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NEXUS: FOURTH QUARTER 2011 DEVELOPMENTS

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We keep track of nexus developments on a regular basis—legislation, administrative interpretations, the passage of rules and regulations, and court cases. In this issue of our newsletter we report on the important nexus developments during the fourth quarter of 2011. The report is organized by state and type of activity—focusing on those types of activities that tend to provide nexus challenges for out-of-state taxpayers, such as the ever-changing provisions and rulings on "doing business," affiliate activities, web nexus, economic nexus, and the limitations of Public Law 86-272.

Notable developments include California's issuance of procedures in response to the temporary repeal of its "click-through" legislation that delayed the effective date and increased the amount of the sales threshold triggering the "click-through" provisions, the Florida Department of Revenue's denial of a taxpayer's request for permission to cease filing consolidated returns based on an erroneous election by a corporate parent that lacked nexus with Florida, the Tennessee Court of Appeals' denial of reciprocity or credit for taxes paid to South Carolina on dividend income from South Carolina S corporations, and the State of Washington's petition to Congress to sign the Main Street Fairness Act.

CALIFORNIA

Issuance of Chief Counsel Rulings for "Doing Business" Questions

Franchise Tax Board Notice 2011-06 (October 12, 2011).

For franchise tax purposes, the California statutes define "doing business" to include "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit" (the "general rule").[1] Effective January 1, 2011, California adopted a factor-

[1] Cal. Rev. & Tax. Code § 23101(a).

presence nexus standard.[2] According to Franchise Tax Board ("FTB") Notice 2011-06, an entity that does not meet the factor-presence nexus standard and is not organized or commercially domiciled in California still must determine whether it has nexus under the general rule. Pursuant to FTB Notice 2011-06:

(i) The FTB will accept requests for written advice on whether a taxpayer has nexus under the general rule but will decline to rule on whether the specific factual thresholds for factor-presence nexus have been met, given the principally factual nature of any such determination.

(ii) A request for a Chief Counsel Ruling will not prevent putative taxpayers from applying for the FTB's Voluntary Disclosure Program ("VDP"). While a person who requests advice pursuant to Notice 2011-06 must disclose the identity of the putative taxpayer, provided a VDP applicant otherwise meets the requirements for VDP eligibility, the person may still request admission into the VDP program. A VDP application may be submitted even when the guidance requested results in a preliminary determination that the taxpayer's activities do constitute doing business, regardless of whether a Chief Counsel Ruling on the issue is ultimately issued to the taxpayer.

(iii) Notice 2011-06 does not supersede the statutory process in place under section 23101.5 for petitioning the FTB for a determination of whether a corporation is not "doing business."

Registration Requirements for Certain Out-of-State Sellers

***Implementation of New Requirements for Certain Out-of-State Retailers to Register and Collect Use Tax Has Been Postponed by Assembly Bill 155 (AB 155)* – Frequently Asked Questions (November 2011).**

The California State Board of Equalization ("BOE") has updated its frequently asked questions to reflect the enactment of Assembly Bill 155 (AB 155), which temporarily repealed Assembly Bill 28, First Extraordinary Session (ABx1 28).[3] As noted on the BOE's website:

(i) The registration requirements for out-of-state retailers making sales to California customers remain the same as they were on June 27, 2011 (prior to June 28, when ABx1 28 was enacted). An out-of-state retailer making sales of tangible personal property to California customers is engaged in business in California and required to register with the BOE to collect California use tax if:

   a. The retailer is maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary or agent, by whatever name called, an office, place of distribution, sales or sample

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[2] *See Id.* § 23101(b).

[3] For a more detailed discussion of ABx1 28 and AB 155, *see Nexus: Update on Recent Developments for the Third Quarter 2011*, JONES DAY STATE TAX RETURN (December 2011).

room or place, warehouse or storage place, or other place of business in California;

b. The retailer has any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in California under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or taking orders for any tangible personal property; or

c. The retailer derives rentals from a lease of tangible personal property in California.

(ii) If a retailer registered before ABx1 was repealed and is not engaged in business under current law, it may ask the BOE to close out its certificate, thereby ending the retailer's obligation to collect use tax.

FLORIDA

Public Law 86-272 Protection

Technical Assistance Advisement, No. 11C1-006, Florida Department of Revenue, September 1, 2011 (Released November 2, 2011).

(i) The Florida Department of Revenue found that the taxpayer was not subject to income tax due to the application of Public Law 86-272.

(ii) The taxpayer's Florida activities consisted of soliciting sales of products that the taxpayer's customers use to reward their employees.

(iii) The taxpayer had previously submitted a request and received a ruling that it did have a tax filing requirement due to the fact that some products were shipped directly to Florida customers from the warehouses of unrelated vendors, some of which were in Florida.[4]

(iv) The taxpayer stated that its facts were different or had changed since the time of the prior ruling and that none of its vendors filled orders from a point within Florida.

(v) The Department determined that the taxpayer's current Florida business activities did not create a tax filing obligation and were protected from the imposition of Florida corporate income tax by Public Law 86-272.

Consolidated Tax Return Election Binding on Group

Technical Assistance Advisement, No. 11C1-007, Florida Department of Revenue, September 1, 2011 (Released November 2, 2011).

A parent/subsidiary consolidated filing group requested permission to cease filing Florida consolidated tax returns due to the fact that the original election to consolidate had been

[4] For a summary of the prior ruling, *see Nexus: Update on Recent Developments for the Third Quarter 2011*, JONES DAY STATE TAX RETURN (December 2011).

made erroneously by the corporate parent, which did not have nexus with the state. The Florida Department of Revenue determined that the group was not permitted to cease filing Florida consolidated tax returns. While nexus is required in order to make an election to file Florida corporate income tax returns, the Department had relied on the representations of the taxpayer, and consequently the taxpayer was estopped from changing its nexus representation.

ILLINOIS

Online Travel Company Found Liable for Hotel Taxes

***The Village of Rosement v. Priceline.com Inc.*, U.S. District Court, N.D. Illinois, No. 09 C 4438 (October 14, 2011).**

The U.S. District Court for the Northern District of Illinois upheld a local hotel tax on the full room-rental fees charged by the taxpayer, an online travel company ("OTC"). The court found that:

(i) The tax is a valid use tax (not a sales tax) and does not violate the dormant Commerce Clause.
(ii) The OTC was the "owner" for purposes of the local hotel tax ordinance because customers could not access their hotel rooms until they had paid the room fee to the OTC (not to the hotels).
(iii) The taxpayer had nexus with Illinois because it entered into contracts with Illinois hotels.
(iv) The tax was fairly apportioned because it was levied upon a use that could occur in only one state.
(v) The tax did not discriminate against interstate commerce, as it was applied at the same rate to every hotel reservation in Rosemont.

KANSAS

Sales Tax Collection Requirements for Out-of-State Vendors

Opinion Letter No. O-2011-012, Kansas Department of Revenue (November 18, 2011).

The Kansas Department of Revenue released a November opinion letter discussing the sales and use tax responsibilities of an out-of-state direct-mail advertising company.

(i) The taxpayer was:
    a. Based in Missouri;
    b. Soliciting customers in Kansas by direct-mail advertising;
    c. Using a Wisconsin-based company to print its advertisements; and
    d. Employing individuals operating in Kansas.
(ii) The Department held that because the taxpayer had employees operating in Kansas, it had nexus and was required to register for sales and use tax purposes.

(iii) The opinion letter also notes that Kansas is a member of the Streamlined Sales and Use Tax Agreement and that the state's definition of "direct mail" expressly includes taxable tangible personal property and conforms to the Streamlined Sales and Use Tax Agreement.

MICHIGAN

Definition of "Actively Solicits"

Michigan SB 669 (Effective January 1, 2012).

The Michigan corporate income tax is imposed on any taxpayer with a physical presence in the state for a period of more than one day during the tax year if the taxpayer actively solicits sales in this state and has gross receipts of $350,000 or more sourced to the state.

SB 669 defines "actively solicits" as meaning either: (1) speech, conduct, or activity that is purposefully directed at or intended to reach persons within Michigan and that explicitly or implicitly invites an order for a purchase or sale; or (2) speech, conduct, or activity that is purposefully directed at or intended to reach persons within Michigan and that neither explicitly nor implicitly invites an order but is entirely ancillary to requests for an order for a purchase or sale. Prior to the enacting of the legislation, the term was undefined by statute.

Franchise Tax Nexus Standards for Financial Institutions

Michigan SB 650 (Effective January 1, 2012).

SB 650 clarifies that a financial institution is subject to the Michigan franchise tax if it: (1) has a physical presence in Michigan for a period of more than one day during the tax year, actively solicits sales in Michigan, and has gross receipts of at least $350,000 sourced to Michigan; or (2) has an ownership interest or a beneficial interest in a flow-through entity, directly or indirectly through one or more other flow-through entities, that has substantial nexus in Michigan.

NEW MEXICO

Existing Nexus and Out-of-State Activities

Ruling No. 405-11-1, New Mexico Taxation and Revenue Department (October 26, 2011).

(i) The taxpayer was a contractor who built a laser under two contracts with the U.S. Army: one for research and development and the other for design, fabrication, and demonstration. All of the work done under both contracts was performed in California. Upon completion of the contracts, the Army considered moving the laser to New Mexico.

(ii) The Department determined that although the contractor had nexus with New Mexico, the contractor was not liable for New Mexico gross receipts tax because the activities occurred outside New Mexico and the laser was initially used outside New Mexico.

NEW YORK

Public Law 86-272 Protection

TSB-A-11(10)C, New York Commissioner of Taxation and Finance Advisory Opinion (November 1, 2011).

(i) The taxpayer sells gifts and awards to companies that wish to honor their employees. Some of the gifts are manufactured by the taxpayer at its North Carolina facility, while others are acquired from third-party vendors, some of which are located in New York. The taxpayer uses sales representatives to solicit sales, including some representatives in New York State.

(ii) The taxpayer's customers typically send it a list of employees and dates or milestones on which the customer wishes a gift or packet to be sent to the employee. The employee can select a gift and place an order by calling the taxpayer by phone, mailing the order to the taxpayer, or logging on to the taxpayer's web site.

(iii) The taxpayer has the gift shipped to the employee via common carrier. If the gift is produced by a third-party vendor, the taxpayer merely directs the third-party vendor to ship the gift directly to the employee. The taxpayer never acquires title to any gift shipped by a third-party vendor.

(iv) The New York Department of Taxation and Finance noted that the taxpayer's business appears to be limited to the sale of tangible personal property. The taxpayer does not employ capital in New York, does not own or lease any property in New York, and does not maintain an office in New York. Although some of the taxpayer's orders may be fulfilled by in-state third-party vendors, the use of fulfillment services provided by nonaffiliated parties does not constitute doing business in New York.

(v) Therefore, the taxpayer's activities fall within the scope of Public Law 86-272 and the taxpayer is not subject to New York corporate franchise tax.

OREGON

Limits of Public Law 86-272 Protection

***Ann Sacks Tile and Stone, Inc. v. Department of Revenue*, TC 4879, Oregon Tax Court (November 29, 2011).**

(i) The Oregon Tax Court determined that the parent corporation of an Oregon taxpayer had Oregon corporation excise tax nexus on the basis of the activities of its employees, distributors, and authorized service representatives.

(ii) Although the activities of its sales force may have otherwise been protected by Public Law 86-272, the parent corporation also secured services of distributors and authorized service representatives in Oregon, who performed services related to warranty repair work.

(iii) Viewing the distributors and service representatives as independent contractors, the court held that the activities of the distributors and service representatives went beyond the activities specifically protected by Public Law 86-272.

(iv) Further, the parent corporation caused certain of its employees to go to Oregon to undertake tasks pertaining to the business operations of its subsidiary, including providing technology assistance, conducting operating meetings, introducing new program managers, conducting accounts-receivable cleanup, performing balance-sheet reconciliations, and performing inventory counts.

(v) The court held that the scope of the work and the number of visits to Oregon by the parent's employees exceeded *de minimis* levels and thus were not protected by Public Law 86-272.

PENNSYLVANIA

Remote Seller Guidance; Affiliate and Click-Through Nexus

***Pennsylvania Revenue Department Offers One-Time Extension on Nexus Compliance Deadline for Remote Sellers,* SALES AND USE TAX BULLETIN 2011-01, Pennsylvania Department of Revenue (issued December 1, 2011).**

The Pennsylvania Department of Revenue asserted that, under current Pennsylvania law, it is authorized to require remote sellers to collect and remit tax on their sales to Pennsylvania customers to the full extent authorized by the U.S. Constitution. Accordingly, the Department issued a noncomprehensive list of remote-seller activities that create Pennsylvania nexus:

(i) Storage of its own property or the property of a representative at a distribution or fulfillment center located within the Commonwealth, whether or not the center also stores property of third parties that is distributed from the same location.

(ii) Entering into a contractual relationship with an entity or individual physically located in the Commonwealth whose web site has a link that encourages purchasers to place orders with the remote seller, provided that the in-state entity or individual receives consideration for the contractual relationship with the remote seller.

(iii) Utilization of affiliates, agents, and/or independent contractors located in Pennsylvania who provide repair, delivery, or other services related to tangible personal property sold by the remote seller to Pennsylvania customers.

(iv) Utilization of affiliates, agents, and/or independent contractors to provide services within the Commonwealth (including, but not limited to, storage, delivery, marketing, or soliciting sales) that benefit, support, and/or complement the remote seller's business activity.

(v) Utilization of employees who regularly travel to Pennsylvania for any purpose related to the remote seller's business activities.
(vi) Accepting orders that are directly shipped to Pennsylvania customers from a Pennsylvania facility operated by the remote seller's affiliate, agent, or independent contractor.
(vii) Regular solicitation of orders from Pennsylvania customers via the web site of an entity or individual physically located in Pennsylvania, such as via click-through technology.

Update to Sales and Use Tax Bulletin 2011-01: Per January 27, 2012 Release, in response to complaints that the original February 2, 2012 deadline was impracticable, the Pennsylvania Department of Revenue has extended to September 1, 2012, the deadline by which remote sellers with physical presence in Pennsylvania must become licensed and begin collecting sales tax or face a variety of escalating enforcement options.

TENNESSEE

Tennessee Residents Denied Credit for Taxes Paid to South Carolina on Dividend Income

***Boone v. Chumley, Commissioner of Revenue*, Court of Appeals of Tennessee (November 30, 2011).**

The taxpayers were Tennessee residents who were disallowed a credit on their Tennessee income tax returns for taxes paid to South Carolina attributable to income received from South Carolina Subchapter S corporations. The taxpayers argued that a reciprocity agreement exists between Tennessee and South Carolina and therefore, their refund request had been improperly denied. The taxpayers also maintained that the Hall income tax, which taxes investment income, violates the U.S. Commerce Clause because Tennessee attempts to tax payments that are the result of commerce that has little or no definite nexus with Tennessee and is not fairly apportioned. The facts in the case were stipulated:

(i) The taxpayers are individuals who resided in Tennessee and received pass-through income, including dividend payments, from South Carolina Subchapter S corporations.
(ii) They were disallowed a credit on their Tennessee income tax return for taxes paid to South Carolina.
(iii) The basis for the disallowance was that there is no express reciprocity agreement between Tennessee and South Carolina that allows a credit for taxes paid.

The appeals court found that reciprocity between the two states could not be implied because the tax schemes are so different (as Tennessee does not have a general income tax) that Tennessee would never receive a reciprocal benefit. The court further found that Tennessee's taxing of dividends paid to a Tennessee resident by South Carolina corporations does not violate the Commerce Clause.

In-State Distribution Facility May Trigger Sales and Use Tax Liability

Opinion 11-71, Tennessee Attorney General (October 3, 2011).

The attorney general of Tennessee issued an opinion stating that a retailer that directly owns or maintains a warehouse or distribution facility in Tennessee has nexus for sales and use tax purposes under the U.S. Commerce Clause. If an out-of-state retailer's subsidiary owns the warehouse or distribution facility, however, the out-of-state retailer has nexus with the state only if its subsidiary's in-state activities are significantly connected with the out-of-state retailer's ability to establish and maintain a Tennessee market. If nexus does exist, the out-of-state retailer will not be relieved of liability for collecting and remitting sales taxes by electronic acceptance of sales orders.

WASHINGTON

U.S. Supreme Court Denies Writ of Certiorari in *Lamtec*

***Lamtec Corp. v. Dep't of Revenue*, 246 P.3d 788 (Washington 2011), writ denied October 3, 2011.**

The U.S. Supreme Court denied Lamtec's petition for writ of certiorari on October 3, 2011. In *Lamtec*, the Supreme Court of Washington held that Washington's imposition of business and occupation tax on New Jersey-based Lamtec Corporation passed constitutional muster despite the fact that the company had no offices or employees in Washington. The Washington Supreme Court held that, to the extent there is a physical-presence requirement for the imposition of the B&O tax, the requirement can be satisfied by the presence of activities within the state as long as the activities are: (1) substantial; and (2) associated with the company's ability to establish and maintain its market within the state. In addition, the Washington Court stated that its analysis would apply regardless of whether the activities were performed by staff permanently employed within the state, by independent contractors, or by persons traveling into the state from without. Lamtec's appeal to the U.S. Supreme Court on April 19, 2011 was denied.

Out-of-State Retailer Found to Have Nexus Due to Activities of In-State Affiliate

Tax Determination No. 10-0057, Washington Department of Revenue (December 20, 2011).

The Washington Department of Revenue determined that the taxpayer, a mail-order retailer located outside Washington, had substantial nexus with the state for B&O tax and retail sales tax purposes because of the activities conducted on the taxpayer's behalf by an in-state affiliate.

(i) The affiliate sold gift cards that could be redeemed online, by mail order, or in a retail store. The affiliate, by selling the gift cards, was facilitating sales on behalf of the taxpayer, according to the Department.

(ii) In addition, the affiliate distributed the taxpayer's catalogs and assisted the taxpayer's customers with returns by contacting customer service to request free shipping labels for affixation to the return packages. These activities were significantly connected to the taxpayer's ability to establish and maintain a market for sales in Washington. Therefore, the taxpayer was found to have substantial nexus with the state.

Sales and Use Tax: Adoption of Memorial Requesting Support of Main Street Fairness Act

SJM 8009, Laws 2011 (Effective December 14, 2011).

In a joint memorial, the Senate and House of Representatives of the State of Washington petitioned the members of Washington's U.S. congressional delegation to join cosponsors of proposed federal legislation, including the Main Street Fairness Act. The Main Street Fairness Act seeks to grant states authority to collect sales taxes from remote sellers regardless of nexus. The memorial further urges President Obama to sign the legislation upon its passage by Congress.