



MULTISTATE TAX COMMISSION

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Maximizing the synergies of multi-state tax cooperation

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Director's Update on Nexus Law Developments since July 25, 2016

Cases

Alabama

Alabama enacted legislation effective October 1, 2015, the Simplified Sellers Use Tax Remittance Act, permitting remote retailers collecting Alabama use tax to qualify for a program allowing them to collect a flat 8% combined state and local use tax rate on their remote sales to Alabama customers. In return, those remote retailers can retain a 2% vendor discount from remitted proceeds, and will be subject only to state-level audits. The Alabama Department of Revenue also published its Rule 801-6-2-.90.03 last fall stating that remote retailers must commence collecting Alabama use tax on remote retail sales to Alabama customers if the remote retailer has at least \$250,000/yr. in remote sales to Alabama customers. In May, 2016, the Alabama Department of Revenue issued use tax assessments against some large remote retailers, and in June, 2016, Newegg has filed an appeal with the Alabama Tax Tribunal of the use tax assessment it received, seeking a determination that the rule and assessment is unconstitutional. (see *State Tax Today*, 6/15/2016, 6/21/2016). The Department reported that as of September 28, 56 remote retailers had voluntarily started collecting use tax on remote sales to Alabama customers, and the Department believes it is getting tax on 80% of online sales. See "Newegg Dispute over Alabama Online Sales Tax Diverts Appeals," by Jennifer McLoughlin, *BNA Bloomberg Daily Tax Report*, 9/29/2016. Joe Garrett, Deputy Commissioner of Alabama Department of Revenue, addressed the MTC Nexus School participants in Montgomery on November 30 that 75 remote retailers had voluntarily registered to start collecting use tax under the simplified system, with \$5.77 million in use tax collected from those volunteers to date. Joe also indicated that the pending litigation was currently dealing with discovery issues.

Amazon.com voluntarily agreed to start collecting use tax on remote sales to Alabama customers, as of November 1, 2016. See "Amazon Begins Collecting Sales Tax for Alabama Orders," by Chris Marr, *Bloomberg BNA Daily Tax Report* (11/4/2016).

Colorado

Direct Marketing Association v. Brohl

On August 29, 2016, Direct Marketing Association (“DMA”) filed a petition for certiorari with the U.S. Supreme Court concerning the Tenth Circuit’s ruling earlier this year (following the U.S. Supreme Court opinion holding that the Tax Injunction Act did not bar DMA’s lawsuit) upholding the Colorado notice and reporting statute against DMA’s Commerce Clause challenge and determining that *Quill* did not apply. DMA argued that the Tenth Circuit’s Commerce Clause analysis was faulty, in that the reporting obligations in the Colorado statute discriminated on its face against out-of-state retailers. Encouraged by Justice Kennedy’s concurring opinion criticizing *Quill* and inviting a challenge to it, Colorado filed a conditional cross petition, requesting that the Court re-examine the *Quill* decision, if it grants DMA’s petition. Amicus curiae briefs have been filed in support of Colorado’s position by a group of law professors, the MTC, and several states (drafted by Alabama). COST and others have filed amicus curiae briefs supporting DMA’s position. The Court is scheduled to conference the pending petitions and cross petitions on December 9, 2016. Professor Richard Pomp recently suggested that states may want to consider marginalizing *Quill*, rather than seeking a complete overturn of the decision, commenting, “does the state want to overrule *Quill* and then motivate this Congress to act?” See “DMA Imperfect Vehicle for *Quill* Reversal, Panelists Say,” by Stephanie Cumings, Tax Analysts State Tax Today (12/9/2016).

Florida

In *American Business USA Corp v. Florida Department of Revenue*, the Florida Supreme Court recently upheld under Commerce Clause nexus the Florida “origin-sourced” sales tax imposed on a florist taking internet orders for flowers in Florida that are delivered out of state. The florist has petitioned for certiorari to the U.S. Supreme Court, arguing that under *Quill*, Commerce Clause nexus should not exist in that situation. Some have raised the question, if the Court were to take the case, does this present it an opportunity to overrule *Quill*? See “New Frontier Opening in States’ Fight Over E-Retailer Sales Tax,” by Chris Marr, Bloomberg BNA Weekly State Tax Report (12/1/16).

Illinois

In *Arris Aviation and Marine, Inc. v. Beard*, 2016 IL App. (1st) 152834-U, the Illinois Appellate Court reversed summary judgment for Arris Aviation and Marine, Inc. (“Arris”), and remanded, for Arris’s failure to exhaust administrative remedies. Arris, a Florida business, had purchased a motor vehicle from an Illinois dealer, through local agent, and claimed a sales/use tax exemption as an out-of-state resident. The Illinois dealer did not collect use tax. Later, the Illinois Department of Revenue questioned whether the transaction qualified for the exemption and requested documentation from Arris. Arris refused to provide the requested documents and responded that because Arris had no nexus with Illinois, the Department had no basis to

request the documents. The Department initiated an audit of the transaction. Arris filed a declaratory action in Illinois district court, seeking a determination that the audit was void, due to lack of nexus, and an injunction. The Department thereafter issued its assessment. After the district court granted the motion and enjoined the assessment, the Illinois Appellate Court reversed, noting that Arris had a full and complete remedy through the Department's administrative appeals process, which it was required to follow before seeking equitable relief.

Ohio

On November 17, 2016, the Ohio Supreme Court handed down its long-awaited decision in: *Crutchfield Corp. v. Testa*, *Newegg Inc. v. Testa*, and *Mason Cos. Inc. v. Testa*, holding constitutional under the Commerce Clause and *Complete Auto* "substantial nexus" prong the factor presence/economic presence nexus provisions (based on the MTC factor presence nexus model provisions: Ohio gross receipts from sales over \$500,000/yr. creates nexus) of the Ohio commercial activity tax (CAT, a "gross receipts" tax). The taxpayers (all remote retailers with no physical presence or representatives in Ohio) contended that a physical presence nexus standard must apply to the CAT for it to be constitutional, even if that physical presence was manifested by activities of independent contractors or other representatives. The court disagreed. The state also contended that physical presence nexus existed in the form of "cookies" installed by the remote seller on its Ohio customer's computers or smart phones, but the court did not address that argument. This is the first state supreme court decision upholding under Commerce Clause analysis a statutory "sales" factor presence/economic presence nexus standard. If the taxpayers should petition for certiorari to the U.S. Supreme Court, some have argued that this could give Ohio the opportunity to cross-petition on the issue of the continuing validity of *Quill* (similar to Colorado's cross petition in *DMA v. Brohl*). See Chris Marr, Bloomberg BNA Weekly State Tax Report (12/1/16).

South Dakota

South Dakota enacted SB 106, signed by the governor on March 22, 2016, providing that remote retailers with no physical presence in the state and sales to South Dakota customers exceeding \$100,000/yr. or 200 transactions/yr. are required to commence registration, collecting, reporting and remitting South Dakota use tax on remote retail sales to South Dakota customers. The act is based on model language developed and promoted by the NCSL. The act itself contains a self-imposed injunction against enforcement until the courts have validated it. Two declaratory judgment actions concerning the act's constitutionality are pending : the first filed April 28 by South Dakota Revenue Department against 4 prominent online retailers: Wayfair Inc., Systemax Inc., Overstock.com Inc., and Newegg Inc., seeking a declaration of constitutionality; the second filed April 29 by American Catalog Mailers Association and Netchoice against the Secretary of the South Dakota Revenue Department,

seeking a declaration of unconstitutionality. The defendants in the first case have sought removal of the action to federal district court on May 25 (see BNA Daily Tax Report, 6/2/2016), and are in the process of seeking summary judgment on the constitutionality issue. South Dakota is seeking remand of the action back to state court. (see BNA Daily Tax Report, 6/23/2016) (see also “South Dakota Agrees State Online Sales Tax Law Violates Federal Law, Wants Quill Challenge,” by Maria Koklanaris, Tax Analysts Document Service, Doc 2016-16657). The U.S. District Court for South Dakota has scheduled oral argument for December 8, 2016 on the taxpayers’ motion for summary judgment in *Wayfair Inc.* that S.B. 106 is unconstitutional, and South Dakota’s motion to remand the case to state court for lack of jurisdiction. See “Federal Court to Dissect South Dakota Online Tax Dispute,” by Jennifer McLoughlin, Bloomberg BNA Weekly State Tax Report (11/30/2016).

South Dakota has contacted the larger online retailers it is aware of to notify them of their potential obligation to register to collect South Dakota use tax. Some of them have voluntarily registered and begun collecting South Dakota use tax.

Washington

In *Avet, Inc. v. Washington Department of Revenue*, No. 92080-0, 2016 BL 391123 (Wash. Nov. 23, 2016), the Washington Supreme Court affirmed the Court of Appeals decision upholding the Department’s assessment of B&O tax against Avet, Inc., an out-of-state distributor of electronic components (with an in-state sales office at Redmond), determining that B&O tax transactional nexus existed for its “national sales” and drop shipments. National sales are delivered to a Washington facility owned by Avnet's customer, even though the customer placed the order from an office outside Washington. Drop-shipped sales are slightly different in that they are delivered to a third party in Washington at the request of Avnet's customer—usually Avnet's buyer's customer. Avnet argued that the Washington office sales staff had no involvement in the national sales or drop shipments, so transactional nexus did not exist. The court disagreed. Although the Redmond office was not involved in the specific national and drop-shipped sales at issue, its presence and business activities in Washington was extensive. Of the over 40 employees, 16 to 18 were account managers who managed customer account portfolios that were each estimated to generate \$ 4 million in annual sales revenue. The Redmond branch also employed sales and marketing representatives, engineers, and technology consultants. Avnet's Washington employees were instrumental in marketing and selling products, establishing and improving customer relations, providing design services to help with the development of new products, and offering technical and engineering support to its Washington customers.

In *Irwin Naturals v. Washington Department of Revenue*, Washington Court of Appeals, No. 73966-2-1, 382 P.3d 689 (July 25, 2016), an out-of-state

wholesaler and retailer of nutritional supplements contested a Washington B&O tax assessment on its wholesale and retail sales receipts, and also assessed sales tax on its retail sales. The taxpayer's staff spent considerable time in Washington developing and promoting its relationships with retailers selling its products. The taxpayer made retail sales of new products through infomercials, and as those products gained footing, then offered those same products to its established retail store customers. On appeal, the taxpayer contended that its retail sales and wholesale sales operated on separate channels, so any activities conducted in the state concerning its wholesale sales should not be attributed to its retail sales, for nexus purposes. The Department contended that under *National Geographic*, once substantial nexus existed for purposes of the taxpayer's wholesale activities, it would apply to all of its sales to Washington customers, and the retail and wholesale business cannot be dissociated. The taxpayer argued that *Quill* invalidated *National Geographic* on that issue. The Court of Appeals disagreed, relying on *Tyler Pipe* in finding that a symbiotic relationship existed between the taxpayer's retail and wholesale sales activities in the state, the wholesale sales activities were creating a market for the retail sales. The court upheld the assessments.

Regulations and Rulings

Arizona

Arizona Department of Revenue issued Transaction Privilege Tax Ruling ("TPR") 16-3 in September 20, 2016 to address the following issue:

Is a business with Arizona nexus for transaction privilege tax ("TPT") purposes that operates an online marketplace through which third-party merchants sell tangible personal property at retail (hereinafter "online marketplace"), a "retailer" making "sales" on behalf of third-party merchants and therefore, responsible for the retail TPT on sales to Arizona customers?

The Department ruled:

A business that operates an online marketplace and makes online sales on behalf of third party merchants as evidenced by the marketplace providing a primary contact point for customer service, processing payments on behalf of the merchant and providing or controlling the fulfillment process, is a retailer conducting taxable sales. The gross receipts of that marketplace business derived from the sales of tangible personal property to Arizona purchasers are subject to retail TPT, provided that the business already has nexus for Arizona TPT purposes.

Arizona has also recently published TPR 16-1, which provides general nexus guidance for its transaction privilege tax.

California

In Chief Counsel Ruling 2016-03 (07/05/2016), the California Franchise Tax Board ruled that in determining whether the taxpayer met the "doing business"

economic nexus threshold under Section 23101(b)(2) (\$529,562 in California sales in the tax year at issue) for franchise tax and income tax, the taxpayer must aggregate the proceeds from sales of TPP with royalties received. Also, the taxpayer was not required to throwback sales of TTP from states where it met the “doing business” standard under Section 2301(b)(2). The taxpayer’s activities in licensing a third-party licensee to use the taxpayer’s trademarks and receiving royalties exceeded the protections afforded under P.L. 86-272. The taxpayer, a designer and distributor of its products, marketed them under famous brand names, and sold its products through store retailers and online retailers. The taxpayer also licensed the use of its trademarks to an unrelated third-party, receiving royalty payments based on a percentage of sales. The taxpayer retained control over use of the licensed trademarks and quality of the goods sold under the license. The taxpayer and the licensee adopted a joint marketing plan, and taxpayer approved the advertising and what stores could sell the goods.

California Franchise Tax Board recently adjusted its “factor presence nexus” thresholds for “doing business” for franchise tax and income tax purposes, effective for tax years beginning on or after 1/1/16: \$54,771 in property, \$54,771 in payroll, or \$547,711 in sales.

D.C.

Amazon.com is now collecting use tax on remote sales to D.C. customers. See “Amazon Will Collect Sales Tax in D.C. Starting October 1,” by Maria Koklanaris, Tax Analysts Document Service, Doc 2016-19179.

D.C. is adopting the MTC’s market based sourcing model regulations for service and intangibles income. See “District of Columbia to adopt MTC’s market-based sourcing regs,” Michael Murphree, Bloomberg BNA, Weekly State Tax Report (11/18/16).

Idaho

Idaho and Airbnb have reached agreement for Airbnb to collect applicable sales and hotel taxes on short-term home rentals by Airbnb hosts, effective December 1, 2016. See “Sales and Use Tax: Airbnb Agrees to Collect Taxes for Idaho Hosts,” CCH State Tax Daily (11/22/2016).

Indiana

In Ruling 2016-07ST (11/4/2016), Indiana Department of Revenue ruled that when a company operating an online “marketplace” for third-party vendors of software, games, apps, movies, books and other digitized products, enters into agreements with such third-party vendors to provide those products to customers via the online marketplace and collect payment and sales tax from the customer for such products, then the third-party vendors should not also charge sales tax on those same transactions.

Montana

In September 2016, Montana Department of Revenue filed amendments to regulations concerning the method for calculating pass-through entity owners' income tax liability on Montana-source income received from pass-through entities.

Nevada

Nevada Department of Revenue adopted regulations R137-15 effective November 2, 2016 describing when use tax nexus exists for remote retailers, including its click-thru/affiliate nexus provisions.

R 123-15, published this summer, provides regulations implementing Nevada's new gross receipts tax and includes at Section 17 a comprehensive description of activities considered "doing business in the state" for purposes of nexus.

North Carolina

In October, 2016, North Carolina published extensive new market-based sourcing regulations for income from services and intangibles.

Ohio

Ohio Department of Revenue published comprehensive guidance on use tax nexus in August 2016 in its Use Tax Information Release ST-2001-01.

Rhode Island

Rhode Island Division of Taxation has adopted comprehensive corporate income tax nexus regulations at R.I. CT 15-02, setting forth its standard for economic nexus.

South Carolina

South Carolina Department of Revenue published SC Ruling # 16-11 dated July 27, 2016, setting forth circumstances creating income tax nexus, closely modeled on its response to the 2016 Bloomberg BNA Survey of State Tax Departments.

Tennessee

Tennessee Department of Revenue earlier this year proposed Regulations 1320-05-01-.63 and 1320-05-01-.129, requiring remote retailers to collect sales/use tax on remote sales to Tennessee customers if their annual gross sales exceeded \$500,000. The proposed regulations are scheduled to be voted on by a House legislative committee on December 14 or 15, and will also be voted on by a Senate legislative committee. The regulations could be rejected by the committees, voted forward for consideration by the legislature without recommendation, or voted forward with a positive recommendation.

Representative Jeremy Faison, chair of the House committee, would not predict how the committee might act. See "Tennessee Legislative Committees Could

Squash DOR Rule Challenging Quill,” by Eric Yauch, State Tax Notes, 12/5/2016.

Utah

A nonresident 100% owner of a business owed Utah personal income tax on income paid by a Utah-registered LLC to the business, which was a member of the LLC, even though the business was incorporated out-of-state. The taxpayer argued that the income paid by the LLC was attributable to services rendered largely to out-of-state customers. However, the records for the business and LLC indicated they had Utah addresses. Commissioner Decision 13-223 (7/6/2016). See CCH State Tax Review (11/23/3016).

Virginia

The Department of Taxation issued P.D. 16-184, ruling that income tax nexus does not exist for an irrevocable trust established by Virginia resident decedent, in that neither trustee nor beneficiary resided in Virginia, trust assets consisted of cash and securities managed by an out-of-state brokerage firm, although trust advisor was located in Virginia.

In Virginia Department of Taxation Ruling P.D. 16-135, taxpayer is an out-of-state LLC in partnership with a software developer located in Virginia. The taxpayer licenses canned software from the software developer, modifies it for its customers' needs, and resells the modified software to its clients. The taxpayer purchases license agreements for the software developer's software through a reseller for the software developer. All of these transactions occur through cloud computing services. The software and data are hosted on servers in the Developer's data centers, one located in Virginia. The taxpayer has access to the data center, but no access to or control over any server. The taxpayer has no employees in Virginia but has a client in Virginia. The taxpayer requested a ruling on whether the taxpayer would be subject to Virginia corporate income tax. The Ruling stated if the taxpayer has a positive Virginia sales, payroll or property factor, then it would be subject to the corporate income tax. If the software developer meets the definition of an independent contractor in P.L. 86-272, then the taxpayer is merely purchasing cloud computer services from the software developer, and those would not be attributed to the taxpayer for nexus purposes. However, if any of the contractual arrangements between the software developer and the taxpayer involve the renting by the taxpayer of servers in Virginia, this would give the taxpayer a positive property factor and subject it to Virginia corporate income tax. The Ruling further stated that lack of physical access to servers does not preclude their inclusion in the property factor (citing P.D. 12-36). As to the sales factor, the Ruling stated that Virginia follows the "cost of performance" rule for sourcing service income, so that would need to be applied to the sales to the Virginia client to determine whether the taxpayer had a positive sales factor in this situation.

In Virginia Department of Taxation Ruling P.D. 16-203, taxpayer, an out-of-state business, enters into rent-to-own lease contracts for portable buildings with customers in several states. These contracts are sold to investors. Taxpayer manages the contracts, collecting and depositing payments, sales and use tax, and issuing certificates of ownership. Taxpayer will be leasing out such buildings to customers in Virginia, and requested to register as a “dealer” on behalf of the investors. The Department determined that ownership of the buildings would give the taxpayer nexus, and taxpayer should register to collect Virginia taxes on the transactions.

Washington

Washington Department of Revenue Determination No. 15-0031 (5/29/16)
Out-of-state manufacturer and seller of bedding products made three types of sales to Washington customers: (1) wholesale sales of “private label” products to large retailers under their labels; (2) wholesale sales of “licensed” products to other retailers; and (3) internet retail sales to customers. The taxpayer had two representatives, one an employee and the other an independent contractor, each making two to four visits a year to Washington wholesale customers. One of the representatives occasionally accepted sales orders on these visits. The Department assessed the taxpayer for B&O tax. The taxpayer contended that the representatives’ visits were limited, so sufficient nexus did not exist. The taxpayer also argued that the sales representatives’ activities as to the wholesale customers did not help establish or maintain a market for the internet retail sales customers. The Department determined that B&O tax nexus existed for all of the taxpayer’s sales into state: both the wholesale and internet retail sales.

In Determination No. 15-0340 (9/30/2016), the Washington Department of Revenue ruled: An out-of-state limited liability company has established substantial nexus for Washington B&O tax with Washington State by employing a resident broker selling Taxpayer’s gluten-free bread products to Washington distributors. The broker’s sales activities in Washington as to distributors were significantly associated with Taxpayer’s ability to establish or maintain a market for Taxpayer’s products to its online retail customers in Washington. P.L. 86-272 did not protect the Taxpayer, because it is inapplicable to the B&O tax.

Airbnb and Washington have entered into an agreement for Airbnb to collect, report and remit sales tax and hotel taxes on behalf of its hosts, effective 10/1/2016. Hosts are responsible for reporting and remitting Washington B&O tax on their gross receipts. See “Airbnb Collecting Tax,” CCH State Tax Day (12/9/2016).

Statutory enactments

Oregon

Oregon voters voted down a ballot initiative for a new gross receipts tax, supported by the public unions in the state. See Oregon Votes Down Gross Receipts Tax measure,” by Paul Shukovsky, Bloomberg BNA Daily Tax Report, 11/9/2016.

Utah

Senator Bramble of Utah reported to the Streamlined Sales Tax Governing Board at its October meeting that it is also contemplating legislation challenging *Quill*, similar to South Dakota’s.

Wyoming

Bloomberg BNA reports that the Wyoming Legislature is now interested in pursuing legislation challenging *Quill*, to be considered during the 2017 session. “Internet Sales Tax Advancing in Wyoming,” by Tripp Baltz, 9/26/2016.

Federal Legislation

Congressman Jim Sensenbrenner of Wisconsin introduced H.R. 5893, the No Regulation without Representation Act, which has been referred to House Judiciary Committee. He is a member. The bill has an effective date of January 1, 2017, and would codify the *Quill* physical presence requirement for states to impose any use tax collection, reporting and remittance requirements on remote retailers. In addition, it would nullify state legislation imposing affiliate or click-thru nexus, marketplace provider or Colorado-style reporting provisions. The bill also gives federal courts original jurisdiction to enforce its provisions.

The Marketplace Fairness Act, S. 698 (which passed the Senate in 2013) and the Remote Transactions Parity Act, H.R. 2775, remain pending, and little activity has occurred since their introduction in 2015-16 session.

These will need to be re-introduced in the next Congress.

House Judiciary Chair Bob Goodlatte released a draft of his Online Sales Simplification Act (as of yet not introduced) on August 25, 2016, proposing hybrid-origin sourcing. MTC staff recently has published a memorandum analyzing the proposal on the MTC website. See “Online Tax Bills Still in Limbo Despite New Goodlatte Draft,” by Jennifer McLoughlin, Bloomberg BNA Weekly State Tax Report (8/26/2016).

Neal Osten on November 18, 2016 commented to the NCSL Executive Committee Task Force on State and Local Taxes that he saw a news clip indicating that President-elect Trump “was going after Amazon for not collecting online sales taxes, and he thought that was unfair for states not

getting their revenue and for businesses that were collecting sales taxes.” See “Trump May Back States on Remote Sellers: NCSL Official,” by David McAfee, Bloomberg BNA Daily Tax Report (11/21/2016). If the report is accurate, that could potentially boost the effort for federal remote seller legislation next year.

On December 6, 2016, several conservative groups on tax policy, including Americans for Prosperity, Grover Norquist, and others, signed a letter to Congress urging that federal remote seller legislation not be considered during the now just-concluded lame duck session. See “Conservative Policy Groups Urge Congress Not to Act on Internet Sales Tax Legislation,” Tax Analysts State Tax Today (12/9/2016).

Streamlined Sales and Use Tax Agreement

Craig Johnson, Executive Director of the SST Governing Board, stated to the NCSL Executive Committee Task Force on State and Local Taxes at the November 18 meeting that the Mississippi governor expressed interest in pursuing collection from online retailers, and Missouri and Idaho had recently introduced legislation along those lines, so there may be interest in those states joining the Agreement. See “Streamlined Sales Tax Agreement Seeking More States,” by David McAfee, Bloomberg BNA Daily Tax Report (11/21/2016).

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