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

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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.

Industry Reaction: Nexus contains both Due Process and Commerce Clause concerns as well as transactional and presence components; each requires a distinct analysis. These components must be satisfied before a person has established sufficient nexus to be subject to a jurisdiction's sales and use tax. "Audit nexus" is outside the scope of this project (i.e., the constitutional limitations of state tax jurisdiction).

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.

Industry Response: This Guideline describes the States' interpretation of constitutional standards. As indicated throughout this document, the States' interpretation varies substantially from industry's interpretation of those same standards. Any conclusions reached in this document are subject to the interpretation by the United States Supreme Court of the United States Constitution. State and local statutory and judicial authority must be consistent with U.S. Constitutional requirements, as enunciated by the Supreme Court. United States Constitutional requirements apply to both the imposition of a sales and use tax, and subjecting the taxpayer/tax collector to audit scrutiny.

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:

Industry Response: The United States Supreme Court has held that the taxpayer must "purposefully direct" its activities toward the taxing state in order to satisfy Due Process requirements. See Quill v. North Dakota, 112 S. Ct. 1904 (1992), Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985), Asahi Metals, Worldwide Volkswagon.

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.

Industry Response: The fact that a sale may or may not have occurred in the taxing state does not necessarily result in Due Process nexus. Due Process nexus requires satisfaction of minimum contacts, purposeful availment and notions of fairness.

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.

Industry Response: As an initial matter, this example is of limited use because the conclusion reached is devoid of underlying analysis. For instance, it is unclear whether the use of a contract versus a common carrier has any bearing on the conclusion reached. Further, the meaning and significance of a "large scale" sale is unclear (e.g., is the type, quantity or price of goods sold relevant?). In this example, the fact that the sale may or may not have occurred within the State does not answer the question of whether the taxpayer has established Due Process nexus within the jurisdiction. If the transfer of the risk of loss is the determining fact, that should be expressly stated (in which case industry is unaware of the explicit authority supporting such a conclusion).

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.

Industry Response: The fact that a taxable use may or may not have occurred in the taxing state does not necessarily result in Due Process nexus. Due Process nexus requires satisfaction of minimum contacts, puposeful availment and notions of fairness.

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.

Industry Response: As an initial matter, this example is of limited use because the conclusion reached is devoid of underlying analysis. Is this example intended to demonstrate an instance of Due Process nexus? Or, alternatively, is this example intended to demonstrate the application of a use tax based on attributional concepts? It is unclear. The example seems to be an attempt to apply the Guideline's definition of a taxable use. It is impossible for Industry to opine on this example without supporting analysis.

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

Industry Response: The mere presence of an out-of-state business within the taxing state does not necessarily result in Due Process nexus. The taxpayer must have purposefully directed its activities toward the taxing state, regardless of whether it is "present" in the State. Further, it is unclear whether "present in the taxing State" reflects physical presence. Moreover, industry believes that in addition to quantitative aspects of presence (which is covered under the de minimis discussion), certain instances of presence, because of their very nature, may fail qualitative aspects.

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.

Industry Response: As an initial matter, this example is of limited use because the conclusion reached is devoid of underlying analysis. To the extent this example is meant to describe the facts and holding in National Geographic Soc. v. California Bd. Of Equalization, 430 U.S. 551 (1977), Industry agrees with the result.

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.

Industry Response: Nexus through a representative requires systematic and continuous solicitation on behalf of the representative. In Scripto and in Tyler Pipe the representatives were systematically and continuously conducting sales-related activities on behalf of the out-of-state taxpayer. The definition of "Regular" contained in the Guidelines means normal but without regard to the frequency of occurrence. This definition is completely inconsistent with the Supreme Court's continuous requirement. Industry objects to the "including, without limitation" language because of the inference that there is some other requirement other than "continuous and systematic."

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.

Industry Response: As an initial matter, this example is of limited use because the conclusion reached is devoid of underlying analysis. This example fails not only the standard established by the U.S. Supreme Court, but also the standard included in these Guidelines because the independent contractor's two days per year presence, especially on an unscheduled basis, does not rise to the level of continuous and systematic solicitation. Further, this activity is not "regular." Finally, the last sentence in the example infers that the identification of State 1 as part of Coporation A's market is sufficient to transmute the non-nexus creating occasional entry of an independent contractor into a regular and systematic activity. The independent contractor's activity must be continuous and systematic, regardless of the taxpayer's identified market.

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.

Industry Response: The United States Supreme Court has defined substantial nexus as requiring that the taxpayer maintain a non-de minimis physical presence within the taxing state. In creating this standard, the Court intended to create a bright line physical presence test which does not depend on the situs of the sale or use.

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.

Industry Response: The United States Supreme Court has defined substantial nexus as requiring that the taxpayer maintain a non-de minimis physical presence within the taxing state. In creating this standard, the Court intended to create a bright line physical presence test which does not depend on the situs of the sale or use.

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

References to examples demonstrating Due Process concerns are inappropriate because the Due Process and Commerce Clause inquiries are separate and distinct and reflect different concerns. Further, the referenced example describes facts that are nearly identical except for the use of a contract versus common carrier. There is no support for the proposition that the mere use of a contract carrier obviates the physical presence requirement.

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.

Industry Response: The United States Supreme Court has defined substantial nexus as requiring that the taxpayer maintain anon-de minimis physical presence within the taxing state. In creating this standard, the Court intended to create a bright line physical presence test which does not depend on the situs of the sale or use.

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

References to examples demonstrating Due Process concerns are inappropriate because the Due Process and Commerce Clause inquiries are separate and distinct and reflect different concerns. The mere use by a third party of property does not result in Commerce Clause nexus.

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.

Industry Response: The United States Supreme Court has defined substantial nexus as requiring that the taxpayer maintain a non-de minimis physical presence within the taxing state. In creating this standard, the Court intended to create a bright line physical presence test which does not depend on the situs of the sale or use. The conclusion in Part (b) that states that physical presence is not needed for Commerce Clause nexus is wholly inconsistent with the U.S. Supreme Court's holdings in National Bellas Hess and Quill. Part (b) indicates that Quill *does not endorse a bright line physical presence test (contrary to the plain language of the opinion), but rather is only a safe harbor for taxpayers who do no more than communicate with their customers by mail or common carrier. Industry completely disagrees with this proposition.*

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_ 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.

Industry Response: Commerce Clause nexus requires that the taxpayer maintain a physical presence in the taxing state. There is no precedent for the principle that the physical presence requirement in Quill merely establishes a safe harbor. Rather, the holding established a bright line test to be applied to all taxpayers. The holding of a purchase money security interest in property in the taxing state does not result in a physical presence in the state (because the taxpayer has no current rights or power over the property) and therefore the taxpayer has not lost the protections provided in Quill.

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 Corporation B, Corporation A is in position to comply with an obligation to collect the State 1 use tax without incurring an unreasonable burden.

Industry Response: The mere presence of an in-state affiliate does not result in nexus. There is no authority to confer nexus based on an in-state affiliate. In fact, several state court holdings confirm that an in-state affiliate does not confer nexus on an out of-state taxpayer, even if the in-state affiliate performs limited services on behalf of the out-of-state taxpayer. SFA Folio, Bloomingdales by Mail. Further, the Guidelines use an "unreasonable burden" standard in an attempt to subvert the physical presence bright line test espoused by the Court on two occasions over the past 30 years. American jurisprudence requires full respect to legitimate corporate boundaries, with the sole exception in determining the source of profit earned by a unitary business.

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.

Industry Response: The mere presence of an in-state affiliate does not result in nexus. There is no authority to confer nexus based on an in-state affiliate. In fact, several state court holdings confirm that an in-state affiliate does not confer nexus on an in-state taxpayer, even if the in-state affiliate performs limited services on behalf of the out-of-state taxpayer. SFA Folio, Bloomingdales by Mail. Further, the Guidelines use an "unreasonable burden" standard in an attempt to subvert the physical presence bright line test espoused by the Court on two occasions over the past 30 years. American jurisprudence requires full respect to legitimate corporate boundaries, with the sole exception in determining the source of profit earned by a unitary business.

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.

Industry Response: Example 3 uses the term "occasional presence," while the Guideline in defining physical presence distinguishes between a permanent and temporary presence. Permanent and temporary are durational concepts while occasional denotes an infrequent presence. In order to conform to the rule in the Guideline, occasional should be deleted from Example 3 and replaced *with temporary.*

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.

Industry Response: This example would create nexus for a company in any state where they have an employee who telecommutes. With the popularity of e-mail and voice mail, nearly all employees telecommute to some extent. Where the location of the employee is for the benefit of the employee rather than the employer, it would seem that more should be required (e.g., phone listing, home office) to ensure interstate commerce is not unduly burdened.

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

Industry Response: The concept of indirect ownership creating nexus is completely without merit. Separate legal entities must be respected. In fact, sales from one legal entity to an affiliate are often subject to tax. It is inconsistent to disregard the separate entity structure for nexus purposes. For instance, in Current, Inc. v. California Board of Equalization *the court rejected - on constitutional grounds - the argument that the corporate affiliation between the taxpayer and an in-state affiliate created substantial nexus.* 29 Cal. Rptr.2d 407 (Cal. App. Ct. 1994).

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.

Example 2: 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.

Example 3: 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.

Industry Response: Solicitation of the marketplace by itself does not create nexus. Because advertising via billboards, kiosks, etc.. can be effected either through the actual rental of property *or through the purchase of an in-state advertising service, in-state advertising cannot be considered a nexus creating activity. Leasing of property that can be occupied by the taxpayer (e.g., showrooms) should be differentiated and may be considered a nexus creating activity.*

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.

Industry Response: The concept of indirect ownership creating nexus is without merit. Separate legal entities should be respected. In fact, sales from one legal entity to an affiliate are often subject to tax. It is inconsistent to disregard the separate entity structure for nexus purposes. In-state presence of a commonly owned corporation, standing alone, is insufficient to create nexus. No court has ever found substantial nexus based on affiliate nexus. For instance, in Current, Inc. v. California Board of Equalization *the court rejected the argument that the corporate affiliation between the taxpayer and an in-state affiliate created substantial nexus. 29 Cal. Rptr.2d 407 (Cal. App. Ct. 1994). In Bloomingdale's By Mail Ltd. v. Commonwealth Department of Rev., the Pennsylvania Supreme Court refused to find "substantial nexus" for an out-of-state mail order seller based on the presence of in-state retail stores operated by its parent company. The court indicated that affiliate nexus requires proof of agency or corporate piercing. 591 A2d 1047 (Pa. 1991) aff'g 567 A.2d 773 (Pa. Commw Ct. 1989), cert. denied 112 S. Ct. 2299 (1992). American jurisprudence requires full respect to legitimate corporate boundaries, with the sole exception in determining the source of profit earned by a unitary business.*

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

Industry Response: While leasing tangible personal property may create nexus, "lease" is defined to include a license for the use of property. Lease typically relates to the right to use tangible or real property while a license typically relates to the use of intangible property. Licensing intangible property does not constitute physical presence nor substantial nexus. The Supreme Court has required the taxpayer's physical presence in the state as a prerequisite to a collection obligation. Therefore, the definition of "lease" should not include any reference to a license. Further, the definition of "maintains" is unclear and should be deleted. The inquiry should be limited to owning or leasing property.

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.
Industry Response: It is irrelevant to the above conclusion whether Corporation A purchases from an unrelated or related business. Moreover, it is irrelevant whether Corporation A is the original obligee; merely having a security interest in property does not create a physical presence. Separate corporate entities must be respected absent proof of agency or an alter ego relationship.

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.

Industry Response: As an initial matter, this example is of limited use because the conclusion reached is devoid of underlying analysis. It would be helpful to have some parameters for determining the amount of property that constitutes "significant property." To the extent that Corporation A did not have title to the paper Corporation A will not have nexus. Further, without supporting analysis it is impossible to determine whether the frequency of the ownership (i.e., 4 times a year) or the duration (one month periods) or both is the determining factor for purposes of conferring nexus.

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.

Industry Response: As an initial matter, this example is of limited use because the conclusion reached is devoid of underlying analysis. The example does not indicate that Corporation A owns property within the taxing state. Therefore, it is impossible to determine whether Corporation A has a physical presence in State 1. If the plane takes off and lands in State 2, Corporation A clearly does not have a physical presence in State 1. The mere use of tangible personal property for advertising purposes does not create nexus (e.g., when the property is used by an advertising agency).

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.

Industry Response: This example should be eliminated. It contradicts the earlier example that temporary presence of employees in a state to assist legal counsel defend a lawsuit does not create nexus, because such situations typically involve the presence of some taxpayer business records.

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.

Industry Response: As an initial matter, this example is of limited use because the conclusion reached is devoid of underlying analysis. While Corporation A may own property within the state, such property may constitute a de minimis presence. Further, there is no reference to the quantity of in-state property owned by Corporation A as there is in Example 3.

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.)

Industry Response: While there is no substantive provision inserted here, it is worth noting that intangible property cannot create a physical presence within the taxing state. The Guidelines should make clear that the in-state use or presence of an intangible cannot, by itself, create a physical presence nor substantial nexus as defined by the U.S. Supreme Court.

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.

Industry Response: Under Scripto , Inc. v. Carson 362 U.S. 207 (1960) and Tyler Pipe Indus., Inc. v. Washington Dep't of Rev., 483 U.S. 232 (1987) third party representatives can create nexus only if their activities involve regular and continuous and are sales related. Any suggestion that less is required is not supported by case law. There is no indication in the above example that the representative's activities constitute continuous solicitation and therefore the representative's activities cannot be attributed to the taxpayer for purposes of determining nexus.

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.

Industry Response: As an initial matter, this example is of limited use because the conclusion reached is devoid of underlying analysis. The independent contractor's activities do not constitute continuous sales related activity and therefore cannot be attributed to Corporation A.

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).

Industry Response: National Bellas Hess and Quill do not provide a "limited safe harbor" rather, they provide a bright-line test for determining substantial nexus. A contract carrier not performing continuous sales related activities does not create a physical presence or substantial nexus for Corporation A.

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.

Industry Response: The representative is not performing regular and continuous sales related activity and therefore cannot create nexus on behalf of Corporation A. The Guidelines attempt to expand sales related activity to include "significantly associated with the ability to establish and *maintain a market."   Such expansion is unfounded.*

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.

Industry Response: Corporation B is not performing regular and continuous sales related activities on behalf of Corporation A and therefore Corporation B's presence cannot be attributed to Corporation A.

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.

Industry Response: Merely making catalogues available or accepting returns on behalf of an affiliate does not constitute continuous and regular sales related activities. Therefore, Corporation A does not have a physical presence nor substantial nexus within the state. Bloomingdale's By Mail Ltd. v. Commonwealth Department of Rev., 591 A.2d 1047 (Pa. 1991), SFA Folio Collections, Inc. v. Bannon, 217 Conn. 220 cert. denied, 111 S. Ct. 2839 (1991).

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

Industry Response: The in-state representative is not conducting regular and continuous sales related activities and therefore its activities or presence cannot be attributed to the out-of-state taxpayer.

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.

Industry Response: A representative's use of its own property in the taxing state is not relevant for determining nexus of an out-of-state taxpayer. The representative is not performing regular and continuous sales related activities on behalf of Corporation A and therefore the representative's activities or property cannot be attributed to Corporation A. Corporation A does not have a 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.

Industry Response: The use of a computer based telecommunication service should be treated no differently than other common or contract carriers. Common carriers do not create nexus on behalf of an out-of-state retailer. Contract carriers do not create nexus unless the contract carrier is performing regular and continuos sales related activities.

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).

Industry Response: While there is no substantive provision provided, it is worth noting that intangible property cannot create a physical presence within the taxing state. The Guidelines should make clear that the in-state use or presence of an intangible cannot, by itself, create a physical presence nor substantial nexus as defined by the U.S. Supreme Court. Certainly, a representative's relationship to intangible property does not create nexus because: intangible property cannot create a physical presence, and a representative does not create nexus unless its activities constitute regular and continuous sales related activities.

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

Industry Response: In order for a representative to create nexus on behalf of an out-of-state taxpayer, the representative must conduct regular and continuous solicitation activities. The mere use of a telecommunication linkage, whether provided by a common or contract carrier, does not result in and of itself constitute regular and continuous solicitation.

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.

Industry Response: In order for a representative to create nexus on behalf of an out-of-state taxpayer, the representative must conduct regular and continuous solicitation activities. Common versus contract carrier does not alter this analysis. The fact that the out-of-state business may "appear" as though it were a local business is irrelevant for purposes of determining nexus.

9. performs or renders services in the taxing State.

Industry Response: In order for a representative to create nexus on behalf of an out-of-state taxpayer, the representative must conduct regular and continuous sales related activities. This provision does not state who is performing or rendering a service, such as an employee or independent contractor. Service providers do not confer nexus on an out-of-state taxpayer unless the services are in the nature of continuous and regular solication.

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.

Industry Response: In order for a representative to create nexus on behalf of an out-of-state taxpayer, the representative must conduct regular and continuous sales related activities. The provision of telecommunication services by a third party for resale does not constitute continuous and regular sales related activities.

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.)

Industry Response: While there is no substantive provision provided, it is worth noting that intangible property cannot create a physical presence within the taxing state. The Guidelines should make clear that the in-state use or presence of an intangible cannot, by itself, create a physical presence nor substantial nexus as defined by the U.S. Supreme Court. Certainly, a representative's relationship to intangible property does not create nexus because: intangible property cannot create a physical presence, and a representative does not create nexus unless its activities constitute regular and continuous sales related activities.

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

Industry Response: Under the Supreme Court's interpretation of the Commerce Clause, the taxpayer must have a substantial nexus in the jurisdiction in order to be subject to tax or tax collection obligation. Any presence that is not substantial is de minimis.

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.

Industry Response: The Due Process Clause requires that the taxpayer purposefully direct its activities toward the taxing state. Worldwide Volkswagen, Asahi Metals. Therefore, inadvertent contacts do not constitute Due Process nexus. Further, use of the term "business practice" is too broad.

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.

Industry Response: The independent contractor activities do not constitute regular and continuous solicitation. Therefore, Corporation A does not have a physical presence nor substantial nexus in State 1.

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.

Industry Response: The independent contractor's activities do not constitute regular and systematic sales related activities and therefore do not create nexus on behalf of Corporation A. To suggest otherwise is silly.

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.

Industry Response: The use of "disinterested observer" and "silly premise" are troublesome as these are vague and undefined terms.

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.

Industry Response: The clear and cogent evidentiary standard originated in United States Supreme Court jurisprudence concerning fair apportionment and the claimed taxation of extraterritorial values:

> *As always, of course, the State's taxation of the company's income is presumptively constitutional. To overcome that presumption, ASARCO has the "distinct burden of showing by `clear and cogent evidence' " that Idaho's scheme "results in extraterritorial values being taxed." Exxon Corp. v. Wisconsin Department of Revenue, supra, at 221 (quoting Butler Bros. v. McColgan, 315 U.S. 501, 507 (1942) (quoting Norfolk & Western R. Co. v. North Carolina ex rel. Maxwell, 297 U.S. 682, 688 (1936))).*

ASARCO Inc. v. Idaho State Tax Commission, 458 U.S. 307, 334 (1982). This evidentiary burden is difficult *to meet. "Clear" is defined as "Obvious, beyond reasonable doubt." Black's Law Dictionary 250 (6th ed. 1990). "Cogent" is defined to mean "convincing or believable by virtue of forcible, clear, or incisive presentation." Webster's Encyclopedic Unabridged Dictionary of the English Language 286 (1989). Thus, the clear and cogent evidentiary standard resembles the beyond a reasonable doubt standard used for criminal matters.*

The extreme difficulty of satisfying the standard is not the only rationale for objecting to its use in a model state regulation. The standard is meant to grant significant deference to the analysis and decisions reached by state courts in determining the constitutional boundaries of the taxation of extraterritorial values. In Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983), the Court stated that:

> *the taxpayer always has the 'distinct burden of showing by 'clear and cogent evidence' that the [state tax] results in extraterritorial values being taxed.' One necessary corollary of that principle is that this Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a 'unitary business.'*

463 U.S. at 175 (internally citations omitted) (emphasis added). Further, the Court went on to recognize that "It will do little good if this Court turns every colorable claim that a state court erred in a particular application of [unitary] principles into a de novo adjudication, whose unintended nuances would then spawn further litigation and an avalanche of critical comment. Rather, our task must be to determine whether the state court applied the correct standards to the case; and if it did, whether its judgment 'was within the realm of permissible judgment.'" Id. at 176 (footnotes omitted).[1] *Thus, the Court's standard, which Justices Black and O'Connor have referred to as a heavy burden,*[2] *is meant to respect the legal analysis of lower courts and limit the quantity of cases the Supreme Court hears regarding taxpayers' claims of taxation of extraterritorial values.*

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[1] Interestingly, while not providing any rationale, the Court noted that this approach is not used in the context of other U.S. Constitutional jurisprudence. *See Container*, 463 U.S. at 176 n.13.

[2] *Norfolk & W. Ry. v. Missouri Tax Comm'n*, 390 U.S. 317 (1968) (Justice Black dissenting), *Allied-Signal v. Director*, 504 U.S. 768 (1992) (Justice O'Connor dissenting).

Because the two rationales that justify the use of the clear and cogent evidentiary standard are not present at the administrative level, incorporating the standard within a Guideline or state regulation concerning the constitutional limitations of sales and use tax nexus is wholly inappropriate. Presumably, state taxing authorities and possibly courts of first impression will apply the standard contained within the Guideline or regulation. However, these decision making bodies do not rely on decisions made by lower courts. Rather, these authorities will be hearing the initial arguments made by the parties. Further, it is inequitable for an administrative body or a court of first impression to dissuade taxpayers from pursuing legitimate claims. Therefore, under the existing Guideline taxpayers will be forced to fulfill an arduous burden despite the fact that the rationales for the burden's use are nonexistent.[3]

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.

Industry Response: Nexus begins once the taxpayer has established a physical presence in the jurisdiction. Nexus is terminated once the taxpayer ceases to have a physical presence in the taxing state. Any notion that nexus will continue and relate back to an earlier date is without support and it would be administratably impossible to link a sale to an earlier nexus. Further, the use of a 1 year presumption is arbitrary and capricous and deprives taxpayers of their constitutional rights.

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.)

Industry Response: The discussion of an audit nexus standard is beyond the scope of determining the US Constitutional boundaries of a state's ability to tax. Any discussion of audit nexus should be removed from this Guideline.

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
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
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.
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

Also, it is interesting to note that the creation of the clear and cogent evidence standard is somewhat mysterious. The Supreme Court in *Butler Brothers v. Franchise Tax Commission*, 315 U.S. 501 (1942) cited *Norfolk & Western Ry. Co. v. North Carolina*, 297 U.S. 682, 688 (1936) as support for the clear and cogent evidentiary burden. The *Norfolk & Western* Court, in turn, cites *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113, 121 (1920) as its support for the clear and cogent evidentiary burden. However, the *Underwood* Court does not mention a clear and cogent evidentiary burden. Rather, the *Underwood* Court held that the taxpayer must show that "its net income is not reasonably attributable" to the taxing state and did not indicate the standard the taxpayer must fulfill in making its showing. *Id.* at 121.

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.

Industry Response: As stated above, "lease" and "license" are separate and distinct concepts that relate to different types of property. This definition of "lease" is overly broad.

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.

Industry Response: The definition of "regular" should include some level of frequency.

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.

Industry Response: Third party representatives can create nexus only if their activities involve continuous and systematic sales related activities. Therefore, the language above regarding "conducts business or provides services" must be deleted. In addition, the language regarding the use of sub-representatives should be eliminated because the use, and activities, of subcontractors typically is outside of the control of the taxpayer.

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. 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.

Industry Response: Part (ii) of the definition is problematic. At the time a business is collecting information about a potential market, the business typically does not know if these information gathering activities will further the creation of an in-state market. In short, this provision will require tax professionals to speculate regarding the future consequences and conclusions of the taxpayer's information gathering activities. Industry feels that from a legal, practical and policy perspective such information gathering should not be considered nexus creating. These activities will often be de minimis. It is difficult to gauge the relevance and importance of these activities. Finally, states should consider encouraging out-of-state businesses to enter their marketplace.

Further, the examples provided in footnote 2 in the definition contain items that do not relate to establishing and maintaining a market. For instance, those activities described as produce fulfillment activities, fall outside the scope of establishing and maintaining a market.

Also, the Guidelines' definition includes the word "significantly" but the use of the term does not require significant association.

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.

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.

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_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.
_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.

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