
Economic Nexus and More

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 - Not tax or legal advice
- **Applicability to specific situations should be determined through consultation with your tax adviser**

Agenda

Nexus

- **Background**
 - *Wayfair* Decision and State Economic Nexus Thresholds
- ***Post-Wayfair* Nexus Challenges**
 - Retroactivity
 - Undue Burden
 - Nexus with the Taxpayer
 - Nexus with the Transaction/Income
 - Due Process Clause
- **Recent US Supreme Court Due Process Nexus Decisions**

PL-86-272

What's Next?

Nexus – Background

South Dakota v. Wayfair, 585 US 162 (2018)

- The U.S. Supreme Court ruled in a 5 – 4 decision
- Court abolished longstanding physical presence requirement. *Bellas Hess*, *Quill* overruled.
- Court enshrined the 4-prong *Complete Auto* test, and focused on Prong 1
 - Prong 1: does the tax apply to an activity with a substantial nexus with the taxing state?
 - “Substantial nexus is established when a taxpayer [or collector] ‘**avails itself of the substantial privilege of carrying on business’ in that jurisdiction.**” *Polar Tankers v City of Valdez*, 557 US 1, 11 (2009)
 - Due process clause nexus: “whether the foreign corporation **purposefully avails itself of the benefits of an economic market in the ...state.**” “[D]ue process and commerce clause standards, though not identical or coterminous, have significant parallels.”
 - “This quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business” in the state. Here nexus is clearly sufficient based on both the **virtual and economic contacts** respondents have with the state.”
- The Court reiterated that, under the DCC, a state cannot discriminate against or place undue burdens upon interstate commerce, and that features of the South Dakota Statute “appear designed to prevent” an undue burden: de minimis safe harbor, no retroactivity, some level of uniform taxation (through membership in Streamlined Sales and Use Tax Agreement)
- The Court remanded (The parties then settled)

Sales Tax - Economic Presence Thresholds

- **Most states have adopted dollar or dollar/transaction thresholds:**
 - \$100,000 – AZ, CO, FL, ID, IA, KS, LA, ME, MA, MO, NM, NC, ND, OK, PA, SC, SD, TN, WA, WI, WY
 - \$100,000 *or* 200 transactions – AK (local), AR, DC, GA, HI, IL, KY, MD, MI, MN, NE, NV, NJ, OH, RI, UT, VT, VA, WV
 - \$100,000 *and* 200 transactions - CT
 - \$250,000 – AL, MS,
 - \$500,000 – CA, TX,
 - \$500,000 *and* 100 transactions – NY,
- **States are moving away from transaction thresholds, focusing solely on sales thresholds**
 - NC – dropped 200 transaction threshold effective July 1, 2024
 - WY – dropped 200 transaction threshold effective July 1, 2024
 - IN – dropped 200 transaction threshold effective January 1, 2024
 - LA – dropped 200 transaction threshold effective August 1, 2023
 - SD – dropped 200 transaction threshold effective July 1, 2023
 - ME – dropped 200 transaction threshold effective January 1, 2022

Income Tax –General Economic or Factor Presence Nexus

Factor presence/Economic nexus pre- <i>Wayfair</i>
<ul style="list-style-type: none">• Alabama• California• Colorado• Connecticut• Maine• Michigan• New Hampshire• New York• Ohio (CAT)• Oregon• Rhode Island• Tennessee• Virginia (positive apportionment)• Washington (B&O) (factor presence)• Vermont• Wisconsin

Factor presence/Economic nexus post- <i>Wayfair</i>
<ul style="list-style-type: none">• Arkansas (in an ALJ determination)• Hawaii (2019 SB 495)• Indiana (2019 SB 563)• Kentucky (FAQ: any sales, property, or payroll)• Maine (factor presence beg. 2022)• Massachusetts (Reg. 830 CMR 63.39.1)• New Jersey (\$100k or 200 transactions beg. 2023)• Oregon (CAT) (2019 HB 3427)• Pennsylvania (Tax Bulletin 2019-04; House Bill 1342 beg. 2023)• Texas (Reg. TAC 34 § 3.586)• Utah (2019 SB 28) <p>Cities</p> <ul style="list-style-type: none">• Philadelphia (Reg. 103)• San Francisco (Proposition D)• New York City

Nexus - Post-*Wayfair* Challenges

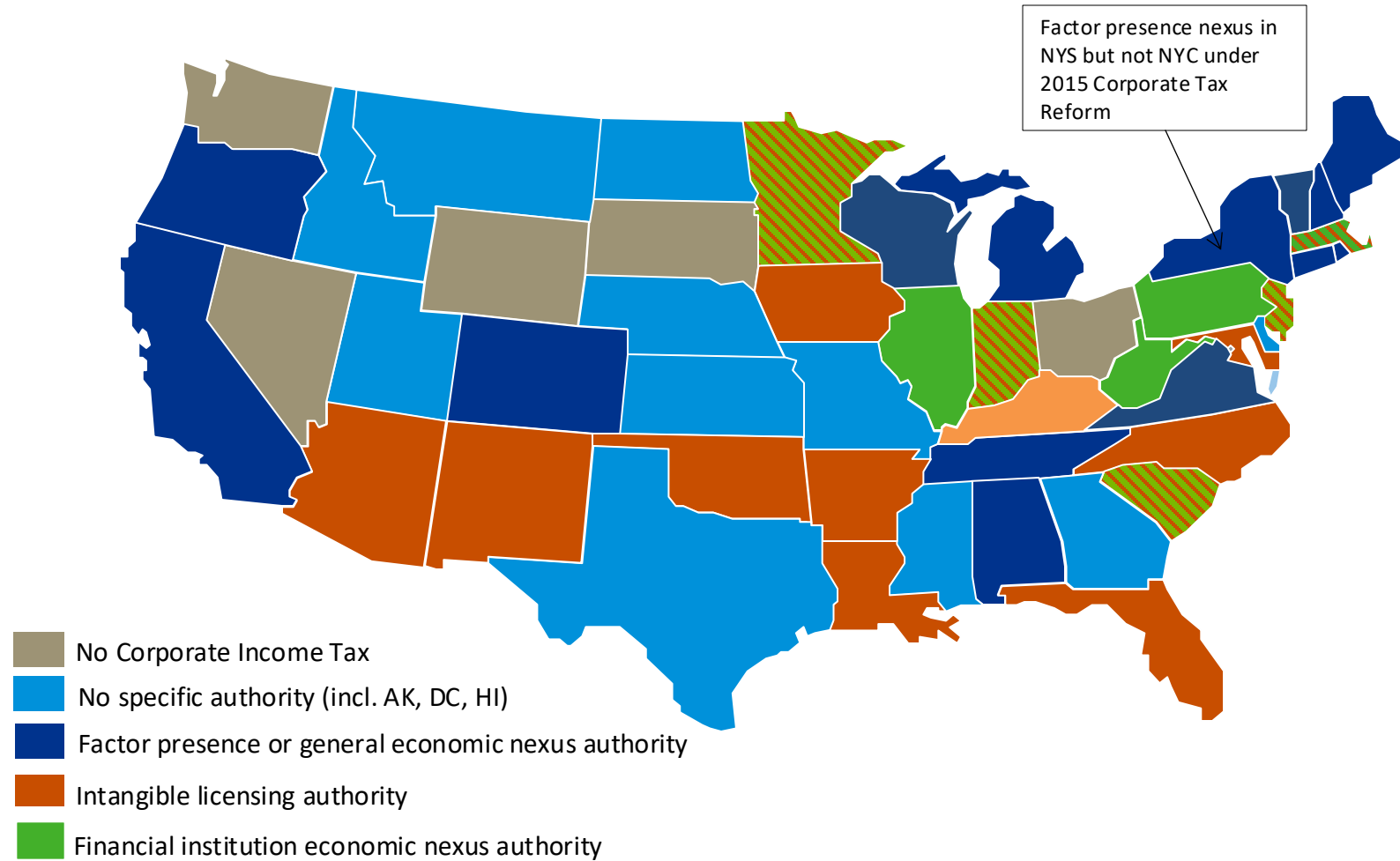
- Retroactivity
- Undue Burden
- Nexus with the Taxpayer
- Nexus with the Transaction/Income
- Due Process Nexus

Retroactivity

- Judicial decisions generally presumed retroactive, as well as prospective
 - *See Harper v. Virginia Dept. of Taxation*, 509 U.S. 86 (1993)
 - *OOMA, Inc. v. Dep't of Rev.*, 369 Ore. 95 (2021) (cert. denied June 21, 2022)
 - *But see, U.S. Auto Parts Network, Inc. v. Comm'r of Rev.*, 199 N.E.3d 840 (Mass. 2022)
- Other limits on retroactive, as well as prospective, application
 - State statute or regulation
 - *Newegg, Inc. v. Alabama Dep't of Rev.*, Docket No. S. 16-613-JP (Ala. Tax Trib., June 14, 2018)
 - *U.S. Auto Parts Network, Inc. v. Comm'r of Rev.*, 199 N.E.3d 840 (Mass. 2022)
 - U.S. Constitution Due Process Clause – Notice requirement

Retroactivity

Pre-*Wayfair* Income Tax Economic Nexus



Undue Burden – Some Issues

- **States vary over how sales tax thresholds are calculated—*i.e.*, *what sales count?***
 - Gross sales?
 - Retail Sales?
 - Does what you sell matter? TPP, Digital Goods, Services, Exempt Sales?
- **States vary over compliance deadlines once economic presence thresholds are met.**
- **Will Congress step in?**

More Issues: Sales Tax - Compliance Deadlines Once Economic Presence Threshold Met

States vary—Examples:

CA, IN—immediately

CO—1st day of month following 90th day after threshold exceeded

IA, KY—1st day of month not more than 30 days after threshold exceeded

LA (DOR FAQ)—register within 30 days after exceeding threshold, commence tax collection with 60 days after exceeding threshold

MA (DOR FAQ)—1st day of the first month beginning two months after the month in which the threshold was exceeded

TN—1st day of third month following month when threshold exceeded

TX—1st day of month of 4th month following month in which threshold exceeded within a consecutive 12-month period

Undue Burden - Litigation

- *Halstead Bead, Inc. v. Richards*,
No. 22-30373, 2023 WL 4414872 (U.S.C.A. 5th Cir. July 7, 2023)
- *Wayfair, LLC v. City of Lakewood, et al.*,
Case #2022CV30710 (Jefferson County Colo. Dist. Ct., 2022)
- *PetMed Express, Inc. v. Illinois Dep't of Rev.*,
Docket No. 23TT104 (Illinois Independent Tax Tribunal)

Nexus with the Taxpayer

OOMA, Inc. v. Dep't of Rev., 369 Ore. 95 (2021) (cert. denied June 21, 2022)

- The Oregon Supreme Court held that a VoIP service provider was required to collect and remit the state's E911 tax imposed on VoIP lines for tax years before the *Wayfair* decision
- The taxpayer purposefully availed itself of the Oregon market and had the minimum contacts necessary to establish Due Process Clause nexus
 - The taxpayer developed marketing plans and employed business strategies intended to reach Oregon residents (and residents of other states), shipped products directly into Oregon, and engaged retailers to sell its products in Oregon
 - Efforts to attract Oregon customers and the services provided in Oregon to those customers established that purposeful availment of the Oregon market, despite Taxpayer's position it did not target Oregon customers directly
- The Taxpayer also asserted that "a court may not conclude that an out-of-state company satisfies the substantial nexus requirement without finding that the company maintains an extensive virtual presence," even if it had surpassed more than \$100,000 of sales or had more than 200 transactions
- The court noted that while the taxpayers in *Wayfair* undoubtedly had an extensive virtual presence, that the U.S. Supreme Court did not articulate that as a specific requirement for establishing nexus

Nexus with the Transaction/Income

Quad Graphics, Inc. v. N.C. Dep't of Revenue, 871 S.E.2d 108 (N.C. 2022) (cert. denied June 20, 2023)

- Quad Graphics was a direct mail retailer based in Wisconsin with a sales representative located in North Carolina. It solicited customers in North Carolina, and remitted tax on sales to North Carolina customers, when those sales were either shipped directly to those customers in North Carolina or to those customers' third-party designees located in North Carolina (direct mail). It did not collect or remit North Carolina sales tax on sales to out-of-state customers, even when those sales were delivered to the out-of-state customer's third-party designees located in North Carolina (direct mail). The state assessed sales tax on out-of-state sales transactions when product was delivered to designees located in North Carolina.
- Applying the US Supreme Court decision in *McLeod v. Dilworth*, the North Business Court determined that, for the sales at issue, title passed outside the state, and North Carolina had no nexus over the sale
- The North Carolina Supreme Court reversed, holding 6-1, that while *Dilworth* had not been explicitly overturned, the U.S. Supreme Court decisions in *Complete Auto* and *Wayfair* represented a rejection of its formalist approach. Under the relaxed standard used in those later cases, the state was permitted to impose sales tax on a transaction when title passed out of state, consistent with destination sourcing.

Nexus with the Transaction/Income

VAS Holdings & Investments, LLC v. Comm’r of Rev.

489 Mass. 669 (Mass. May 16, 2022)

- An out-of-state corporation was subject to Massachusetts’ corporate excise tax on an apportioned share of gain from the sale of its ownership interest in a non-unitary, in-state LLC.
- Taxpayer argued tax is permitted only on capital gain from the sale of a subsidiary when (i) there is enterprise unity (functional integration, centralization of management, and economies of scale between two entities); or (ii) asset unity (the investment in the in-state entity served an operational function of the out-of-state corporation) consistent with the unitary business principle.
- The Commissioner argued tax on an apportioned share of gain from the sale of the non-unitary entity was constitutional, because a portion of the gain had been generated in Massachusetts – i.e., the subsidiary had activity in the state that contributed a portion of the value of the entity and thus a portion of the gain.
- The court rejected the taxpayer’s argument that unity with the seller was the sole criteria for determining when tax on an apportioned share of gain from the sale of a business was constitutional. Further, it found the Commonwealth’s nexus with the in-state entity was constitutionally sufficient to justify the taxation
- However, the court concluded apportionment had not been statutorily adopted by Massachusetts for these circumstances, making the assessment impermissible under state statute.
- See also, *Matter of Goldman Sachs Petershill Fund Offshore Holdings Corp.* (NYC Tax App. Trib. March 12, 2021)

Market-based sourcing for services

Benefit received	Service delivered	Service used/ Customer location	Service received
<ul style="list-style-type: none"> • Arizona (elective)* • California* • Georgia* • Indiana • Iowa* • Michigan* • Missouri* • New Jersey * • New York* • Ohio (CAT) • Rhode Island* • Utah • Washington (B&O) • Wisconsin* 	<ul style="list-style-type: none"> • Alabama • Colorado* • District of Columbia* • Kentucky* • Louisiana* • Massachusetts • Montana • New Hampshire • New Mexico • North Carolina* • Oregon (CAT and corporate income tax)* • Pennsylvania* • Tennessee • Vermont 	<p><i>Service Used</i></p> <ul style="list-style-type: none"> • Connecticut* • Hawaii <p><i>Customer Located</i></p> <ul style="list-style-type: none"> • Maryland* (SSF phase in) • Nebraska* • Oklahoma 	<ul style="list-style-type: none"> • Illinois* • Maine* • Minnesota*gle

Due Process Nexus

***Robinson v. Jeopardy Productions*, 315 So. 3d 273 (La. Ct. App. 2020)**

- Jeopardy earned royalties through agreements with CBS to distribute show to TV stations (some in Louisiana), and with IGT to license the use of trademarks on gaming machines (some in Louisiana). DOR filed suit to collect corporate income and franchise tax.
- Dismissed: lack of personal jurisdiction and due process. No intentional contact with state, no control over the unrelated third parties independently entering into agreements for distribution of the show and use of the trademarks in Louisiana. No reason to reasonably anticipate being brought into court.
- See also, *McIntyre Mach., Ltd. v. Nicastro*, 564 U.S. 873 (2011); *Griffith v. ConAgra Brands*, 229 W. Va. 190 (2012)

Due Process Nexus

Online Merchants Guild v. Hassell, 282 A.3d 871 (Pa. Commw. Ct., Sept. 9, 2022)

- Merchants that sold through Amazon’s “Fulfillment by Amazon” (FBA) program challenged the Pennsylvania DOR requirement that they complete a Business Activities Request, which asserted the merchants “may have” a physical presence in Pennsylvania.
- The Merchants argued they lacked due process nexus with Pennsylvania, as they had no control over their inventory, or knowledge of its location, after delivering it to Amazon. The Department argued the defense was “premature.” But the Court held the Request was “not merely a “demand for information.” Rather, the Request indicates that “[f]ailure to provide the information requested will result in additional enforcement actions,” clearly suggesting pending enforcement actions.
- The Court then held:
 - Placement of goods into the stream of commerce with an expectation they will be purchased by a state's consumers may indicate purposeful availment; however, “as a general rule, it is not enough that the defendant might have predicted that its goods will reach the forum [s]tate.” **J. McIntyre Mach., Ltd. v. Nicastro**, 564 U.S. 873 (2011).
 - Due process requires a connection between the taxing authority and the person or entity it seeks to tax and “some act” indicating the alleged taxpayer has availed itself of the taxing authority's protections, opportunities, and services.
 - “We are hard pressed to envision how, in these circumstances, an FBA Merchant has placed its merchandise in the stream of commerce with the expectation that it would be purchased by a customer located in the Commonwealth, or has availed itself of the Commonwealth's protections, opportunities, and services.”
- Compare *OOMA, Inc. v. Dep’t of Rev.*

Nexus –U.S. Supreme Court on Due Process

- U.S. Supreme Court has recently considered at least three cases dealing with Due Process Clause issues:
 - *Ford Motor Co. v. Montana Eighth Judicial District Court, et. al.*
592 U. S. 351 (2021)
 - *Thomas E. Dobbs, et. al., v. Jackson Women’s Health Organization, et. al.,*
597 U. S. 215 (2022)
 - *Robert Mallory v. Norfolk Southern Railway Co.,*
600 U. S. 122 (2023)
- Implications for State Tax?

Nexus –U.S. Supreme Court on Due Process

Ford Motor Co. v. Montana Eighth Judicial District Court, et. al. 592 U. S. 351 (2021)

- **Majority Opinion:** “And we do not here consider internet transactions, which may raise doctrinal questions of their own. See *Walden v. Fiore*, 571 U.S. 277 (2014) (“[T]his case does not present the very different questions whether and how a defendant’s virtual ‘presence’ and conduct translate into ‘contacts’ with a particular State”)” [**Barrett took no part**]
- **Alito, Concurring:** “And there are also reasons to wonder whether the case law we have developed since [*International Shoe*] is well suited for the way in which business is now conducted.”
- **Gorsuch, joined by Thomas, Concurring:** “But, today, even an individual retiree carving wooden decoys in Maine can “purposefully avail” himself of the chance to do business across the continent after drawing online orders to his e-Bay “store” thanks to Internet advertising with global reach. ... Perhaps this is the real reason why the majority introduces us to the hypothetical decoy salesman. Yes, he arguably availed himself of a new market. Yes, the plaintiff’s injuries arguably arose from (or were caused by) the product he sold there. Yes, *International Shoe*’s old causation test would seemingly allow for personal jurisdiction. But maybe the majority resists that conclusion because the old test no longer seems as reliable a proxy for determining corporate presence as it once did.... **I finish these cases with even more questions than I had at the start.**”

P.L. 86-272

15 USC. 381, *et seq.* (P.L. 86-272)

- (a) No State, or political subdivision thereof, shall have power to impose . . . a net income tax on the income derived within such State by any person from interstate commerce if the only business activities **within such State** by or on behalf of such person during such taxable year are either, or both, of the following:
- (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State;
 - (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

MTC Statement of Information

In *Wayfair*, the Court stated:

“... an Internet seller “may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term.”

* * *

On August 4, 2021, the Multistate Tax Commission adopted revisions to its Statement of Information on P.L. 86-272. The revised Statement states in part:

As a general rule, when a business interacts with a customer via the business’s website or app, the business engages in a business activity within the customer’s state.

And one year later, the Commission adopted a resolution recommending that states that adopt the Revised Statement should also adopt a factor presence standard.

State Adoption- Key Developments to Date

- **California** was the first state to adopt the MTC revised statement, first publishing Technical Advice Memorandum 2022-01 in February 2022 and then revising its Publication 1050.
 - **Oregon** considers adopting the revised statement, but then places its effort on hold while exploring the possibility of enacting a factor presence nexus statute.
 - In April 2023, **Minnesota** circulates a draft Revenue Notice, indicating its intent to adopt the revised statement.
 - In December 2023, **New York State** adopts corporate income tax regulations which include the MTC revised statement.
 - **New Jersey** first issues informal guidance (NJ TB-108) and in March 2024 issues draft regulations generally tracking the revised statement.
 - In May 2024, **New York City** indicates that it will issue regulations tracking the New York State interpretation of P.L. 86-272.
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P.L. 86-272 - Recent Litigation

– MTC Model Approach

- *American Catalogue Mailers Ass'n v. Cal. FTB* (decided Cal. Sup. Ct. Dec. 13, 2023; motion to vacate and modify judgement filed Feb. 13, 2024)
- *American Catalogue Mailers Ass'n v. NY Dep't of Tax'n & Finance* (filed April 5, 2024)

– Other P.L. 86-272 Challenges

- *ASAP Cruises, Inc. v. Wisconsin Dep't of Rev.* (decided Wisc. Tax App. Comm'n May 23, 2022; remanded for further consideration May 31, 2023)
 - *Kuta Software LLC v. Dep't of Rev.*, Dec. No. 21-W-080 (Wis. Tax. App. Comm. 2023)
 - *Santa Fe Natural Tobacco Co. v. Dep't of Rev.*, 372 Ore. 509 (2024)
 - *Uline, Inc. v. Comm'r. of Rev.*, 10 N.W.3d 170 (Minn. 2024).
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Hawaii ITR No. 2020-05

- “Unprotected Activities....
 22. Making sales that equal or exceed \$100,000 during the current or preceding calendar year; and
 23. Engaging in 200 or more business transactions with persons within Hawaii during the current or preceding calendar year.”

What's Next?