# Lagniappe

A Publication for LOUISIANA CERTIFIED PUBLIC ACCOUNTANTS

November 2010 Volume 36, Number 5

SMALL BUSINESS ISSUE

Open

OPENING TIMES

MONDAY - FRIDAY 7.30AM - 11.00PM

SATURDAY 8.30AM - 11.00PM

SUNDAY 8.30AM - 10.30PM

# Big Help for Small Business

***An overview of the 2010 Small Business Jobs Act's tax breaks and incentives***

## IN THIS ISSUE

- State Tax Nexus Issues
- Keeping the Best and Brightest
- Evolution of the CPA Exam
- Is Your Desktop Changing
- Building the Knowledge Worker Team

***plus*** . . . Tax Prepares Apply Yourself: Get Your PTIN ASAP

# State Tax Nexus Issues *By Blane Clark and Matthew Meiners*

As companies expand their operations into foreign states, it is essential to determine the potential tax liability for conducting business in those jurisdictions. Although states differ as to their treatment of out-of-state taxpayers, all states are bound by the U.S. Constitution and federal law and jurisprudence, which require a nexus between a taxpayer and a foreign state before a tax may be imposed.

A state's authority to tax out-of-state taxpayers is limited by the Due Process Clause of the 14th Amendment and the Commerce Clause. In *Quill v. North Dakota*, the U.S. Supreme Court provided guidance for these determinations.[1] In order for a state tax to comply with the Due Process Clause, 1) there must be a definite link, a minimum connection, between a state and the person, property or transaction it seeks to tax,[2] and 2) the "income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.'"[3] Focusing on the first of these requirements, the *Quill* court noted that the presence of sales personnel in the state or the maintenance of local retail stores in the state serve as sufficient contact.[4] However, even if the taxpayer has no physical presence in the taxing state, contact with the state is sufficient if the company's efforts are "purposefully directed" toward residents of the state.[5]

A state tax will survive a challenge under the Commerce Clause if the tax: 1) is applied to an activity with a substantial nexus with the taxing State, 2) is fairly apportioned, 3) does not discriminate against interstate commerce, and 4) is fairly related to the services provided by the State.[6] Regarding the first requirement, the *Quill* court explained that despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical, as due process concerns fundamental fairness of governmental activity, while the Commerce Clause concerns the effects of state regulation on the national economy.[7] Accordingly, a company may have "minimum contacts" required by the Due Process Clause, and yet lack the "substantial nexus" as required by the Commerce Clause.[8]

Adhering to a bright-line rule established by the court in *Bellas Hess v. Illinois* regarding sales and use taxes, the court in *Quill* declared that companies which do no more than communicate with customers in the state by mail or common carrier as part of a general interstate business are free from state-imposed duties to collect sales and use taxes.[9] In other words, "physical presence" of a taxpayer in a taxing state is required in order to impose a sales and use tax.[10] Examples of "physical presence" include 1) sales arranged by local agents in the taxing State;[11] and 2) maintenance of retail stores.[12]

It is important to note that, although the constitutional analysis of *Quill* applies generally to state taxing authority, the court's retention of the *Bella Hess* "physical presence" rule may be limited to sales and use taxes. The court itself noted that it has not, in its review of other types of taxes, articulated the same physical-presence requirement.[13] This passage was cited by the Supreme Court of South Carolina in *Geoffrey v. South Carolina* for the inapplicability of the physical presence rule to state income taxes.[14] In that case, Geoffrey, a wholly owned subsidiary of Toys R Us, licensed certain intellectual property to Toys R Us for use in multiple states, including South Carolina. The License Agreement


## Making a Difference in Louisiana

As the State's chief auditor and fiscal advisor, the Legislative Auditor recommends ways to improve state government operations and identifies critical issues to protect public resources.

We are currently hiring CPAs and CPA candidates for staff and senior auditor positions in the Baton Rouge area. Auditing experience preferred. Salary DOE.

In addition to challenging and rewarding work, we offer:

- Competitive salaries
- Flexible work schedules
- Opportunities for career development and growth
- Comprehensive benefits package
- Continuing professional education
- Assistance with certification exams
- Limited travel

**For more information,
visit www.llajobs.com and www.lla.la.gov
Apply online or send resume with salary requirements to:
P.O Box 94397,
Baton Rouge, LA 70804-9397
or fax to 225-339-3870**

also allowed Toys R Us to use Geoffrey's merchandising skills, techniques, and "know-how" in connection with the advertising and sale of products. In return, Geoffrey received a royalty of one percent of the net sales of Toys R Us.[15] Reasoning that the presence of intangible property alone is sufficient to establish nexus,[16] the court concluded that "by licensing intangibles for use in this State and deriving income from their use here, Geoffrey has a 'substantial nexus' with South Carolina."[17] Other state courts have used similar reasoning and found the existence of a substantial nexus without physical presence.[18] Accordingly, until the issue is resolved by the U.S. Supreme Court, jurisprudence of the taxing state should be consulted.

With an apparent lack of a general bright-line rule for state taxation (other than sales and use taxes), courts in different states will have varying standards for what types of activities create a "substantial nexus" with the state for purposes of the Commerce Clause. However, a fair degree of clarity exists for taxation of income derived by certain sellers of tangible property. Public Law 86-272, codified at 15 U.S.C. § 381, prohibits States and their political subdivisions from imposing a tax on a company's net income derived within that State if: 1) the only business activity within the State by or on behalf of such company is the mere solicitation of orders for sales of tangible personal property; 2) all orders are sent outside the state for approval or rejection; and 3) all approved orders are filled by shipment or delivery from a point outside the state.

The U.S. Supreme Court, in *Wisconsin v. Wrigley*, addressed what the court recognized as the "primary sources of confusion" regarding Public Law 86-272, which were: 1) the scope of the term "solicitation of orders"; and (2) whether there is a de minimis exception to the activity that forfeits tax immunity.[19] Regarding the first issue, the court explained that "solicitation of orders" is broader than that which is strictly essential to making requests for purchases, but is limited to those activities that are "entirely ancillary to requests for purchases-those that serve no independent business function apart from their connection to the soliciting of orders."[20] By this definition, activities which the court found to qualify as "solicitation of orders" included in-state recruitment, training, and evaluation of sales representatives, as well as use of hotels and homes for sales-related meetings.[21] Activities which would not qualify include repair or service of the company's products within the taxing State.[22] Finally, the court recognized the application of the de minimis principle and declared that loss of tax immunity under Public Law 86-272 is avoided if the activity which exceeds "solicitation of orders" does not establish "a nontrivial additional connection with the taxing State."[23]

As the discussion above indicates, ambiguity remains in the determination of tax liability for out-of-state taxpayers. Relative clarity exists for sales and use tax liability, as physical presence in the taxing state is required. Look for the maintenance of an office, plant or retail store, as well as sales made within the taxing state by agents of the company. Income derived from sales of tangible property will be exempt from state taxation if the requirements of Public Law 86-272 are met. However, this immunity can be forfeited if business is conducted in the taxing state which is not entirely ancillary to soliciting orders. For other types of taxes, liability will turn on the imprecise and evolving constitutional nexus standards and may be found to exist absent physical presence. In particular, look for income derived (even indirectly) from business conducted in the taxing state. If a taxpayer potentially meets any of these standards in a foreign taxing state, tax liability should be investigated by consulting that state's tax statutes, regulations, and jurisprudence.

***Editor's Note:*** *Blane Clark is a partner in the Baton Rouge office of Kean Miller. He has more than two decades of experience handling complex industrial commercial and health care transactions for clients. In addition to handling transactions for his clients, Blane works with clients in planning their overall corporate structure and in helping with day-to-day issues that surface in the operation of their businesses. He can be reached at (225) 382-3414 or* blane.clark@keanmiller.com.

*Matthew Meiners is an associate attorney in the Baton Rouge office of Kean Miller. He joined the firm in 2009 and practices in the Business and Corporate group. Matthew received his J.D., cum laude, in 2009 from the LSU Law Center. He received his B.S. in International Trade and Finance and a minor in Economics from Louisiana State University in 1998. He can be reached at (225) 382-3416 or* matthew.meiners@keanmiller.com.

---

1 *Quill Corp. v. North Dakota By and Through Heitkamp*, 504 U.S. 298, 305-319, 112 S.Ct. 1904 (U.S. 1992).

2 *Id.*, at 306, citing *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-345, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1954)

3 *Id.*, citing *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273, 98 S.Ct. 2340, 2344, 57 L.Ed.2d 197 (1978) (citation omitted).

4 *Id.*; citing *Felt & Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62, 59 S.Ct. 376, 83 L.Ed. 488 (U.S. 1939); *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, 61 S.Ct. 586, 85 L.Ed. 888 (U.S. 1941).

5 *Id.*, at 308, citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 105 S.Ct. 2174, at 2184, 85 L.Ed.2d 528 (U.S. 1985)

6 *Id.*, at 311, citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S., at 285, 97 S.Ct., at 1079.

7 *Id.*, at 312.

8 *Id.*, at 313.

9 *Id.*, at 317-318; citing *National Bellas Hess, Inc. v. Department of Revenue of State of Ill.*, 386 U.S. 753, 758, 87 S.Ct. 1389, 1392 (U.S. 1967).

10 See *National Bellas Hess, Inc. v. Illinois Rev. Dept.*, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967); *National Geographic Soc. v. California Bd. of Equalization*, 430 U.S. 551, 559, 97 S.Ct. 1386, 1392 (U.S. 1977).

11 See *Felt & Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62, 59 S.Ct. 376, 83 L.Ed. 488 (U.S. 1939); *General Trading Co. v. State Tax Comm'n*, 322 U.S. 335, 64 S.Ct. 1028, 88 L.Ed. 1309 (U.S. 1944).

12 See *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, 61 S.Ct. 58, 85 L.Ed. 888 (U.S.1941); *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373, 61 S.Ct. 593, 85 L.Ed. 897 (U.S. 1941).

13 *Quill*, at 314.

14 *Geoffrey, Inc. v. South Carolina Tax Com'n* 313 S.C. 15, 23, 437 S.E.2d 13, 18 (S.C. 1993).

15 *Id.*, at 15.

16 *Geoffrey, Inc. v. South Carolina Tax Com'n* 313 S.C. 15, 23, 437 S.E.2d 13, 18 (S.C. 1993); citing *American Dairy Queen Corp. v. Taxation and Revenue Dep't*, 93 N.M. at 747, 605 P.2d at 255. See also *Int'l Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 441-442, 64 S.Ct. 1060, 1063-64, 88 L.Ed. 1373, 1379 (1944).

17 *Id.*., at 18.

18 See *Lanco, Inc. v. Director, Div. of Taxation*, 188 N.J. 380, 382, 908 A.2d 176, 177 (N.J. 2006); A & F Trademark, Inc. v. Tolson 167 N.C.App., 150, 162, 605 S.E.2d 187, 195 (N.C. App. 2004); Tax Com'r of State v. MBNA America Bank, N.A., 220 W.Va. 163, 169, 640 S.E.2d 226, 232 (W.Va. 2006).

19 *Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 223, 112 S.Ct. 2447, 2453 (U.S. 1992).

20 *Id.*, at 232.

21 *Id.*, at 232.

22 *Id.*, at 232.

23 *Id.*, at 232.