State Participant Revised **Public Participation Working Group *Draft* of the Constitutional Nexus Guideline for Application of a State's Sales and Use Tax to an Out-of-State Business (D*R*A*F*T—01/98)**

THE MTC STAFF HAS PREPARED THIS LATEST DRAFT, State Participant Revised *Public Participation Working Group* Draft *of the Constitutional Nexus Guideline for Application of a State's Sales and Use Tax to an Out-of-State Business (D*R*A*F*T—01/98)*, IN ACCORDANCE WITH THE FOLLOWING PROCESS: THE MTC STAFF POLLED THE STATES PARTICIPATING IN THE PPWG ON SALES AND USE TAX CONSTITUTIONAL NEXUS TO UNDERSTAND IN A COLLECTIVE SETTING (WHERE UNANIMITY ON ALL POINTS IS NOT REASONABLY ACHIEVABLE) HOW THE PARTICIPATING STATES DESIRED THE GUIDELINE TO BE FURTHER REVISED BEFORE ITS BEING OFFERED TO THE BUSINESS REPRESENTATIVES OF THE PPWG. FROM THIS POLLING, THE MTC STAFF COMPLETED THE State Participant Revised Draft THAT REFLECTS THE OVERWHELMING SENTIMENT OF RESPONDING STATES. THE PARTICIPATING STATES ARE NOW OFFERING THE State Participant Revised Draft TO THE BUSINESS REPRESENTATIVES OF THE PPWG. THE BUSINESS REPRESENTATIVES INTEND TO IDENTIFY THE PRINCIPLES OF THE OFFERED GUIDELINE WITH WHICH THEY DISAGREE. UPON THE IDENTIFICATION OF THE DISPUTED PRINCIPLES, BOTH THE STATE REPRESENTATIVES, ASSISTED BY THE ACADEMIC CONSULTANTS, PROFESSORS MCINTYRE AND POMP, AND THE BUSINESS REPRESENTATIVES, ASSISTED IN ANY MANNER THAT THEY DESIRE, WILL PREPARE CONCISE STATEMENTS IN SUPPORT AND OPPOSITION TO THE IDENTIFIED PRINCIPLES. ONCE THE OPPOSING STATEMENTS ARE INCORPORATED INTO THE GUIDELINE, FORMING THE *Commentary Draft*, BOTH SIDES WILL HAVE THE OPPORTUNITY TO REVIEW WHAT IS BEING SAID AND TO REEVALUATE THE GUIDELINE AS IT THEN EXISTS. THIS DIALOGUE WILL PROBABLY OCCUR AT A MEETING OF THE PPWG ON MARCH 27, 1998, IN ST. PETERSBURG, FL.

GIVEN THIS PROCESS, IT GOES WITHOUT SAYING THAT THE State Participant Revised Draft IS NOT A FINAL STATEMENT OF THE GUIDELINE. THE PPWG PROCESS ANTICIPATES FURTHER SUBSTANTIVE DELIBERATIONS. STATE PARTICIPANTS WHO HAVE EXPRESSED SUPPORT FOR THE INCLUSION OF SPECIFIC CONCEPTS WILL REVIEW THE *Commentary Draft* TO SEE HOW STAFF HAS TRANSLATED THOSE CONCEPTS INTO SUBSTANTIVE PROVISIONS OF THE GUIDELINE. THE SUBSTANTIVE WORK OF THE PPWG ON SALES AND USE TAX CONSTITUTIONAL NEXUS IS NOT YET COMPLETE. CITATIONS TO THIS DOCUMENT, THEREFORE, SHOULD MAKE CLEAR REFERENCE TO THE INEVITABILITY OF FUTURE REVISIONS. PERSONS REVIEWING THIS DOCUMENT OUTSIDE OF THE PPWG PROCESS MAY SUBMIT COMMENTS TO THE MULTISTATE TAX COMMISSION. PLEASE SEND COMMENTS TO

Multistate Tax Commission
Attn: Paull Mines, General Counsel
444 North Capitol Street, N.W., Suite 425
Washington, D.C. 20001
(202) 624-8699—Telephone//(202) 624-8819—Fax
pmines@mtc.gov—e-mail

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(D*R*A*F*T—01/98)

State Participant Revised **Public Participation Working Group** ***Draft*** **of the Constitutional Nexus Guideline for Application of a State's Sales and Use Tax to an Out-of-State Business**

I. *Preliminary Comments.*

A. *Differentiating a sales tax, a use tax, and a use tax collection duty.* A state sales or use tax can potentially arise in three different contexts with respect to an **out-of-state business**: (i) the application of a sales tax; (ii) the application of a use tax; and (iii) the imposition of a use tax collection duty with respect to a third-party's obligation to pay the use tax to the taxing State.

B. *Form of sales and use taxes.* There are three types of sales and use taxes: a vendee form, a vendor form and a combined form. A vendee sales tax is a sales tax that places the legal incidence of the tax on the purchaser, even though the seller may be required to collect and remit the tax from collections made from the purchaser. A tax that places the legal incidence of the sales tax on the seller but also requires the seller to collect the tax from the purchaser is also a vendee sales tax. A vendor sales tax is a sales tax that places the legal incidence of the tax on the seller, even though the seller may have the option to collect the tax from the purchaser. A combined sales tax is a sales tax that displays aspects of both a vendee form and a vendor form.

C. *Nexus.* One necessary condition to the application of a state sales tax or a state use tax, or the imposition of a use tax collection duty, is the satisfaction of the U.S. constitutional requirement of nexus. Nexus means there is sufficient connection with the taxing State for that State to apply its sales or use tax or to impose a use tax collection duty. Some kind of nexus may also be necessary to support the administration of a state sales and use tax, including the right to audit an out-of-state business.

D. *Application of Guideline.* This Guideline describes when, under the U.S. Constitution, sales and use tax nexus with respect to an **out-of-state business** is present. Nexus must be present in each of three separate circumstances for which a state sales and use tax may apply: the application of a state sales tax, the application of a state use tax, or the imposition of a use tax collection duty. The Guideline does not extend beyond state sales and use taxes. In using the Guideline to determine the presence of nexus under the U.S. Constitution, users, in addition to determining the presence of nexus with respect to an **out-of-state business**, must also determine in the first instance whether, based upon applicable state law, the taxing State's sales and use tax applies at all and if so, how. This Guideline does not address these state law considerations. Thus, any conclusions reached in this document is limited to an interpretation of the U.S. Constitution and does not extend to state law, whose requirements must also be met in the application of any State's sales and use tax. Establishment of state limits on the application of a sales and use tax, including the satisfaction of state statutory nexus, is, subject to the limitations of the U.S. Constitution, the province of the state legislatures.

This Guideline also describes *two* circumstances where a taxing State may have, depending upon state law authorization, sufficient nexus within the limitation of the U.S. Constitution to support the audit of the books and records of an **out-of-state business** for purposes of determining compliance with the State's sales and use tax. *See* II.F., below. The Guideline does not address whether and under what conditions state law may authorize the audit of an **out-of-state business**. Regardless of what may be permitted by the U.S. Constitution, a State must have authority under its own laws to subject the books and records of an **out-of-state business** to a sales and use tax audit.

II. *Due Process Clause and Commerce Clause define nexus*. The Due Process Clause and the Commerce Clause of the U.S. Constitution define U.S. constitutional nexus. Before a taxing State may apply a sales tax or a use tax, or impose a use tax collection duty, the application or imposition must satisfy the nexus requirements of both Clauses.

A. *Due Process Clause Nexus*. "Minimum contacts nexus" is the term that describes the Due Process Clause component of nexus. A determination of minimum contacts nexus is made by reference to the quality and quantity of contacts with the taxing State. Minimum contacts nexus involves notions of fairness and substantial justice in the application of the sales tax or use tax, or the imposition of a use tax collection duty. Provided the magnitude of contact satisfies notions of fairness and substantial justice, minimum contacts nexus is satisfied for:

1. The application of a sales tax (whether in vendee, vendor, or combined form) to a taxable **sale** concluded by an **out-of-state business**, when the taxable **sale** occurs in the taxing State.

> *Example 1:* Corporation A is an **out-of-state business** with respect to State 1. Corporation A sells large scale electrical generators to persons in State 1 without maintaining any business location or the use of personnel or representatives in State 1. The generators sold are sent to State 1 by a private contract carrier selected by Corporation A. Corporation A, responding to a purchase order, ships a generator to an person in State 1. Under the terms of the transaction the purchaser's risk of loss does not occur until the generator is tendered for delivery to the person in State 1. Regardless of whether transfer of title occurs in State 1 or outside of State 1, the **sale** has occurred in State 1.

2. The application of a use tax (whether the sales tax for which the use tax compensates is a vendee, vendor, or combined form) to a taxable **use** of the **out-of-state business**, when the **out-of-state business**' taxable **use** occurs in the taxing State.

> *Example 1:* Corporation A is an **out-of-state business** with respect to State 1. Corporation A sells tangible goods to persons in State 1 by catalogs. The catalogs and goods sold are sent to State 1 by the U.S. Mails. Corporation A purchases some of its inventory for its catalog operation from a supplier in State 1. Corporation A supplies specialized shipping containers to the supplier in State 1 to minimize breakage during shipment. The supplier in State 1 uses the specialized containers to ship the goods it supplies to Corporation A. A **use** of the specialized containers by Corporation A occurs in State 1.

3. The imposition of a use tax collection duty on an **out-of-state business**, when

   a. The **out-of-state business** is present in the taxing State; or

> *Example 1:* Corporation A is an **out-of-state business** with respect to State 1. Corporation A sells tangible goods to persons in State 1 by catalogs. The catalogs and goods sold are sent to State 1 by the U.S. Mails. Corporation A maintains an office in State 1 that is devoted to operations unrelated to the actual selling of goods by catalog. Corporation A is present in State 1. *See* II.C.2.

b. The **out-of-state business purposefully,** on its own or through a **representative,** avails itself of the benefits of an economic market in the taxing State, including, without limitation, the engaging in of **regular** and **systematic** solicitation of business in the taxing State.

> *Example 1:* Corporation A is an **out-of-state business** with respect to State 1. Corporation A has a presence in State 1 derived solely from the fact that an independent contractor representing Corporation A enters State 1 on an unscheduled basis for an average of two days per year to solicit orders for the sale of merchandise to persons in State 1. State 1 is a part of the assigned territory of the independent contractor even though the **sales** made to persons in State 1 are not numerous or significant to the overall operation of the business. Corporation A engages in **regular** and **systematic** solicitation in State 1. Because State 1 is identified by Corporation A as a part of its market, the **occasional** entry of the representative is a normal business activity undertaken by Corporation A and is in furtherance of the business of Corporation A.

B. *Commerce Clause Nexus.* "Substantial nexus" is the term that describes the Commerce Clause component of nexus. Substantial nexus protects interstate and foreign commerce from unreasonable burdens that would impair the free flow of that commerce.

1. Substantial nexus is satisfied for the application of a sales tax (whether in vendee, vendor, or combined form) to a taxable **sale** concluded by an **out-of-state business**, when the taxable **sale** occurs in the taxing State.

> *See Example 1* of II.A.1. illustrating when a sale occurs in the taxing State.

2. Substantial nexus is satisfied for the application of a use tax (whether the sales tax for which the use tax compensates is a vendee, vendor, or combined form) to a taxable **use** of the **out-of-state business**, when the taxable **use** occurs in the taxing State.

> *See Example 1* of II.A.2. illustrating when a use occurs in the taxing State.

3. Substantial nexus is satisfied for the imposition of a use tax collection duty on an **out-of-state business**, when

a. The **out-of-state business** is physically present in the taxing State, *provided*, the **out-of-state business** has not established that its presence is *de minimis*; or

b. The **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.

Example 1: Corporation A is an **out-of-state business** with respect to State 1. Corporation A makes catalog sales of tangible personal property to persons in State 1. As a part of its normal business practice, Corporation A retains from time to time purchase money security interests[1] in merchandise it sells on installment to persons in State 1. An **out-of-state business regularly** and **systematically** securing purchase money security interests in merchandise that it sells on installment to persons in State 1 has established a meaningful commercial connection with State 1 so that imposition of a use tax collection duty with respect to sales that it makes to persons in State 1 does not unreasonably burden commerce. It is irrelevant to this conclusion whether Corporation A retains the purchase money security interests it acquires or assigns them immediately following their acquisition to a third-party.

Example 2: Corporation A is an **out-of-state business** with respect to State 1. Corporation A makes mail-order sales of merchandise (tangible goods) to persons in State 1 through the U.S. mail. Persons in State 1 order the merchandise from Corporation A using catalogs sent to them by Corporation A through the U.S. mail. Corporation A also has a wholly-owned subsidiary, Corporation B, that operates a retail store in State 1. Corporation B sells in State 1 merchandise similar to what Corporation A sells, although the merchandise is branded and marketed differently. Corporation B is subject to State 1's sales and use taxes for its sales. The relationship of Corporation A to Corporation B establishes Corporation A's substantial nexus with State 1. The imposition by State 1 of a use tax collection duty on Corporation A with respect to sales that it makes to persons in State 1 does not result in the imposition of an unreasonable burden on interstate or foreign commerce. As a result of its relationship with

[1]A purchase money security interest in the context of this example is the taking or retention by the **out-of-state business** of the collateralizing merchandise to secure all or part of its purchase price.

> Corporation B, Corporation A is in position to comply with an obligation to collect the State 1 use tax without incurring an unreasonable burden.
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> *Example 3:* The facts are substantially the same as in Example 2 except that Corporation A does not own any stock of Corporation B. Corporation B, however, owns a controlling interest in Corporation A. Corporation A has substantial nexus with State 1.

C. *Concept of physical presence in taxing State.* An **out-of-state business** is physically present in the taxing State within the meaning of II.A.3.a. and II.B.3.a., when the business engages in one or more of the following activities:

1. maintains (a) the **permanent** presence of one or more employees; or (b) the **temporary** presence of one or more employees where the **temporary** presence is **significantly associated with the ability of the out-of-state business to establish and maintain the market in the taxing State** with respect to the sale for which the possible use tax collection duty may be imposed.

> *Example 1:* Corporation A is an **out-of-state business** with respect to State 1. Corporation A stations in State 1 for an indefinite duration that is likely to exceed one year in length an on-site “print engineer,” an employee of Corporation A, to oversee quality control at the printer of corporation A’s national catalogs. Corporation A has a presence in State 1. The indefinite presence of one or more employees in State 1 is **permanent** and constitutes physical presence, even if the stationed employee is not directly associated with the establishment and maintenance of a market in State 1.
>
> *Example 2:* Corporation A is an **out-of-state business** with respect to State 1. Corporation A decides that it will for a period likely to exceed one year indefinitely maintain through rotation of its employees at least one employee in State 1 to foster positive relationships with its important suppliers. The identity of the specific employee in State 1 changes from time in accordance with the rotation system. The **out-of-state business** maintains a **permanent** presence of one or more of its employees in State 1 and has a physical presence in State 1.
>
> *Example 3:* Corporation A is an **out-of-state business** with respect to State 1. Corporation A assigns State 1 as a part of the sales territory to be covered by a salesperson who lives and maintains his/her office outside State 1. The salesperson travels to State 1 on an **occasional** basis, depending upon market conditions. Corporation A has a presence in State 1. The **occasional** presence in State 1 of a salesperson

with an assigned territory in that State is **significantly associated with the ability of the out-of-state business** (Corporations A) **to establish and maintain a market in the taxing State** (State 1) with respect to the sale for which the possible use tax collection duty may be imposed. This presence though limited in time constitutes physical presence.

Example 4: Corporation A is an **out-of-state business** with respect to State 1. Corporation A on a **temporary** basis sends different employees into State 1 to assist its independent legal counsel in that State to defend a lawsuit. The **temporary** presence of the employees is not **significantly associated with the ability of the out-of-state business** (Corporation A) **to establish and maintain a market in the taxing State** (State 1) with respect to the sale for which the possible use tax collection duty may be imposed. Corporation A has no physical presence in State 1 by virtue of the **temporary** presence of its employees in that State to assist in the defense of a suit.

Example 5: Corporation A is an **out-of-state business** with respect to State 1. One of Corporation A's employees lives in State 1. The employee's presence in State 1 is not associated with the activities of Corporation A. Corporation A has no presence in State 1 by virtue of the mere residence of one of its employee.

Example 6: Corporation A is an **out-of-state business** with respect to State 1. Corporation A permits on an indefinite basis that is likely to exceed one year one of its employees who lives in State 1 to telecommute from his/her residence in State 1. The **out-of-state business** maintains a **permanent** presence of one or more of its employees in State 1 and has a physical presence in State 1.

2. directly or indirectly owns, **leases**, or maintains real property located in the taxing State, including, without limiting the foregoing, an office or other facility; or

Example 1: Corporation A is an **out-of-state business** with respect to State 1. Corporation A maintains an office in State 1. The activities of the office are not related to the catalog sales Corporation A makes to persons in State 1. The office constitutes physical presence, even if the office's activities do not relate to the sales being made by the Corporation A to persons in State 1.

Example2: Corporation A is an **out-of-state business** with respect to State 1. Corporation A owns investment real estate in State 1 that is not related to its business of making catalog sales to persons in State 1. Corporation A has a physical presence in State 1. Ownership of real estate in State 1, even if unrelated to the business conducted with respect to State 1, constitutes the holding of property in State 1. The principle of dissociation of *Norton Co.* v. *Dept. of Revenue of Illinois*, 340 U.S. 534 (1951), however valid with respect to direct taxes, is inapplicable to the vendee, vendor and combined forms of sales and use taxes.

Example3: Corporation A is an **out-of-state business** with respect to State 1. Corporation A owns, **leases**, licenses or uses billboards, showrooms, advertising kiosks, sample and display rooms, or other similar property devoted to advertising, solicitation, and other marketing purposes. Corporation A maintains real property in State 1. Corporation A has a physical presence in State 1.

Example 4. Corporation A is an **out-of-state business** with respect to State 1. Corporation A engages in catalog sales to persons in State 1. Corporation A holds investment real estate in State 1 that is not related to its catalog sales. The real estate causes Corporation A to have physical presence in State 1 under the principle illustrated in Example 2 of this section II.C.2. In an attempt to avoid having physical presence in State 1, Corporation A transfers its investment real property located in State 1 to Corporation B, its wholly-owned subsidiary. Corporation A continues to own real property indirectly in State A and thus continues to have physical presence in State 1.

3. owns, **leases**, or maintains tangible personal property located in the taxing State; or

Example 1: Corporation A is an **out-of-state business** with respect to State 1. Corporation A in accordance with its normal business practice consigns tangible personal property to unrelated persons in State 1 who thereafter sell or **lease** or license the consigned property. The owner of property consigned to another holds property in the State where the property is consigned. Corporation A has a physical presence in State 1.

Example 2: Corporation A is an **out-of-state business** with respect to State 1. Corporation A purchases from unrelated businesses at discount, and/or lends money with security provided by, accounts receivable, including accounts whose payment is secured by security interests in property located in State 1. Corporation A is not the original obligee of any the accounts. In the absence of other connections, Corporation A does not have a physical presence in State 1.

Example 3: Corporation A is an **out-of-state business** with respect to State 1. Corporation A, in accordance with its normal business practice, orders and stores (following its supplier’s shipment) paper stock at the printer of its catalogs which is located in State 1. Paper stock quantities in significant amounts are held at the printer for one month periods four times each year to support the four-season printing of its national catalog. Corporation A has physical presence in State 1.

Example 4: Corporation A is an **out-of-state business** with respect to State 1. Corporation A as an experiment to increase market share hires for one sport's season an airplane with a pilot to navigate during games days around the outside of a baseball stadium in State 1 to advertise its product to fans attending the games. Corporation A maintains tangible personal property in State 1 temporarily. Corporation A has physical presence in State 1.

Example 5: Corporation A is an **out-of-state business** with respect to State 1. Corporation A stores some its business records with its auditors who are located in State 1. Corporation A has physical presence in State 1 by virtue of the storage of some of its accounting records in State 1. But see *Example 2* of II.D., below.

Example 6: Corporation A is an **out-of-state business** with respect to State 1. Corporation A in accordance with its normal business practice stores finished product at a supplier in State 1 that fabricated the product for Corporation A until such time as it has a sufficient quantity for the product to be economically shipped in bulk to a point outside the State. The storage of finished product at the fabricator of that product until it can be economically shipped in bulk outside the State constitutes physical presence.

4. [Reserved.] (This paragraph is reserved for a possible discussion of physical presence based upon an **out-of-state business**' relationship to intangible property located in the taxing state.)

5. retains a **representative** or **representatives** who solicit or conduct business or perform services on behalf of the **out-of-state business** in the taxing State and either this activity is **significantly associated with the ability of the out-of-state business to establish and maintain a market in the taxing State** with respect to the sale for which the possible use tax collection duty may be imposed or is conducted by the representative or an employee of a representative with the understanding that the activity will be performed on a substantially full-time basis for a permanent period and the services are performed under the primary direction or control of the out-of-state business.

Example 1: Corporation A is an **out-of-state business** with respect to State 1. Corporation A makes catalog sales of tangible personal property to persons in State 1. Corporation A hires an independent contractor who is located outside State 1 to provide customer complaint and warranty services to the **out-of-state business**' customers in State 1. The independent contractor makes visits in State 1 to resolve customer complaints and to perform warranty service on the product sold by Corporation A. Corporation A has a physical presence in State 1. The contractor visits are **significantly associated with the ability of the out-of-state business** (Corporation A) **to establish and maintain a market in the taxing State** (State 1) with respect to the sale for which the possible use tax collection duty may be imposed.

Example 2: Corporation A is an **out-of-state business** with respect to State 1. Corporation A makes catalog sales of tangible personal property to persons in State 1 and makes in-state deliveries of merchandise sold or its catalogs to these persons by a **contract carrier** and not a **common carrier** acting in its **common carrier** status. Corporation A secures benefits beyond mere delivery at a reduced price from dealing with its shipper on a private contract basis. Corporation A has a presence in State 1. The **contract carrier** is a **representative** of the **out-of-state business**. The deliveries do not fall within the limited safe harbor of contact with customers being limited to **common carrier** and U.S. mail. *See National Bellas Hess, Inc. v. Dept. of Revenue of Illinois*, 386 U.S. 754 (1967), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

Example 3: Corporation A is an **out-of-state business** with respect to State 1. Corporation A sells tangible goods to persons in State 1 by catalogs. The catalogs and goods sold are sent to State 1 by the U.S. Mails. Corporation A hires a representative to determine market conditions in State 1. The representative for Corporation A goes to State 1 to seek information in State 1 about the reliability and performance, pricing, and availability of competing products, general market conditions, customers' financial condition, fashion trends, and other local information. Corporation A has a physical presence in State 1. The **representative** is conducting business or performing services on behalf of the **out-of-state business** in the taxing State and this activity is **significantly associated with the ability of the out-of-state business** (Corporation A) **to establish and maintain a market in the taxing State** (State 1) with respect to the sales for which the possible use tax collection duty may be imposed.

Example 4: Corporation A is an **out-of-state business** with respect to State 1. Corporation A hires Corporation B that is located in State 1 to designate one of its employees to maintain Corporation A's books of account on an exclusive basis for a period of time likely to exceed one year. The bookkeeping services are performed under the primary direction or control of Corporation A. Corporation A has a physical presence in State 1 because of this relationship.

Example 5. Corporation A is an **out-of-state business** with respect to State 1. It makes catalog sales of merchandise (tangible property) to persons in State 1 through the U.S. mail. Corporation B is a wholly-owned subsidiary operating a retail sales store in State 1. Corporation B makes the catalogs of Corporation A available to persons in State 1 at its retail store in State 1. Corporation B is a **representative** of Corporation A and its activity in State 1 on behalf of Corporation A is **significantly associated with the ability of the out-of-state business** (Corporation A) **to establish and maintain a market in the taxing State** (State 1). As a result, Corporation A has physical presence in State 1. The result in this example would not be changed if Corporation B, instead of making the catalogs of Corporation A available to persons in State 1, made itself available to accept the return of merchandise sold by Corporation A.

6. retains a **representative** or **representatives** who are not described in paragraph 5 but who own, **lease**, use or maintain an office, other establishment, or property in the taxing State, and this property is used in the representation of the **out-of-state business** in the taxing State and is **significantly associated with the ability of the out-of-state business to establish and maintain a market in the taxing State** with respect to the sale for which the possible use tax collection duty may be imposed; or

Example 1: Corporation A is an **out-of-state business** with respect to State 1. Corporation A is a reseller of interexchange telecommunications services and sells prepaid phone cards as one method for providing this service. In order to initiate the interexchange telecommunications originating from State 1, the holder of the prepaid phone card must use the local exchange and the facilities-based interexchange carrier, both of which have property in State 1 that actually permit the call to go through. By virtue of arrangements that exist for interconnectivity, the property of the local exchange carrier and the interexchange carrier that facilitates the completion of the call is **significantly associated with the ability of the out-of-state business** (Corporation A) **to establish and maintain a market in the taxing State** (State 1) with respect to the sale for which the possible use tax collection duty may be imposed. Corporation A by virtue of its use of the property of its **representatives** in State 1 has physical presence in State 1.

Example 2: [Reserved.] (This example and possibly others are reserved for a possible illustration of physical presence based upon the ownership, lease, use or maintenance of an establishment in the taxing State that facilitates the conduct of a business through computer-based telecommunications.

7. [Reserved.] (This paragraph is reserved for a possible discussion of physical presence based upon a representative of an **out-of-state business** having a relationship to intangible property located in the taxing state).

8. either on its own or through a **representative** or **representatives**, maintains in the taxing State by private contract, and not by purchase from a **common carrier** in the **common carrier**'s status as a **common carrier**, telecommunication linkage that is **significantly associated with the ability of the out-of-state business to establish and maintain a market in the taxing State** with respect to the sale for which the possible use tax collection duty may be imposed; or

Example 1: Corporation A is an **out-of-state business** with respect to State 1. Corporation A maintains local telecommunications access in State 1 by virtue of an agreement with an interexchange carrier not acting in its capacity as a **common carrier** when dealing with Corporation A. The carrier by contract with the telecommunications company serving the local exchanges in State 1 arranges for transparent switching that achieves Corporation A's objective of appearing as a business with which the customers in State 1 can access as easily as if the business were located "down the street" in State 1, including the making of a local telephone call. Corporation A has presence in State 1. The interexchange carrier acts on behalf of the **out-of-state business** by providing local access and this representation in State 1 is **significantly associated with the ability of the out-of-state business to establish and maintain a market in the taxing State** with respect to the sale for which the possible use tax collection duty may be imposed.

9. performs or renders services in the taxing State.

Example 1: Corporation A is an **out-of-state business** with respect to State 1. Corporation A is a reseller of interexchange telecommunications services. A facilities-based, interexchange telecommunications service provider actually supplies the telecommunications services being resold under bulk purchase contract with Corporation A. Corporation A has presence in State 1. The reseller is providing a service in State 1 when a subscriber of the reseller places an interexchange call in State 1, because the services are not performed until the purchased telecommunications services are delivered in State 1.

Example 2: [Reserved.] (This example and possibly others are reserved for possible illustration of physical presence based upon the delivery of services into the taxing State through computer-based telecommunications.)

D. *Concept of* de minimis *and application of* de minimis *concept.*

1. *Concept of* de minimis. An **out-of-state business**' presence in the taxing State is *de minimis* when that presence either does not exceed a slightest presence or is inadvertent.

   a. ***Slightest presence***. Although not easily stated in objective terms, presence of the **out-of-state business** does not exceed a **slightest presence** when the collective judgment of disinterested observers would conclude the presence is a frivolous basis upon which to support a finding of nexus.; or

   b. *Inadvertent*. The presence is inadvertent when it does not represent a conscious choice of the **out-of-state business** to submit to the jurisdiction of the taxing State. A conscious choice to submit to the jurisdiction to the taxing State exists when the presence arises from a **regular** and **systematic** business practice, the pursuit of an established company policy on a continuing basis, an affirmative decision of management, or a step taken to assist in the establishment and maintenance of a market in the taxing State with respect to the sale for which the imposition of a use tax collection obligation may be imposed.

Example 1: Corporation A is an **out-of-state business** with respect to State 1. Corporation A sells tangible goods to persons in State 1 by catalogs. The catalogs and goods sold are sent to State 1 by the U.S. Mails. Corporation A also has developed a canned proprietary software that allows its customers to order goods through computer-assisted telecommunications from their locations in State 1 and other States. Corporation A licenses four copies of this software on diskettes that it sends to the four licensees in State 1. The taxpayer maintains (and there is no evidence suggesting a contrary understanding) that the diskettes were not **significantly associated with the ability of the out-of-state business** (Corporation A) **to**

establish and maintain the market in the taxing State (State 1). Although Corporation A has some physical presence, this presence is *de minimis*. It would be silly to support a finding of nexus on the presence of four diskettes containing proprietary ordering software where the taxpayer maintains the software was not significantly associated with its ability to establish and maintain its market in State 1 and there is no evidence suggesting the contrary.

Example 2: Corporation A is an **out-of-state business** with respect to State 1. Corporation A stores some its business records with its independent (non-employee) auditors who are located in State 1. The records are needed by the auditors to do their work for Corporation A. Although Corporation A has some physical presence, this presence is *de minimis*. It would be a silly to support a finding of nexus on the presence of business records of the **out-of-state business** being in the hands of the business' auditors where the records are needed for the auditors' work.

Example 3: Corporation A is an **out-of-state business** with respect to State 1. Corporation A has a presence in State 1 derived solely from the fact that a customer in violation of its affirmative covenants to the business moved the property sold by installment and in which the business has a perfected security interest from an authorized locality in another State to State 1. The presence of Corporation A in State 1 is *de minimis*. The presence is inadvertent, because it did not arise from Corporation A's conscious submission to the jurisdiction of State 1.

Example 4: Corporation A is an **out-of-state business** with respect to State 1. Corporation A's business is the rental of scaffolding for use at construction projects. Corporation A's business is generally limited to contractors who operate in the same State as Corporation A. Corporation A has a presence in another State, State 1, derived solely from the fact that *one* of its customer's has rented scaffolding that it has taken to a construction project in State 1. Corporation A's rental agreement with this customer gives no indication, and the personnel of Corporation A have no understanding, that the scaffolding was to be used in State 1. Corporation A has no reason to know that any of its scaffolding has ever been used before in State 1 or that it was going to be used in State 1 in this instance. The presence of Corporation A in State 1 is *de minimis*. The presence is inadvertent, because it did not arise from Corporation A's conscious submission to the jurisdiction of State 1.

Example 5: Corporation A is an **out-of-state business** with respect to State 1. Corporation A has a presence in State 1 derived solely from the fact that an employee on his/her own initiative, and without the territory being assigned to him/her, entered State 1 and secured an order for a single **sale** in the amount of $100. Corporation A allowed the **sale** to go through on a one-time basis to avoid embarrassment to the company. The presence of Corporation A in State 1 is *de minimis*. The presence is inadvertent, because it did not arise from a conscious submission to the jurisdiction of State 1. Corporation A's presence in State 1 also does not exceed a slightest presence. It also would be a silly to support a finding of nexus on the presence of a single, in-person solicitation of a $100 sale on behalf of the **out-of-state business** in State 1.

Example 6: Corporation A is an **out-of-state business** with respect to State 1. Corporation A has a presence in State 1 derived solely from the fact that an independent contractor representing the business enters State 1 on an unscheduled basis for an average of two days per year to solicit orders for the sale of merchandise to persons in State 1. State 1 is a part of the assigned territory of the independent contractor even though the **sales** made to persons in State 1 are not numerous or significant to the overall operation of the business. The **occasional** entry of a representative engaged in **regular** and **systematic** solicitation in State 1 constitutes a presence. The presence of Corporation A in State 1 is not *de minimis*. Corporation A has made a conscious choice to submit to the jurisdiction of State 1 because State 1 is identified as a part of Corporation A's market. In addition, **regular** and **systematic** solicitation exceeds a slightest presence. Corporation A as a part of its normal business operations deliberately seeks to further its business, *i.e.*, establish and maintain the market, by activities that give rise to physical presence. Disinterested observers would not conclude that these activities would be a silly premise upon which to support a finding of nexus.

Example 7: Corporation A is an **out-of-state business** with respect to State 1. Corporation A has a presence in State 1 derived solely from the fact that the business has hired an independent contractor that is not located in State 1 to perform on behalf of the business warranty service with respect to property sold to persons in State 1 and the independent contractor comes into State 1 on an unscheduled basis for an average of two times per year to perform the warranty service. The presence of Corporation A in State 1 is not *de minimis*. The presence derived from the **occasional** entry of a representative to perform warranty service on average of two times per year in State 1 arises from Corporation A's conscious choice to submit to the jurisdiction of State 1. Corporation A has effected an arrangement for the performance of its warranty service

> obligation in State 1 that is important to the establishment and maintenance of the market in State 1. This arrangement reflects either a **regular** and **systematic** business practice, an established company policy pursued continuously, or an affirmative decision of management. In addition, the occasional performance of in-state warranty service on behalf of the out-of-state business exceeds a slightest presence. Corporation A as a part of its normal business operations deliberately seeks to further its business, *i.e.*, establish and maintain the market, by activities that give rise to physical presence. Disinterested observers would not conclude that these activities would be a silly premise upon which to support a finding of nexus.
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> *Example 8:* Corporation A is an **out-of-state business** with respect to State 1. Corporation A has a presence in State 1 derived solely from the fact that it owns a 10 acre parcel of undeveloped real property in State 1. The real property is not used in the business of Corporation A. The presence of Corporation A in State 1 is not *de minimis*. The presence derived from Corporation A's ownership of real property located in State 1 arises from a conscious choice to submit to the jurisdiction of State 1, because a corporation cannot acquire ownership of real property without the affirmative decision of management. In addition, the ownership of real estate exceeds a slightest presence. Corporation A has deliberately established and thereafter maintains a physical presence in State A. Disinterested observers would not conclude that presence arising from the ownership of a 10 acre parcel of undeveloped real property would be a silly premise upon which to support a finding of nexus.

2. *Proof of* de minimis. If an **out-of-state business** is present in the taxing State, then the **out-of-state business** has the burden of establishing its presence is *de minimis* by clear and cogent evidence.

E. *Duration of Nexus*. Once minimum contacts nexus or substantial nexus exists under principles of this guideline, that nexus will continue to exist for any sale, even though the circumstances that gave rise to the nexus have ended, in accordance with the following principles. First, nexus will be conclusively presumed to last for at least the one-year period beginning at the temporal point of the end of the circumstances that gave rise to nexus. Second, nexus will continue to exist where the pre-existing circumstances that gave rise to the nexus have any meaningful connection to the sale.

F. *Audit Nexus*. A taxing State may audit the books and records of an **out-of-state business** for compliance with the State's sales and use tax in accordance with the following principles. (This paragraph II.F. does not attempt to identify all circumstances under which a taxing State may audit the books and records of an **out-of-state business**.)

1. A taxing State may conduct a reasonable audit of the books and records of an **out-of-state business** for compliance with the State's sales and use tax when for the period under audit

   a. The **out-of-state business** has engaged in activities sufficient to support the imposition of a use tax collection duty under the "Due Process nexus" rule of II.A.3.b.; or

   b. The contacts of the **out-of-state business** with the taxing State are sufficient under the U.S. Constitution to subject the business to the personal jurisdiction of the courts of general jurisdiction of the taxing State.

2. The audit conducted under subparagraph II.F.1. relates to the business for which the described activities supporting Due Process nexus are conducted or for which the described contacts supporting personal jurisdiction pertain.

3. An **out-of-state business** may contest whether it may be subject under the limitations of the U.S. Constitution to the taxing State's audit. If the taxing State shows that there is a reasonable possibility of establishing facts that meet either II.F.1.a. or II.F.1.b., no final resolution of the dispute over the right of the taxing State to conduct its audit will be made without a reasonable opportunity to ascertain by discovery whether the facts that will support the conduct of the audit exist.

~~F.~~ G. *Definitions*. The following definitions apply to the terms used in this guideline, including the examples. The definitions do not apply outside of the guideline. Thus, the definitions do not apply to the same or similar terms used in an adopting State's statutes, or regulations, rules or other official communications without an affirmative statement to that effect.

1. [Reserved.] (This paragraph is reserved for possible definition of the term "business situs".)

2. "**Common Carrier**." The term "common carrier" means one who holds itself out to the public as engaged in the business of providing transportation of persons or property, including intangible property or services through telecommunications, from place to place for compensation on an indifferent basis.

3. "**Contract Carrier**." The term "contract carrier" means one who is in the business of providing transportation of persons or property, including intangible property or services through telecommunications, from place to place for compensation under exclusive agreement.

4. "**In-State Person**." The term "in-state person" means any individual who is resident in, or any entity which is organized under the laws of or commercially domiciled in, this State.

5. "**Lease**." The term "to lease" means any arrangement, including a license, allowing for the use, possession, or occupancy of property in return for rent or other consideration. The term does not extend to non-operating leases that are strictly financing mechanisms.

6. "**Occasional**." The term "occasional" means occurring at infrequent or irregular intervals in a State.

7. "**Out-of-State Business**." The term "out-of-state business" means any individual or entity conducting business that is not an **in-state person**.

8. "**Permanent**." The term "permanent" means a duration lasting one year or more or a duration of an indeterminate or indefinite length that at any time during its existence is likely to exceed one year.

9. "**Purposefully**." The term "purposefully" means willfully.

10. "**Regular**." The term "regular" means normal but without regard to the interval or frequency of occurrence or, alternatively, occurring at fixed or uniform intervals.

11. "**Representative**." The term "representative" means any individual or entity that solicits sales, conducts business, or provides services in the taxing State on behalf of an **out-of-state business**. The term includes, without any limitation on the foregoing, agents, corporate or other business entities, related or unrelated to the **out-of-state business**, and independent contractors whose activities fall within the preceding sentence. The term also includes sub-representatives. A representative may be resident or non-resident in the taxing State. The term does not include employees of the **out-of-state business**.

12. "**Sale**." The term "sale" means for tangible goods the point in time when there has been both the transfer of either title or possession and the passage of risk of loss to the purchaser. The term "sale" for tangible goods that have been leased to a

third-party also means the point in time where both the transfer of possession of the tangible good to the third-party and the agreement for leasing have been completed. The term "sale" means for services or intangible goods the commencement of the receipt of the service or of the delivery of the intangible property. The term "sale" for the sale of a service contract that provides for contingent services in the future means the point in time, without regard to any waiting period, that the contractual obligation to provide possible contingent services has been established.

13. "**Significantly associated with the ability of the out-of-state business to establish and maintain the market**." The term "significantly associated with the ability of the out-of-state business to establish and maintain the market" means activities that (i) involve contact with the customer or potential customer in the capacity as a customer or potential customer or (ii) involve the collection of information that pertains to the market in the taxing State or to information about a customer or potential customer that furthers the business of the **out-of-state business** with respect to the customer or potential customer in the capacity of a customer or potential customer.[2] It is not necessary that the activity actually establish and maintain the market, only that the activity be significantly associated with the ability of the **out-of-state business** to do so.

14. "**Systematic**." The term "systematic" means methodically planned in furtherance of the business of the **out-of-state business**.

15. "**Temporary**." The term "temporary" means a duration that is not **permanent**.

[2] Activities falling within "**significantly associated with the ability of the out-of-state business to establish and maintain the market**" includes solicitation and marketing directed to in-state persons, including market research for sales to be made into the taxing State; product fulfillment activities, including delivery, distribution, installation, training, testing, and consultation; repair services that are on behalf of the **out-of-state business**; and customer adjustment services, including handling of complaints and returns. Other activities include providing the seller with 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.

16. "**Use**." The term "use" means for tangible goods, services and intangible property storage, use, distribution or other consumption of the object of the use tax.