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CHAPTER 2

Reflections on the Current State of "Attributional Nexus": When May a State Use the Presence of an In-State Entity to Claim Jurisdiction Over an Out-of-State Seller

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Synopsis

¶ 200 INTRODUCTION

The downturn in the national economy has triggered a budgetary crisis for many state governments. For example, as of this writing, California recently resolved a staggering $40 billion-plus shortfall that virtually paralyzed the state government for almost five months. Jennifer Steinhauer, *California, Almost Broke, Nears Brink*, N.Y. Times, Feb. 17, 2009; Jennifer Steinhauer, *In Budget Deal, California Shuts $41*

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Billion Gap, N.Y. Times, February 19, 2009. Other states face similar—if less numerically daunting—challenges. Undoubtedly, legislatures will seek increased revenues as part of the solution to the budgetary shortfalls. In some cases, that will mean new or higher tax rates for the state's citizenry. In virtually all cases, states' increased enforcement of existing taxes will also play a role, particularly if the burden can be shifted to out-of-state enterprises that have little clout at the ballot box. One politically easy solution is to expand the reach of the state's taxes to sweep in companies that earn income or enjoy other benefits that can be viewed as occurring within the state's boundaries, i.e., by expanding the state's jurisdiction to tax to more out-of-state entities.[1]

In this article, we review controversies involving the limits of the state's jurisdiction to tax—commonly called "nexus"—with an eye toward plotting the lines that currently govern a state's reach to impose its use taxes. Seventeen years ago, the United States Supreme Court issued a decision some thought might put an end to controversies over jurisdiction to tax by establishing a "bright–line" standard that required, quite simply, that a taxpayer be physically present (beyond a de minimis presence) within the state as a condition for being subject to its taxing regime. *See Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) ("*Quill*"). That decision reaffirmed the earlier Supreme Court decision in *National Bellas Hess, Inc. v. Illinois Department of Revenue*, 386 U.S. 753 (1967) ("*Bellas Hess*"), involving the same issue. But the ink was hardly dry before states and their localities began exploring theories for avoiding that test for nexus. The battles continue to this day and there is little reason to believe they will be resolved soon. Indeed, Dell's recent petition for writ of certiorari with the United States Supreme Court to obtain the Court's guidance on the very issues addressed by this article was denied. *Dell Catalog Sales LP v. Taxation & Revenue Dep't*, 199 P.3d 863 (N.M. Ct. App.), *cert. denied*, 189 P.3d 1215 (N.M. 2008), *cert. denied* 129 S. Ct. 1616 (U.S. Mar. 23, 2009) (No. 08–770) ("*Dell (NM)*").

Current controversies over nexus generally arise in two different contexts.[2] The first,

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[1] As a case in point, among the provisions in the recent legislation breaking California's budget impasse are changes to California Revenue & Taxation Code section 23101 that expand the scope of the definition of "doing business" in California by codifying an economic nexus standard. Under the newly revised code, a taxpayer is "doing business" in California if the taxpayer's: a) sales in the state exceed $500,000 or 25% of the taxpayer's total sales, whichever amount is less; b) property in the state exceeds $50,000 or 25% of the taxpayer's total property, whichever amount is less; or c) payroll in the state exceeds $50,000 or 25% of the taxpayer's total payroll, whichever amount is less. *See* Cal. Rev. & Tax. Code § 23101 (2009) (as amended by Stats 2009-2010 3d Ex Sess ch 10 § 7 (AB 15XXX), effective Feb. 20, 2009, ch 17 § 7 (SB 15XXX), effective Feb. 20, 2009).

[2] In addition to these categories, from time to time, taxpayers and states also struggle with the core issue of what constitutes more than de minimis physical presence. *Talbot's Inc. v. Ariz. Dep't of Revenue*, Docket No. 1255-94-S/U, 1995 Ariz. Tax LEXIS 79 (Ariz. Bd. Tax App. Oct. 12, 1995); *In re Orvis Co.*

known as "attributional nexus," arises in the context of whether a state may impose an obligation to collect its use tax on an out-of-state seller that has customers but no employees or property within the state. That will be the subject of this article. The second, often referred to as "economic nexus," arises in the context of whether a state may impose its income tax on a company that is not physically present in the state but nonetheless earns income in the state's market.[3] We will leave that discussion for

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v. Tax Appeals Tribunal and In re Vt. Info. Processing, Inc. v. Tax Appeals Tribunal, 654 N.E.2d 954 (N.Y.) (consolidated opinion), *cert. denied*, 516 U.S. 989 (1995).

[3] Over the last few years, there has been considerable litigation concerning whether the physical presence requirement for nexus applies at all to taxes other than sales and use taxes such as income or gross receipts taxes. Currently, the state courts are split on whether physical presence is required to impose an income tax. However, in the interest of complete candor, we should acknowledge that most appellate courts to date have now concluded that a significant economic presence within the jurisdiction (not physical presence) is all that is required. For example, in *Tax Commissioner v. MBNA America Bank, N.A.*, 640 S.E.2d 226 (W. Va. 2006), *cert. denied*, 127 S. Ct. 2997 (2007) ("*MBNA (WV)*"), the West Virginia Supreme Court held that the physical presence standard for nexus imposed by *Quill* did not extend to income taxes, and therefore concluded that the bank had substantial nexus with the state, even though it had no physical presence there. The court based its decision on: (1) its belief that the *Quill* case, discussed *infra*, rested principally on *stare decisis* concerns that are not present in the income tax area; (2) its view that the Supreme Court expressly limited *Quill* to sales and use taxes; (3) its view that *Quill* is premised on the heavy compliance burden imposed by use taxes (e.g., monthly filing requirements) that is not present with income and franchise taxes; and (4) its conclusion that the physical-presence standard makes little sense in today's commercial world. *MBNA (WV)*, 640 S.E.2d at 232-34. Instead, the court concluded that substantial nexus should be based upon "significant economic presence," which, in the court's view, includes a requirement that there be some "purposeful direction" toward the state's market and an examination of the "quality and quantity of the company's economic presence." *Id.* at 234 (quoting Christina R. Edson, *Quill's Constitutional Jurisprudence and Tax Nexus Standards in an Age of Electronic Commerce*, 49 Tax Law. 893, 944 (Summer 1996)). In this regard, the court concluded that this standard required an analysis beyond that applied under the Due Process Clause into the "frequency, quantity and systematic nature of a taxpayer's economic contacts with a state." *Id.* (quoting Edson, *supra* at 945). The court further concluded that "an entity's exploitation of the market must be greater in degree than under the Due Process standard so that its economic presence can be characterized as significance or substantial." *Id.* at 235. In this case, the court found that MBNA's "continuous[] and systematic[] engag[ing] in direct mail and telephone solicitation and promotion in West Virginia" combined with the $8 to $10 million in gross receipts from West Virginia customers was sufficient to meet the standard. *Id.* at 235-36. *See also Lanco, Inc. v. Dir., N.J. Div. of Taxation*, 908 A.2d 176 (N.J. 2006), *cert. denied*, 127 S. Ct. 2974 (2007); *MBNA Am. Bank, N.A. v. Ind. Dep't of State Revenue*, 895 N.E.2d 140 (Ind. T.C. 2008); *Capital One Bank v. Comm'r of Revenue*, 899 N.E.2d 76 (Mass. 2009), *petition for cert. filed*, 77 U.S.L.W. 3544 (Mar. 19, 2009) (No. 08–1169); *Geoffrey, Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993). To be sure, there is one state appellate court that has reached a conflicting conclusion in a well-reasoned opinion that rejects the notion that there are effectively two Commerce Clauses, one for sales and use taxes and one for income taxes. *See J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999) (physical presence required to impose an income tax). Moreover, as implied by the dissent in the West Virginia *MBNA* case, the newly-minted nexus standard based upon a "significant economic presence standard" seems in application to most cases identical to the long-arm standard used

another day.

We discuss the concept of attributional nexus largely by reference to the court decisions that have considered this question. We begin with a discussion of the two United States Supreme Court decisions on which subsequent courts have relied for the theory of attributional nexus. Thereafter, we explore the ways in which courts have applied the two factors, stemming from these Supreme Court decisions, that determine whether attributional nexus can be imposed, namely i) whether an in-state entity is acting "on behalf of" an out-of-state seller and ii) whether the in-state entity is performing activities in support of the marketing or sales activities of that out-of-state entity. Finally, we outline a list of principles intended to provide guidance in evaluating whether an out-of-state entity may be viewed as physically present within a state by reason of the activities of a third party that is plainly present in the state.

¶ 201 ROLE OF STATE STATUTES

At the outset, it is worth noting that judicial decisions concerning whether a state has jurisdiction to tax a remote seller often begin by determining whether jurisdiction exists under the state's statutes or regulations. This is frequently referred to as whether the taxpayer is "doing business" in the state. *See, e.g.*, *Praxair Tech., Inc. v. Dir., Div. of Taxation*, 961 A.2d 738 (N.J. Super. Ct. App. Div. 2008) (notwithstanding a finding that the taxpayer may have had nexus for Commerce Clause purposes, the statute did not impose an obligation on the taxpayer to pay income tax until 1996, the year in which a regulation expanded the statutory nexus standards). Often the statutory analysis will closely mirror, and effectively substitute for, the constitutional analysis since many state statutes extend the state's jurisdiction to tax to the full limits permitted by the U.S. Constitution or articulate their limit using logic articulated in the court cases discussing the constitutional standards. *Compare* Me. Rev. Stat. Ann. tit. 36 § 1754-B.1.G. (requiring "[e]very seller of tangible personal property or taxable services that has a substantial physical presence in this State sufficient to satisfy the requirements of the due process and commerce clauses of the United States Constitution" to register and remit sales tax), *and* Ohio Rev. Code Ann. § 5741.01(I) (defining "substantial nexus" for sales tax collection purposes as coextensive with nexus under "Section 8 of Article I of the Constitution of the United States"), *with* N.M. Stat. Ann. § 7-9-10.A. (imposing a collection obligation on "[e]very person carrying on or causing to be carried on any activity within this state attempting to exploit New Mexico's markets"). Where the constitutional and statutory standards are

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to determine court jurisdiction over an out-of-state defendant under the Due Process Clause. *MBNA (WV)*, 640 S.E.2d at 175 (Benjamin, dissenting). If so, use of such a standard to establish nexus in income tax cases would appear directly contrary to the teaching of the *Quill* Court that the nexus requirements imposed by the Commerce Clause are generally more rigorous than (or at least different from) those imposed by the Due Process Clause.

not identical, and if the state statute is satisfied, the court must then determine whether the constitutional standard is also met because the Commerce Clause and the Due Process Clause requirements must be met in every instance. *See generally Borders Online, LLC v. State Bd. of Equalization*, 129 Cal. App. 4th 1179 (2005) (evaluating the constitutional requirements after determining that the statutory requirements were met).

¶ 202 ATTRIBUTIONAL NEXUS

Since the precise issue in both *Quill* and *Bellas Hess* was whether use tax could be constitutionally collected from a remote seller, subsequent sales and use tax controversies have proceeded on the assumption that physical presence remains the operative nexus standard for use tax collection, i.e., *Quill* is viewed as *stare decisis* for these controversies. Thus, the question in these cases is: What constitutes physical presence under *Quill*? And in the current world, the particular issue is often: Can the physical presence of a party other than the remote seller be attributed to the remote seller to provide the necessary nexus, and, if so, under what circumstances?

Two Supreme Court cases provide support for the notion that the physical presence of a third party can be attributed to an out-of-state seller to create nexus. In *Scripto, Inc. v. Carson* ("*Scripto*"), the United States Supreme Court held that a nonresident corporation may be subject to tax even if its sole connection with the taxing state occurs through in-state solicitation by independent contractors, because the "fine distinction" between contractors and employees is "without constitutional significance" given that it neither impacts the "local function of solicitation nor bears upon its effectiveness in securing a substantial flow of goods into [the state]." 362 U.S. 207, 211 (1960).

In the second case, *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue* ("*Tyler Pipe*"), the Court noted that "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in the state for the sales." 483 U.S. 232, 250 (1987) (quoting the Washington Supreme Court decision on appeal, 105 Wash. 2d 318, 323, 715 P.2d 123, 126 (1986)).[4] As in *Scripto*, the out-of-state seller in *Tyler Pipe* had neither property nor employees in the state, but utilized an in-state independent contractor to solicit business. Because those "representatives maintain[ed] and improve[d] the name recognition, market share, goodwill, and individual customer relations of Tyler Pipe," the representatives' activities in Washington created nexus with the out-of-state-seller. *Tyler Pipe*, 483 U.S. at 249

[4] Although the Court found that the out-of-state seller had nexus, it nevertheless struck down the tax at issue because it failed the internal consistency standard of the Commerce Clause. *Tyler Pipe*, 483 U.S. at 247-48.

(quoting Washington Supreme Court decision on appeal, 105 Wash. 2d at 325, 715 P.2d at 127), 251.

Accordingly, under *Scripto* and *Tyler Pipe*, an out-of-state seller will have nexus by attribution of a third party's in-state activities when 1) the third party is acting "on behalf of" the out-of-state seller, and 2) the third party's activities are "significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales."

While this attributional nexus test is clear in theory, application of the test by the courts has yielded less than fully predictable results. As discussed below, courts have tended to interpret both tests expansively and have implicitly situated the parts in an inverse relationship to one another. Thus, where the court finds that the in-state entity has a close relationship with the out-of-state seller, either because their business operations are extensively integrated or the in-state entity's actions are substantially controlled by the out-of-state entity, then the court will likely place less emphasis on the degree to which the in-state entity's activities are associated with establishing and maintaining the out-of-state seller's market. On the other hand, where a court determines that the in-state entity's activities are very significantly associated with establishing and maintaining a market for the remote seller, the question regarding the extent to which the in-state entity is acting "on behalf of" the remote seller will be less critical. As a consequence, the court opinions considering nexus often have a certain gestalt quality reflecting a test that apparently turns on all the facts and circumstances rather than a surgical examination of two independent factors. Nonetheless, taking each of the tests in turn provides a useful discipline for making judgments as to the risk that certain activities will result in nexus.

¶ 203 RELATIONSHIP BETWEEN IN-STATE AND OUT-OF-STATE ENTITIES

With regard to the first part, "[t]he critical issue is whether substantial business activities have been carried on in the taxing state *on the taxpayer's behalf*." *Arco Bldg. Sys., Inc. v. Chumley*, 209 S.W.3d 63, 74 (Tenn. Ct. App.), *appeal denied*, No. M2004-01872-SC-R11-CV, 2006 Tenn. LEXIS 1002 (Oct. 30, 2006) ("*Arco*") (internal quotation marks omitted; emphasis original). An examination of that question is likely to begin with a determination as to whether the two entities are under common ownership, on the theory that an in-state entity is more likely to represent the interests of its out-of-state affiliate if the two entities are commonly owned. *See generally St. Tammany Parish Tax Collector v. Barnesandnoble.com*, 481 F. Supp. 2d 575, 580-81 (E.D. La. 2007) ("*B&N (La.)*"). While that may prove a workable assumption in many cases, it is clear that common ownership does not by itself result in attributional nexus. *See, e.g.*, *Current, Inc. v. State Bd. of Equalization*, 24 Cal. App. 4th 382 (1994) ("*Current, Inc.*") (out-of-state mail order seller's ownership of the stock of a retailer doing business in the state did not create nexus over the out-of-state seller under the

Commerce Clause); *see also SFA Folio Collections, Inc. v. Tracy*, 652 N.E.2d 693 (Ohio 1995) (in-state presence of an affiliated corporation that distributed taxpayer's catalogues and accepted returns of taxpayer's merchandise was insufficient to create substantial nexus with taxpayer); *SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666 (Conn. 1991), *cert. denied*, 501 U.S. 1223 (1991) (out-of-state taxpayer's linkage with in-state corporation via a common parent and a common enterprise was insufficient to support a finding of substantial nexus). As a corollary, the absence of common ownership may be a significant factor in preventing attributional nexus; plainly, however, it is not sufficient to prevent nexus, particularly where the evidence shows that the in-state entity should be viewed as acting on behalf of the out-of-state entity. *See State v. Dell Int'l, Inc.*, 922 So. 2d 1257, 1266 (La. Ct. App.), *reh'g denied*, 2006 La. App. LEXIS 867 (2006) ("*Dell (La.)*").

Likewise, it does not appear that the in-state entity must actually be viewed as a formal agent of the out-of-state entity under state law to support a finding of attributional nexus. *Dell (La.),* 922 So. 2d at 1264.[5] Rather, a finding that the out-of-state seller "retained control over many of the significant aspects of the services to be provided by [the in-state entity]" is likely to be sufficient to support a finding that the in-state entity's activities were "on behalf of" the out-of-state seller. *Dell (La.)*, 922 So. 2d at 1264, 1266. Similarly, where a remote seller "relies heavily" on an in-state company to perform critical functions in support of the sale, including, for example, accepting and depositing payment, a court is likely to find that the in-state entity is acting on behalf of the out-of-state entity. *Arco*, 209 S.W.3d at 74.[6]

In fleshing out the test, courts often cite relationships that are traditionally associated with a unitary business analysis. *See Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983). For example, the California Court of Appeal in *Current, Inc.* held that the mere fact that an out-of-state mail order seller owned a retailer that did business within California was not enough to provide nexus under the Commerce Clause, because the two companies "did not have integrated operations or management" and "were organized and operated as separate and distinct corporate entities," and "[n]either . . . was the alter ego or agent of the other for any purpose." *Current Inc.*, 24 Cal. App. 4th

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[5] *Compare with Barnesandnoble.com LLC v. State Board of Equalization*, Cal. Tax Rep. (CCH) ¶ 404-488 § III(a) (Cal. Super. Ct. Oct. 12, 2007) ("*B&N (Cal.)*"), where, based upon a recent Court of Appeal decision, a California Superior Court concludes that the California attributional nexus statute uses the terms "agent" and "representative" interchangeably, and concludes that the in-state entity must have authority to bind the out-of-state seller.

[6] However, that is not to say that merely authorizing the third party to accept payment of the sale proceeds should be sufficient to establish attributional nexus. *Cf. AT&T Commc'ns of Md., Inc. v. Comptroller of the Treasury*, 950 A.2d 86 (Md. 2008) (accepting payment from customer for charges by remote information service providers does not alter the fact that a telecommunications company is acting as a common carrier and not as an agent of the remote information services provider).

at 388. Similarly, a federal district court in Louisiana held that an out-of-state Internet seller did not have nexus with Louisiana by virtue of the in-state retail presence of its sister corporation because the two companies did not share management, employees, offices, and other important elements of their businesses. *B&N (La.)*, 481 F. Supp. 2d at 576, 581; *see also B&N (Cal.)*, (CCH) ¶ 404-488 (noting that the out-of-state Internet seller and the in-state retailer had no shared operations, employees, common management, inventory, facilities, or information systems).[7]

¶ 204 APPLICATION OF THESE PRINCIPLES IN THE BOOKSELLERS CASES

Two cases decided by the California courts involving Borders and Barnes & Noble, two booksellers with apparently similar business models, provide a useful opportunity to examine how the courts have determined whether the in-state entity is acting on behalf of the out-of-state entity. In those cases, the fundamental facts were the same: each involved stores operating within the state (so-called "brick & mortar" operations) owned by one corporation and a separately incorporated operation that provided sales over the Internet (and that was not physically present in the state seeking to impose the tax) (the "Internet seller"). In each case, the California State Board of Equalization sought to impose use tax collection over the remote Internet sales operation based upon activities of the brick & mortar stores in the state. *See Borders*, 129 Cal. App. 4th 1179 and *B&N (Cal.)*, Cal. Tax Rep. (CCH) ¶ 404-488.

In the case involving Borders, the court of appeal concluded that the in-state operation acted on behalf of the out-of-state operation based upon cross-marketing by the two entities, and, primarily, a return policy under which customers could return products purchased from the Internet seller to the brick & mortar store. *See Borders*, 129 Cal. App. 4th at 1184, 1190-92.

In contrast, in *B&N (Cal.)*, the trial court concluded that the brick & mortar store did not act on behalf of the Internet seller and so was not a representative or agent of the remote seller under the California statute. In reaching that decision, the court focused upon the fact that during the years at issue, the brick & mortar company did not control the remote seller, because more than 50% of the remote seller's stock was owned by other parties, noting that "the fact that Plaintiff [the Internet seller] and Booksellers [the brick & mortar company] are sister corporations does not support a finding that

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[7] While the courts in these cases have evaluated factors that are typically employed in a unitary analysis, the precise question of whether a unitary business exists between the in-state and out-of-state entity should not be determinative of whether the in-state entity is acting on behalf of the out-of-state entity. As one prominent commentator has noted that it is wholly "inappropriate to apply the unitary business doctrine to the nexus issue for sales tax purposes, since the doctrine is not intended to affect or extend the taxing jurisdiction of the states." Hellerstein & Hellerstein, *Cases and Materials on State and Local Taxation* ¶ 19.02(8)(e) (8th ed. 2005).

Booksellers was Plaintiff's agent." Cal. Tax Rep. (CCH) ¶ 404-488, § III(a). The court also noted that, unlike in the Borders case, the sole activity that the brick & mortar store performed for the Internet seller was to distribute coupons for purchases from the Internet seller that had been inserted into the store's shopping bags by a third-party vendor. *Id.* § II. This activity was not enough to create an agency relationship: "The concept of agency requires something significantly more than simply passing out information at someone else's request." *Id.* § III(a). Therefore, the Internet seller did not have nexus with California, because the brick & mortar entity was not a representative or agent of the Internet seller. *Id.* § III(b).

¶ 205 ACTIVITIES OF THE IN-STATE ENTITY

The second part of the attributional nexus test focuses upon whether the activities of the in-state third party are "significantly associated with the taxpayer's ability to *establish and maintain a market* in this state for the *sales*." *Tyler Pipe*, 483 U.S. at 250 (emphasis added). As an initial matter, the authors are unaware of any decision in which the Supreme Court has articulated a rationale for why the third party's activities must be related to support for sales and marketing activities as opposed to support for other, more general, activities of the remote seller in order for those activities to create attributional nexus for sales tax purposes. Nonetheless, as a common-sense matter, this limitation makes sense, given that jurisdictional issues that arise in the context of sales and use taxes are ultimately triggered by sales to the in-state consumer.[8] More importantly, the cases, including the Supreme Court's decisions in *Scripto* and *Tyler Pipe*, support that limited examination.[9]

That said, the courts have cast a broad net to find that a wide variety of activities establish or maintain the remote seller's market in the state. For example, the Tennessee Court of Appeals concluded that the various functions performed by an in-state manufacturer for an out-of-state vendor, ranging from "the preparation of price quotes[,] to drawing up blueprints[,] to fabricating the product[,] to arranging for shipment of the product[,] to accepting final payment from the customer," satisfied that

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[8] In this regard, the requirement that the in-state activities of a third party must be related to the out-of-state seller's sales activities can be analogized to specific jurisdiction in the context of a court's personal jurisdiction over out-of-state parties to a lawsuit. Thus, just as specific jurisdiction is exercised over a person with respect to a dispute when that dispute arises out of the person's contacts with the forum state, so too would jurisdiction to impose sales tax collection obligations be exercised on the basis of sales activities performed on the taxpayer's behalf in the state.

[9] By contrast, where the state relies upon the in-state presence of the taxpayer, as opposed to attributing the presence of an in-state third party, in order to establish nexus, the Supreme Court has made it clear that the activities need not be associated with the sales operation the state seeks to tax. *See Nat'l Geographic Soc'y v. Cal. Bd. of Equalization*, 430 U.S. 551, 561 (1977). Continuing the personal jurisdiction analogy, it is as if the taxpayer, by conducting activities in the state, subjects itself to the "general" taxing jurisdiction of the state, including jurisdiction to impose a sales tax collection obligation.

standard. *Arco*, 209 S.W.3d at 74. Two courts examining Dell's business model have determined that in-state warranty repair services sold by Dell in connection with its remote mail order sales of computers, and provided by a third-party contractor, should be viewed as supporting Dell's efforts to obtain sales in the markets where the warranty repair services are provided. *Dell (La.)*, 922 So. 2d 1257; *Dell (NM)*, 199 P.3d at 872 (noting that the "reality of the relationship" between the repair company and Dell and the "critical nature" of the repair company's activities to Dell's business together supported a finding of nexus).

State tax administrators predictably have taken an even more expansive view of the definition of activities in support of obtaining or maintaining a market. The Kansas Department of Revenue, for example, has concluded local third-party contractors that installed security locks and related equipment sold by an out-of-state seller should be viewed as creating and maintaining the market for the remote seller. Kan. Dep't of Revenue Priv. Ltr. Rul. P-2005-016 (June 20, 2005). The Texas Comptroller has concluded that in-state independent contractors that "perform maintenance and repair services" result in attributional nexus with an out-of-state entity that sells those services. Hearing No. 46,541, Texas Comptroller of Public Accounts (May 10, 2006).

¶ 206 APPLICATION OF THESE PRINCIPLES TO THE BOOKSELLER CASES

The decisions reached in two bookseller cases, the *Borders* case decided by a California Court of Appeal, discussed above, and a second case involving Barnes & Nobles decided by a Louisiana court, provide a useful opportunity to examine how courts have analyzed whether in-state activities should be viewed as creating or maintaining a market. The cases are of particular utility because the courts have reached different conclusions after examining the two seemingly similar business models.

In the *Borders* case, decided by the California Court of Appeal, the in-state retailer: 1) accepted returns from, and provided refunds and exchanges to, the remote seller's customers; 2) issued receipts to its customers with the message "Visit us online at www.Borders.com"; and 3) encouraged its employees to refer customers to the remote seller's website. *Borders*, Cal. App. 4th at 1199. The "cross-selling synergy" was also supported by the entities' similar logos and by a link between the entities' websites. *Id.* The court found that these activities were significantly associated with the remote seller's "ability to establish and maintain a market" in California and so created nexus with the out-of-state seller. *Id.* (citation omitted).

By contrast, in the Barnes & Noble case, decided by a U.S. District Court in Louisiana, the court analyzed the activities of the in-state retailer and came to the opposite conclusion.[10] There, the brick & mortar operation and the Internet seller participated in a "membership program," whereby customers who purchased memberships were entitled to certain discounts from participating retailers and the retailers shared members' contact information for use with direct mail advertising, and also a gift card program, whereby customers could redeem gift cards at the brick & mortar store, with the Internet seller, or at any other participating retailer. *B&N (La.)*, 481 F. Supp. 2d at 578-79. However, the court found that these activities did not "produce[] revenue to Online by virtue of sales made or orders taken by the entity that is physically present in the Parish," since the revenue from the programs was simply divided among participating entities on a pro rata basis. *Id.* at 581.

In addition, when an in-state store had to order a particular item that it did not have in stock, in some instances the order would be filled from the Internet seller's distribution center, for which the Internet seller would charge the brick & mortar store a commission. *Id.* at 579. The court again found that this did not justify "treat[ing] Booksellers as acting as a marketing presence for Online," because the brick & mortar store filled orders for merchandise from many wholesalers and did not treat the remote Internet seller any differently from those other wholesalers. *Id.* at 581.

Also, unlike in the Borders case, the brick & mortar stores did not refer customers to the remote Internet seller or otherwise promote that entity's business, except in connection with the membership and gift card programs. *Id.* at 580. However, similar to the brick & mortar retailers in Borders, Barnes & Nobles stores accepted returns of merchandise purchased from the remote Internet seller, treated that merchandise "as if it were its own," and gave it preferential treatment over merchandise purchased from third parties. *Id.* at 582. The court nonetheless distinguished the Borders case on this point, on the grounds that the Barnes & Noble stores "initiated the return policy to generate goodwill and to serve the convenience of its customers," implying that the activity was associated with establishing and maintaining the store's own market, not that of the remote Internet seller. *Id.*

Ultimately, the court concluded that the activities performed within the state were not of the same magnitude and nature as those performed by the in-state entities in *Scripto* and *Tyler Pipe*, largely because the activities at issue either benefited third-party competitors just as they benefited the Internet seller or were motivated by the business interests of the brick & mortar stores. *Id.* at 581-82.

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[10] The record in the Louisiana Barnes & Noble case appears to differ slightly from the facts relied upon by the California Superior Court case, discussed above, although both courts reached the same conclusion that the in-state stores did not perform activities for the online seller that would result in attributional nexus. The differences in the factual record apparently may be traced to the different years at issue in each decision.

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¶ 207 THE NEW EXPANDED STATE NEXUS STATUTES

Recently, states have moved to expand their statutes to increase further the scope of their jurisdiction to tax. These statutes clearly extend beyond the boundaries for attributional nexus established by the courts to date and therefore their constitutionality remains to be seen.

Certain states have now expanded their statutes to attribute nexus based upon no more than common ownership of the in- and out-of-state entities coupled with a similar line of business and the same or a similar business name. For example, under a new Idaho statute, a retailer has substantial nexus with the state if it is related, under the Internal Revenue Code, to a business with a retail location in the state (e.g., because both companies are treated as members of the same controlled group of corporations under Section 1563 of the Internal Revenue Code) and the in-state business uses a substantially similar name to promote or sell products. H.B. 360, 59th Leg., 2d Reg. Sess. (Idaho 2008). Similarly, a new Kansas statute creates a presumption that a retailer is "doing business" in the state if it holds a substantial ownership interest in, or is owned in substantial part by, a retailer with a sales location in Kansas that sells the same or similar products with the same name as, or a similar business name to, those sold by the out-of-state retailer. Kan. Dep't of Revenue Priv. Ltr. Rul. P-2005-016 (June 20, 2005); Kan. Stat. Ann. § 79-3702(h)(2)(A). Florida's statute casts an even wider net. It delineates eleven bases for nexus with an out-of-state mail-order seller, one of which asserts nexus over sellers that otherwise do not have nexus with the state, but that are a member of an affiliated group, of which one of the members does have nexus with Florida. Fla. Stat. 212.0596(2)(e)-(k).

¶ 208 NEW YORK'S AMAZON LAW

New York's statute represents another theory for pushing the boundaries of attributional nexus, particularly in its expansion of both the required relationship between the entities to support a finding that the in-state entity acted "on behalf of" the out-of-state entity and the types of activities that will be viewed as creating or maintaining a market. The legislation in question amended the definition of a "vendor" in New York Tax Law Section 1101(b)(8) to create an evidentiary presumption that an out-of-state seller is deemed to be "soliciting business" in the state if the seller enters into an agreement with a New York state resident whereby the seller pays the resident a commission or other compensation for direct or indirect customer "referrals" that result in sales. N.Y. Tax Law § 1101(b)(8)(vi). The seller presumed to be a New York "vendor" is required to collect New York sales and use tax on sales to customers in New York, if the seller's aggregate gross receipts surpass a de minimis threshold ($10,000 for the prior four quarters). *Id*. The presumption may be rebutted by proof that the New York resident party to such agreements "did not engage in any solicitation in the state on behalf of the seller that would satisfy the nexus requirement of the United States constitution."[11] *Id.*

This legislation is colloquially known as the "Amazon law," because it directly implicates the business model successfully employed by Amazon.com. The industry quickly filed two suits to preempt application of the new law, arguing that the statute was unconstitutional both on its face and as applied to the particular taxpayers. See *Amazon.com LLC v. N.Y. State Dep't of Taxation & Fin.*, No. 601247/08, 2009 N.Y. Misc. LEXIS 28, 2009 N.Y. Slip. Op. 29007 (N.Y. App. Div. Jan. 12, 2009) ("*Amazon.com*"); *Overstock.com v. New York State Dep't of Taxation & Fin.*, No. 107581/08, STATE-CASE-TRL-CT (CCH) ¶ 406-294 (N.Y. Sup. Ct. Jan. 12, 2009) ("*Overstock.com*").[12]

In January 2009, the trial court dismissed those lawsuits and positioned the cases for an appellate battle that may well eventually rise to the United States Supreme Court. The court began with the proposition that an out-of-state seller need not collect sales and use tax if its *only* connections with the state are solicitation through catalogs, flyers, advertisements in national periodicals, or telephone calls and delivery of merchandise by common carrier. *Amazon.com*, 2009 N.Y. Slip. Op. 29007 at 5 (citing *Quill* and *Bellas Hess*).

The court rejected the taxpayer's facial challenge under the Commerce Clause, because the statute gave the seller the opportunity to rebut the presumption, and thus shield itself from the obligation to collect the tax, by proving that none of its contractors actively sought sales on its behalf in New York, notwithstanding the referral arrangement. *Id.* Moreover, the court found that the statute required demonstrably more than the "slightest presence," in that it required meaningful economic activity in New York performed by the vendor's personnel or on its behalf. *Id.* at 6. In addition, the court found that the statute did not create nexus based on mere advertising, but rather imposed a "tax-collection obligation on sellers who contractually agree to compensate New York residents for business that they generate and *not* simply for publicity." *Id.*

The court also rejected the as-applied Commerce Clause challenge, because it found that Amazon's referral system went beyond the safe harbor created by *Quill*. The court

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[11] The New York Department of Taxation and Finance has now issued two statements providing information on how sellers may rebut the new presumption. See TSB-M-08(3)S, New Presumption Applicable to Definition of Sales Tax Vendor (N.Y.S. Dep't of Tax. & Fin. May 8, 2008), and TSB-M-08(3.1)S, Additional Information on How Sellers May Rebut the New Presumption Applicable to the Definition of Sales Tax Vendor as Described in TSB-M-08(3)S, (N.Y.S. Dep't of Tax. & Fin. June 30, 2008).

[12] Our discussion will focus upon the *Amazon* decision, which is mirrored by the *Overstock.com* decision.

found that Amazon did have physical presence in the state, by way of its contracts with thousands of associates that provided it with a New York address, therefore suggesting that they were New York residents. *Id*. It also found that Amazon had a fair opportunity to rebut the presumption, because it had the ability to ascertain readily through public information whether any particular associate was a New York resident. *Id*. The court found that the associates' activities, i.e., referring customers to Amazon's website through links on their own websites, were sufficiently associated with establishing and maintaining a market for Amazon in the state, and that it was immaterial that the associates did not solicit New York business at Amazon's express direction and that Amazon contractually prohibited them from engaging in certain types of conduct (i.e., offering its customers money back for Amazon purchases made through associate links). *Id*. at 6-7. Finally, in the court's view, Amazon was using an "incentivized New York sales force" to perform activities that, if performed by employees, would have produced nexus. *Id*. at 7.

Several other states have noted New York's new law and have recently introduced similar legislation that would impose a sales tax collection obligation on an out-of-state seller if the seller enters into certain agreements with in-state businesses to solicit sales on the seller's behalf. *See* S.B. 1741 (Tenn. 2009); S. 487, Sess. 2009 (N.C. 2009); A.B. 178 2009-2010 Reg. Sess. (Cal. 2009); R.B. 806, Jan. Sess. (Conn. 2009); H.B. 1405, 25th Leg. (Haw. 2009); H.F. 401, 86th Sess. (Minn. 2009). Indeed, a few of these states have borrowed New York's legislation nearly verbatim. *See, e.g.*, S. 487, Sess. 2009 (N.C. 2009), S.B. 1741 (Tenn. 2009).

¶ 209 GUIDELINES FOR AVOIDING ATTRIBUTIONAL NEXUS

Because the battle lines continue to shift and because the cases that have recently considered this issue often turn on specific facts, it is difficult to develop any practical rules for avoiding attributional nexus based solely on corporate structure or even operational limits. However, notwithstanding the variation among individual cases, we believe it is possible to establish at least four guidelines that can be used to analyze the risk that an in-state business operation may produce nexus for an out-of-state sales operation.

⇒ First, common ownership of a remote seller and an in-state entity, by itself, should not result in attributional nexus. This conclusion is supported by case law. *See, e.g.*, *Current, Inc.*, 24 Cal. App. 4th at 385. But it is also supported by the broad principles underlying the unitary income tax cases which have long conceded that a unitary finding (which requires common ownership) does not support a direct tax on out-of-state entities even if the income from those entities must be included in a combined report to determine the income of the in-state entity. *See also* Hellerstein & Hellerstein, *Cases and Materials on State and Local Taxation* ¶ 19.02(8)(e) (8th ed. 2005), discussed above at footnote 7. That said, the absence of common ownership may go a long way to establishing that the in-state entity is acting in its own interest and not on behalf of the out-of-state entity and, thus, may be very helpful in avoiding attributional nexus. While there certainly are cases where the activities of a third party provide attributional nexus, courts seem to be more willing to attribute nexus where the in-state entity shares common ownership and control with the out-of-state entity.

⇒ Second, contracting with an entity that is plainly not involved in the success of the marketing and sales activity of the out-of-state entity should not result in attributional nexus. This principle will be strongest where the in-state entity is engaged in an obviously unrelated business, for example, where the in-state entity is a professional service provider (e.g. lawyer or accountant) rather than involved in marketing or servicing of the same or similar products. Michigan Dep't of Treasury, Revenue Administrative Bulletin 1999-1, *Use Tax Nexus Standards* ¶ I.6(c) (May 12, 1999). But even where the in-state entity is involved in sales of similar products, attributional nexus should not result if the in-state activities provide no meaningful assistance or are, in fact, arguably detrimental to the out-of-state seller's sales. *See, e.g.*, Tax Determination No. 08-0128, Wash. Dep't of Revenue (May 14, 2008, released Jan. 28, 2009) (concluding the presence of an in-state entity did not result in attributional nexus in part because the in-state entity's promotions of sales of products to retailers may have, in fact, reduced the market share of the out-of-state seller by allowing local retailers to compete with the out-of-state entity's sales over the Internet and telephone).

⇒ Third, as a corollary to this principle, merely placing an advertisement in a local newspaper or other media should not result in nexus over the out-of-state entity that places the advertisement. *Current, Inc.*, 24 Cal. App. 4th at 386, 391; *see also In re Laptops Etc. Corp.*, 164 B.R. 506, 521 (Bankr. D. Md. 1993). As noted in the *Amazon.com* litigation above, it may be important to demonstrate that the compensation paid to the media company is for the media company's product (namely, providing publicity), not for promoting the sales of the out-of-state company. Thus, it may be important to avoid contracts (such as sales commission contracts) that are tied to the success of marketing the out-of-state seller's product.

⇒ Fourth, using a common carrier or similar entity to provide delivery in the state (and even accept payment for the product) should not result in nexus over the out-of-state entity. *AT&T Commc'ns of Md., Inc. v. Comptroller of the Treasury*, 950 A.2d 86 (Md. 2008) (noting that accepting payment from customer for charges by remote information service providers does not alter the fact that a telecommunications company is acting as a common carrier and not as an agent of the remote information service providers, and that such a relationship was approved in the *Quill* and *Bellas Hess* decisions involving C.O.D. collections by traditional common carrier companies).

Undoubtedly, the operations of many taxpayers will not fit neatly within these guidelines. And, while it is useful to think of these guidelines as providing "safe harbors," the law is probably not yet sufficiently developed to ensure that all courts will adhere to these principles. As a result, at least until the United States Supreme Court weighs in to fully reconcile the holdings of its decisions in *Quill*, *Bellas Hess*, *Scripto,* and *Tyler Pipe,* there will always be a measure of risk that the tax authorities, at least, will construe any substantial relationship with an in-state entity as providing attributional nexus over a remote seller.