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ATTORNEYS AT LAW

ILLINOIS CPA SOCIETY

STATE & LOCAL TAX CONFERENCE

Navigating Nexus Issues From Digital And Cloud Activity

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Nexus – In General

- The Application Of State Taxing Statutes To Out-Of-State Businesses
- Federal Protection:
 - United States Constitution (Due Process Clause, 14th Amendment & Commerce Clause, Article I, Paragraph 8, Clause 3)
 - Federal Laws (Public Law 86-272 & Internet Tax Freedom Act)
 - United States Supreme Court Decisions
- State Protection - Laws & Court Decisions



State Tax Nexus

- Physical Presence
- Attributional
- Economic
- Click-Through
- Notice & Reporting
- Federal Laws - Internet Tax Freedom Act
- Digital & Cloud Issues



Physical Presence - Background

- Miller Brothers Co. v. Maryland, 347 U.S. 340 (1954)
 - Due Process Clause “requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.”
- National Bellas Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753 (1967)
 - Commerce Clause bright-line physical presence requirement for use tax.
- Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977)
 - Rejected line of cases holding that State taxation of interstate commerce was impermissible.
 - Requires: 1) substantial nexus with taxing State; 2) fairly apportioned; 3) no discrimination against interstate commerce; and 4) fairly related to the services provided by the State.



Physical Presence - Background

- Quill v. North Dakota, 504 U.S. 298 (1992)
 - The Due Process Clause and the Commerce Clauses each require a different connection between the state and the tax imposition
 - Due Process Clause – Minimum Contact
 - Commerce Clause - Substantial Nexus (“a means for limiting State burdens on interstate commerce”)
 - Tax jurisdiction requirements are similar to in personam jurisdiction (presence nexus).
- Allied Signal v. Director, Division of Taxation, 504 U.S. 768 (1992)
 - The state must have a connection to the activity which they seek to tax not on just a connection to the taxpayer.
 - U.S. Supreme Court ruled that New Jersey did not have the power to include the gain where the unitary factors were not met.



Physical Presence - Background

- MTC: Factor Presence Nexus Standard for Business Activity Taxes – MTC Policy Statement 02-02 (Approved by the Multistate Tax Commission October 17, 2002)
 - Substantial nexus:
 - \$50,000 of property
 - \$50,000 of payroll
 - \$500,000 of sales
 - 25% of total property, total payroll or total sales



Physical Presence- P.L. 86-272 Background

- United States Supreme Court 1959 Actions
 - Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959)
 - Brown-Forman Distillers Corp. v. Collector of Revenue, 234 La. 651, appeal dismissed, 359 U.S. 28 (1959)
 - International Shoe Co. v. Fontenot, 236 La. 279, cert. denied, 359 U.S. 984 (1959)
- “Persons engaged in interstate commerce are in doubt as to the amount of local activities within a State that will be regarded as forming a sufficient ... connection with the State to support the imposition of a tax on net income from interstate operations and ‘properly apportioned’ to the State.” Heublein, Inc. v. South Carolina Tax Commission, 409 U.S. 275, 280 (1972)(quoting S.Rep. No. 658, 86th Cong., 1st Sess., 2-3 (1959))
- Congress Passes Public Law 86-272 (15 U.S.C. Sec. 381-384)



Physical Presence- P.L. 86-272

- Public Law 86-272 (15 U.S.C. Sec. 381-384): protects certain activities (i.e. solicitation) in certain situations (i.e. interstate commerce) from state income tax.
- Cannot impose a net income tax on income if the only business activities within a State 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).
- Applies only to net income tax and to sales of tangible personal property.
- Activities performed by independent contractors receive P.L. 86-272 protection.
- The provisions of P.L. 86-272 do not apply to domestic corporations or persons domiciled or residents of that State.



Physical Presence- P.L. 86-272

- Wisconsin Department of Revenue v. Wrigley, 505 U.S. 214 (1992)
 - Wrigley, an Illinois gum manufacturer, sold products in Wisconsin. The Supreme Court held that Wrigley had nexus in Wisconsin and was not protected by P.L.86-272 because its sales force activities, including replacing stale gum, supplying and storing gum in the state, exceeded the protections.
 - The Court created a two part test for “solicitation” – activities which are ancillary to requests for purchase and if activity is more than solicitation but it is de minimis when considered in the aggregate.
- Multistate Tax Commission – Statements of Information Concerning Practices of Multistate Tax Commission States Under P.L. 86-272 (July 11, 1986) (Modified/ Revised January 22, 1993, July 29, 1994 & July 27, 2001)
- Illinois 1995 Proposed Nexus Regulations – Never Promulgated



Physical Presence – Cases

- American Multi-Cinema v. Hegar, No. 03-14-00397-CV, Tex.App.Austin (January 6, 2017)
 - Texas Court of Appeals held that definition of TPP includes a movie for franchise tax purposes as Texas Code Section 171.1012 defines TPP as personal property that can be seen, weighed, felt, or touched or that is perceptible to the senses in any other manner.
- Matter of the Appeal of Personal Selling Power, CA BOE Case No. 380557 (March 16, 2009):
 - P.L. 86-272 does not apply to the solicitation of magazine advertising as a placement of advertising in a magazine is solicitation of a service and not the sale of tangible personal property.
 - Taxpayer conducted a regular, systematic and substantial connection with and physical presence within California establishing substantial nexus to support the imposition of the corporate franchise tax.



Physical Presence – Flash Title

- Missouri Gas Energy v. Schmidt, 2008 OK 94 (Supreme Court of OK, October 21, 2008) U.S. Supreme Court cert. denied 130 S.Ct 2141 (2010):
 - Oklahoma Supreme Court ruled that gas had a taxable situs given that a volume of gas was in the state on the assessment date.
 - The taxpayer argued that it was gas moving in interstate commerce which was temporarily stored in an interstate pipeline system.
- Wascana Energy Marketing, NY DTA No. 817866 (August 8, 2002):
 - The momentary transfer of title at the Canadian/US border (at the pipeline) did not provide physical presence in New York.
 - NY ALJ found “Quill requires physical presence within the taxing state irrespective of the degree to which the vendor engages in exploitation of the consumer market of the taxing state.”
 - The issue was whether business was carried on in New York.



Physical Presence - Digital

- Ohio Commercial Activity Tax Case –
 - Ohio Supreme Court holds Ohio CAT does not require physical presence; *Crutchfield v. Testa*, Slip Opinion No 2016-Ohio-7760 (11/17/16)
 - Tax Commissioner argued Physical Presence through “cookies” – Electronic Software stored on customers’ computer and mobile devices
 - Ohio Supreme Court agreed with Tax Commissioner’s economic nexus position and therefore did not address the Commissioner’s physical presence “cookies” argument.



Attributional Nexus

- Attributional Nexus is generally nexus created by the presence of others (i.e. independent contractors and agents)
- *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960)
 - Independent contractor salespersons activities created sales tax nexus.
- *Tyler Pipe Ind. v. WA State Dept. of Rev.*, 483 U.S. 232 (1987)
 - Independent contractors activities must be “significantly associated with the taxpayer’s ability to establish and maintain a market in the state for the sales.”



Attributional Nexus – Independent Contractors

- Independent Contractors:
 - Graduate Supply House (Alabama Law Division Dkt. No. S. 05-751 (Nov 20, 2007))
 - In state agents created sales tax nexus because they measured students, provided order forms and had property (caps and gowns) in the state, which enabled the taxpayer to establish and maintain a market.
 - Scholastic Book Clubs, Inc. v. Comm. Of Revenue Services (No. CV 07 4013027 S (Conn. Super. Ct. April 9, 2009))
 - Teachers were not sales representatives for purposes of school book orders
 - Other states have reached different conclusion
 - Dell Catalog Sales v. Taxation and Revenue Department of New Mexico, 199 P.3d 863 (June 3, 2008)
 - Independent contractor created nexus for the taxpayer because it benefits from the in-state presence and this helps in the New Mexico marketplace.
 - State of Louisiana v. Dell (State of Louisiana Court of Appeal, First Circuit, Number 2004 CA 1702 (Feb 15, 2006))
 - Independent contractor activities that included repairs under service contracts, which had oversight by Dell, were critical to establish and maintain a market.



Attributional Nexus – Affiliates

- Affiliates:
 - National Geographic Society v. CA State BOE, 430 U.S. 551 (1977)
 - Mail-order seller will be subject to use tax if they have some presence in the taxing State even if that activity has no relation to the transaction being taxed (two small offices in CA solicited advertisement for National Geographic Magazine).
 - Matter of Reynolds (CA State BOE No. 208940, May 31, 2007)
 - A related partnership assembled, held, contacted taxpayer when completed and released goods for shipment for the taxpayer in California and this was doing business in California for the taxpayer.
 - Drugstore.com, Inc. v. Division of Taxation, 23 N.J. Tax 624 (Feb. 11, 2008)
 - Online drug retailer had nexus for NJ sales and use tax purposes because it had physical presence, was making sales to New Jersey residents and its subsidiary never transferred cash or had physical possession of the items that were sold. The taxpayer claimed that its subsidiary was actually making the sales and that it was a drop shipment transaction.
 - Harley-Davidson, Inc., v. FTB, 237 Cal. App. 4th 193 (May 28, 2015)
 - Activities of in state agents resulted in substantial nexus for California corporate franchise tax purposes even though corporation taxpayers at issue had no California physical presence. California Supreme Court denied petition for review on 09/1615.



Attributional Nexus – Internet Sales

- Amazon.com v. New York State Department of Taxation and Finance, 877 NYS2d 842 (N.Y. App. Div. 2010)
 - New York law enacted on April 23, 2008, that requires an out-of-state seller to collect sales tax was upheld because the law was based on an out-of-state seller's "conscious decision" to contract with in-state resident contractors that actively seek sales in New York.
 - Appellate Division of State Supreme Court Opinion (Nov. 4, 2010):
 - 1) confirmed that the companies' claims that this law is facially unconstitutional are unfounded;
 - 2) held that further discovery is needed before it can resolve Amazon.com's and Overstock.com's claim that the statute is unconstitutional as applied to their specific facts; and;
 - 3) granted both plaintiffs the opportunity to return to the Supreme Court to present evidence that the law is unconstitutional with respect to their business practices.
 - The US Supreme Court denied cert. on 12/2/13.



Attributional Nexus–Internet Sales

- Barnesandnoble.com v. State Bd. of Equalization (No. CGC-06-456465 Sept 7, 2007)
 - An out-of-state internet retailer did not have nexus for California use tax because the physical store, which did limited marketing, was not fully controlled by the internet company.
- St. Tammany Parish Tax Collector v. Barnesandnoble.com, 481 F. Supp.2d 575 (March 22, 2007)
 - An out-of-state internet retailer did not have nexus for Louisiana sales and use tax because there was insufficient activities between the internet retailer and the in-state physical store to create nexus (i.e. commissions on in-store sales of online products did not generate cross-revenue)
- *New Mexico Taxation & Revenue Department v. Barnesandnoble.com, LLC (N.M. June 3, 2013)*
 - In-state bookstores established nexus for out-of-state, affiliated online retailer



Attributional Nexus – State Rulings & Opinions

- South Carolina Revenue Ruling, 09-9 (June 16, 2009)
 - Examples of when a retailer that has established Commerce Clause nexus with South Carolina include delivery and: 1) The retailer advertises via advertising media located in the jurisdiction of delivery (e.g., newspapers, television, cable systems, and radio) or 2) The retailer advertises via advertising media located outside the jurisdiction but which has coverage within the jurisdiction of delivery (e.g., newspapers, television, cable systems, and radio).
- Utah State Tax Commission, Opinion No. 08-006 (May 2009)
 - A telemarketer with a call center had nexus because it had the call center and was soliciting business in Utah.
- Tennessee Attorney General, Opinion No. 09-101 (May 28, 2009)
 - A vendor’ s agreement with a Tennessee resident under which the resident refers potential customers to that vendor in exchange for compensation creates nexus for sales tax purposes (Amazon situation)



Attributional Nexus – State Rulings & Opinions

- Virginia Ruling of the Commissioner, P.D. 09-81 (May 26, 2009)
 - Taxpayer provides, develops and maintains delivery systems and manages the coordination and movement of tangible personal property for affiliated and unrelated entities at arm's length rates – the taxpayer had no property or payroll in Virginia but its employees periodically performed logistical support activities in VA and these activities exceeded the protections of P.L. 86-272.
- Virginia Ruling of the Commissioner, P.D. 09-44 (April 27, 2009)
 - Installation of storage systems by an unrelated third-party contractor did not create nexus as the third-party contractors are independent businesses and the taxpayer does not have an ownership interest in any of the contractors.



Economic Nexus

- Generally States attempt to tax companies that have activity in the State that has a purposeful direction at a market with sales or benefits derived by these activities
- Look to companies with intangible assets or customers in the State
- Originated from perceived intangible holding company abuse
- States continue to litigate the economic nexus issue
- Geoffrey 1993 – The Beginning
 - Geoffrey, Inc. v. South Carolina Tax Comm’n, 313 S.C. 15 (1993). Geoffrey’s income was derived from South Carolina’s Toys R Us customers and South Carolina has made it possible for Geoffrey to earn income.



Economic Nexus – Litigation

- A&F Trademark v. Tolson, 605 S.E.2d 187 (N.C. Ct. App. 2004)
 - The taxpayer had income tax nexus by virtue of having intangible property in the state along with receiving income from use of property in state
- K Mart Corp. v. Taxation and Revenue Dept., N.M. Sup. Ct. Docket No. 27,260 (Dec. 29, 2005)
 - The New Mexico Supreme Court discussed gross receipts tax and income tax nexus resulting from the use of trademarks in New Mexico and the impact of the relationship between the taxpayer and the in-state operating company



Economic Nexus – Litigation

- West Virginia v. MBNA, 640 S.E.2d 226 (W.Va. 2006)
 - The Court ruled that nexus is created under a significant economic presence test which includes purposeful direction toward a state while measuring the degree of the contacts
 - The degree is measured by “the frequency, quantity, and systematic nature of a taxpayer’s economic contacts with a state”
- Lanco, Inc. v. Dir, Div. of Taxation, 908 A.2d 176 (N.J. 2006)
 - Appellate Court found that physical presence necessary for sales and use tax nexus is not applicable to income tax
 - Licensing fees attributable to New Jersey created income tax nexus
 - Ruling upheld by the New Jersey Supreme Court



Economic Nexus – Litigation

- Praxair Technology v. Director, Division of Taxation, 404 N.J. Super. 287 (2008)
 - The Court relied on Lanco and reasoned that a taxpayer does not need physical presence for income tax nexus
 - Presence of intangible property creates income tax nexus
- Geoffrey, Inc. v. Comm. Of Revenue (453 Mass. 17, 899 N.E. 2d 87) (2009)(cert. denied to U.S. Supreme Court, Dkt. 08-1207, June 22, 2009)
 - Taxpayer had substantial nexus because they carried on business in Mass. through the licensing of intangibles (pursuant to Capital One)



Economic Nexus – Litigation

- *AccuZIP, Inc. v. Director, Div. of Taxation, 25 N.J. Tax 158 (Tax 2009)*:
 - Division of Taxation Director requests that court adopt the significant economic presence test to determine whether a substantial nexus exists
- *Capital One Bank v. Comm. Of Revenue (453 Mass. 1, 899 N.E. 2d 76) (2009)(cert. denied U.S Supreme Court, Dkt. 08-1169, June 22, 2009)*
 - Taxpayer had substantial nexus under Complete Auto because it deliberately solicited and conducted significant credit card business in Mass and they used Mass banking and credit facilities



Economic Nexus – Litigation

- W.V. Admin. Decision No. 06–544 N (January 6, 2010)
 - Royalty income from licensing trademarks and trade names to corporations selling products in West Virginia resulted in out-of-state corporation being subject to West Virginia corporate net income and business franchise taxes
- Lamtec Corporation v. Department of Revenue of State of Washington, 170 Wash. 2d 838 (January 20, 2011)
 - Taxpayer argued it did not maintain a physical presence in Washington
 - Court held that even though Taxpayer’s employees did not solicit sales in Washington, the employee visits and activities constituted substantial nexus and therefore the imposition of the B&O tax did not violate the Commerce Clause
 - The United States Supreme Court denied cert. on October 3, 2011



Economic Nexus – Litigation

- KFC Corporation v. Iowa Department of Revenue, Iowa Supreme Court (Case No. 09-1032, 2010):
 - Iowa Supreme Court upheld district court decision attributing income tax nexus to an out-of-state franchisor as a result of the franchisor's receipt of royalties from Iowa franchisees. Iowa Supreme Court found that the taxpayer's receipt of royalties from its Iowa franchisees using the taxpayer's intangible property constituted nexus.
 - DOR argued that no physical presence required when a franchisor licenses intellectual property that generated income from within the state based on operation of its franchisees (Subsequent Iowa Administrative Hearing Appeal– Matter of Jack Daniels Properties (July 28, 2011))
 - The United States Supreme Court denied cert. on October 3, 2011



Economic Nexus – Litigation

- Telebright Corp. v Director, New Jersey Appellate Division of Superior Court DOCKET NO. A-5096-09T2 (March 2, 2012)
 - Court found that an out-of-state corporation that regularly and consistently permitted an employee to telecommute from her New Jersey residence was doing business in New Jersey.
 - Employee worked full time in New Jersey and was entitled to the legal protections afforded to New Jersey residents and caused corporation also to have protections.



Economic Nexus – Litigation

- Scioto Insurance v. OK Tax Comm. 279 P.3d 782 (May 1, 2012)
 - Oklahoma Supreme Court found 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 (Wendy’s International) who has a bona fide obligation to do so under a contract not made in Oklahoma.”
 - Court found Oklahoma simply has no connection to or power to regulate the licensing agreement and cannot summarily disregard it simply because it produces a deduction that the Commission does not like.



Economic Nexus – Litigation

- Griffith v. ConAgra Brands, Inc., 728 S.E.2d 74 (W. Va. May 24, 2012)
 - Supreme Court of Appeals of West Virginia found that “Assessments against a foreign licensor for West Virginia corporation net income and business franchise tax, on royalties earned from the nation-wide licensing of food industry trademarks and trade names, satisfied neither ‘purposeful direction’ under the Due Process Clause nor ‘significant economic presence’ under the the Commerce Clause, where the foreign licensor, with no physical presence in this State, did not sell or distribute food-related products or services in West Virginia....”
 - Court weighed the following factors in their decision: ConAgra did not have any property in WV, had no employees in WV, did not direct or dictate how the licensees distributed the products and ConAgra Brands was not a shell corporation
 - Court found ConAgra did not engage in solicitation as in MBNA
 - Court also distinguished Geoffrey and KFC



Economic Nexus - Litigation

- Capital One Financial Corp. v. Hamer, Ill. Cir. Ct. (May 11, 2011)
 - Court rejected Taxpayer's argument that physical presence was required for substantial nexus holding that significant economic presence existed based on: revenues received from Illinois residents; solicitation of Illinois customers via telephone, direct mail and email' use of Illinois courts for delinquent accounts; and filing of enforcement liens in Illinois.
 - Appeal filed June 4, 2015 - Case settled
- *ConAgra Brands, Inc. v. Comptroller of the Treasury*, Maryland Tax Court, No. 09-IN-00-0150 (Feb. 24, 2015)
 - Out of state intangible holding company had no economic substance apart from parent and therefore had income tax nexus
- *Staples, Inc. v. Comptroller of the Treasury; Staples The Office Superstore, Inc. v. Comptroller of the Treasury*, Maryland Tax Court, Nos. 09-IN-00-0148; 09-IN-00-0149,(May 28, 2015)
 - Petitioners were not separate business entities and were part of a unitary business and had nexus with Maryland



Economic Nexus – Internet Sales

- Cruthfield v. Testa, Slip Opinion No 2016-Ohio-7760 (11/17/16)
 - Ohio Supreme Court holds Ohio CAT does not require physical presence.
 - Commissioner argued Taxpayer's economic presence of interstate online sales (more than \$500,000 in sales to Ohio customers) as well as in state presence through digital assets that are downloaded on Ohio customer's computer.
 - Similar cases - Newegg Inc. v. Testa, Case No. 15-0483 (Ohio filed Mar. 25, 2015) and Mason Cos. Inc. v. Testa (Ohio filed May 19, 2015)



Additional Economic Nexus Cases

- *In re Washington Mutual* (Bankr. D. Del. Dec. 19, 2012)
 - No Oregon income tax nexus for out-of-state corporate parent
- *Comptroller of the Treasury v. Gore Enterprises Holdings* (Md. App., 01/24/13)
 - Intangible holding companies subject to income tax as nexus resulted from unitary business activities of parent company. Appeal before Maryland Court of Appeals
- *New York Dept. of Taxation & Finance, TSB-A-13(6)C* (April 11, 2013)
 - Visits to suppliers and trade show attendance was temporary and did not establish income tax nexus
- *Allied Domecq Spirits and Wines USA, Inc. v. Commissioner of Revenue* (Mass. ATB May 27, 2013)
 - Intentional creation of nexus voided as a sham
- *McNeil Trust v. Commonwealth of Pennsylvania* (Pa. Commw. Ct. 2013)
 - Look to Trust activities rather than settlor/beneficiaries
- *Swart Enterprises v. California Franchise Tax Board, Ca Court of Appeals, Fifth District, No. 13CECG02171* (January 12, 2017)
 - Taxpayer's LLC interest was that of a Limited Partner and taxpayer was not doing business in California based solely on its minority interest in the LLC.



Click-Through Nexus

- Initially referred to as “Amazon” type nexus
- Out of state retailers may have nexus by virtue of commission arrangement through its website
- If customer clicks on linked website, retailer may have nexus by virtue of the website company’s nexus
- 18 states currently have enacted some type of “click-through” legislation
- Online Retailers’ Collecting Tax



Click-Through Nexus

- NY
 - NY Tax Law Sec. 1101(b)(8)(vi) (“Amazon”)
 - Agreements with a NY resident for referrals by link on an internet website for commission
 - New York Technical Release (TSB-M-09(3)S, New York State Department of Taxation and Finance (May 6, 2009) – Sales Tax Affiliate Nexus Standard for sales made or uses on or after June 1, 2009
 - Overstock.com, Inc. v. New York State, 20 N.Y. 3d 586 (N.Y. 2013) – Court of Appeals held click-through nexus law facially constitutional, contains rebuttable presumption. On December 2, 2013, the U.S. Supreme Court denied cert.
- CA
 - SBX3 15 (for tax years beginning on or after Jan 1, 2011)
 - Sales of \$500,000 or 25% of total sales
 - Real property of 50,000 or 25% of total real property and TPP
 - Payroll of \$50,000 or 25% of total compensation



Click-Through Nexus - Illinois

Beginning January 1, 2015, Section 1.1 of 35 ILCS 105/2(1.1) expressly provides:

1.1. A retailer having a contract with a person located in this State under which the person, for a commission or other consideration based upon the sale of tangible personal property by the retailer, directly or indirectly refers potential customers to the retailer by providing to the potential customers a promotional code or other mechanism that allows the retailer to track purchases referred by such persons. Examples of mechanisms that allow the retailer to track purchases referred by such persons include but are not limited to the use of a link on the person's Internet website, promotional codes distributed through the person's hand-delivered or mailed material, and promotional codes distributed by the person through radio or other broadcast media. The provisions of this paragraph 1.1 shall apply only if the cumulative gross receipts from sales of tangible personal property by the retailer to customers who are referred to the retailer by all persons in this State under such contracts exceed \$10,000 during the preceding 4 quarterly periods ending on the last day of March, June, September, and December. A retailer meeting the requirements of this paragraph 1.1 shall be presumed to be maintaining a place of business in this State but may rebut this presumption by submitting proof that the referrals or other activities pursued within this State by such persons were not sufficient to meet the nexus standards of the United States Constitution during the preceding 4 quarterly periods.



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Click-Through Nexus Litigation

- Performance Marketing Association v. Hamer, 998 N.E. 2d 54 (October 18, 2013)
- The Illinois Supreme Court found that Illinois ‘ new click-through nexus law was preempted by federal law and the provisions are void and unenforceable
- Plaintiff argued that the new law was preempted by the Internet Tax Freedom Act (“ITFA”) because the Act discriminated against electronic commerce by treating print and over-the-air broadcasters differently
- Illinois Law Amended to correct ITFA issue and ITFA extended



Internet Tax Freedom Act

- Public Law 105-277, 47 U.S.C. 151, prohibits state and local governments from imposing multiple or discriminatory taxes on electronic commerce and taxes on Internet access.
- “Electronic commerce” is any transaction over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access.
- On February 24, 2016, President Obama signed HR 644 which makes permanent the ban on state and local taxation of Internet access or the imposition of multiple and discriminatory taxes on Internet commerce.

Notice & Reporting Requirements

- 2010 Colorado Notification and Reporting Regulation - Section 39-21-112(3.5)
- *Direct Marketing Ass'n v. Brohl*, Case No. 12-1175 (10th Cir., Feb. 22, 2016) – At issue is Colorado's sales and use tax notice reporting requirements for out-of-state retailers – Court found law did not violate the Commerce Clause and the Court interpreted Quill narrowly (Cert. denied Dec 12, 2016)
- National Conference of State Legislature Letter



Nexus – Illinois Issues

- Sales of “canned” computer software are taxable retail sales in Illinois.
- Canned computer software is considered to be tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means, or other media.
- If the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. 86 Ill. Adm. Code 130.1935.
- Computer software that is not custom software is considered to be canned computer software, whether it is “standalone” or not.



Nexus – Illinois Issues

- Transactions for the licensing of computer software that meet all 5 of the following criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software nor the subsequent software updates will be subject to the Retailers' Occupation Tax:
 - License is evidenced by written agreement signed by licensor and customer;
 - License restricts customer's duplication and use of software;
 - License prohibits customer from licensing, sublicensing or transferring software to 3rd party without permission and continued control of the licensor;
 - Licensor has a policy of providing another copy to licensee; and
 - Customer must destroy or return all copies of the software to licensor at end...



Nexus – Illinois Issues

- Software maintenance agreements that cover computer software are treated the same as maintenance agreements for other types of tangible personal property. 86 Ill. Adm. Code 130.1935(b).
- Sale of Agreements for the repair or maintenance of tangible personal property sold separately from tangible personal property are not taxable.
- In contrast to a patch or bug fix, if the sale of a maintenance agreement by a software provider includes charges for updates of canned software, which consists of new releases or new versions of the computer software designed to replace an older version of the same product and which include product enhancement and improvements, the general rules governing taxability of maintenance agreements do not apply. ST-13-0058 GIL (10/18/13), Reg 130.1935.



Nexus – Illinois Issues

- The Department does not consider the viewing, downloading or electronically transmitting of video, text and other data over the internet to be the transfer of tangible personal property. ST 16-0006-GIL (2/2/16), ST 16-0033-GIL (8/17/16)
- Currently, computer software provided through a cloud-based delivery system – a system in which computer software is never downloaded onto a client’s computer and is only accessed remotely – is not subject to tax. ST 16-0035-GIL (8/17/16)
- The Department is currently evaluating the taxability of Software as a Service (SaaS), cloud computing, computer software Application Providers (ASPs) and similar types of transactions. ST 15-0013 GIL (3/16/15)
- If the Department determines that these transactions are subject to tax, it will apply this determination prospectively. ST 16-0035-GIL (8/17/16)



Previously Proposed Expanded Illinois Sales Tax Base – 39 Services

- Other warehousing and storage
- Travel agent services
- Carpet and upholstery cleaning services
- Dating services
- Dry cleaning and laundry (except coin operated)
- Consumer goods rental
- Health clubs, tanning parlors, reducing salons
- Linen supply
- Interior design services
- Other business services, including copy shops
- Bowling Centers
- Coin operated video games and pinball machines
- Membership fees in private clubs
- Admission to spectator sports (excluding horse tracks)
- Admission to cultural events
- Billiard Parlors
- Scenic and sightseeing transportation
- Taxi and Limousine services
- Unscheduled chartered passenger air transportation
- Motion pictures theaters, except drive-in theaters
- Pet grooming
- Landscaping services (including lawn care)
- Income from intrastate transportation of persons
- Mini-storage
- Household goods storage
- Cold storage
- Marina Service (docking, storage, cleaning, repair)
- Marina towing service (including tugboats)
- Gift and package wrapping service
- Laundry and dry cleaning services, coin operated
- Other services to buildings and dwellings
- Water softening and conditioning
- **Internet Service Providers**
- Short term auto rental
- **Information Service**
- Amusement park admission and rides
- Circuses and fairs – admission and games
- Cable and other program distribution
- Rental of video tapes for home viewing



Business Activity Tax Simplification Act of 2015 (H.R. 2584)

- Addresses issue of sufficient contacts (nexus) to allow a state to tax
- Proposes a physical presence standard – greater than 14 days during a taxable year
- Applies to direct taxes that are imposed on business engaged in interstate commerce (corporate income taxes, gross receipts taxes, franchise taxes, single business taxes, etc. – not sales and use taxes)
- Updates 86–272 to include all sales and transactions – not just tangible personal property
- Streamline Sales Tax – Impact



Other Proposed Federal Legislation

- Main Street Fairness Act – H.R. 2701 /S. 1452
 - Requires large internet and mail-order retailers to collect state and local sales taxes
- Marketplace Equity Act – H.R. 3179
- Marketplace Fairness Act – S.B. 1832
 - Requires large internet and mail-order retailers to collect state and local taxes and forces states to also simplify sales tax laws
 - U.S. Senate passed 69–27 on May 6, 2013
 - Reintroduced March 10, 2015
- Remote Transactions Parity Act
 - Introduced June 15, 2015
- Online Sales Simplification Act of 2016
 - Draft Circulating, no physical presence requirement



Nexus – Digital & Cloud Activities?

- Taxability of Cloud Computing Based on Provider and Customer Facts – Information Bulletin #8, Indiana Department of Revenue, December 2016.
- It Depends:
 - Your Facts – Past, Present, Future?
 - Multiple Points of Use
 - What State(s) is at Issue?
 - What Year(s) is at Issue?



Related Nexus Issues & Impact

- Nexus Questionnaires – How/Who to Respond
- Registrations – Doing Business/Withdrawals
- Franchise Tax - Standards/”Good Standing”
- Audit – States Looking for Revenue
- Nexus Updates – Update Your Knowledge
- Exemption Certificates – Maintenance
- Property Tax - Allocations From Third Parties



Related Nexus Issues & Impact

- Voluntary Disclosure – Expanding Look Back
- SEC Filings – Public Disclosures
- State Tax Returns – Filings/Disclosures
- Amnesty – Opportunity/Penalties & Interest
- Restructurings – Business Changes Daily
- Employees – New Responsibilities/Combining
- Opinions/FIN 48 – Work Product Privilege



Questions?



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