



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 March 3, 2016

Cases

Alabama

Congratulations to the legal staff of the Alabama Department of Revenue in their recent use tax nexus victory in *Scholastic Book Clubs v. Alabama*, in which the Alabama Tax Tribunal held that representational nexus existed. This case will likely travel through the appellate courts.

Florida

In *Florida Department of Revenue v. American Business USA Corp.*, the Florida Supreme Court upheld the Department's use tax assessment against a Florida florist taking orders via the internet for flowers to be delivered outside the state by out-of-state florists. The Florida florist taking the orders received payment from the purchaser placing the order. The out-of-state delivering florist did not collect any payment. Florida enacted a sales tax imposition statute expressly taxing the Florida order taking transaction. However, the Florida florist did not collect any Florida sales tax, contending that this was an out-of-state sale and physical presence nexus did not exist. The Florida Supreme Court disagreed, holding that the tax at issue was the Florida sales tax imposed at the time the order was taken and payment received by the Florida florist, and determining that physical presence did exist by virtue of the Florida florist's location in the state. Tax observers have identified this case as a possible illustration of how the Goodlatte "hybrid origin sourcing" proposal might work, if expanded to a national level. (see *State Tax Today*, 5/27/2016)

Illinois

In *Village of Bedford Park v. Expedia, Inc.*, U.S. District Court, N.D. Ill., No. 13 C 5633 (6/20/2016), in a lawsuit filed by 14 Illinois municipalities against Expedia (removed to federal court by Expedia) to collect their hotel occupancy taxes on Expedia's mark-up for hotel rooms, the court upheld only the Village of Lombard's tax, determining that it was worded so as to apply to Expedia

(which marketed but did not own or operate hotel room rentals). The other municipalities' tax imposition ordinances were faulty, in that they applied to hotel operators, but did not apply to Expedia's services. Most importantly, the court determined that nexus existed sufficient to satisfy Due Process and Commerce Clause concerns.

North Carolina

In *The Kimberly Rice Kaestner 1992 Family Trust v. Department of Revenue*, No. COA15-895 (July 5, 2016), the Court of Appeals of North Carolina held that North Carolina's attempt to tax undistributed income of an *inter vivos* trust, which was subject to the laws of another state, the settlor was a nonresident, the trustee was a non-resident, none of the trust assets were located in North Carolina, and the sole connection between the trust and North Carolina was the noncontingent beneficiary, who had recently moved to North Carolina, violated the Due Process Clause for lack of "minimum contacts" between the state and the trust. The Department of Revenue relied on two state court cases: *Chase Manhattan Bank v. Gavin*, 249 Conn. 172, 733 A.2d 782 (1999) and *McCulloch v. Franchise Tax Board*, 61 Cal. 2d 186, 390 P.2d 412 (1964), both of which held that a state's imposition of tax on the income of a trust, based solely on the residence of the beneficiary, did not violate Due Process. The court contrasted two U.S. Supreme Court decisions: *Greenough v. Tax Assessor*, 331 U.S. 486 (1947) (upholding against a due process challenge Rhode Island's ad valorem tax levy against a resident trustee's proportionate share of intangibles held in a foreign trust with other non-resident trustees) and *Brooke v. Norfolk*, 277 U.S. 27 (1928) (Virginia and City of Norfolk tax assessment against corpus of testamentary trust violated due process; Maryland resident established testamentary trust naming Virginia resident as beneficiary to receive trust income for life, trustee was in Maryland, trust intangibles assets were located in Maryland). The Court relied on *Brooke* in finding insufficient contacts between North Carolina and the trust. (see State Tax Today, 7/7/2016)

Ohio

Three cases pending before the Ohio Supreme Court: *Crutchfield Corp. v. Testa*, *Newegg Inc. v. Testa*, and *Mason Cos. Inc. v. Testa*, all raise the issue of the constitutionality of the Ohio commercial activity tax (CAT, a "gross receipts" tax), in view of its 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 CAT nexus). The taxpayers contend that a physical presence nexus standard must apply to the CAT for it to be constitutional. The state contends that physical presence nexus exists in the form of "cookies" installed by the remote seller on its customer's computers or smart phones. Oral arguments were heard on May 3.

In *Diversified Ingredients, Inc. v. Testa*, E.D. Mo., No 4:15-CV-01935 (5/19/2016), a federal district court dismissed an action for lack of jurisdiction, relying on the Tax Injunction Act, in which the taxpayer, a Missouri company, argued no nexus for Ohio's CAT assessment against it on its wholesale sales of animal feed and pet food ingredients to manufacturers, some located in Ohio, for product shipped to out-of-state customers by third parties. (see BNA Daily Tax Report, 5/24/2016)

In *Corrigan v. Testa*, Slip Op. No. 2016-Ohio-2805 (see BNA Daily Tax Report 5/5/2016), the Ohio Supreme Court held that the Ohio income tax, as applied to capital gain income of a nonresident owner of an LLC that did business in Ohio (producer of sanitary supplies), from the sale of the owner's interest in that business, violated the Due Process Clause. The nonresident owner had owned a majority of the business and regularly attended management meetings in Ohio. The court distinguished between Ohio's taxing of the nonresident owner's share of the income from business operations in Ohio, which was permissible, and taxation of the nonresident owner's capital gain on the sale of his interest of the business, which was not.

Regulations and Rulings

Illinois Compliance Alert

Illinois Department of Revenue published a compliance alert dated June 2016, indicating that homeowners renting rooms to the public through web-based platforms are required to register, collect and file returns reporting Illinois hotel operators' occupancy tax. (see tax.illinois.gov).

New York Reg. section 1-3.2

On June 3, 2016, New York State Department of Taxation and Finance published draft revisions to its regulation interpreting the economic nexus provisions (threshold of \$1 million in receipts from New York business activity) for its corporate franchise tax. (see *State Tax Today*, 6/6/2016)

Tennessee proposed Regs. 1320-05-01-.63 and 1320-05-01-.129

On June 16, 2016, Tennessee Department of Revenue proposed two regulations, 1320-05-01-.63 requiring residential property owners and property management companies renting rooms out for less than 90 days to register to report and remit sales tax as dealers, and 1320-05-01-.129, requiring remote retailers with annual sales to Tennessee customers exceeding \$500,000 or more to register as dealers by January 1, 2017, and begin collecting use tax by July 1, 2017, unless notified of a later date by the Department. Tennessee had

enacted “click-thru nexus” provisions in 2015. (see State Tax Notes, 6/22/2016)

Texas Comptroller Decision No. 112,189 (5/10/2016)

Out-of-state company acted as waste management consultant to commercial property owners nationwide, and provided services to Texas commercial property owners and tenants, contracting with local trash hauling services to handle those properties. Company had no physical presence in Texas. It paid sales tax on its purchase of trash hauling services for its Texas clients, but did not charge its clients any sales tax on its charges to them. Following an administrative appeal of an assessment for franchise tax and sales tax against the company, the Comptroller determined that nexus existed through the activities of independent contractors providing trash hauling services in Texas and upheld the assessments, finding no Commerce Clause or Due Process Clause violations.

Virginia Tax Commissioner Ruling No. 16-15 (3/3/2016)

Foreign S corporation sold services provided via the internet to Virginia customers to set up their own websites. S corporation also has an employee in Virginia performing administrative and accounting support services to the corporation, not involved in any selling or solicitation activity. The ruling indicates that insufficient information was provided to determine whether the employee’s activities were *de minimis* for corporate income tax nexus purposes, but those activities otherwise fell outside the scope of protection of P.L. 86-272. Virginia Tax Commissioner Ruling No. 16-77 (see State Tax Today, 5/11/2016) The Virginia Tax Commissioner ruled that an out-of-state retailer of healthcare products that used a third party’s website to sell its products online to Virginia customers, the website being hosted on servers located in Virginia, did not have use tax nexus in Virginia.

Washington

Det. No. 15-0218, 35 WTD 206 (2016) (See State Tax Today, 5/4/2016)

Washington Department of Revenue administrative law judge applied Washington’s statutory 1-year trailing nexus provision for the B&O tax to deny a taxpayer’s refund claim, even though the taxpayer had not nexus-creating activities in that year.

On May 31, 2016 Washington published its revised Rule 193, providing guidance on legislative changes effective September 1, 2015 that provide for “click-thru nexus” for use tax and “economic nexus” on wholesale sellers for the Washington B&O tax. (see BNA Daily Tax Report, 6/9/2016)

Det. No. 15-0251 (see CCH State Tax Day, 6/13/2016)

Washington Department of Revenue ruled that an affiliate of a German pharmaceutical company was subject to Washington B&O tax on royalties it received on sales of its products in the state, when the amount of royalty payments exceeded Washington's factor presence threshold.

Statutory enactments

Alabama 2015 SB 437 (Act 448), Rule 810-6-2-.90.03

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)

Louisiana HB 30 (see State Tax Today, 3/14/2016)

On March 14, 2016, Louisiana adopted use tax "click-thru nexus" for remote retailers with sales to Louisiana customers exceeding \$50,000/yr. Louisiana has also expanded its statutory definition of use tax nexus to include "dealer" affiliate nexus activities applicable to those out-of-state dealers with Louisiana sales exceeding \$50,000/yr.

Louisiana HB 722

Effective July 1, 2016, Louisiana has expanded its definition of "hotel" for purposes of registration requirements, to include residences that furnish rooms for transient guests. (see CCH State Tax Day, 6/15/16)

Louisiana HB 1121

Louisiana enacted notice provisions modeled on the Colorado law, effective July 1, 2017, that would require remote retailers with more than \$50,000 in Louisiana sales per calendar year to notify Louisiana customers of their use tax

obligation by January 31 of each year and mandate that businesses send a report of their prior year's sales each Louisiana customer to the DOR by March 1.

Minnesota HF 848 (see State Tax Today, 5/25/2016)

Minnesota Legislature enacted expanded “affiliate nexus” provisions, also including the activities of “market providers,” if the out-of-state retailer has Minnesota sales of at least \$10,000/yr.

Oklahoma HB 2531

Effective November 1, 2016, Oklahoma has expanded its definition of “retailer doing business in this state” to include a rebuttable presumption of nexus for certain “affiliate nexus-type” activities, such as selling similar products, use of trademarks, operating a warehouse or fulfillment center, delivery or installation work, etc. The legislation also includes an “outreach” program to encourage voluntary registration of remote retailers, in return for prospective liability. The law includes notice provisions, requiring remote retailers to annually notify their Oklahoma customers of their use tax obligations.

South Dakota SB 106

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) 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.

Utah

Utah Senator Curtis Bramble has stated that he intends to pursue enactment in Utah of legislation similar to South Dakota's next year. (see BNA Daily Tax Report, 7/1/2016)

Vermont HB 873

Vermont has enacted legislation, effective July 1, 2017 or when *Quill* is overturned, whichever is later, requiring remote retailers to commence registration, collection and remittance of Vermont use tax on remote sales to Vermont customers when the remote retailer has sales exceeding \$100,000 to or 200 sales transactions with Vermont customers in the prior 12 months. For remote retailers that do not have to register, they will be required to annually notify their purchasers making over \$500 in purchases/yr. that use tax is owed on their purchases, effective July 1, 2017, or when Colorado implements its reporting requirements, whichever is earlier. (see BNA Daily Tax Report, 5/11/2016)

Washington HB 2938

Washington enacted legislation effective July 1, 2016 creating a use tax "physical presence nexus" exception for attendance or participation at a trade convention once per calendar year. (see State Tax Today, 5/31/2016)

Federal Legislation

On July 14, 2016, 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. Representative Goodlatte, Chair of the House Judiciary Committee, also has a proposal that has not yet been introduced, his "hybrid origin sourcing" proposal. He released recently a written explanation of his proposal. (see State Tax Today, 5/16/2016) Given that this is an election year, there seems little likelihood of legislative action concerning any of these bills in 2016, although

U.S. Senator Heidi Heitkamp announced at the FTA Annual meetings in Annapolis on June 14 that she does expect the U.S. Senate to vote on the Marketplace Fairness Act.

State Tax Amnesty Programs

Currently, Alabama has a tax amnesty program, which expires at the end of August 2016.

Arizona recently enacted House Bill 2708, which provides a new tax amnesty program, running from September 1, 2016 to October 31, 2016, covering taxes administered by the Arizona Department of Revenue for tax periods prior to January 1, 2014. Waiver of all interest and penalties is available. It contains a new feature: a three-year payment plan. Arizona just completed a tax amnesty program in 2015.

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