



Multistate Tax Commission

States Working Together Since 1967 ... To Preserve Federalism and Tax Fairness

June 26, 1997

TO: Participants in the Public Participation Working Group for the Constitutional Nexus Guideline for Application of a State's Sales and Use Tax to an Out-of-State Business

FROM: Paull Mines, General Counsel
Multistate Tax Commission

RE: Deleted materials on taxpayer relationships with intangibles and electronic commerce

Pursuant to the express request of the Public Participation Working Group, I am attaching excerpts from an earlier version of the nexus guideline that were deleted from the version now under study as the *first phase* guideline. These items were deleted from the current version to allow for consideration of the principles reflected in the items at a time subsequent to the development of the first phase nexus guideline. I understand that the Public Participation Working Group desires access to these items now to determine what, if anything, should be done to consider the issues raised by these items. The deleted items that are underscored with a wavy line are placed in context to allow you to understand their effect.

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.

* * *

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:

* * *

4. has any interest in, or a right to use, intangible property that has a **business situs** in the taxing State; or

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 **in-state persons** of State 1. Corporation A licenses a trademark or service mark, franchise, or patent, copyright, or other protected intellectual property right, such as know-how, trade secrets or the like, that authorizes the commercial exploitation of the intangible property within the State 1. Corporation A has a presence in State 1. The licensed intangible has a business situs in State 1.

*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 **in-state persons** of State 1. Corporation A licenses a celebrity endorsement that authorizes commercial exploitation of the celebrity endorsement within the taxing State. Corporation A has a presence in State 1. The licensing of the right to use the celebrity endorsement establishes a business situs for that right in State 1.*

*Example 3: Corporation A is an **out-of-state business** with respect to State 1. Corporation A licenses to **in-state persons** in State 1 the use of a database, e.g., demographic information allowing the development of a list of potential customers of the licensees. Corporation A is paid for each name derived from the database. Corporation A has a presence in State 1. The licensing of a database that is used in State 1 to develop a list of potential customers and whose use results in compensation being paid to Corporation A establishes a business situs for the database in State 1.*

*Example 4: Corporation A is an **out-of-state business** with respect to State 1. Corporation A grants an **in-state person** the right to broadcast programming owned, produced or licensed by Corporation A within the taxing State. Corporation A has a presence in State 1. The programming has a business situs in State 1.*

*Example 5: Corporation A is an **out-of-state business** with respect to State 1. Corporation A posts security in the form of intangible assets pledged to an **in-state person**, e.g., a surety company, that discharges an obligation imposed on the **out-of-state business** by law or contract as a condition for conducting business with respect to the taxing State. Corporation A has a presence in State 1.*

* * *

6. retains a **representative** or **representatives** who are not described in paragraph 5 but who own, **lease**, use or **maintain** an office or other establishment 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 2: Corporation A is an **out-of-state business** with respect to State 1 to which Corporation nonetheless directs business through a World-Wide Web page. Corporation A hires Corporation B, an Internet "cybermall" service that is not an **in-state person** of State 1 for purposes of linking Corporation A's World-Wide Web page on a host computer located in State 1 whose use Corporation B licenses. Corporation A has presence in State 1. The host computer used in State 1 by the "cybermall" service provider is used to represent the **out-of-***

state business. Corporation A, in its establishment and maintenance of a market in State 1.

7. retains a **representative** or **representatives** who are not described in paragraph 5 but who have any interest in, or a right to use, intangible property that has a business situs in the taxing State and the intangible property is used in the representation of the **out-of-state business** in the taxing State; or

Example 1: Corporation B, the developer of an Internet World-Wide Web "browser" program, that is an **out-of-state business** with respect to State 1, licenses "client" software to users in State 1. These users install the client software on their computers in State 1. Corporation B also licenses to Corporation A, which also is an **out-of-state person** with respect to State 1, a compatible "Internet Server" program that Corporation A installs on its computer system. The server program allows the users of the client software in State 1 to make secure on-line purchases over the Internet from Corporation A. Corporation A has a presence in State 1. The presence of Corporation B's intangible property in State 1 is significantly associated with Corporation A's ability to establish and maintain a market in State 1.

* * *

9. either on its own or through a **representative** or **representatives**, performs or renders services in the taxing State.

* * *

Example 2: Corporation A is an **out-of-state business** with respect to State 1. Corporation A sells computers to in-state persons in State 1. Corporation A hires an unaffiliated firm that is not an **in-state person** as an independent contractor to provide technical support for purchasers of the computers. Among other things, the technicians can operate the computers of the purchasers remotely on a real time basis to perform diagnostics and effect fixes to problems. Corporation A has presence in State 1. The firm providing remote technical support to purchasers in State 1 is providing a service in State 1, because the services are not completely performed until the services on behalf of Corporation A are delivered in State 1.

* * *

- F. *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. **"Business Situs."** The term "business situs" means the location at which

Memorandum to Participants in Public Participation Working Group

Re: Deleted materials on taxpayer relationships with
intangibles and electronic commerce

June 26, 1997

Page 4

- a. intangible property has become an integral part of a business being conducted at that location, *provided* the intangible property must be commercially exploited at the location by the **out-of-state business** or by another person to whom the **out-of-state business**, while retaining an interest in the intangible property, has granted a right to exploit the intangible property in order for the intangible property to be an integral part of the business; or
- b. intangible property been deposited or pledged with an **in-state person** for purposes of discharging a legal or contractual obligation that is a condition to the **out-of-state business** conducting business within respect to the taxing State.

wrd\ppwgsund.doc
06/97