OF NAMES, NOTICES & NEXUS:
A PERSPECTIVE ON MULTI-STATE TAXATION

GEORGIA SOCIETY OF CPAs
NORTH PERIMETER CHAPTER
BUCKHEAD CHAPTER

Presented By

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OF NAMES, NOTICES & NEXUS: A PERSPECTIVE ON MULTI-STATE TAXATION

Presented By

Anson H. Asbury

I. INTRODUCTION. On September 13, 2006, the Georgia Department of Revenue announced that it would join the Multistate Tax Commission's ("MTC") National Nexus Program effective October 1, 2006. The Georgia Department of Revenue declared that it would participate in the National Nexus Program for sales and use taxes as well as franchise, corporation, and personal income taxes.

The National Nexus Program is touted by the MTC for assisting multistate businesses in voluntarily resolving potential liabilities where nexus is the central issue. In other words, the National Nexus Program allows taxpayers who suspect that they may have nexus in states where they are not currently filing an opportunity to voluntarily disclose that liability, pay back taxes, and sometimes incur no penalty. The true benefit of increasing tax liabilities and compliance responsibilities must be determined by each individual taxpayer.

The announcement indicates that Georgia, who has been a passive associate member of the MTC, is taking a more active role in the MTC. One consequence of Georgia's growing tie to the MTC is that the MTC routinely shares taxpayer information among its members as part of the National Nexus Program and the Joint Audit Program. Georgia is no longer an island state from which you may send goods into interstate commerce without tax consequences.

II. NEXUS.

A. What is Nexus? Nexus is the Constitutional requirement that there be some definite link or minimum connection between the state seeking to impose a tax and the person, property, or transaction it seeks to tax.[1]

B. The Concept. The concept underlying nexus is that a state is justified in imposing a tax in exchange for providing protection, opportunities, and services to the taxpayer. Without some connection between the taxpayer and the state, the state cannot avail itself of the position that is providing a benefit to the taxpayer for which it may collect revenue.

[1] *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 777 (1992).

C. **Legal Standard.** The legal standard that governs nexus is based upon U.S. Constitution, specifically the Fourteenth Amendment Due Process Clause and the Commerce Clause.

1. **Due Process under the Fourteenth Amendment.** The Due Process Clause is applied to determine jurisdiction for all manner of federal legal process. That is, due process determines whether an individual, company, or piece of property is subject to the laws of a particular state. Its application in determining the proper taxing jurisdiction operates under the same principles.

2. **The Commerce Clause.** Known variously as the "Interstate" Commerce Clause or the "Dormant" Commerce Clause, this Constitutional principle restricts states from enacting legislation that might burden interstate commerce.

3. **Application to State Taxation.** The Constitutional standards applied to state tax statutes developed though litigation that challenged the legitimacy of the first income-based state taxes in the early 20th century. A long line of U.S. Supreme Court authority has relied upon these two principles for determining the Constitutional parameters on state tax statutes.

D. **Different Standards for Different Taxes.** Prior to 1992, Supreme Court jurisprudence did not distinguish between nexus established under the Due Process Clause and the Commerce Clause. In a sales and use tax case requiring actual physical presence to satisfy the nexus requirement, the Court noted that the Commerce Clause requirement of nexus "encompasses as well the Due Process requirement that there be a 'minimal connection' between the interstate activities and the tax and state." *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756-757 (1967).

The landscape changed in 1992 when, in *Quill Corporation v. North Dakota,* 504 U.S. 298 (1992), the Supreme Court adopted a two-part analysis noting that the Due Process Clause and the Commerce Clause "are analytically distinct." The Commerce Clause's "substantial-nexus requirement is not, like Due Process' minimum contacts requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce." *Id.*

A business may have minimum contacts with a taxing state under the Due Process Clause but lack the substantial nexus with the state required by the Commerce Clause. That was exactly the case in *Quill*.

E. The Constitutional Standards and State Taxation.

1. **Due Process Under the Fourteenth Amendment.** The Due Process Clause analysis for state taxation begins with "minimum contacts." The concept of minimum contacts was drawn from the Supreme Court's decision in *International Shoe Co. v. Washington*, 326 U.S. 310, 316, (1945), a case about a court's ability to exercise personal jurisdiction over an out-of-state resident in a civil matter. The Supreme Court held that by delivering magazines into the state of North Dakota, Quill had established minimum contacts with that taxing jurisdiction. Nonetheless, minimum contacts alone were insufficient to establish nexus for Quill. The Court elaborated that the Due Process nexus analysis also requires a consideration of whether the connections are "substantial enough to legitimate the state's exercise of power over [the taxpayer]."[2]

   The Court considered also whether Quill had purposely directed itself in its business activities at North Dakota residents. Quill's intent was an important consideration. The Court found that Quill did direct its marketing efforts at North Dakota and therefore held that Quill availed itself of the protections and benefits of North Dakota sufficient to justify the state's exercise of taxing jurisdiction.

2. **Commerce Clause.** The Commerce Clause restricts burdens on interstate commerce imposed by state statutes or regulations. The Commerce Clause does not operate through executive mandate or Congressional enactment but, rather, has been developed through a body of Supreme Court case law. The Commerce Clause is often called dormant because it is only applied as a defense in litigation.

F. Applying of the Constitutional Standard to Different Tax Types.

1. Which Standard Applies? Following the *Quill* decision, the Constitutional guidelines for nexus are divided into two basic tax types: sales and use taxes, and income-based taxes.

2. Sales & Use Taxes**.** The *Quill* decision affirmed the bright line physical presence test for establishing sales and use tax nexus. You must have employees or property in the taxing state to establish nexus.

[2] *Quill*, 504 U.S. at 312 (1992).

3. **Income Taxes.** Income tax nexus has a less specific standard. Since *Quill,* the Supreme Court has not decided a nexus case involving a state income tax. The specific application of the Court's holding in *Quill* to sales and use taxes coupled with its extensive discussion of the standards for determining nexus under the Due Process Clause has left the treatment of income tax nexus open to determination by the many states. The development of doctrines like economic nexus are evidence of the confusion and vagaries that can surround income tax nexus.

4. **Franchise and Business Privilege Taxes.** Corporate privilege and franchise taxes generally are not subject to the Constitutional standards applied to income taxes and sales and use taxes. Though many business privilege taxes seem to be "income based" because they are calculated on the business' income, the basic statutory precept is different than an income based tax. The premise behind a business privilege tax is that the company is "doing business" in the state. It is possible, however, to have substantial nexus in a state (and therefore income tax nexus) but not be doing business in that state. For example, a Wisconsin court held that an out-of-state company whose only contact with Wisconsin was vehicles leased in the state has substantial nexus for income tax purposes but was not doing business in the state for purposes of the franchise tax. *Wisconsin Dept. of Revenue v. Amerco Lease Co.,* Dane County Civ. Ct., No. 87-CV-3997, Mar. 16, 1998, appeal dismissed as untimely, 147 Wis.2d 884, 434 N.W.2d 623 (App. 1988).

   Similar cases have been decided in Alabama, *Union Tank Car Co. v. Alabama Dept. of Revenue*, Corp. 04-247, Ala. Dept. of Revenue, Admin. Law Div., Jan 11, 2005, and Georgia, *Williams v. American Refrigerator Transit Co.,* 91 Ga. App. 522, 86 SE2d 336 (1955).

III. UNDERSTANDING NEXUS THROUGH THE CASE LAW.

Nexus is a judicial doctrine. The best way to understand nexus is by understanding the seminal cases that have defined the activities that create nexus.

A. Income Tax Nexus – Fairly Apportioned.

1. ***Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959).**

   Background – *Northwestern* is the consolidation of two different cases, one from Minnesota and one from Georgia, which

challenged the minimum contacts necessary for a state to impose a corporate income tax on out-of-state businesses.

a. The Minnesota Case.

(i) **Facts.** The first case challenged the constitutionality of a Minnesota statute which imposed an annual tax upon the taxable net income of residents and non-residents. The Minnesota statute determined income based on a three factor apportionment formula, *i.e.*, total sales assignable to Minnesota relative to sales everywhere, total tangible personal property in Minnesota relative to total property everywhere, and total payroll in Minnesota relative to total payroll everywhere. The taxpayer did not dispute the fairness of the apportionment formula as applied by Minnesota accuracy as applied under the taxpayer's facts.

(ii) **Issue.** The specific issue was whether a tax imposed upon an Iowa corporation engaged in the manufacture and sale of cement at a plant in Mason City, Iowa, some 40 miles away from the Minnesota border, was subject to Minnesota income tax. The Iowa company made sales into Minnesota, maintained a sales office in Minnesota, and employed two salesmen in Minnesota. The taxpayer argued that the Minnesota tax was an unconstitutional violation of the Due Process Clause and the Commerce Clause.

(iii) **Procedural Background.** The trial court, District Court, Hennepin County, entered judgment for the State of Minnesota and against the corporation. The corporation appealed and the Minnesota Supreme Court affirmed the judgment. The taxpayer appealed to the United States Supreme Court.

b. The Georgia Case.

(i) **Facts.** The second case originated in Georgia. Georgia imposed a tax on the net income of every corporation owning property or doing business in the state. The Georgia statute apportioned the income using three factors based on inventory,

wages, and gross receipts. The taxpayer, Stockham Valves and Fittings, Inc., was a Delaware corporation with its principle office and plant in Birmingham, Alabama. The taxpayer manufactured and sold valves and pipe fittings through wholesalers and jobbers. The corporation maintained no warehouse or storage facilities in Georgia; however, it did have a one-person sales office based in Atlanta.

(ii) **Issue.** The taxpayer paid the tax under protest and sought a refund of taxes paid to Georgia arguing that the tax was unconstitutional as applied.

(iii) **Procedural Background.** The State Revenue Commissioner denied the refund claim and the taxpayer brought suit in the Superior Court of Fulton County. The Superior Court entered judgment in favor of the Department of Revenue and the taxpayer appealed to the Georgia Supreme Court. The Georgia Supreme Court reversed the judgment of the trial court, finding in favor of the taxpayer. 213 Ga. 713, 101 S.E.2d 197 (1958). The State Revenue Commis-sioner petitioned the Supreme Court for a *writ of certiorari*.

c. **U.S. Supreme Court Holding.** The Supreme Court distinguished the apportioned taxes imposed by Minnesota and Georgia from taxes imposed upon the privilege of doing business in a state. Because the tax was based upon the net income received by the corporations in interstate commerce, and fairly apportioned to the state from which it had derived that income, the Court found that the taxes imposed no burden on interstate commerce. The Court also noted that in both instances there was a direct connection between the taxpayer and the taxing state. There was no inherent discrimination in the taxing scheme and the method of apportionment sought to avoid multiple taxation. This decision firmly established the state's right to impose a fairly apportioned corporate income tax on non-resident businesses.

2. **California – *General Motors Corp. v. Franchise Tax Board*, Court of Appeal, Second District, Division 2, No. B165665 (January 29, 2007).** The California Court of Appeals remanded a

corporate franchise an income apportionment case to the trial court. On remand, the trial court is instructed to consider the Franchise Tax Board's argument that gross receipts from short-term security investments included in the apportionment formula sales factor produced distortion and should therefore be excluded under California's alternative apportionment formula. The remand from the Appellate Court was the result of the California Supreme Court remanding the issue to the Appellate Court to consider whether the Franchise Tax Board could meet its burden of proof that inclusion of the gross sales proceeds required the use of the alternative apportionment formula to prevent distortion, particularly in light of the California Supreme Court's decision in *Microsoft Corporation v. Franchise Tax Board*, 39 Cal.4th 750 (2006). Unlike the Microsoft case, the trial court in this case did not fully consider the Franchise Tax Board's argument because the case was decided on summary judgment.

B. Income Tax Nexus - Solicitation of Orders.

1. **Congress Reacts to *Northwestern*.** Congress responded to the Supreme Court's decision in *Northwestern* with the passage of Public Law 86-272 which set forth the standards for determining the "solicitation of orders" for purposes of income tax nexus.

2. **Public Law 86-272.**

   a. Public Law 86-272 provides that a state shall not impose a net income tax on the income derived within the state from interstate commerce if the only business activity in that state is the solicitation of sales for orders which are approved and filled outside the state. In other words, Congress created an exemption from state income tax for the mere "solicitation of orders."

   b. Public Law 86-272 is carefully drawn and limited to the sales of tangible personal property (it does not account for the sale of services). The requirement that orders be approved and delivered from out of state precludes a taxpayer from having a local warehouse or sales office in the state. Further, the statute applies only to taxes imposed or measured by net income. Sales and use taxes and taxes based on the value of a company, such as a capital stock tax, are not subject to the exemption created by Public Law 86-272. The lasting effect of Public Law 86-272 is to

insure that the mere act of soliciting sales in a state is not sufficient to subject a taxpayer to income tax in that state.

c. Though codified at 15 U.S.C. §§ 381-384, this statute has long been referred to as "Public Law 86-272" or "P.L. 86-272" by both the government and practitioners.

3. ***Wisconsin Department of Revenue v. William Wrigley, Jr. Co.*, 505 U.S. 214 (1992).**

a. **Facts.** The taxpayer, the William Wrigley, Jr. Co., popularly known for its Wrigley's Chewing Gum, made sales into Wisconsin through a sales representative. The sales representative resided in Wisconsin but Wrigley did not provide him with a sales office. Wrigley did not lease or own real property in Wisconsin. There was no warehouse or manufacturing facility in Wisconsin. All orders from Wisconsin were delivered to Chicago where they were approved, processed, and filled by shipment originating outside the state of Wisconsin.

The sales representative would visit customers in Wisconsin and provide them with materials to support their sales of Wrigley's gum, including display racks and other promotional materials. The sales representative would often seek to have the display racks prominently located and encourage the use of the promotional materials. The sales representative also carried about $1,000 of replacement inventory, gum, with him and if necessary he would refill stock from the supply he had on hand. The customers were charged for the stock refills by the application of a credit memo to the Chicago office. In 1980, Wisconsin Department of Revenue assessed tax on Wrigley's activities in Wisconsin. Wrigley challenged Wisconsin's assessment of tax on the grounds that it violated Public Law 86-272, 15 U.S.C. § 381.

b. **Issue.** The primary issue in the case was the meaning and scope of the phrase "solicitation of orders" and whether the activities of Wrigley's sales representative exceeded the scope of that definition.

c. **Procedural Background.** Wrigley sought an evidentiary hearing in front of the Wisconsin Tax Appeals Commission which unanimously upheld the imposition of the tax. CCH

Wisconsin Tax Reporter ¶ 202-792 (1986). The case was reversed on the merits by the county circuit court finding in favor of Wrigley. The Wisconsin Court of Appeals reversed the county circuit court holding in favor of the state. 153 Wis.2d 559, 451 N.W.2d 444 (1989). The Wisconsin Supreme Court in a unanimous opinion reversed the outcome yet again, thus finally disallowing the Wisconsin tax. 160 Wis.2d 53, 465 N.W.2d 800 (1991). The state petitioned for *writ of certiorari* which the Supreme Court granted.

d. **U.S. Supreme Court Holding.** The Supreme Court considered and rejected both the narrow construction of the phrase "solicitation of orders" put forth by Wisconsin and the broad construction advanced by Wrigley. The Court struck a limited balance between the two concepts. The Court's analysis focused the actual activities of the sales representative and whether those activities were *de minimus non curat lex* as that term was historically defined.[3]

Despite the fact that the statutory language of P.L. 86-272 defined business activity as "only" the solicitation of orders, the Court held that the law should be construed in light of the *de minimus* standard. The Court held that Wrigley's activities in the state exceeded that *de minimus* standard and were sufficient to allow Wisconsin to impose a tax. The Court viewed the activities in their totality and emphasized that the customer paid for gum stock that was replaced by the sales representative.

4. **The Legacy of P.L. 86-272 and *Wrigley*.** The scope of Public Law 86-272 remains an active source of controversy among the states.

a. **California – *Brown Group Retail, Inc. v. Franchise Tax Board*, 44 Cal. App. 4th 823, 52 Cal. Reporter 2d 202 (2d Dis. 1996).** The California Court of Appeal held that an out-of-state wholesaler exceeded the scope of "solicitation of orders" because two employees provided assistance to independent retailers to establish and maintain their retail stores. The court noted that while the

[3] *De minimus non curat lex*: The law does not care for, or take notice of, very small or trifling matters. Black's Law Dictionary, 6th Ed., p. 431 (1990).

employee's efforts might increase sales, "it is not enough that the activity facilitates sales; it must facilitate the requesting of sales, which this did not."

b. **Maine – *Peterson v. State Tax Assessor*, 724 A.2d 610 (Me. 1999).** The Maine Supreme Court held that two salesmen who accepted orders in the state, picked up items from customers, lent items to customers, and accepted payments from customer exceeded the scope of P.L. 86-272. The activities were not "*de minimus*" within the meaning of *Wrigley*.

c. **New Jersey – *Asher, Inc. v. Director, Division of Taxation*, 22 N.J. Tax 582 (2006).** The New Jersey Tax Court issued an opinion determining whether a Pennsylvania corporation that manufactured and delivered candy into New Jersey was engaged in the solicitation of orders for purposes of the corporation business tax. The New Jersey Tax Court determined that the collection of payments by the company's driver, the acceptance of returned goods, and on at least one occasion the acquisition of supplies in New Jersey, was sufficient activity within the state to subject the company to tax.

d. **Michigan – *International Home Foods, Inc. v. Department of Treasury*, Michigan Supreme Court, Docket Nos. 130542 and 130543, January 5, 2007.** The Michigan Supreme Court reversed an appellate court decision and reinstated the trial court decision which found that the Michigan Department of Revenue was not estopped from retroactively applying the decision in *Gillette Company v. Department of Treasury*, 198 Mich. App. 303 (1993), which held that the Michigan single business tax was not an income tax and therefore the protection of Public Law 86-272 did not apply.

C. Income Tax Nexus – *Geoffrey v. South Carolina*.

1. **A Theoretical Vacuum.** The Supreme Court's extensive discussion of Due Process "minimum contacts" in *Quill* coupled with its analysis of *de minimus* solicitation activities in *Wrigley* created a space between the two theories. A cartoon giraffe soon filled that space courtesy of the South Carolina Supreme Court.

2. *Geoffrey, Inc. v. South Carolina Tax Commission*, 313 S.C. 15, 437 S.E.2d 13 1993, *cert denied* 510 U.S. 992 (1993).

a. Facts. "Geoffrey" is the carton giraffe mascot for the Toys R Us Company. Geoffrey, Inc. was a wholly-owned subsidiary of Toys R Us incorporated in Delaware. The sole purpose of Geoffrey, Inc. was to hold and manage the trademarks developed and used by Toys R Us. Geoffrey licensed the Toys R Us name, logo, and the Geoffrey image to Toys R Us. In return, Toys R Us paid Geoffrey 1% of the net sales of products sold under the licensed marks.

The taxpayer, Geoffrey, Inc., sued the State Tax Commission seeking a refund of income taxes paid. The Circuit Court, Greenville County, entered judgment for the Commission and Geoffrey, Inc. appealed.

The Commission argued that South Carolina enjoyed sufficient nexus with Geoffrey, Inc. as a result of Geoffrey's use of its intangibles in the state to warrant taxation. Geoffrey challenged the Commission's assessment under the Due Process and Commerce Clauses.

b. South Carolina Supreme Court's Holding. The South Carolina Supreme Court held that the royalty income that Geoffrey, Inc. obtained from trademark licenses issued to an affiliate could be taxed without violating the Due Process Clause and the tax could be imposed without violating the Interstate Commerce Clause. Citing *Quill,* the Court observed that "the nexus requirement of the Due Process Clause can be satisfied even where the corporation has no physical presence in the taxing state if the corporation has purposely directed its activity at the state's economic forum." The South Carolina Supreme Court relied on the presence of Geoffrey's intangible property in the state as an alternative ground for its Due Process argument, even though neither Geoffrey nor Toys R Us had any physical locations in South Carolina for the tax periods in question.

The South Carolina Supreme Court's analysis of the Commerce Clause prong of *Quill* was brief. In a footnote, the Court's interpreted the holdings of *National Bellas Hess* and *Quill* to require a physical presence only for sales and

use taxes. There was no discussion of substantial nexus concept described in the *Quill* opinion.

3. **Reaction to *Geoffrey*.** Upon its release, the South Carolina Supreme Court's opinion in *Geoffrey* was soundly criticized by scholars and tax practitioners. Nonetheless, it remains the law of South Carolina and has spawned progeny in many jurisdictions.

D. Income Tax Nexus – Economic Nexus (the Post-*Geoffrey* world).

1. **Economic Nexus.** The concept of nexus loosely defined by the South Carolina Supreme Court in *Geoffrey* has come to be known as "economic nexus."

   a. **Economic Nexus Considered.** In some ways, economic nexus is the intersection between *Wrigley* and *Quill*. Pushing the limits of theory, economic nexus occupies the space where a company's activities in a state are indeed *de minimus* with relation to the solicitation of orders under Public Law 86-272, but nonetheless exceed the "minimum contacts" necessary to satisfy the Due Process Clause's standard for tax jurisdiction. By bifurcating the Constitutional standards as the U.S. Supreme Court did in *Quill*, the possibility of predicating nexus on satisfaction of only the Due Process Clause became real in *Geoffrey*. Multistate companies have been walking on eggshells since.

2. **Administrative Adoption of Economic Nexus.** In the aftermath of *Geoffrey*, many states issued administrative pronouncements and other technical advice embracing the economic nexus rationale put forth in *Geoffrey*.

   a. **Florida - Fla. Admin. Code Ann. r. 12C-1.011(1)(p)(1) (Westlaw 2006).** Florida revised its regulations to include the use of intangible property in the definition of business activities.

      The following activities … will be construed as conducting business, earning or receiving income in this state…

      Selling or licensing the use of intangible property in Florida … for example, licensing the use of a trade name or trademark or patent to a business entity located in

Florida will subject a corporation to the corporate income tax.

b. **Massachusetts – Corporate Excise DOR Directive 96-2, Mass. Dept. of Revenue, July 3, 1996.** Massachusetts subjects intangible property to the corporate income tax when:

1. The intangible property generates, or is otherwise a source of, gross receipts within the state for the corporation, including through a license or franchise;

2. The activity through which the corporation obtains such gross receipts from its intangible property is purposeful (e.g., a contract with an in-state company; and

3. The corporation's presence within the state, as indicated by its intangible property, is more than de minimus.

3. **Follow the Leader - Cases Adopting Economic Nexus.**

a. **New Mexico - *K-Mart Properties, Inc. v. Taxation and Revenue Department*, 139 N.M. 177, 131 P.3d 27 (App. 2001).** The New Mexico Court of Appeals held that K-Mart Properties, Inc, which owned and managed trademarks such as "Blue Light Special", had substantial nexus with New Mexico for income and gross receipts taxes despite the facts that it had performed no services in New Mexico and had no employees or property in the state.

b. **West Virginia – *Steager v. MBNA Am. Bank, NA*, No. 04-AA-157, 2005 WL 1978490 (W. Va. Cir. Ct. June 27, 2005).** The West Virginia Circuit court determined that MBNA, an out-of-state bank who issued and serviced credit cards, was subject to West Virginia's corporate net income tax despite the fact that it had no physical presence in the state. The court held:

> *As a matter of law that MBNA's lack of a physical presence in West Virginia is not a prerequisite to a finding of substantial nexus to satisfy the Commerce Clause for the imposition of corporate net income and business franchise taxes.*

4. **<u>The Other Side of the Coin – Cases Adopting the Physical Presence Requirement for Income Tax Nexus</u>.**

   a. **<u>Tennessee - *JC Penney National Bank v. Johnson*, 19 S.W.3d 831 (Tenn. App. 1999), *cert denied* 531 U.S. 927 (2000)</u>.** The Tennessee Court of Appeals adopted *Quill's* physical presence test for income taxes holding that an out-of-state credit card bank lacked substantial nexus with Tennessee to subject it to the states' income-based franchise and excise taxes.

5. **<u>The Latest Thing – Add Back Statutes</u>.**

   a. **<u>Alabama – *VFJ Ventures, Inc. v. Surtees*, Circuit Court of Montgomery County, No. CV-03-3172 (January 24, 2007)</u>.** Montgomery County Circuit Court Judge Tracey S. McCooey held that VFJ Ventures, Inc. did not have to add back royalty payments it paid to two unrelated intangible management companies because, under the Alabama Statute, it was unreasonable to require the disallowance of those payments as deductions.

   VFJ Ventures, Inc. (VFJ) formerly known as VF Jeans Wear, manufactures jeans and related products primarily under the Wrangler and Lee brand names. During 2001, VFJ paid $100 million in royalties to the H.D. Lee Company, Inc. and Wrangler Clothing Corp. for the right to use the trademarks owned by those two companies. VFJ, Lee and Wrangler are all subsidiaries of a common parent company, VF Corporation. VFJ deducted these royalty payments as ordinary and necessary business expenses on its federal tax return, and the deductions flowed through to its Alabama tax return.

   Alabama's "add back" statute, Alabama Code Section 40-18-35(b), was enacted in 2001. The add back statute requires that, unless certain exceptions apply, corporation must–

   > [A]dd back otherwise deductible . . . intangible expenses and costs directly or indirectly paid, accrued, or incurred to . . . one or more related one or more related members.

There was no factual dispute that the royalties constituted intangible expenses or that Lee and Wrangler were related members. Therefore, the only questions were whether an exception applied that might not require VJF to add back the royalty payments under the statute or whether the statute itself was unconstitutional.

Tracking the language of the statute which stated that an add back was not required if "corporations establish that the adjustments are unreasonable", the Court held that it was unreasonable to require VFJ to add back its royalties. The Court held that in VFJ's circumstances, requiring the add back effectively denied the deduction for the necessary cost of doing business in Alabama and resulted in a calculation of taxable income that included income properly attributable to other states.

Judge McCooey found that VFJ Ventures had a strong business purpose and engaged in economically substantive transactions. The court specifically noted that Lee and Wrangler shared 3,200 square feet of office space in Wilmington, Delaware and employed at least 15 employees, including two trademark attorneys, six trademark paralegals, one licensing paralegal, three trademark assistants, a controller and a staff accountant. All of these employees carried on substantial activities in maintaining trademark registrations and protecting against infringement and licensing of the trademarks. The court also found that the intangible management organizations increased efficiency in trademark management, developed the expertise of employees dedicated to trademark management, and reduced duplicative efforts, duplicative costs and unnecessary reliance on outside counsel for management of the trademarks.

The court did not rule on VFJ's arguments under the Commerce Clause or its arguments concerning the so-called "subject to tax" exception. The parties had vigorously disputed whether "included in income under Alabama Code Section 40-18-35(b)(1) meant included in post-apportionment income or included in any income." Judge McCooey, while not ruling, did note that it was clear to her "that if the legislature had wanted the subject to taxes assumption to mean post-apportioned income, then they would have stated it in the statute."

E. <u>Sales & Use Tax Nexus</u>.

1. <u>The Physical Presence Requirement</u>.

a. <u>*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)</u>.

(i) **<u>Facts</u>.** Quill Corporation sold, and still sells, office supplies. Quill sold office supplies into North Dakota through an out-of-state mail order house. Quill had no warehouses, real property, or sales representatives in the state of North Dakota. Quill Corporation, however, did regularly solicit sales in North Dakota through the regular mass mailing of catalogues.

The applicable North Dakota statute defined "retailer" to include "every person who engages in regular or systematic solicitation of a consumer market in the state." The supporting regulations defined "regular or systematic solicitation" to include mail delivery of three or more advertisements within a twelve month period. There was no dispute that Quill exceeded three mass mailings within a twelve month period.

(ii) **<u>Issue</u>.** North Dakota maintained that Quill was subject to use tax in the state by virtue of its solicitations. Quill objected on the grounds that the North Dakota statute violated the constitutional standards as set forth in the Due Process Clause and Commerce Clause.

(iii) **<u>Procedural Background</u>.** The Tax Commissioner of North Dakota filed an action in state court to require Quill Corporation to collect and pay use tax on goods purchased for use in the state of North Dakota. The trial court ruled in favor of the taxpayer finding the case indistinguishable from the Supreme Court precedent in *National Bellas Hess*. The Tax Commissioner appealed and the North Dakota Supreme Court reversed the trial court concluding that pursuant to *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), the Commerce Clause no longer mandated the sort of physical presence nexus test suggested in *National Bellas*

Hess; and with respect to the Due Process Clause, no cases following *National Bellas Hess* had construed minimum contacts to require physical presence within a state as a prerequisite to taxation. Quill filed a petition for *writ of certiorari* which was granted by the United States Supreme Court.

(iv) **U.S. Supreme Court Holding.** The Supreme Court framed the question by first firmly establishing that the Due Process Clause and the Commerce Clause had different standards for purposes of determining nexus. Noting that a number of prior cases decided by the Supreme Court had relied on both the Due Process Clause and the Commerce Clause to establish nexus for purposes of state taxation, the Court noted that the Due Process Clause requires some definite link, some minimal connection, between a state and the person, property, or transaction it seeks to tax. Further, the income attributed to the state must be rationally related to values connected with the taxing state. Under the Due Process Clause the question facing the court was more closely defined as judicial jurisdiction and the court framed its analysis as such. Thus the relevant inquiry was whether Defendant had minimum contacts with the jurisdiction such that the state could impose a tax.

In considering whether Quill's activity as an out-of-state vendor exceed the minimum contacts required by the Due Process Clause, the Court determined that–

> [I]t matters little that solicitation is accomplished by a deluge of catalogues rather than a phalanx of drummers: the requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing state.[4]

Said differently, the intent of Quill coupled with the minimum contacts established by its solicitation materials was sufficient to satisfy the Due Process

[4] *Quill,* 504 U.S. at 308 (1992).

Clause. Having satisfied itself that Quill had nexus for Due Process purposes, the Court proceeded to analyze Quill under the Commerce Clause.

The Court noted that the Commerce Clause requires more than minimum contacts. Instead, a taxpayer must have "substantial nexus" with the state seeking to impose a tax. The Court followed the physical presence test it established 25 years earlier in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967). The Court determined in *National Bellas Hess* that actual physical presence by the taxpayer was required before the state could impose a use tax. The court did not address the necessary standard for imposing an income tax.

Under the facts presented, the Court held that the use tax did not apply to Quill because there was no physical presence in the state. The Court defended the physical presence rule by noting that it firmly establishes the boundaries of legitimate state authority, reduces litigation, and encourages settled expectations. In effect, the Court chose the practical, common sense standard for sales and use tax; however, in so doing it opened the door to a murky, and still unsettled, understanding of income tax, franchise tax, and other types of taxes.

F. Attributional Nexus.

1. *Borders Online, LLC v. State Board of Equalization*, 129 Cal.App.4th 1179, 29 Cal. Rptr. 176 (1st Dist. 2005).

a. Facts. Borders is a national book retailer with locations in many states including California. Borders created a subsidiary, Borders Online LLC, to operate its internet sales from the Borders.com website. Borders Online's only physical location was in Michigan. Through its website, Borders Online sold books in many states, including California. The books sold by Borders Online were delivered to customers by common carrier. In states where Boarders had a store, Borders Online allowed customers to return or exchange books purchased on-line at the store.

Borders collected and remitted sales tax in states where its bookstores were located. Borders Online, however, only collected sales or use tax on sales in Michigan. It did not collect and remit sales tax, or pay use tax, on sales to any other states. Borders Online was not registered for sales and use tax purposes in California.

California imposes a use tax on any "retailer engaged in business in this state" to include "any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of a retailer or its subsidiary."

b. **Procedural Background.** The California State Board of Equalization made an assessment against Borders Online for sales tax on sales made into California. Borders Online paid the tax under protest and filed for a refund. After the claim was denied, Borders Online filed suit in the San Francisco Superior Court. The trial court entered judgment for the state and the taxpayer appealed.

c. **Issue.** The issue was whether Borders was an agent or representative of Borders Online because it accepted and processed returns on behalf of Borders Online.

d. **California Court of Appeals Holding.** The Court of Appeal found that Borders was an "agent" and "representative" of Borders Online for purposes of the California use tax. The Court also found that the acceptance of returned merchandise was "selling" as that phrase was broadly defined in the use tax statute. Accordingly, it held that Borders Online was subject to the use tax.

As for the Constitutional question of whether Borders Online had satisfied the physical presence test required by *Quill*, the court noted that the "crucial factor" was whether Border's activities on behalf of Borders Online were "significantly associated with its ability to establish and maintain its California market." The Court side-stepped the Constitutional issue of whether or not Borders Online had a physical presence in California as required by Quill. Instead, it characterized obvious use tax standard in a way similar to the economic nexus standard established by *Geoffrey*.

2. **New York – *TSB-A-06(29)S*, New York Commissioner of Taxation and Finance, November 30, 2006.** An out-of-state company selling extended service contracts to New York customers through unrelated third-party retailers at locations in New York was found to have sufficient Nexus to require collection of sales and use tax. The company met the statutory definition of vendor under tax law Sec. 1101(b)(8)(i)(A) because the extended service contract were among those services subject to sale tax in New York. The company also sold service contracts directly to New York customers from its website. This activity did not necessarily have a direct presence with New York, but because the company engaged service providers to perform the services on behalf of the company under the service contracts, the company was deemed to have sufficient Nexus for sales and use tax.

IV. MULTI JURISDICTIONAL TAX ORGANIZATIONS.

A. **Multistate Tax Commission.** The Multistate Tax Commission (MTC) is an organization of state governments organized to administer tax laws that apply to multistate and multinational companies.

The MTC was created in 1967 through the Multistate Tax Compact, an interstate statute enacted by each Compact Member State. The Commission is comprised of the principal tax administrator of each Compact Member State acting as the representative of the state.

The MTC studies state tax issues and recommends uniform tax laws and regulations that apply to multistate and multinational enterprises. The Commission administers a Multistate Alternative Dispute Resolution Program that enables a taxpayer to resolve a common tax issue with several states at once.

The MTC protects state taxing authorities through active participation in significant court cases and by lobbying Congress about state tax authority and interests.

The MTC encourages proper compliance by businesses with state tax laws. It maintains a Joint Audit Program that audits businesses for several states at the same time. The MTC administers the National Nexus Program that encourages businesses that are not registered with states, but should be, to comply with state tax requirements.

1. **MTC Membership.** Forty-six states and the District of Columbia participate in the MTC as Compact Members (20), Sovereignty Members (5), Associate Members (19), and Project Members (3).

a. **Compact Members include:** Alabama, Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington.

b. **Sovereignty Members include:** Florida, Kentucky, Louisiana, New Jersey and Wyoming.

c. **Associate Members include:** Arizona, Connecticut, Georgia, Illinois, Maine, Maryland, Massachusetts, Mississippi, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, Vermont, West Virginia and Wisconsin.

d. **Project Members include:** Iowa, Nebraska, and Rhode Island.

2. **MTC "Factor Presence Nexus Standard" for Business Activity Taxes.** The MTC published this document on October 17, 2002 as an amendment to its MTC Policy Statement 02-02, *Ensuring the Equity, Integrity and Viability of State Income Tax Systems.* A working group of states formulated the proposal over several months with the intent to represent a simple, certain and equitable standard for the collection of state business activity taxes. A copy of the document is attached as Appendix III.

B. **Federation of Tax Administrators.** The Federation of Tax Administrators (FTA) was organized in 1937 to improve the quality of state tax administration by providing services to state tax authorities and administrators. These services include research and information exchange, training, and intergovernmental and interstate coordination. The FTA also represents the interests of state tax administrators before federal policymakers where appropriate.

The FTA serves the principal tax collection agencies of the 50 states, the District of Columbia, and New York City. The work of FTA is directed and governed by an eighteen-member Board of Trustees composed of tax administrators representing all regions of the country. The Commissioner of the Internal Revenue Service is an ex-officio board member.

The FTA works with state tax agencies and the Internal Revenue Service to foster cooperative tax administration projects among states and with IRS. In recent years, most of these efforts have involved assisting states in

applying emerging technologies to tax administration as well as to simplify the administration of current taxes on a multistate basis.

The FTA also coordinates state activities in the development of joint electronic filing programs and the electronic exchange of information between state and federal tax agencies

C. Streamlined Sales and Use Tax Agreement. The Streamlined Sales and Use Tax Agreement (SSUTA) is the most recent multi-jurisdictional organization in state taxation. Unlike the other groups which advocate and coordinate, the SSUTA actually has the authority to collect taxes and initiate audits. The objective of the SSUTA is the uniform definition and application of sales and use tax statutes so that multiple states can efficiently and effectively collect sales and use tax.

1. Member States.

a. Full Members. There are sixteen full members of the SSUTA: Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, West Virginia.

b. Associate Members. There are six associate member states: Arkansas, Nevada, Ohio, Tennessee, Utah, and Wyoming

APPENDIX I

P.L. 86-272, 73 STAT 555 (1959), 15 U.S.C. §§ 381-384

Sec. 101. (a) No state, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act, any 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; and

(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 person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) Domestic corporations; persons domiciled in or residents of a State. The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to--

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) Sales or solicitation of orders for sales by independent contractors. For purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) Definitions. For purposes of this section--

(1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale

of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

APPENDIX II

AICPA Sample Nexus Questionnaire

State Tax Nexus Checklist — The following is a list of frequently asked questions on state nexus questionnaires compiled by the American Institute of Certified Public Accountants. If you are member of the AICPA you can access this checklist and more at http://www.aicpa.org.

1) Is the business qualified to do business in the state?

2) Is the business currently filing with the state (specify type of tax)?

3) Does the business have an office, agency, warehouse, or other business location owned or leased in the state?

4) Does the business maintain a telephone answering service in the state?

5) Does the business own or lease real property in the state?

6) Does the business own or lease tangible personal property located in the state?

7) Does the business rent or lease tangible personal property to others who then use the property in the state?

8) Does the business license intangible property for use in the state?

9) Does the business license software for use in the state?

10 Has the business ever executed contracts in the state?

11) Does the business have employees or representatives who perform any of the following activities in the state:

   a) Solicit orders with or without authority to approve?

   b) Engage in managerial or research activities?

   c) Secure deposits on sales?

   d) Make collections on regular or delinquent accounts?

   e) Repossess items or property of the business?

   f) Offer technical assistance and training to purchasers of its products before or after the sale?

   g) Repair, service, or replace faulty or damaged goods?

h) Install or assemble its products?

i) Does the business license software for use in the state?

j) Inspect the installations of the business' products by its customers or users of its products?

k) Pick up or verify destruction of damaged or returned merchandise from customers or users of the business' products?

l) Coordinate delivery of merchandise, whether or not special promotions are involved?

m) Distribute replacement parts?

n) Conduct credit investigations or arrange for credit and financing for purchasers of its products?

o) Rectify or assist in rectifying any product, credit, shipping or similar complaint arising from the purchase or use of its products?

p) Service or maintain displays of its products?

q) Accept returned merchandise for customers?

r) Selling of tangible personal property?

s) Make "on the spot" sales of company products?

t) Carry out engineering or design functions?

u) Advise customers or distributors as to minimum inventory levels, remove obsolete, damaged or outdated goods?

v) Process complaints?

12) Does the business have a standard form of written agreement with sales representatives? If so, please enclose a copy.

13) Is the business a member of an affiliated group of corporations? If so, does the business file a consolidated or combined return in the state?

14) Does the business have display merchandise in leased space in the state?

15) Do employees have samples in the state? If yes, then state the average value thereof.

16) Does the business reserve the right of inspection of the customer's facilities or products after delivery?

17) Does the business provide sales or service manuals to customers, distributors, or agents?

18) Does the business advertise in the state? If so, list the different advertising media use.

19) Does the business do any localized advertising (cooperative or otherwise) in the state?

20) Does the business have any employees or representatives who use their home in state:

    a) As a business address?

    b) To receive business callers?

    c) To store inventory?

    d) To maintain books/records?

    e) To maintain company property?

21) Are employees reimbursed for telephone, fax or utilities expenses?

22) Are home numbers listed in local advertisements of the business?

23) Do employees of the company solicit orders for the sale of:

    a) Real estate?

    b) Services?

    c) Intangible property?

24) Does the business perform construction contracts in the state?

25) Is the business listed in any telephone directories in the state?

26) Does the business have any consigned stock of goods in the state?

27) Does the business operate a mobile store in the state?

28) Has the business previously filed income tax returns in the state?

29) Does the business maintain a security interest/mortgage in property until the contract price or amount borrowed has been paid?

30) Do employees either investigate, recommend, or appoint potential dealers, agents, or distributors of the company in the state?

31) Do employees ever check the inventories of customers or distributors in the state?

32) Do employees authorize credits, warrant adjustments or repairs in the state?

33) Does the business have agents or independent contractors selling products in the state? If so, are they forbidden from selling or promoting competitors' services?

34) Does the business give approval to servicing distributors and dealers within the state where customers can have products serviced or repaired?

35) Does the business participate in a partnership, as general or limited partner, which has operations, conducts business, or owns real property in the state?

APPENDIX III

MTC Nexus Factors – The following is a publication of the Multistate Tax Commission endorsing a uniform stand for evaluating and determining state tax nexus for corporate income taxes. You can find this document and more at http://www.mtc.gov.

Factor Presence Nexus Standard for Business Activity Taxes

Approved by the Multistate Tax Commission
October 17, 2002

A. (1) Individuals who are residents or domiciliaries of this State and business entities that are organized or commercially domiciled in this State have substantial nexus with this State.

(2) Nonresident individuals and business entities organized outside the State that are doing business in this State have substantial nexus and are subject to [list appropriate business activity taxes for the state, with statutory citations] when in any tax period the property, payroll or sales of the individual or business in the State, as they are defined below in Subsection C, exceeds the thresholds set forth in Subsection B.

B. (1) Substantial nexus is established if any of the following thresholds is exceeded during the tax period:

(a) a dollar amount of $50,000 of property; or

(b) a dollar amount of $50,000 of payroll; or

(c) a dollar amount of $500,000 of sales; or

(d) twenty-five percent of total property, total payroll or total sales.

(2) At the end of each year, the [tax administrator] shall review the cumulative percentage change in the consumer price index. The [tax administrator] shall adjust the thresholds set forth in paragraph (1) if the consumer price index has changed by 5% or more since January 1, 2003, or since the date that the thresholds were last adjusted under this subsection. The thresholds shall be adjusted to reflect that cumulative percentage change in the consumer price index. The adjusted thresholds shall be rounded to the nearest $1,000. As used in this subsection, "consumer price index" means the Consumer Price Index for All Urban Consumers (CPI-U) available from the Bureau of Labor Statistics of the

United States Department of Labor. Any adjustment shall apply to tax periods that begin after the adjustment is made.

C. Property, payroll and sales are defined as follows:

(1) Property counting toward the threshold is the average value of the taxpayer's real property and tangible personal property owned or rented and used in this State during the tax period. Property owned by the taxpayer is valued at its original cost basis. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period; but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(2) Payroll counting toward the threshold is the total amount paid by the taxpayer for compensation in this State during the tax period. Compensation means wages, salaries, commissions and any other form of remuneration paid to employees and defined as gross income under Internal Revenue Code § 61. Compensation is paid in this State if (a) the individual's service is performed entirely within the State; (b) the individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or (c) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) the base of operations or the place from which the service is directed or controlled is not in any State in which some part of the service is performed, but the individual's residence is in this State.

(3) Sales counting toward the threshold include the total dollar value of the taxpayer's gross receipts, including receipts from entities that are part of a commonly owned enterprise as defined in D(2) of which the taxpayer is a member, from

(a) the sale, lease or license of real property located in this State;

(b) the lease or license of tangible personal property located in this State;

(c) the sale of tangible personal property received in this State as indicated by receipt at a business location of the seller in this State or by instructions, known to the seller, for delivery or shipment to a purchaser (or to another or at the direction of the purchaser) in this State; and

(d) The sale, lease or license of services, intangibles, and digital products for primary use by a purchaser known to the seller to be in this State. If the seller knows that a service, intangible, or digital product will be used in multiple States because of separate charges levied for, or measured by, the use at different locations, because of other contractual provisions measuring use, or because of other information provided to the seller, the seller shall apportion the receipts according to usage in each State.

(e) If the seller does not know where a service, intangible, or digital product will be used or where a tangible will be received, the receipts shall count toward the threshold of the State indicated by an address for the purchaser that is available from the business records of the seller maintained in the ordinary course of business when such use does not constitute bad faith. If that is not known, then the receipts shall count toward the threshold of the State indicated by an address for the purchaser that is obtained during the consummation of the sale, including the address of the purchaser's payment instrument, if no other address is available, when the use of this address does not constitute bad faith.

(4) Notwithstanding the other provisions of this Subsection C, for a taxpayer subject to the special apportionment methods under [Multistate Tax Commission Regulations IV.18.(d) through (j)], the property, payroll and sales for measuring against the nexus thresholds shall be defined as they are for apportionment purposes under those regulations. Financial institutions subject to an apportioned income or franchise tax shall determine property, payroll and sales for nexus threshold purposes the same as for apportionment purposes under the [MTC Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions]. Pass-through entities, including, but not limited to, partnerships, limited liability companies, S corporations, and trusts, shall determine threshold amounts at the entity level. If property, payroll or sales of an entity in this State exceeds the nexus threshold, members, partners, owners, shareholders or beneficiaries of that

pass-through entity are subject to tax on the portion of income earned in this State and passed through to them.

D. (1) Entities that are part of a commonly owned enterprise shall determine whether they meet the threshold for nexus as follows:

(a) Commonly owned enterprises shall first aggregate the property, payroll and sales of their entities that have a minimum presence in this State of $5000 of combined property, payroll and sales, including those entities that independently exceed a threshold and separately have nexus. The aggregate number shall be reduced based on detailed disclosure of any intercompany transactions where inclusion would result in one State's double counting assets or revenue. If that aggregation of property, payroll and sales meets any threshold in Subsection B, the enterprise shall file a joint information return as specified by the [tax agency] separately listing the property, payroll and sales in this State of each entity.

(b) Those entities of the commonly owned enterprise that are listed in the joint information return and that are also part of a unitary business grouping conducting business in this State shall then aggregate the property, payroll and sales of each such unitary business grouping on the joint information return. The aggregate number shall be reduced based on detailed disclosure of any intercompany transactions where inclusion would result in one State's double counting assets or revenue. The entities shall base the unitary business groupings on the unitary combined report filed in this State. If no unitary combined report is required in this State, then the taxpayer shall use the unitary business groupings the taxpayer most commonly reports in States that require combined returns.

(c) If the aggregate property, payroll or sales in this State of the entities of any unitary business of the enterprise meets a threshold in Subsection B, then each entity that is part of that unitary business is deemed to have nexus and shall file and pay income or franchise tax as required by law.

(2) "Commonly owned enterprise" means a group of entities under common control either through a common parent that owns, or constructively owns, more than 50 percent of the voting power of the outstanding stock or ownership interests or through five or fewer individuals (individuals, estates or trusts) that own, or constructively own,

more than 50 percent of the voting power of the outstanding stock or ownership interests taking into account the ownership interest of each such person only to the extent such ownership is identical with respect to each such entity.

E. A State without jurisdiction to impose tax on or measured by net income on a particular taxpayer because that taxpayer comes within the protection of Public Law 86-272 (15 U.S.C. § 381) does not gain jurisdiction to impose such a tax even if the taxpayer's property, payroll or sales in the State exceeds a threshold in Subsection B. Public Law 86-272 preempts the state's authority to tax and will therefore cause sales of each protected taxpayer to customers in the State to be thrown back to those sending States that require throwback. If Congress repeals the application of Public Law 86-272 to this State, an out-of-state business shall not have substantial nexus in this State unless its property, payroll or sales exceeds a threshold in this provision.