Nexus for Sales Tax Purposes
Agenda

• Overview of U.S. Supreme Court Precedent

• Recent U.S. Supreme Court Developments

• State Reactions
What is Nexus?

• Nexus is the creation or establishment of a connection with a state.
• The state tax nexus standard for income and transaction taxes differs.
• For income tax purposes, state statutes and state courts generally provide or have held that only an economic presence is required to create an income tax filing requirement in the state. This standard has been applied more aggressively to:
  ▪ Trademarks and intangibles
  ▪ Financial institutions
• Federal law provides some protection from the imposition of income taxes by states to sellers of tangible personal property.
What is Nexus?

• For sales and use tax and transaction tax purposes, more of a connection with the state is required.

• In order for a state to impose a sales and use tax collection obligation on an out-of-state seller, the U.S. Supreme Court has held that a physical presence in the state is required.

• The physical presence must be more than de minimis.

• The landmark case that is referenced by SALT for this principle is Quill Corp. v. North Dakota (1992).

- In North Dakota, Quill engaged in the following activities:
  - Solicited business through numerous catalogs and flyers, advertisements in nationally distributed “card packs,” advertisements in notional periodicals and trade journals and telephone solicitation of existing customers (amounted to more than 230,000 separate pieces of mail, weighing over 24 tons, sent annually by Quill);
  - Delivered merchandise to customers by mail or common carrier from locations outside of North Dakota;
  - Provided an unconditional 90-day guaranty on merchandise purchased;
  - Held title to a few floppy diskettes located in the state; and
  - Licensed a computer software program to some of its North Dakota customers that enabled them to check Quill’s current inventories and prices and to place orders directly, but Quill maintained all rights in the software and the right to terminate the license without prior notice and without cause.

- State argued that *Quill’s “economic presence”* in the state established a physical presence in the state.
- The Supreme Court rejected North Dakota’s argument that Quill's "economic presence" in North Dakota depended on services and benefits provided by the State and therefore generated "a constitutionally sufficient nexus to justify imposition of the purely administrative duty of collecting and remitting the use tax."
- Court instead held that a “substantial nexus” is required and that Quill’s activities did not meet the physical presence nexus standard.
  - “Although title to a few floppy diskettes present in a State might constitute some minimal nexus, we expressly rejected a ‘slightest presence' standard of constitutional nexus. We therefore conclude that Quill's licensing of software in this case does not meet the "substantial nexus" requirement of the Commerce Clause.”
What we know from *Quill*…

- “Substantial nexus” entails some level of physical presence; *i.e.*, more than a de minimis physical presence may result in substantial nexus.

- What constitutes “physical presence”? 
  - More than slightest presence:
    - Employees working in the state
    - Employees performing activities in the state
    - Lease or ownership of tangible property
    - Lease or ownership of real property
What has the Court said since *Quill*

- *Direct Marketing Ass’n v. Brohl* – Justice Kennedy’s Concurrence:
  - Calls for end of physical presence requirement in *Quill*
  - Tax laws should change with the economy, noting substantial increase in remote sales from 1992 to 2008
  - “[I]t is unwise to delay any longer a reconsideration of the Court's holding in *Quill* …[the] legal system should find an appropriate case for this Court to reexamine *Quill* and *Bellas Hess.*”
State Response to DMA

Connecticut Revenue Comm’r Sullivan:

“[W]e are going to push the envelope hard, on what's called economic nexus . . . it's the far edge of being able to demonstrate that you have a presence in the state of Connecticut and therefore are subject to paying sales tax.”

* “Connecticut Revenue Department Looks to Increase Remote Sales”, State Tax Today, April 7, 2015
Joe Huddleston, executive director of the Multistate Tax Commission:

“Some states have been delaying challenges to Quill because of concerns that the Supreme Court wasn't interested in taking a fresh look at the decision. Justice Kennedy's opinion and his suggestion that a second look at Quill is warranted because the Internet has significantly changed the way business is conducted will likely ease those concerns.”

“I would not be surprised to see a direct challenge to Quill this year.”

* “Kennedy's Call To Reconsider Quill Could Spawn Test Case”, Law360, March 03, 2015.
State Reaction to *DMA*

- **Utah SB 125**
  - Requires certain sellers to obtain a sales and use tax license even if they do not have nexus in the state.

- **Utah SB 192**
  - Creates a rebuttable presumption that a seller is required to pay or collect and remit sales or use tax if the seller makes more than $10,000 of sales of TPP, services, or products delivered electronically into the state in prior 12 months.

- **Arkansas SB 527**
  - Requires that remote retailers file an annual statement with the state reporting sales to Arkansas residents for $500 or more and to give notice to purchasers both at the time of sale and annually that use tax is due.
State Reaction to DMA

• Washington HB 2224

  - Provides that a seller has a substantial nexus with Washington if it makes sales to Washington customers in an aggregate amount exceeding $10,000 in one year and meets any of the criteria specified in the bill. None of the criteria require a seller to have a physical presence in Washington.

  - The legislature offers the following justification for deviating from Supreme Court precedent: “overwhelming support among the public, states, and municipalities, and many national and local associations representing brick-and-mortar businesses for federal legislation requiring remote sellers to collect and remit retail sales tax.” It claims that because Washington is “unique in that it relies so heavily on sales tax to fund education and other vital state services . . .”
Legislation Expanding Quill

- In addition to anti-Quill legislation, states have continued to enact legislation that expands the limits of Quill.
- While New York’s click-through legislation was challenged by Amazon and Overstock, the New York Court of Appeal upheld the constitutionality of New York’s click-through legislation in Overstock.com, LLC v. New York State Department of Taxation and Finance, Court of Appeals, Nos. 33 and 34, March 28, 2013.
Click-Through Legislation

- State’s Continue to Propose and Enact Click-Through Legislation and Similar Laws
  - Florida HB 101
  - Louisiana HB 536, HB 355, SB 199
  - Maryland HB 726
  - Nevada AB 380/SB 302
  - South Carolina S 170
  - Utah HB 455
  - Washington HB 1678/SB 5541 and HB 2224
Activities of Affiliates/Third Parties

- The presence of affiliated entities or third parties in the states can also create substantial nexus.
- The U.S. Supreme Court held in two landmark decisions (*Tyler Pipe* and *Scripto*) that the activities of third parties must “establish and maintain a market” in the state for an out-of-state entity for the in-state presence to be nexus creating.
- “Establish and maintain a market” has been interpreted to mean:
  - Sales solicitation
  - Promotional or marketing activities (e.g., distribution of promotional materials)
  - Sales of services performed in-state
  - Performing warranty repairs
  - Accepting returns
  - Use of the same or similar trademarks or tradenames
  - Joint discount or marketing programs
- Based on *Tyler Pipe* and *Scripto*, states have enacted “affiliate nexus statutes.”
Affiliate and Attributional Nexus Legislation

• States have continued to enact expanded affiliate nexus statutes which provide that out-of-state affiliates have nexus if an affiliate or any other person conducts certain activities in the state.

• The activities that must be conducted in the state include:
  ▪ Use of the same or similar trademarks or trade names;
  ▪ Selling a similar line of products under the same or similar name;
  ▪ Providing delivery, installation or similar services;
  ▪ Using an in-state location to facilitate delivery;
  ▪ Conducting any other market making activity.
Affiliate and Attributional Nexus Legislation

- **Washington HB 2224**
  - “Remote seller representative nexus”
  - “Credit card/payment facilitator nexus”
  - “Economic nexus”

- **Michigan**
  - MCL 205.52b, 205.95a (enacted Jan. 1, 2015, effective Oct. 1, 2015)
  - Expanded affiliate nexus statute which includes sharing management, business systems, business practices or employees with the in-state seller
Affiliate and Attributional Nexus Legislation

• Iowa
  ▪ Enacted affiliate nexus statute
  ▪ Expanded attributional nexus statute
  ▪ Prior to enactment of these provisions, Iowa did not have an affiliate nexus statute.
  ▪ Iowa regulations previously set forth a list of activities that was nexus creating, but no similar language was in the statute.

• Missouri
  ▪ Enacted expanded affiliate nexus statute
Marketplace Collection

• New York A. 3009 (Budget)
  ▪ Bill would have required marketplace providers to collect sales tax on transactions that they facilitate, but was ultimately excluded from final legislation
  ▪ Legislation was ultimately removed from final Budget

• Washington HB 2224
  ▪ Marketplace facilitators required to collect for sellers on marketplace.
Trailing Nexus

- States have more aggressively enacted “trailing nexus” provisions which provide that for some period of time after nexus is severed the seller continues to have nexus.

- Washington HB 2224 provides for a one-year trailing nexus provision.

- Many states have a one quarter (or more) provision.

- Constitutionality of these longer provisions is suspect.
Sales to State Agencies

• Several recent expanded nexus bills have also provided that if an out-of-state seller is selling to a state agency (e.g., schools, etc), the seller has nexus.
  - See expanded nexus statutes in Iowa and Georgia

• These provisions may also require affiliates of the seller to register.

• Rationale is that if you want to contract with state agencies you have to be in compliance.
Questions?

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