Internet Taxation

• No Clear Rules For State And Local Taxation Of Out Of State ("Remote") Sellers

• To Date Courts Have Had The Primary Say On This Issue
  • States Aggressive With Enforcement And Statutes
  • Court Guidance Often Fact Dependent And Not One Size Fits All

• Congress Has The Ability To Provide States Clearer Authority
  • Political Football, But May Get Over The Goal Line
Internet Taxation

- Multiple, potentially conflicting interests
  - Consumers who don’t want to pay tax
  - In state retailers subject to tax who want to level the playing field
  - Large brick and mortar retailers who see untaxed internet competition as unfair
  - State and local governments that lose revenue on internet sales
  - Legislators listening to all of the above
OVERVIEW

• IN ABSENCE OF CONGRESSIONAL ACTION
  • Federal Constitution “nexus” concepts govern state taxing authority
  • Slow Evolution of Nexus Law Before *Quill v. North Dakota* (1992)
    • *Quill*
      - Due Process and Commerce Clause Tests Distinguished
    • *Quill* to Present
      - Transaction Nexus
      - Physical Presence Nexus
      - Economic Nexus-Customer in the State
      - State statutory efforts to codify nexus

• CONGRESSIONAL AUTHORITY
GENERAL PRINCIPLES

• TAX “NEXUS”
  • FEDERAL CONSTITUTION
  • COMMERCE CLAUSE
    ─ BURDEN ON INTERSTATE COMMERCE
    ─ SALES AND USE TAX
    ─ INCOME TAX
  • DUE PROCESS CLAUSE
    ─ MINIMUM CONTACT/CONNECTION AND PURPOSEFUL AVAILMENT OF JURISDICTION
    ─ SALES AND USE TAX
    ─ INCOME TAX
BEFORE QUILL

- **Western Live Stock v. Bureau of Revenue (1938): Sales Tax**
  - Commerce Clause Not Intended To Protect Those in Interstate Commerce From Their Just Share of State Tax Burden Even if it Adds to Cost of Doing Business
  - Tax Imposed on Local Activities
  - Commerce Clause Does Not Bar Taxation of Revenue From Contract Between Citizens of Different States

- **Wisconsin v. J.C. Penney (1940): Income**
  - Due Process
  - Whether State Has Given Anything For Which It Can Ask In Return
**BEFORE QUILL**

- **Miller Brothers Co. v. Maryland (1954):** Use Tax
  - Due Process
  - Delaware Store Sales; Vendor Deliveries to Maryland Customers
  - No Exploitation of Maryland Market
  - “No Minimum Contacts”

- **Northwestern States Portland Cement v. Commissioner (1959):** Income
  - Due Process and Commerce Clause
  - In State Solicitation of Orders From Dealers
  - Orders Accepted and Filled Out of State
  - Nexus
BEFORE QUILL

• National Bellas Hess v. Dep’t of Revenue (1967): Use Tax

  • Commerce Clause: Commerce Must Bear Fair Share of Cost of Local Government Whose Protection it Enjoys
    • Complex and varied state tax systems, rates, deductions and exemptions can pose undue burden on interstate commerce

  • Due Process: Whether State Has Given Anything for Which it Can Ask in Return

  • Mail Order Catalog Business

  • No Illinois Physical Presence

  • Only Contact Was Delivery by Mail or Common Carrier (unrelated third party)
BEFORE QUILL

- Commerce Clause Substantial Nexus
    - **Transaction** Taxed Must Have “**Substantial Nexus**” With Taxing State
    - Later *National Geographic* case: more than the slightest physical presence
  - **Attributional Nexus:**
    - *Scripto, Inc. v. Carson* (1960): Use Tax
      - Due Process and Commerce Clause
      - No Physical Presence in Florida
      - Use of Independent Contractors To Solicit Sales a “Distinction Without Constitutional Significance”
      - Independent Sales Representatives in Washington
      - Test: Whether Activities Performed on Behalf of Seller a State are Significantly Associated With Seller’s Ability to “Establish and Maintain Market” in the State.
Quill v. North Dakota (1992)

- Use Tax On Mail Order Retailer
- Commerce Clause' Substantial Nexus' Not The Same As Due Process "Minimum Contacts"

Due Process

- Fundamental Fairness and Adequate Notice to Taxpayer
- "Minimum Contacts"
- Purposefully Direct Efforts Toward Residents of Another State
- "Purposeful Availment" of Benefits of Economic Market
- Continuous and Widespread Solicitation of Business in the State
- Does Not Require Physical Presence
- 
- *Scripto* was Court’s Furthest Extension of Power To Tax

- **Commerce Clause**
  - Bars “Undue” Burden on Interstate Commerce
  - Effects of State Regulation on National Economy
  - Substantial Nexus
    - More Than Slightest *Physical Presence* Required
    - Not Present on the Facts of *Quill*
  - Bright-Line Physical Presence Test Encourages Settled Expectations and Investment
  - Stare Decisis based upon *National Bellas Hess*

- **Congress Free to Disagree With Supreme Court Dormant Commerce Clause Decisions**
  - Court’s Previous Decisions For Taxes Other Than Sales and Use Did Not Articulate Bright Line Test
DEVELOPMENTS AFTER QUILL

• Most States Confine Quill Commerce Clause Physical Presence Test to Sales and Use Taxes
  • Financial Institutions
  • Intangible Property

• Internet Commerce/Affiliate Nexus: Sales and Use
  • Bricks and Clicks
  • Warranty Repairs
  • Affiliate sales reps/Amazon

• Due Process Getting a Second Look
  • Some commentators suggest that recent U.S. Supreme Court Due Process cases outside the tax arena may provide a stronger nexus defense than previously thought
    – Due process violated if one does not purposefully direct activities at a state
    – Placing goods in stream of commerce not sufficient
    – Need continuous and systematic general business contacts
Mail and Internet Transactions-Sales and Use

- Brick and Mortar Affiliates (“bricks and clicks”)
  - *SFA Folio v. Bannon (Ct. 1991)* (no nexus; rejects “economic nexus”)
barnesandnoble.com

- New Mexico Supreme Court June, 2013

- Gross receipts tax (a transactional tax similar to sales tax)

- Internet retailer with no physical presence in New Mexico
  - No employees
  - No property, facilities, etc. in New Mexico

- Sister corporation operated retail stores in New Mexico

- Court: barnesandnoble.com had Commerce Clause nexus

- Court: *Tyler Pipe* attributional nexus analysis
  - Acting on behalf of taxpayer
  - Activities in state must be significantly associated with establishing and maintaining market in the state
barnesandnoble.com

- Court: Brick and mortar retailer performed activities significantly associated with bn.com’s ability to establish and maintain a market in New Mexico

- Court: In state retailer need not be a sales agent as in facts of *Tyler Pipe* or *Scripto*
  
  - Activities benefited bn.com
  
  - Use of same trademarks, licensed from third party (consumers could reasonably infer one company)
  
  - Cross marketing inferred
  
  - Store gift cards redeemable at bn.com (and other unrelated retailers)
  
  - Some shared customer information
  
  - Store locator on bn.com
  
  - Instate retailer accepted returns from all vendors
    
    - bn.com advertised return to stores
Barnesandnoble.com

- However, in state retailer did not expressly act “on behalf of” bn.com
- Only incidental benefit to bn.com from retailer activities
- Inferred, at best, that activities of store retailer were for the benefit if bn.com
NEXUS CONCLUSION

• Required for State Tax Jurisdiction in Absence of Affirmative Congressional Action

  • Presence Nexus
    • Due Process
      – Purposeful Availment
      – Minimum Contacts

  • Commerce Clause
    – Substantial Nexus Requires More Than Minimum Contacts
    – More Than The Slightest Presence
NEXUS CONCLUSION

- Transactional Nexus
  - Transaction Relationship to Taxing Jurisdiction

- Economic Nexus/Customer in State
  - Due Process
    - Purposeful Availment of Market
  - Commerce Clause
    - Transaction Must Have Substantial Nexus
POST-QUILL STATE LEGISLATIVE ACTIVITY

- Streamlined Sales Tax
  - State Effort to Support Congressional Action
  - Theory is that greater uniformity in sales taxation will reduce Congressional resistance

- Objective/Quantitative Substantial Nexus Business Activity Taxes
  - Harkens Back To Quill “Bright Line” Nexus Physical Presence Standard
  - MTC Factor-Based Economic Presence
    - $50,000 or 25% of property; or
    - $50,000 or 25% of payroll; OR
    - $500,000 or 25% of sales
POST-QUILL STATE LEGISLATIVE ACTIVITY

• States With Similar Objective Schemes
  • Ohio (MTC verbatim)
  • California (1/1/2011)
  • Colorado (Regulation eff. 4/30/2010)
  • Washington (6/1/2010)
• Maine Has Detailed Regulations Addressing Many Types of Activities
POST-QUILL STATE LEGISLATIVE ACTIVITY

- Subjective/Qualitative Nexus Factors
  - New Hampshire (7/1/07)
    - Substantial Economic Presence
    - Purposeful Direction of Business
  - Wisconsin (1/1/09)
    - Broad Definition of “Doing Business in this State”
    - Includes Sales To Customers in Wisconsin, Intangibles, Loans Secured by Real or Tangible Personal Property in Wisconsin
  - Oregon (DOR;5/08; retroactive)
  - Michigan (1/1/2008)
    - Active Solicitation of Sales
    - Gross Receipts $350,000 Or More Sourced to Michigan
    - Subject to P.L. 86-272 Limitations On Net Income Tax
POST-QUILL STATE LEGISLATIVE ACTIVITY

• Subjective/Qualitative Nexus Factors
  • Connecticut (1/1/2010)
    • Substantial Economic Presence
    • Purposeful Direction of Business
  • New Jersey (“Guidance”; 1/10/2011, retroactive to 1/1/2002)
    • Perform Services Outside of New Jersey When In-State Solicitation
    • Derive Receipts From Sources in New Jersey
    • May Request UDITPA Equitable Adjustment
“AMAZON” Statutes

- Statutory Attributional Nexus For Sales and Use Tax
- Statutory Presumption of Nexus
  - Nonresident vendor agreements with residents for web site links to non-resident vendor web site
  - Nonresident vendor pays commission to residents for sales
  - Presumption of solicitation of business through independent contractor in state
  - Threshold level of sales to in-state customers
- New York (nexus; in New York courts)
- Rhode Island (nexus)
- Illinois (nexus)
- North Carolina (nexus)
- Texas (nexus)
- Colorado (information reporting requirement; in litigation)
CONGRESSIONAL ACTIVITY

• BUSINESS ACTIVITY TAX SIMPLIFICATION ACT (“BATSA”)

  • Congressional authority under federal Commerce Clause
    • Introduced many times, including August 2013
    • Modernization of Public Law 86-272 (income tax; only protects solicitation of sales of tangible personal property)
    • Limited to income type taxes, not sales and use
  • Effort to put physical presence nexus standard in federal statute
    • Minimum of 15 days of individuals physically present during a taxable year (pro rate for lesser taxable periods)
    • Exclusive agent to establish or maintain market
    • Leasing or owning tangible personal property or real property
CONGRESSIONAL ACTIVITY

• BUSINESS ACTIVITY TAX SIMPLIFICATION ACT ("BATSA")
  • Some activities in state ignored
    - Customer in market (not seller)
    - Information gathering
    - Furnishing information
    - Soliciting sales (PL 86-272)
    - Fulfillment of sales
    - Physical presence in prior periods
    - Agents in state solely engaged in sales or fulfillment
Congressional Activity

• MARKETPLACE FAIRNESS ACT
  
  • Introduced 2013 (similar to Market Place Equity Act of 2011)
  
  • Requires remote sellers to pay sales tax IF state simplifies its tax laws.
    
    • Exclusion if annual remote sales less than $1,000,000.
  
  • Simplification Options
    
    • Option 1: State joins Streamlined Sales and Use Tax Agreement as full member
    
    • Option 2: Simplification mandates
      
      - Notify retailers in advance of rate changes
      
      - Rate simplification to single rate in most instances
      
      - Single entity to handle sales tax registrations, filings, audits
      
      - Statewide uniform sales tax base
      
      - Destination sourcing for out of state purchases
      
      - Provide free software to manage compliance
QUESTIONS?

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