

Minutes of Teleconference of Task Force III
(July 14, 1997 at 2:00pm, EDT)

I Identified parties present:

June Zivley (Co-Leader)	Kaye Caldwell (Co-Leader)
Dennis Fox	Merle Buff
Alan Friedman	Jeff Friedman
Paull Mines (Reporter)	Kendall Houghton
Dale Vettel	Bruce Reid
Larry O'Nan	Art Rosen
George Sorenson	
Marshall Stranburg	
June Summers	
Joe Thomas	
Mark Wainwright	

II No public comments were made.

III **Common carrier definition as it pertains to NBH's recognized safe harbor of contact limited to U.S. mail and common carrier:** There appears there to be a disagreement within the Task Force over the proper classification and treatment of a common carrier and a private contract carrier.

One group supports the view that a private contract carrier is outside the safe harbor of *NBH*. The use of a private contract carrier to this group constitutes utilization of an in-state representative that gives rise to the conclusion that the out-of-state seller is present within the taxing State. The analysis to this group should be on the *relationship* of the carrier to the out-of-state seller for purposes of determining whether it is fair to describe the private contract carrier as an in-state representative of the seller.

The group supporting the view that a private contract carrier may well still be within the safe harbor of *NBH* sees little difference between a common carrier and a contract carrier by virtue of the similarity of the *services* undertaken by both. This group discounts the effect of the relationship between the seller and the carrier. To this latter group, a rule that would distinguish based upon the legal capacity of the carrier is nonsensical, since both carriers essentially perform the same services.

The Task Force began to undertake to understand what the terms of common carrier and private contract carrier precisely mean,

especially in the context of the U.S. Supreme Court's use of the term common carrier in *NBH* in 1967. The common law understanding of a common carrier is not much different from what is quoted in the definition of the guideline, putting aside the issue of telecommunications common carriers for the moment.¹ Confusion reigns, however, when one looks at an organization that offers both common carrier services and private contract services.

Some would apparently argue that discounts in charges are reflective of shipment volumes and not discriminatory to the ordinary user because the ordinary user would not want to secure the same benefit. Others noted that private contract carriers may well offer services not generally available to the public. There needs to be an examination of the actual agreement with the out-of-state seller. In addition, the discrimination in available services that occurs by carriers is on a continuum and everyone would concede that at some point the legality of that discriminatory treatment is dependent upon the special status of the carrier being a private contract carrier. The Task Force suspected without a lot of expertise that understanding these distinctions would be difficult especially in the context of a world where there is increased deregulation of the common carrier transportation industry.

At this point the best that could be resolved was an agreement to disagree. There appeared to be no sentiment to try to reach a compromise over this issue by having the Phase II document reflect a practical position that might accommodate the positions of the two sides to some extent. Persons were invited to bring to Whitefish bullet summaries of where there actually were on this issue.

IV. Illustrating tension between safe harbor of *NBH/Quill* and "physical presence test." The Task Force requested a briefing on precisely what this issue was all about to get sighted on their target. The introduction described this issue as pertaining to the statement in the guideline at II.B.3.b., lines 100-105.² The tension issue derives from the fact that the Supreme Court indicates that the out-of-state seller enjoys the safe harbor of having no use tax

¹The guideline at II.F.2., lines ***.*** defines common carrier to "[mean] one who holds itself out to the public as engaged in the business of providing transportation of persons or property * * * from place to place for compensation on an indifferent basis.

²The guideline at II.B.3.b. states, "Under substantial nexus, a use tax collection duty may be imposed on an out-of-state business, when * * *[t]he out-of-state business lacks a physical presence in the taxing State but the business' connection with the taxing State is not limited to contact with its customers by common carrier or the U.S. mail and the imposition of a use tax collection duty does not unreasonably burden interstate or foreign commerce."

collection obligation when the seller's only contact is limited to common carrier and the U.S. mails. The unanswered question is what happens when the taxpayer has something less than what some may be comfortable calling "physical presence" and but the taxpayer is out of the safe harbor in the stormy seas of interstate commerce. The guideline statement under examination at this point attempts to answer that question by calling for a determination of the burden on interstate commerce if a use tax collection obligation is imposed. II.B.3.b. while a fluid concept nevertheless has some support in the reading of *Quill*.

No consensus was reached on the validity of II.B.3.b. but the following summary sets forth the gist of the participants' various reactions to the provision—

1. *Define physical presence broadly.* One participant wanted to define physical presence to include the precise statement of II.B.3.b. instead of having the principle isolated from the general physical presence definitions. Another in response noted the beating that occurred when the earlier drafts of the guideline used the phrase "*deemed* physical presence" that was a concept that only attempted to capture the sentiment of physical presence arising from other than the out-of-state seller's own employees and property. The advantage of the present approach of isolating the stated principle apart from the specific definitions of physical presence is that it forces the reader to come to an understanding of the proffered justification for stating the principle in the first place. Still another thought it would go too far to state that physical presence included everything that was outside of the safe harbor. This party did not believe that everything outside the safe harbor automatically subjected the out-of-state seller to a use tax collection duty.
2. *States state one end of extreme and business other.* After the foregoing discussion, another participant supported the suggestion that physical presence be broadly defined, although not necessarily in the precise terms first outlined in item #1. This party favored a statement that equated the leaving of the safe harbor with physical presence. Business, of course, would have the opportunity to react to the statement by contesting its basis in fact.
3. *Examples noted.* The wisdom of illustrating II.B.3.b., lines 100-105, was examined. Circumstances that potentially could come within this provision included an electronic service provider's use of a switching node of a local exchange carrier. Intangibles

that have a business situs in the taxing State might be another. One participant was disturbed by the approach that would distinguish taxability based upon the way the services were delivered.

4. *Growth potential exists—guideline potentially a living document.* A participant described II.B.3.b. as a useful provision, because it allowed the guideline to be a living document that could grow once the Supreme Court started filling in the interstices left by its less than clear *Quill* decision.
5. *Enough already.* Another participant interjected at the conclusion of the discussion on II.B.3.b. that there was no justification for the provision. *Quill* contemplates the bright line of physical presence and nothing less in all circumstances.

V. Understanding the concept of market enhancement activities.

No consensus formed on whether the guideline properly uses the market enhancement concept in its statement of principles. Some contended the concept unreasonably restricted the finding of constitutional nexus. Others submitted that the concept was backed by the Supreme Court and properly attached to the principles stated by the guideline.

The Task Force briefly took note of the listings of market enhancement and non-market enhancement activities provided by MTC staff as an attachment to the minutes of the Task Force's earlier meeting. The listing of non-market enhancement activities disclose to some extent what States might be willing to forego even though someone might try to make a case that some of these activities constituted market enhancement activities. Some business representatives believed that the listings with some tweaking could be a reasonable statement. Another was concerned that if the activities involved any market enhancement the tendency would be to paint all activity as market enhancement. One state representative noted that the U.S. Supreme Court's approving quotation of the Washington Supreme Court opinion in *Tyler Pipe* took note of activities that were viewed as market enhancement, even though it involved no customer contact.³ Many, especially the lawyers, had doubts about including this kind of list in the Phase I document, the constitutional understanding of nexus.

³These additional activities were providing virtually all the seller's information about the market, including product performance, competing products, pricing, market conditions, and trends; existing and upcoming products; customer financial status; and other critical local information.

The Task Force left this subject with three possibilities, all of which were unresolved: (i) eliminate the market enhancement concept from the guideline entirely; (ii) include the market enhancement concept; (iii) include the market enhancement concept, but provide a listing of activities falling within and without. The middle ground, listed as neither within or without could be either up for resolution by the parties or by default thought to constitute a market enhancement activity without evidence strongly suggesting a contrary understanding.

VI. Distinguishing employees on basis of permanent or temporary presence in State and application of market enhancement concept to independent contractors. The discussion of what the market enhancement concept actually meant led into the discussion of the guideline distinguishing between permanent and temporary presence of employees in the State. See II.C.1., lines 110-116. No consensus was reached whether temporary presence of an employee needed to be supported by market enhancement activities to trigger a physical presence. Participants also considered application of the market enhancement activity concept as applied to independent contractors also without reaching a consensus. The following example elicited viewpoints from both sides—

Assume an out-of-state seller of computers that employs an independent contractor company to staff a national help desk for the seller's customers. All customers, including customers in the taxing State, access the help desk by calling a 1-800-number. Neither the seller nor the help desk gives any indication of the location of the help desk. Does the presence of the help desk in the taxing State establish physical presence?

Some said the help desk fulfilled a function that is clearly the seller's and the seller has in effect substituted independent contractors for what otherwise would have been employees. [*Ed. Note:* Would this his observation would especially ring true if the independent contractors operated exclusively for the out-of-state seller.] Others by placing emphasis on the market enhancement concept indicated that there was no reasonable way to argue that the presence of the independent contractors in the taxing State was significantly associated with the ability of the out-of-state seller to establish and maintain the market in the State. The independent contractors of the help desk were engaged in national market enhancement and not the taxing State's market enhancement.

VII. Adjournment. Without reaching consensus on the many issues described above the Task Force adjourned until the meeting of the full PPWG in Whitefish, Montana, on August 5, 1997, from 1:30pm - 5:00pm. There is some possibility that the individual task forces of the full PPWG may meet into the evening on August 5, 1997, ending no later than 10:00pm that date.