption by presenting proof that the Vermont resident with whom the person had an agreement did not engage in solicitation in Vermont which would satisfy the constitutional nexus requirements.

WASHINGTON

Drop Shipments: *Drop Shipments,* Washington Dep't of Revenue Guidance (April 29, 2011)., http://dor.wa.gov/Content/GetAFormOrPublication/PublicationBySubject/TaxTopics/DropShipment.aspx.

i. The Washington Department of Revenue issued guidance on the sales tax treatment of certain drop shipment transactions. For purposes of the guidance, a "drop shipment" is when goods are ordered by a Washington customer from a seller, who then orders the goods from a manufacturer, and the manufacturer then delivers the goods to the customer within Washington.

ii. The Department of Revenue noted that the manufacturer does not need to charge the Washington customer for sales tax because the manufacturer is making a wholesale sale. To document the wholesale nature of the sale, however, the manufacturer must obtain from the seller a reseller permit, a streamlined sales tax exemption certificate, or a multistate tax exemption certificate.

iii. On the other hand, if the manufacturer has nexus with Washington, the manufacturer would owe wholesaling business and occupation tax on the drop shipment. If the seller has nexus with Washington, the seller would owe retailing business and occupation tax and would need to collect sales tax from the customer.

Nexus Requirements of Apportionable Activities: Wash. Admin. Code § 458-20-19401 (eff. May 27, 2011, reenacted eff. Oct. 13, 2011).

i. The Department of Revenue has re-adopted, on an emergency basis, rules explaining nexus requirements for apportionable activities. WAC 458-20-19401 was adopted effective May 27, 2011 and re-adopted September 12

effective October 13, 2011, and may be used to determine tax liability for periods after May 31, 2010.

ii. According to the rule, "apportionable activities" are those under the following classifications: service, royalties, travel agents, disposing of low-level waste, title insurance producers and agents, public hospitals, real estate brokers, horse races, printing materials, etc. Under the rule, a substantial nexus is deemed to exist where a person is: (1) an individual and a resident or domiciliary of Washington during the year; (2) a business entity organized or commercially domiciled in Washington during the year; or (3) a nonresident individual or business entity that has, in any calendar year: (i) more than $50,000 of property in Washington; (ii) more than $50,000 of payroll in Washington; (iii) more than $250,000 of receipts attributable to Washington; or (iv) at least 25 percent of its total property, total payroll, or total receipts attributable to Washington.

WEST VIRGINIA

Printers' Nexus: Technical Assistance Advisory No. 11-002 (W. Va. Mar. 28, 2011).

i. The corporation requesting the Technical Assistance Advisory was an out-of-state corporation providing print services in West Virginia and other states to a nationwide client base. The out-of-state printer's clients would contract with printer to print and distribute, via the U.S. Postal Service, magazines, catalogs, color advertising circulars, and similar items. The out-of-state printer requested the State Tax Commissioner to advise whether its clients' utilization of its services at its facility in West Virginia would be sufficient to impose on its out-of-state clients the requirement to collect consumer sales and service tax or use tax.

ii. In utilizing the out-of-state printer's services, clients of the printer would temporarily store raw materials (*e.g.*, paper), print work in progress, and completed print work at the printer's West Virginia facility. The completed print work would eventually be shipped by printer either to the client or to the client's customers. In addition, printed materials were shipped from printer's facilities in other states to the West Virginia facility for binding, finishing, and shipping. The printer sometimes delivered its clients' printed materials to consumers in West Virginia.

iii. The out-of-state printer's clients would sometimes send personnel to West Virginia for the purposes of reviewing and approving printed materials and performing other ancillary tasks in connection with these clients' print jobs.

iv. Applying *Quill*, the State Tax Commissioner concluded that these facts alone were not sufficient to impose on the printer's out-of-state clients the requirement to collect consumer sales and service tax or use tax.

WISCONSIN

Publisher Safe Harbor: Wis. Dep't of Rev. Pub. No. 203 (May 2011). Wis. Stat. § 71.23(3)(a)–(b) is the printers' nexus safe-harbor statute for corporate franchise tax. Wisconsin's safe harbor is narrower than most states' and does not encompass the visits of employees or agents of the foreign corporation to the premises of an in-state printer. The Wisconsin Department of Revenue issued a publication describing Wisconsin's safe harbor for printers that are foreign corporations, stating that such a publisher is not required to collect Wisconsin use tax on the sale or delivery of its property, items, goods, or taxable services at retail if its activities in Wisconsin do not exceed:

i. The storage of the publisher's raw materials for any length of time in Wisconsin, in or on property owned by a person other than the publisher, and the delivery of the publisher's raw materials to another person in Wisconsin if that storage and delivery are for printing by that other person.

ii. The purchase from a printer of a printing service or of printed materials in Wisconsin for the publisher.

iii. The storage of the printed materials for any length of time in Wisconsin, in or on property owned by a person other than the publisher.

iv. Maintaining, occupying, and using, directly or by means of another person, a place that is in Wisconsin, is not owned by the publisher, and is used for the distribution of printed materials.

Affiliate Nexus: Wis. Dep't of Rev. Pub. No. 221 (May 2011) describes some of the conditions that are sufficient to establish affiliate nexus for purposes of the Wisconsin use tax:

i. A taxpayer has nexus if an affiliate of the taxpayer uses facilities in Wisconsin to advertise, promote, or facilitate the establishment of a market for sales of items by the taxpayer to Wisconsin consumers.

ii. *Similarly*, nexus is established if the affiliate provides services to the taxpayer's purchasers in Wisconsin, including accepting returns of purchases or resolving customer complaints.

iii. The publication defines "affiliate" the same way it is defined in Wis. Stat. § 77.51(13g)(d) (2009).

Doing Business in the State: Wis. Dep't of Rev. Pub. No. 221 (May 2011) describes some of the conditions that are sufficient to establish nexus for purposes of the Wisconsin use tax:

i. The retailer owns any real property in Wisconsin.

ii. The retailer licenses, leases, or rents out any property, items, or goods located or used in Wisconsin.

iii. The retailer maintains, occupies, or uses, permanently or temporarily, directly or indirectly, or through a subsidiary, agent, or other person, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business in Wisconsin (except for foreign corporation publishers).

iv. The retailer has any representative, agent, salesperson, canvasser, or solicitor operating in Wisconsin under the authority of the retailer or its subsidiary for the purpose of selling, delivering, or taking orders for any property, items, goods, or taxable services.

v. The retailer services, repairs, or installs, in Wisconsin, any property, items, or goods.

vi. The retailer delivers any property, items, or goods into Wisconsin in company-operated vehicles.

vii. The retailer performs construction activities in Wisconsin.

Nexus Guidelines: Wis. Dep't of Rev., Bulletin No. 171 (April 1, 2011).

i. Wisconsin clarified nexus-related issues and reminded taxpayers of certain rules in a bulletin, including the fact that filing a tax return in a state is not sufficient by itself to create nexus in that state.

ii. The bulletin also noted that an entity conducting business in Wisconsin for part of a year is considered to be doing business in the state for the entire year.

iii. For taxable years beginning January 1, 2009, nexus is determined for a combined group as a unitary business as a whole. If a business is not filing as a combined group, or for a taxable year before January 1, 2009, nexus is determined on a separate-entity basis.