

Dissociation – A Valid Transactional Nexus Argument?

by Richard L. Cram



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In this article, Cram argues that while taxpayers may still cite the dissociation concept established in two U.S. Supreme Court cases — *Dilworth* and *Norton* — in transactional nexus litigation, it has no

precedential value given the substantial evolution of nexus law since the 1950s.

Taxpayers in three recent state tax cases — *Avnet Inc. v. Washington Department of Revenue*,¹ *Crutchfield Corp. v. for Testa*,² and *Florida Department of Revenue v. American Business USA Corp.*³ — unsuccessfully argued lack of “transactional nexus,” relying on the concept of “dissociation” applied in *McLeod v. J.E. Dilworth*⁴ and *Norton Co. v. Illinois Department of Revenue*.⁵ Taxpayers contended that since neither *Dilworth* nor *Norton* has been expressly overruled, both decisions are still valid precedent.

The U.S. Supreme Court has acknowledged that earlier but not expressly overruled decisions construing state tax authority may “no longer

fully represent the present state of the law.”⁶ Is the dissociation concept valid as a transactional nexus argument?

The dissociation concept rested on the assumption that sales in interstate commerce were immune from state taxation. Even if the out-of-state seller was otherwise subject to jurisdiction by conducting activities in the state, those sales remained tax-free if the seller could show that its in-state activities were dissociated — that is, not connected with them. If the seller could not make such a showing, then those sales lost their interstate commerce status and became local sales subject to state taxation. Taxpayers recently used the dissociation concept to make a transactional nexus argument, generally to the effect that the out-of-state seller (or representative) must carry on in-state activities (that is, maintain a physical presence) and, even when that exists, the state cannot tax the seller's interstate sales unless a direct connection (nexus) exists between those transactions and the seller's in-state activities.⁷

The Court discarded the theory that interstate commerce was immune from state taxation in *Complete Auto Transit Inc. v. Brady*.⁸ Under the *Complete Auto* four-part test, a state can tax interstate commerce if the tax “[1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate

¹ 187 Wash. 2d 44, 384 P.3d 571 (2016).

² ___ N.E.3d ___, 2016 WL 6775765, 2016-Ohio-7760 (Nov. 17, 2016). Although a petition for certiorari was expected, the parties recently settled and the taxpayer has agreed to register and pay the tax. See Brian Bardwell, “Parties Settle Constitutional Challenge in Ohio Economic Nexus Case,” *State Tax Notes*, Apr. 17, 2017, p. 339.

³ 191 So.3d 906 (Fla 2016), cert. denied ___ U.S. ___, 137 S. Ct. 1067 (2017).

⁴ 322 U.S. 327 (1944), cited in *Norton Co. v. Illinois Department of Revenue*, 340 U.S. 534, 537 (1951).

⁵ 340 U.S. 534 (1951).

⁶ *Northwest States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457–458 (1959) (quoting *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344 (1954)). For a summary of the evolution of the Court's interpretation of the dormant commerce clause through *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977), applied in challenges of various types of state taxes, see *Oklahoma Tax Commission v. Jefferson Lines Inc.*, 514 U.S. 175, 179–83 (1995).

⁷ 187 Wash. 2d at 54, 384 P.3d at 576–577; and 2016-Ohio-7760, paras. 1, 14, 30–31.

⁸ 430 U.S. 274, 288–289 (1977), overruling *Spector Motor Service Inc. v. O'Connor*, 340 U.S. 602 (1951).

commerce, and [4] is fairly related to the services provided by the State.”⁹ With the Court’s rejection of the underlying assumption that interstate sales were immune from tax, the concept of dissociation lost its legal significance.¹⁰ Taxpayers’ recent attempts to revive it as a transactional nexus argument have fallen short.

Dilworth and *Norton*, undermined by other decisions, provide the backdrop for the dissociation concept. The recent *Avnet*, *Crutchfield*, and *American Business USA Corp.* courts correctly disposed of taxpayers’ transactional nexus arguments based on the dissociation concept.

***Dilworth* (1944)**

In *Dilworth*, the Tennessee sellers — who had no facilities in Arkansas — received orders by telephone and mail, and from traveling salesmen soliciting in Arkansas. The sellers accepted the orders and received payment in Tennessee, and shipped product from Tennessee FOB to Arkansas purchasers, with title passing to the purchaser on delivery to the carrier in Tennessee. The Arkansas revenue commissioner filed suit against the sellers, alleging they were liable for Arkansas gross receipts tax on their sales to Arkansas purchasers. The sellers objected. The Arkansas Supreme Court affirmed the lower court’s dismissal, determining that the Arkansas tax was a sales tax, not a use tax, and that because the sales were consummated in Tennessee or in interstate commerce, they were beyond

Arkansas’ taxing power.¹¹ The U.S. Supreme Court agreed in a 6-3 decision, stating: “For Arkansas to impose a tax on such transactions would be . . . to tax an interstate transaction.”¹² The Court added: “The very purpose of the Commerce Clause was to create an area of free trade among the several States.”¹³

The *Dilworth* Court considered interstate transactions to be off-limits to state taxation.¹⁴ If the out-of-state seller’s only activity in the taxing state was solicitation by traveling salesmen, the orders were accepted out-of-state, and the product was shipped from out of state to the customer, then the transaction was considered to be “in interstate commerce” — hence immune from taxation.¹⁵ The Court left open the possibility that the Arkansas tax might have been upheld were it a use tax instead of a sales tax. That is because use tax would apply to use in the state after the sale, an activity that has lost its interstate character.¹⁶

The dissent reflected the contrasting view that states could require interstate commerce to bear its fair share of the tax burden. Justice William O. Douglas saw the distinction between a sales tax and a use tax as irrelevant for commerce clause purposes, calling the effect of a sales tax and a use tax on interstate commerce “identical.”¹⁷ He said that “receipt of goods within the State of the buyer is as adequate a basis for the exercise of the taxing power as use within the State.”¹⁸ Douglas identified the inconsistency between the majority opinion and the earlier decisions that upheld applying the sales tax against out-of-state sellers delivering

⁹ *Id.* at 279.

¹⁰ Speaking at the 2017 American Bar Association/Institute for Professionals in Taxation Advanced Sales Tax Seminar on March 21, 2017, in New Orleans, professor Richard Pomp of the University of Connecticut responded to the question listed on the agenda “Dissociation — Is *Norton* Still Good Law?” with a resounding no. He pointed out that the *Norton* decision was based on the rejected theory that business in interstate commerce should enjoy immunity from state taxation. He emphasized that the Illinois gross receipts tax imposition statute at issue in *Norton* included an obsolete statutory exemption for “business in interstate commerce.” See *Norton*, 340 U.S. at 535.

Professor John Swain likewise considers *Norton* as obsolete for its reliance on the theory of interstate commerce tax immunity. According to Swain, it also made an outdated distinction between an impermissible direct tax on interstate commerce — such as a gross receipts tax imposed on an out-of-state seller, vs. an indirect tax, such as a use tax collection obligation imposed on an out-of-state seller soliciting sales through traveling salesmen. See John A. Swain, “The Zombie Precedent: *Norton Co. v. Department of Revenue*,” *State Tax Notes*, Apr. 17, 2017, p. 301.

¹¹ 205 Ark. 780, 171 S.W.2d 62 (1943).

¹² 322 U.S. at 330.

¹³ *Id.* at 331.

¹⁴ See *supra* note 12.

¹⁵ *Id.* at 330-331.

¹⁶ *Id.* U.S. at 331. See *General Trading Co. v. Tax Commission of Iowa*, 322 U.S. 335, 336-340 (1944), a contemporaneous decision, upholding Iowa’s use tax collection duty on a retailer accepting orders out-of-state and shipping products to customers in Iowa from out of state when it had no physical presence in Iowa, except for traveling salesmen soliciting orders. See also *McGoldrick v. Berwind-White Co.*, 309 U.S. 33 (1940) in which New York City’s sales tax imposition was upheld on an out-of-state seller of coal (with an office in the city) delivering to customers in the city.

¹⁷ *Id.* at 332-333 (Douglas, J., dissenting).

¹⁸ *Id.* at 334.

their products to customers in the taxing jurisdiction.¹⁹

Norton (1951)

Norton Co., a Massachusetts manufacturer, sold abrasives and supplies from its headquarters in Worcester. It had authority to do business in Illinois, with a branch retail office and warehouse in Chicago. Illinois customers could place orders with either the Chicago office or the Massachusetts headquarters. Norton filled Illinois orders both from inventory in the Chicago warehouse and from products shipped from Worcester directly to the Illinois customer. Illinois imposed its occupation tax (a gross receipts tax) on retail sales, but exempted business in interstate commerce.²⁰ The Illinois Department of Revenue assessed tax on all of Norton's sales to Illinois customers, whether the orders were accepted in Chicago or Worcester, and whether they were distributed from the Chicago warehouse or shipped directly from Massachusetts to the customer. Norton agreed that it owed tax on sales from orders accepted in Illinois or when product was delivered from its Chicago warehouse, but disputed owing tax on sales from orders received and accepted at Worcester, when the product was shipped from Worcester directly to the customer. The Illinois Supreme Court upheld the DOR's assessment, determining that in view of Norton's activities at its Chicago facilities, none of its sales to Illinois customers were exempt as business in interstate commerce.²¹

In a 5-4 decision, the U.S. Supreme Court upheld the Illinois Supreme Court's determination that sales out of Norton's Chicago facilities to Illinois customers were subject to tax. But the Court held that no tax could be imposed on sales to Illinois customers when those customers had placed orders directly with the Worcester headquarters, and Norton had shipped

the products from Worcester directly to them.²² The Court focused on the question of whether Norton's sales to Illinois customers were in interstate commerce (and therefore immune from tax) under the applicable Illinois tax imposition statute and the commerce clause.²³

The Court stated the following as the *Norton* rule:

Where a corporation chooses to stay at home in all respects except to send abroad advertising or drummers to solicit orders which are sent directly to the home office for acceptance, filling, and delivery back to the buyer, it is obvious that the State of the buyer has no local grip on the seller. Unless some local incident occurs sufficient to bring the transaction within its taxing power, the vendor is not taxable.²⁴

The Court recognized that an out-of-state seller might be subject to jurisdiction through in-state activity that was not mere sales solicitation — that is, a “local incident”²⁵ by the seller has occurred. In that situation, for the seller's sales to remain immune from taxation as interstate commerce, it had the burden to show that those sales “are dissociated from [its] local business [that is, the local incident in-state activity] and interstate in nature.”²⁶

In an earlier decision, the Court characterized the local incident requirement as based on due process, along with a concern about multiple taxation.²⁷ Norton had physical presence, or local incidents, in Illinois: an office and warehouse in Chicago to service its Illinois customer base. The only issue to decide was whether Norton's Illinois

²² *Id.* at 539.

²³ *Id.* at 537.

²⁴ *Id.* [citing *Dilworth*].

²⁵ *Id.*

²⁶ *Id.* at 537.

²⁷ See *Freeman v. Hewitt*, 329 U.S. 249, 270–71 (1946) (overruled in *Complete Auto*, 430 U.S. at 288–89, as recognized in *Jefferson Lines Inc.*, 514 U.S. at 183:

Selection of a local incident for pegging the tax has two functions relevant to determination of its validity. One is to make plain that the state has sufficient factual connections with the transaction to comply with due process requirements. [footnote omitted] The other is to act as a safeguard, to some extent, against repetition of the same or a similar tax by another state. [footnote omitted]

¹⁹ *Id.* at 332, citing *McGoldrick v. Felt & Tarrant*, 309 U.S. 70 (1940) (New York City sales tax on Illinois manufacturer of adding machines upheld under commerce clause; Illinois manufacturer had office and salesmen in New York City who took orders from customers there, forwarding orders to Illinois for acceptance; product was shipped to New York office from Illinois and inspected before delivery to customer, who sent payment directly to Illinois); and *Berwind-White*, 309 U.S. at 33.

²⁰ 340 U.S. at 535.

²¹ *Id.* at 537.

activities would cause its sales from orders received and filled out of state to lose their status (and tax immunity) as interstate transactions.

Mentioning *Dilworth*, the Court observed that if Norton's activities in Illinois were limited to solicitation, then it would be entitled to "the immunity of interstate commerce."²⁸ In the context of a gross receipts tax, the out-of-state seller could apparently carry on any level of solicitation activity in the taxing state and remain immune from tax on its interstate sales.²⁹

The Court disagreed with the Illinois Supreme Court that sales from orders accepted at the Worcester headquarters and shipped from there to the Illinois customer were taxable, determining that those sales were "dissociated" and therefore immune from tax.³⁰ Under the *Norton* rule, an out-of-state seller, in addition to carrying on unlimited solicitation, could also apparently conduct any level of other activity in the taxing state, as long as the seller could show that this activity was dissociated from the interstate transactions the state was seeking to tax.³¹

Decisions before and after have undermined the *Norton* rule.³² In *General Trading Co. v. State Tax Commission of Iowa*,³³ the Court upheld Iowa's imposition of a use tax collection duty on an out-of-state seller whose only presence in the state consisted of sales solicitation activity (traveling salesmen). *Northwestern States Portland Cement Co. v. Minnesota*³⁴ upheld Minnesota's imposition of its apportioned net income tax on an out-of-state seller whose operations in the state were limited to sales solicitation; it had permanent sales staff and an office in the state. However, P.L. 86-272,³⁵

enacted in reaction to *Northwestern States Portland Cement Co.*, essentially codified the *Norton* rule — for net income tax — by prohibiting states from taxing the net income of an out-of-state seller of tangible personal property when the seller's only activity in the taxing state is sales solicitation, the order for a sale is accepted out of state, and the item is shipped from out of state.³⁶

As noted, *Complete Auto* disposed of the interstate commerce tax immunity theory underlying the *Norton* rule (overruling *Spector Motor Service Inc.*³⁷ and stating the current four-part test).³⁸ The Court in *D.H. Holmes Co. v. McNamara*³⁹ observed: "*Complete Auto* abandoned the abstract notion that interstate commerce 'itself' cannot be taxed by the States."⁴⁰

In *Quill Corp. v. North Dakota*,⁴¹ an out-of-state office equipment and supplies seller, Quill, extensively solicited sales in North Dakota by catalog, flyers, advertising, and telephone, and had significant sales there. Quill had an insignificant amount of tangible property and no employees or facilities in North Dakota. It received orders by mail and telephone and delivered product to customers in North Dakota by mail and common carrier. North Dakota sought to impose a use tax collection duty on Quill, which it challenged. Given Quill's widespread business solicitation in North Dakota, the Court overruled *National Bellas Hess Inc. v. Department of Revenue of Illinois*⁴² to the extent that it indicated that the due process clause required physical presence for imposition of a use tax collection duty.⁴³ However, the Court reaffirmed *Bellas Hess's* "bright line" physical

²⁸ *Id.* at 538 [citing *Dilworth*].

²⁹ According to Justice Stanley Forman Reed, as stated in his dissent, under the Court's rule, even sales solicited by Norton salesmen operating out of Norton's Chicago office should have been considered immune from taxation as interstate commerce. *Id.* at 540-541 (Reed, J., dissenting).

³⁰ *Id.* at 539 ("The only items that are so clearly interstate in character that the State could not reasonably attribute their proceeds to the local business are orders sent directly to Worcester by the customer and shipped directly to the customer from Worcester").

³¹ Justice Tom C. Clark (joined by Justices Douglas and Hugo Black) dissented from the majority's holding that a portion of Norton's sales were immune from Illinois tax, disagreeing that the taxpayer had met its burden to establish dissociation. *Id.* at 541 (Clark, J., dissenting).

³² See the cases in note 55.

³³ 322 U.S. 335 (1944).

³⁴ 358 U.S. 450 (1959).

³⁵ 15 U.S.C. section 381.

³⁶ As explained in his dissent in *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 238-40 (1992), Justice Harry Blackmun viewed P.L. 86-272 as the legislative response to *Northwestern States Portland Cement Co.* and three state court decisions. *Id.* at 238, citing *International Shoe Co. v. Fontenot*, 236 La. 279, 107 So.2d 640 (1958), cert. denied, 359 U.S. 984 (1959); and *Brown-Forman Distillers Corp. v. Collector of Revenue*, 234 La. 651, 101 So.2d 70 (1958), appeal dismissed, 359 U.S. 28 (1959).

³⁷ 340 U.S. 602.

³⁸ 430 U.S. 274, 288-289 (1977) ("Accordingly, we now reject the rule of *Spector Motor Service Inc. v. O'Connor*, [340 U.S. 602 (1951)] that a state tax on the 'privilege of doing business' is per se unconstitutional when it is applied to interstate commerce, and that case is overruled").

³⁹ 486 U.S. 24 (1988).

⁴⁰ *Id.* at 30-31.

⁴¹ 504 U.S. 298 (1992).

⁴² 386 U.S. 753 (1967).

⁴³ 504 U.S. at 308.

presence rule for imposing a use tax collection duty under the commerce clause substantial nexus prong of the four-part *Complete Auto* test.⁴⁴

As noted, *Norton's* local incident requirement derived from due process principles and the concern with multiple taxation.⁴⁵ *Quill's* holding that physical presence was not required for due process nexus disposed of *Norton's* local incident (that is, non-sales solicitation activities) requirement, to the extent that this requirement was based on due process principles.⁴⁶

Courts applying the *Complete Auto* test to determine the constitutionality of a tax under the commerce clause now address the multiple taxation concern under the second prong: whether the tax is fairly apportioned.⁴⁷ It is not part of substantial nexus analysis under the first prong. The second prong of the *Complete Auto* test thus makes *Norton's* local incident requirement irrelevant — to the extent that it was based on the multiple taxation concern.

Avnet (2016)

In *Avnet*, a large out-of-state distributor of electronic components with 35 offices nationwide — including one in Redmond, Washington, employing 40 sales and technical staff — had approximately \$200 million in wholesale sales to Washington, including \$80 million from national and drop-shipped sales, during the three-year audit period. For the national and out-of-state sales, orders for products were received and shipped from out of state. Avnet paid Washington's business and occupation (B&O) tax, a gross receipts tax, on its wholesale sales, except for the national and drop-shipped sales. The Washington Department of Revenue assessed Avnet for B&O tax on the national and drop-shipped

sales. Avnet challenged the assessment, claiming that under *Norton*, the national and drop-shipped sales were “dissociated” from its in-state wholesaler activities because the Redmond staff was not involved in those sales, either in handling the orders or delivering the products to customers. The Washington Court of Appeals upheld the assessment,⁴⁸ and the Washington Supreme Court affirmed it 6 to 3.⁴⁹

Avnet acknowledged that it had the burden to prove dissociation under Washington DOR Rule 193(7)(c)⁵⁰ and *Norton*. Avnet contended that Washington had to have transactional nexus regarding the sale, citing *Allied-Signal Inc. v. Director, New Jersey Division of Taxation*.⁵¹ The taxpayer's specific argument regarding *Allied-Signal* was that “states may impose a tax on interstate sales only if there is a substantial nexus between the seller's activities and the state and those activities are significantly associated with the sales at issue.”⁵²

⁴⁸ 187 Wash. App. 427, 348 P.3d 1273 (2015), as amended (May 19, 2015), review granted sub nom. *Avnet Inc. v. Washington Department of Revenue*, 184 Wash.2d 1026, 364 P.3d 120 (2016), and affirmed sub nom. *Avnet Inc.*, 187 Wash.2d 44, 384 P.3d 571.

⁴⁹ 187 Wash.2d at 66, 384 P.3d at 583.

⁵⁰ Washington Department of Revenue Rule 193(7)(c) provided: If a seller . . . conducts no other business in the state except the business of making sales, this person has the distinct burden of establishing that the in-state activities are not significantly associated in any way with the sales into this state.

⁵¹ 504 U.S. 768 (1992). The *Allied-Signal Inc.* Court stated: Although our modern due process jurisprudence rejects a rigid, formalistic definition of minimum connection, we have not abandoned the requirement that, in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax.

Id. at 777-778. Nexus was not an issue in *Allied-Signal Inc.* That case concerned the application of the unitary business principle to the determination whether New Jersey could tax the gain from the sale of the interest of Bendix Corp. (a foreign corporation, its successor in interest being *Allied-Signal*) in another foreign corporation, ASARCO Inc. Also, the *Allied-Signal* quotation above refers to a connection between the state and the activity being taxed. In a case concerning the taxation of gross receipts from interstate sales into the taxing state, there would be many connections between the taxing state and the sales activity being taxed: The purchaser is located there, delivery occurs there, and the product purchased may be used or consumed there.

⁵² 187 Wash. App. at 443, 348 P.3d at 1280.

⁴⁴ *Id.* at 317-318.

⁴⁵ *Freeman*, 329 U.S. at 270-271.

⁴⁶ *Id.*

⁴⁷ See *Goldberg v. Sweet*, 488 U.S. 252, 260-61 (1989).

The Washington Court of Appeals concluded that *Allied-Signal* did not impose a requirement that a taxpayer's activities in a state must have "some direct connection" to the sales being taxed.⁵³ The court, in upholding the assessment, discounted *Norton*, noting that its foundations had been "eroded by subsequent precedent." That was because the U.S. Supreme Court had rejected (1) the argument that a state has no "local grip" on an out-of-state seller whose only activity in the state is solicitation through "advertising or drummers," and (2) the theory that interstate commerce is immune from state taxation.⁵⁴ The court of appeals also stated that "subsequent precedents have expanded the range of activities relevant to the substantial nexus analysis."⁵⁵

The Washington Supreme Court affirmed the court of appeals but was reluctant to completely

discount *Norton*. It paid slight homage to that ancient case by declaring that it was still "good law" on the principle that the taxpayer has the burden to show dissociation. The court said:

What has changed in the 60 years since *Norton* is the Supreme Court's interpretation of how a company must demonstrate dissociation.⁵⁶

The Washington Supreme Court held that Avnet had not met its burden to show dissociation, finding that Avnet's Redmond office provided market intelligence and was available to assist with the sales if necessary. The court also noted that Avnet's in-state activities were at least minimally associated with the company's ability to establish and maintain a market in Washington for the sale of its products. The court concluded that merely showing that an in-state office was not involved in the placing or completion of a national or drop-shipped sale was insufficient to dissociate the sale from the bundle of in-state activities essential to establishing and holding the market. The court determined that the taxpayer needed to show the absence of any connection between the local office or activity and the underlying sales to meet that burden,⁵⁷ arguably an impossibly high one to meet.⁵⁸

Crutchfield (2016)

Effective September 1, 2015, Washington has adopted a "factor presence"⁵⁹ nexus standard for its B&O tax on nonresident wholesalers.⁶⁰ Washington courts have not yet had the opportunity to address a constitutional challenge

⁵³ 187 Wash. App. at 443–444, 348 P.3d at 1280–1281. The Court in *National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 560 (1977) (taxpayer operating mail-order retail business from the District of Columbia with two advertising offices in California that had no connection with the mail-order retail business held obligated to collect California use tax on mail-order sales to California customers) made clear that there need not be any connection between the local activity and the sales at issue in the use tax collection duty context:

However fatal to a direct tax a "showing that particular transactions are dissociated from the local business," *Norton Co. v. Illinois Revenue Dept.*, [340 U.S.] at 537 [citations omitted] such dissociation does not bar the imposition of the use-tax-collection duty.

See Swain, *supra* note 10 at 302, criticizing the Court for needlessly advertent to the formal distinction made in *Norton* between a direct tax and imposition of a use-tax-collection duty.

⁵⁴ 187 Wash. App. at 445–446, 348 P.3d at 1281–1282.

⁵⁵ *Id.* The court cited as subsequent precedents *General Motors Corp. v. Washington*, 377 U.S. 436 (1964) (upholding as constitutional the application of the Washington B&O tax on gross receipts of an out-of-state automobile manufacturer from orders from Washington dealers received and accepted out of state for parts shipped from out of state to those dealers; the automobile manufacturer also had staff present in Washington who had extensive contacts with the dealers); *Standard Pressed Steel Co. v. Department of Revenue*, 417 U.S. 560 (1975) (upholding application of the B&O tax on gross receipts of out-of-state steel supplier that had in-state technical employee); *Tyler Pipe Industries Inc. v. Washington Department of Revenue*, 483 U.S. 232 (1987) (upholding application of the B&O tax on gross receipts of out-of-state pipe supplier that had in-state independent contractor); and *Lamtec Corp. v. Department of Revenue*, 170 Wn.2d 838, 246 P.3d 788 (2011) (upholding application of the B&O tax on gross receipts of out-of-state wholesaler with three in-state salesmen who made occasional visits, not involved in sales at issue). See Brief of Amicus Curiae Multistate Tax Commission in Support of Respondent Department of Revenue, *State of Washington, Department of Revenue, respondent, v. Avnet Inc., petitioner*, Supreme Court of the State of Washington, No. 92080-0, pp. 5–10.

As the MTC's amicus brief pointed out, the majority opinion in *General Motors Corp.* adopted the narrow view of dissociation expressed in Douglas's *Norton* dissent. The taxpayer's burden to prove dissociation required a showing of lack of any connection between the local activities and the interstate sales.

⁵⁶ 187 Wash. 2d at 60, 384 P.3d at 580. Swain, commenting on *Norton* dissociation in the *Avnet* decision, felt it unnecessary for the court to have addressed the dissociation question at all, given *Norton's* fall in stature. See Swain, *supra* note 10, at 305.

⁵⁷ *Id.* at 61, 384 P.3d at 580.

⁵⁸ The dissent disagreed, arguing that *Norton* is still binding precedent and not factually distinguishable. The dissent drew a distinction between business nexus, which it agreed Avnet had, and transactional nexus, which it considered lacking for the national and drop-shipped sales. *Id.* at 74, 384 P.3d at 586. The majority opinion did not recognize the concept of business vs. transactional nexus. *Id.* at 65–66, 384 P.3d at 582–583.

⁵⁹ Charles E. McLure Jr., senior fellow at Stanford University's Hoover Institute, first proposed the factor presence nexus concept in his December 2000 *National Tax Journal* article, "Implementing State Corporate Income Taxes in the Digital Age." The MTC expanded on McLure's concept, approving a uniformity proposal in 2002 titled "Factor Presence Nexus Standard for Business Activity Taxes."

⁶⁰ RCW 82.04.067.

to this standard. However, in *Crutchfield*,⁶¹ the Ohio Supreme Court addressed the factor presence nexus standard's constitutionality as applied to Ohio's commercial activity tax (CAT), a gross receipts tax.

The Ohio General Assembly approved the CAT in 2005 as part of a strategy to replace the state's corporate income tax, net worth tax, and some business property taxes. The CAT includes a factor presence nexus standard applying to an out-of-state business when its Ohio sales exceed \$500,000 per year, regardless of whether the business has any in-state physical presence.⁶² After receiving a CAT assessment, *Crutchfield*, an out-of-state mobile electronics retailer, argued that it lacked nexus. *Crutchfield* contended that the *Quill* physical presence standard applied. *Crutchfield* cited *Tyler Pipe Industries Inc. v. Washington State Department of Revenue*⁶³ (holding that an independent contractor's solicitation activities in Washington helped establish and maintain a market for an out-of-state pipe manufacturer, creating B&O tax nexus) and *Norton*. The taxpayer claimed that for nexus to exist, there must be a local incident — that is, at least some in-state activity by the seller or seller's representative to establish and maintain the seller's market. *Crutchfield* contended that it had no physical presence in Ohio, either by itself or through a representative, so no local incident, or nexus, existed, and its internet sales to Ohio customers were not subject to the CAT.

Crutchfield's nexus arguments harkened back to the pre-*Complete Auto* era, urging the court to consider all of its sales to Ohio as interstate transactions immune from tax — no matter how large their volume — because the company conducted no activity in the state. The Ohio tax commissioner contended that the *Quill* physical presence nexus standard did not apply to the CAT, and even if it did, physical presence nexus existed through the presence of *Crutchfield's* or its

contractors' software and through cookies on its Ohio customers' computers.⁶⁴

In a 5-2 decision, the Ohio Supreme Court upheld the assessment as constitutional,⁶⁵ determining that under *Tyler Pipe*, physical presence is a sufficient but not necessary requirement for nexus.⁶⁶ The court held that the *Quill* physical presence standard did not apply to the CAT, as it only applies to the imposition of a use tax collection duty on an out-of-state seller. The court also found that \$500,000 is a sufficient economic nexus sales threshold to establish substantial nexus under the dormant commerce clause.⁶⁷ The court did not address the Ohio tax commissioner's physical presence nexus argument.⁶⁸

The court viewed *Complete Auto* as the "pivot point" in how the dormant commerce clause interacted with two competing state taxing power propositions: (1) States cannot tax the privilege of engaging in interstate commerce vs. (2) interstate commerce must pay its fair share for the benefits and protections afforded by the states, resolving that enigma by

⁶⁴ 2016-Ohio-7760, para. 2. See Massachusetts Department of Revenue Directive 17-1, "Requirement That Out-of-State Internet Vendors With Significant Massachusetts Sales Must Collect Sales or Use Tax," making similar arguments, published April 3, 2017.

⁶⁵ A recent commentator disagrees with the *Crutchfield* court's conclusion. See Robert J. Firestone, "Does the Ohio CAT Violate the Commerce Clause?" *State Tax Notes*, May 1, 2017, p. 491. Firestone cites *J.D. Adams Manufacturing Co. v. Storen*, 304 U.S. 307 (1938) (determining that an unapportioned Indiana gross receipts tax imposed on an Indiana manufacturer's interstate sales violated the commerce clause) as the "seminal case" for the applicable gross receipts tax nexus standard. Firestone, p. 491. *J.D. Adams* and most of the other cases Firestone discusses suffer from the same defect as *Dilworth* and *Norton*: they are all based on the now-rejected pre-*Complete Auto* view of the interstate commerce tax immunity theory. See Firestone, pp. 493-498.

Firestone implies that the "risk of multiple taxation" analysis (including the internal consistency test) should be addressed as part of substantial nexus analysis. Firestone, pp. 492, 495-497. *J.D. Adams* did include double taxation analysis. 304 U.S. at 311-12. But that analysis now belongs in the second prong of the four-part *Complete Auto* test, which considers whether the tax is fairly apportioned. See *Goldberg*, 488 U.S. at 260-261.

In *J.D. Adams*, the taxpayer was in Indiana, so nexus clearly existed. To the extent that *J.D. Adams* may be relevant, it is only in the context of the apportionment prong analysis. See *Comptroller of Treasury of Maryland v. Wynne*, ___ U.S. ___, 135 S.Ct. 1787, 1794 (2015) (citing *J.D. Adams* as part of its "double taxation" analysis). *Crutchfield* focused on the first prong: substantial nexus. Whether the CAT is fairly apportioned was not at issue. 2016-Ohio-7760, para. 29.

⁶⁶ Swain suggests that *Tyler Pipe* should be read "as a limitation on the attribution of the in-state presence of independent contractors to a taxpayer" and not as a limitation on the taxpayer's "actual physical presence" in the state. Swain, *supra* note 10, at 305.

⁶⁷ *Id.* at para. 3.

⁶⁸ *Id.*

⁶¹ *Supra* at note 2.

⁶² Ohio Rev. Code 5751.01(I)(3).

⁶³ 483 U.S. 232 (1987).

abolishing the former and embracing the latter.⁶⁹ Like the Washington Court of Appeals in *Avnet*, the Ohio Supreme Court discounted *Norton* as based on the outdated theory of interstate commerce tax immunity disposed of when *Complete Auto* overruled *Spector Motor Service Inc.*⁷⁰ The court correctly rejected Crutchfield's argument that the local incident requirement in the *Norton* rule was equivalent to substantial nexus in the *Complete Auto* test:

That is wrong. *Complete Auto* abolished the prohibition against levying a tax on the privilege of engaging in interstate commerce, and the Supreme Court's articulation of the substantial-nexus test was not intended to resurrect it.⁷¹

American Business USA Corp. (2016)

In *American Business USA Corp.*, the Florida Department of Revenue assessed sales tax against a Florida florist on sales for out-of-state deliveries under the state's special origin-sourced sales tax imposition statute applicable to florists.⁷² The taxpayer took orders over the internet for delivery out of state and received payment in Florida, and the orders were filled by out-of-state florists from their out-of-state inventory. The taxpayer did not collect Florida sales tax on the out-of-state deliveries. The taxpayer argued that it lacked transactional nexus because the flowers were never located in Florida and were delivered out of state. The DOR argued that nexus existed because the taxpayer's activities all occurred in Florida. Although the Florida Court of Appeals agreed

with the taxpayer,⁷³ the Florida Supreme Court reversed and upheld the assessment against both commerce clause and due process challenges.⁷⁴ Neither of the Florida appellate court opinions cited or discussed *Dilworth*.

In its unsuccessful petition for certiorari to the U.S. Supreme Court, the taxpayer cited *Dilworth* in arguing that because the delivered flowers were never located in Florida, transactional nexus did not exist for those sales.⁷⁵ The taxpayer ignored the fact that taking the order, receiving the payment, and coordinating with the delivering florist all occurred in Florida. The taxpayer's argument resembled a claim that those sales should be immune from tax simply because they were in interstate commerce, despite its Florida presence. Perhaps that was a winning argument in the 1940s, but it is not in 2017, 40 years after *Complete Auto*.

Conclusion

Other U.S. Supreme Court decisions have dissolved the foundations for the use of the dissociation concept as a transactional nexus argument. *Complete Auto* disposed of the theory that interstate sales are immune from state taxation. *Quill's* due process nexus analysis eliminated the requirement that the out-of-state seller must have a local incident (physical presence) in the state — other than in the context of a use tax collection duty, and then, only under commerce clause substantial nexus analysis.

As the Washington Court of Appeals concluded in *Avnet*,⁷⁶ *Allied-Signal* imposed no requirement that an out-of-state seller's in-state activities must be directly connected to the interstate sales being taxed. To the extent that the *Norton* local incident requirement once addressed

⁶⁹ *Id.* at para. 28, quoting *United Air Lines Inc. v. Porterfield*, 28 Ohio St.2d 97, 102, 276 N.E.2d 629 (1971).

⁷⁰ *Id.* at para. 30.

⁷¹ *Id.* at paras. 30-35. Although it did not cite either *Norton* or *Dilworth*, the dissent agreed with Crutchfield's argument that *Quill* and *Tyler Pipe* both dictate a physical presence nexus standard for the CAT, arguing that the case should be remanded to consider whether physical presence existed. *Id.* at para. 79.

⁷² Section 212.05(1)(l), Florida Statutes (2012). 191 So.3d at 908.

⁷³ 151 So.3d 67 (2014).

⁷⁴ 191 So.3d at 917. For diverging views on the constitutionality of Florida's origin-sourced sales tax on florists, compare David Brunori, "Florida's Bizarre Sales Tax Held Constitutional When It Really Isn't," *State Tax Notes*, June 13, 2016, p. 885, and Swain and Walter Hellerstein, "Florida's (Not So) Bizarre Tax on Florists' Sales: A Reply to Brunori," *State Tax Notes*, July 18, 2016, p. 189. Swain and Hellerstein explain that Florida's origin-sourced sales tax, unique to the floral industry, has clear constitutional footing, in that the florist receiving and accepting the order and payment — and required to collect the tax — is in Florida, providing both "enforcement" and "substantive" taxing jurisdiction.

⁷⁵ Petition for certiorari, p. 21, *American Business USA Corp. v. Florida Department of Revenue*, U.S. Supreme Court.

⁷⁶ See *supra* at note 53.

the concern about multiple taxation, that issue is outside the scope of substantial nexus analysis. It belongs under the “fair apportionment” prong of the *Complete Auto* test.⁷⁷

Given the substantial evolution of nexus law since the 1950s, *Dilworth* and *Norton* have lost whatever precedential value they may have had. The *Avnet*, *Crutchfield*, and *American USA Business Corp.* courts correctly rejected the taxpayers’ attempts to reincarnate the interstate commerce tax immunity theory as a transactional nexus argument in the form of the dissociation concept.⁷⁸ ■

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⁷⁷ See *supra* note 47.

⁷⁸ *Id.* As Judge (now Justice) Neil M. Gorsuch wrote in a recent concurring opinion:

[W]hile some precedential islands manage to survive indefinitely even when surrounded by a sea of contrary law . . . , a good many others disappear when reliance interests never form around them or erode over time.

Direct Marketing Association Brohl, 814 F.3d 1129, 1151 (10th Cir.), *cert. denied*, ___ U.S. ___, 137 S. Ct. 591 (2016), and *cert. denied*, ___ U.S. ___, 137 S. Ct. 593 (2016) (suggesting that *Quill*’s *ratio decidendi* itself may “eventually wash away with the tides of time.”).