Economic Nexus Curtailed, Again

by Craig B. Fields, Mitchell A. Newmark, and Richard C. Call

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Introduction

In a period of 18 months, three state courts have refused to extend economic nexus approaches to the facts before them, despite prior decisions in those states that corporations without physical presence in the state were subject to tax. Most recently, it was the Indiana Tax Court that held in a published and precedential decision on a motion for summary judgment that physical presence is required for corporations to be subject to the Indiana corporate income tax and the Indiana premiums tax, which is imposed on insurance companies.[1] The time for appeal has not yet expired.

The Indiana Tax Court's *UPS* decision confirms that Indiana does not apply an economic nexus approach to corporate income tax. The court distinguished its earlier decision in *MBNA Am. Bank NA v. Indiana Dep't of State Revenue*, 895 N.E.2d 140 (Ind. Tax Ct. 2008), which applied an economic nexus approach to the Indiana financial institutions tax (FIT). Corporations that have wondered whether *MBNA* would apply to the Indiana corporate income tax now have an answer from the tax court. Further, the decision demonstrates that the tide is changing in the nexus area, as Indiana joins the states that have recently curtailed economic nexus.

Courts are pushing back against economic nexus theories (as well as other nexus theories).[2] As more states reject economic nexus, the U.S. Supreme Court may be more encouraged to take an economic nexus case.

UPS Refuses to Extend *MBNA* to Other Taxes in Indiana

Five years ago in *MBNA*, the Indiana Tax Court addressed whether a corporation that issued credit cards to customers located in Indiana but which itself had no physical presence in the state could be subject to the FIT. The court said "The stipulated facts in [the] case indicate[d] that, during the years at issue, MBNA had an economic presence in Indiana. . . . Thus, during the years at issue, MBNA had a substantial nexus with Indiana for purposes of the FIT."[3]

Despite *MBNA*'s confirming an economic presence test for the FIT, the *UPS* court held that "there is no tension between Indiana's premiums tax and its corporate income tax because each utilizes a physical presence standard."[4] The court continued, "Furthermore, while this Court has found that an economic presence rather than a physical presence is a sufficient basis for imposition of the FIT, it cannot reach the same conclusion regarding Indiana's premiums tax."[5]

While based on statutory grounds, rather than due process or commerce clause grounds, the Indiana Tax Court's language in a published precedential decision provides clarity to corporations regarding the nexus standard for the corporate income tax and premiums tax, especially for corporations that

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[1]*United Parcel Service Inc. v. Indiana Dep't of State Revenue*, No. 49T10-0704-TA-24 (Ind. Tax Ct. 2013).

[2]For further analyses of various nexus theories, see Craig B. Fields et al., "'Inherited Nexus' and Other Extreme Nexus Theories," *State Tax Notes*, July 1, 2013, p. 27; Paul H. Frankel et al., "The Due Process Clause as a Bar to State Tax Nexus," *State Tax Notes*, Oct. 29, 2012, p. 343.

(Footnote continued in next column.)

[3]*MBNA*, 895 N.E.2d at 144.

[4]*UPS*, slip op. at 6.

[5]*Id.* The department argued that "a foreign reinsurer need only show that it has a certificate of authority to satisfy the statutory 'doing business' requirement." *Id.* at 7. The tax court rejected this notion. *Id.* at 7-8. We agree with the tax court's rejection and do not believe that due process clause purposeful availment or commerce clause substantial nexus are satisfied merely because a taxpayer has a certificate of authority or some other certificate to do business in a state.

were unsure of whether the economic nexus standard in *MBNA* applied to those taxes. When combined with the state court decisions discussed below and in our previous articles,[6] *UPS* further demonstrates the changing tide in the state tax nexus area.

Scioto Refuses to Extend *Geoffrey* in Oklahoma

In *Scioto Insurance Co. v. Oklahoma Tax Commission*, 279 P.3d 782 (Okla. 2012), we asserted[7] that Oklahoma could not impose a corporate income tax on Scioto as a result of its licensing of intellectual property to a related party. Scioto was an insurance company organized under the laws of Vermont with no physical presence in Oklahoma. It licensed intellectual property to Wendy's International Inc. under an agreement executed outside Oklahoma. Wendy's International then sublicensed the intellectual property to Wendy's restaurants, including restaurants owned by third-party franchisees in Oklahoma.

In May 2012 the Oklahoma Supreme Court agreed with us, finding no "basis for Oklahoma to tax the value received by Scioto from Wendy's International under a licensing contract . . . no part of which was to be performed in Oklahoma."[8] It further stated that "due process is offended by Oklahoma's attempt to tax an out of state corporation that has no contact with Oklahoma other than receiving payments from an Oklahoma taxpayer . . . who has a bona fide obligation to do so under a contract not made in Oklahoma."[9]

Scioto is significant because it ruled on due process grounds and refused to extend to *Scioto*'s facts a lower court's decision in *Geoffrey Inc. v. Oklahoma Tax Comm'n*, 132 P.3d 632 (Okla. Civ. App. 2006), that found economic nexus based on the receipt of royalties from a payer that was physically present in Oklahoma.

ConAgra Refuses to Extend *MBNA* in West Virginia

In *Tax Commissioner v. MBNA America Bank NA*, 640 S.E.2d 226 (W. Va. 2006), the West Virginia Supreme Court of Appeals held that a corporation that issued credit cards to customers located in West Virginia could be subjected to tax despite not having a physical presence in West Virginia because the corporation had a significant economic presence there. However, in May 2012 in *Griffith v. ConAgra Brands Inc.*, 728 S.E.2d 74 (W. Va. 2012), the West Virginia court distinguished its earlier *MBNA* decision and refused to find that a corporation that licensed intangible property that was displayed on consumer products sold in the state was subject to the West Virginia corporate income tax. The corporation in *ConAgra* licensed intangibles to related and third-party manufacturers that manufactured products bearing the licensed intangibles outside West Virginia and sold them to customers located in West Virginia.

The *ConAgra* court found for the corporation on due process clause grounds and, alternatively, on commerce clause grounds. For due process clause purposes, it stated that tax assessments against a foreign licensor "on royalties earned from the nation-wide licensing of food industry trademarks and trade names [did not] satisfy . . . '*purposeful direction*' under the Due Process Clause."[10] It alternatively reasoned that "assuming arguendo the elements of the Due Process Clause were satisfied, the assessments against ConAgra Brands would fail under the substantial nexus component of the Commerce Clause."[11]

Trend Continues in Taxpayers' Favor

A New Jersey court also refused to extend a prior economic nexus decision in its own state to different facts. In *AccuZIP Inc. v. Director, Division of Taxation*, the New Jersey Tax Court distinguished the facts before it from a prior New Jersey decision permitting the imposition of tax on a company that had no physical presence in New Jersey.[12] In so doing, the *AccuZIP* court reasoned that a corporation's sales of computer software to customers located in New Jersey did not result in the corporation being subject to corporate income tax.

AccuZIP is also notable because the New Jersey Tax Court refused to adopt the significant economic presence test set forth in the *MBNA* West Virginia decision. The tax court summarized the facts in *MBNA* West Virginia and stated, "The significant economic presence test applied in *MBNA* is not binding on this court."[13] We note however, that the New Jersey Division of Taxation's published guidance disregards the tax court's decision and states that the division "appl[ies] the principles" of the West Virginia *MBNA* decision.[14]

Other state courts have ruled that a physical presence standard applies to the state's corporate income tax, including Michigan, Tennessee, and

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[6]*Id.*

[7]Paul H. Frankel of Morrison & Foerster LLP argued the case before the Supreme Court of Oklahoma.

[8]279 P. 3d 783 (2012).

[9]*Id.* at 784.

[10]*Id.* at 200 (emphasis added).

[11]*Id.* at 200-201.

[12]25 N.J. Tax 158 (N.J. Tax Ct. 2009) (finding inapplicable *Lanco Inc. v. Director, Division of Taxation*, 908 A.2d 17 (N.J. 2006)).

[13]*AccuZIP*, 25 N.J. Tax at 186.

[14]New Jersey Division of Taxation Technical Advice Memorandum 2011-6.

Texas.[15] Also, in the last few years, we have seen courts rein in state tax agencies' assertions of nexus on other grounds as taxpayers have successfully challenged such assertions in various courts.[16] Those decisions demonstrate that nexus is a case-by-case inquiry based on facts and circumstances. Corporations should not assume that merely because a state has a case applying economic nexus that all assertions of economic nexus by a state tax agency are appropriate or will be upheld by the courts.

The tide is turning. Given the states' split decisions on economic nexus, the U.S. Supreme Court should, and may be more inclined to, hear the question whether substantial nexus has the same meaning for sales and use taxes as for other taxes, although we believe *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), previously answered that question in the affirmative for all taxes. ☆

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[15]*Guardian Indus. Corp. v. Dep't of Treasury*, 499 N.W.2d 349 (Mich. Ct. App. 1993); *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999); *INOVA Diagnostics Inc. v. Strayhorn*, 166 S.W.3d 394, 402 (Tex. App. 2005), citing *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296 (Tex. App. 2000).

[16]*See, e.g., State v. NV Sumatra Tobacco Trading Co.*, No. M2010-01955-SC-R11-CV (Tenn. 2013); *In re Washington Mutual Inc.*, 485 B.R. 510 (Bankr. D. Del. 2012).