

NEXUS OVERVIEW

Purpose

The purpose of providing this information is to define nexus and give general guidelines for determining whether a business entity's activities create nexus.

Definitions

The ability of a taxing district to impose its taxes on a potential taxpayer depends on whether that business has a sufficient connection with the taxing district. In legalese this is what is referred to as "nexus", which is a fancy word for sufficient connection. The extent of the connection is determined by the contacts the business has in the taxing district.

It is difficult to define precisely what constitutes adequate nexus, and hundreds of courts and taxing authorities have tried. Generally, nexus for taxes based on net income exist if the corporation regularly and systematically conducts activities in the taxing district. (Maintaining an office, consigned inventory, or employees or agents regularly acting for the company within the taxing district.)

The standards for determining whether nexus has been established for sales tax or for taxes based on net income are different and distinct. The appropriate standard must be applied to determine whether a taxing district has the authority to impose a tax upon a business entity. This document provides brief descriptions of the business activity that must be present before a taxpayer is required to pay taxes based on net income.

The United States Constitution limits the taxing district's right to tax through the Due Process Clause and the Commerce Clause.

Due Process Clause

The Due Process Clause of the Fourteenth Amendment requires some definite link, some minimum connection between a taxing district and the person, property, or transaction it seeks to tax. The most minimal connection will satisfy this requirement. The connection need not include physical presence in the taxing district. Due Process also requires that the income attributed to the taxing district for tax purposes must be rationally related to values connected with the taxing district. This last requirement is rarely a bar to enforcement of tax.

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Commerce Clause

The Commerce Clause of the Constitution (Article 1, Section 8, C13) gives to congress the power to regulate commerce among the states. Therefore, a state (or taxing district) may not impermissibly affect interstate commerce without congressional authorization.

The U.S. Supreme Court held in Complete Auto Transit (430 US 274 (1976)) that a state does not impermissibly affect interstate commerce if it meets each of four tests:

1. The taxed activity has a substantial nexus to the taxing state.
2. The tax is fairly apportioned among states.
3. The tax does not discriminate against interstate commerce.
4. The tax is fairly related to services provided by the taxing state.

The area of greatest confusion in this four-part test is what constitutes "substantial nexus" for purpose of the Complete Auto test.

Net Income Based Taxes

In addition to the limitations imposed by the Due Process and Commerce Clause, the Congress of the United States created an additional protection from nexus for certain potential taxpayers. Public Law 86-272 prohibits a state from imposing any tax on a company measured by net income that is derived "from interstate commerce if the only business activities within the state by or on behalf of the company are the minimum activities described in the bill." The minimum activities are that the company must limit its activities in the state to the mere "solicitation" of sales of "tangible personal property." Also, all of the company's orders must be sent outside the state for approval or rejection and, if approved, the order must be filled by a "delivery" from a location outside the state. The terms "solicitation," "delivery" and "tangible personal property" are pivotal in the application of the Act. However, these terms are not defined.

- ✓ Public Law 86-272 immunizes solicitation only for sale of tangible personal property. Efforts to sell intangibles, such as franchises, patents, copyrights, trademarks and service marks, are not protected, nor is solicitation for the leasing, renting or licensing of tangible personal property.
- ✓ Public Law 86-272 does not apply to companies that provide services. Advertising firms, trucking and transportation companies, entertainment, professional, scientific, and technical services.

For the in-state (or in-district) activity to be a protected activity under P.L. 86-272, it must be limited solely to solicitation, except for de minimis activities and activities

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conducted by independent contractors. “De minimis” means those activities that, when taken together, establish only a trivial connection with the taxing state (or taxing district).

- ✓ An activity regularly conducted within the taxing district or a regular or systematic basis or pursuant to a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether an activity consists of a trivial or nontrivial additional connection with the taxing district is to be measured on both a qualitative and quantitative basis. If the activity either qualitatively or quantitatively creates a non-trivial connection with the taxing district, then the activity exceeds the protection of PL 86-272.

Specific activities that are considered to be beyond “mere solicitation” and therefore, unprotected by PL 86-272.

- Making repairs or providing maintenance or service to the property sold or to be sold.
- Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.
- Investigating credit worthiness.
- Installing or supervising installation at or after shipment or delivery.
- Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation of sales of tangible personal property.
- Providing any kind of technical assistance or service, including engineering assistance or design service, when one of the purposes goes beyond the solicitation of orders.
- Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints, when the sole purpose of such mediation is to ingratiate the sales personnel with the customer.
- Approving or accepting orders.
- Repossessing property.

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- Securing deposits on sales.
- Picking up or replacing damaged or returned property.
- Hiring, training, or supervising personnel, other than personnel involved only in solicitation.
- Using agency stock checks or any other instrument or process by which sales are made within the taxing jurisdiction by sales personnel.
- Maintaining a sample or display room in excess of two weeks (14 days) at any one location within the taxing jurisdiction during the tax year.
- Carrying samples for sale, exchange or distribution in any manner for Consideration or other value.
- Owning, leasing, using or maintaining any of the following facilities or property In the taxing jurisdiction:
 - Repair shop.
 - Parts department.
Any kind of office other than an in-home office
 - Warehouse.
 - Meeting place for directors, officers, or employees.
 - Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.
 - Telephone answering service that is publicly attributed to the company or to an employees or agents of the company in their representative status.
 - Mobile stores, i.e., vehicles with drivers who are sales personnel making sales from the vehicles.
 - Real property or fixtures to real property of any kind.
- Consigning stock of goods or other tangible personal property to any person, including an independent contractor, for sale.
- The maintenance of any office or other place of business in a taxing district that does not strictly qualify as an "in-home" office shall, by itself, cause the loss of protection under PL 86-272. A telephone listing or other public listing within the taxing district for the nonresident or for an employee or other representative of the nonresident in such capacity or other indication through advertising or business literature that the nonresident or its employee or representative can be contacted at a specific address within the taxing district shall normally be determined as the nonresident maintaining within this taxing district an office or place of business attributable to the nonresident or to its employee or representative in a representative capacity. However, the normal distribution and use of business

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cards and stationary identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the nonresident shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the nonresident or to its employee or other representative.

- Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchiser or licensor to its franchisee or licensee within the taxing district.
- Conducting any activity that is not entirely ancillary to requests for orders, even if such activity helps to increase purchases

Specific activities that are considered to be “protected activities” under PL 86-272.

- Soliciting orders for sales by any type of advertising.
- Soliciting orders for sales by an in-state resident employee or representative of the nonresident, so long as that person does not maintain or use any office or place of business in the taxing district besides an "in-home" office.
- Carrying samples and promotional materials only for display or for distribution without charge or other consideration.
- Furnishing and setting up display racks and advising customers on the display of the nonresident's products without charge or other consideration.
- Providing automobiles to sales personnel for their use in conducting protected activities.
- Passing orders, inquiries and complaints on to the home office.
- Missionary sales activities; i.e., the solicitation of indirect customers for the nonresident's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers would be protected if those solicitation activities are otherwise immune.
- Coordinating shipment or delivery without payment or other consideration and providing information relating to shipment or delivery either prior or

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subsequent to the placement of an order.

- Checking of customers' inventories without charge (for re-order, but not for other purposes such as quality control).
- Maintaining a sample or display room for two weeks (14 days) or less at any one location within the taxing district during the tax year.
- Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel.
- Mediating direct customer complaints when the purpose is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.
- Owning, leasing, using or maintaining personal property for use in the employee's or representative's "in-home" office located within the residence of the employee or other representative that is not publicly attributed to the nonresident or to the employee or other representative of the nonresident in a representative capacity or automobile, when that use is solely limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software, shall not, by itself, remove the protection under this Section, so long as the use of the office is limited to:
 - soliciting and receiving orders from customers;
 - transmitting orders outside the taxing district for acceptance or rejection by the nonresident; or
 - other activities that are protected under PL 86-272 or this Section.
- Shipping or delivering goods into the taxing district by means of vehicles or other modes of transportation owned or leased by the nonresident taxpayer or by means of private carrier, whether by motor vehicle, rail, water, air or other carrier and irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser.

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Independent Contractors

Independent Contractors. PL 86-272 provides immunity to certain in-state activities, if conducted by an independent contractor, that would not be afforded if performed by the nonresident or its employees or other representatives.

Independent contractors may engage in the following limited activities in the taxing jurisdiction without the nonresident's loss of immunity:

- soliciting sales;
- making sales;
- maintaining an office.

Sales representatives who represent a single principal are not considered to be independent contractors and are subject to the same limitations as those provided under PL 86-272.

Maintenance of a stock of goods in the taxing jurisdiction, by the independent contractor under consignment or any other type of arrangement with the nonresident, except for purposes of display and solicitation, shall remove the protection.