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The Use Tax Collection Duty for Internet Vendors

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THE USE TAX COLLECTION DUTY FOR INTERNET VENDORS

This section will provide an overview of the various United States Supreme Court and state court cases dealing with the use tax collection duty, and particularly the type of in-state physical presence needed to satisfy the substantial nexus requirement.

3.1 Traveling Salesmen: the *Dilworth-General Trading* Distinction.

A. Presence of traveling salesmen is insufficient to support imposition of a sales tax.

McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944), involved Tennessee businesses that sold goods into Arkansas. Arkansas attempted to impose its sales tax on these sales. The sellers had no place of business, employees or property in Arkansas. The sellers' only contact with Arkansas was the solicitation of orders by traveling salesmen who resided in Arkansas, with some orders being taken over the telephone or by mail. The orders were accepted in Tennessee, not in Arkansas; the goods were shipped from Tennessee and title passed to the purchaser in Tennessee upon delivery to the carrier. Arkansas attempted to impose its sales tax on those sales. It should be noted that from a sales law standpoint, most of the indicia of the sale took place in Tennessee, with the order being accepted in Tennessee and delivery and title passing in Tennessee. Nevertheless, Arkansas imposed the sales tax and Dilworth objected on Commerce Clause grounds. The United States Supreme Court, in a narrow 5 to 4 decision, struck down the Arkansas sales tax on the transactions:

> [I]n this case the Tennessee seller was through selling in Tennessee. We would have to destroy both business and legal notions to deny that under these circumstances the sale – the transfer of ownership – was made in Tennessee. For Arkansas to impose a tax on such transactions would be to project its powers beyond its boundaries and to tax an interstate transaction.

322 U.S. at 330.

Arkansas argued that it could have levied a use tax on the Arkansas buyers and if it could impose such a use tax, it should be able to impose a sales tax directly on the seller. The Supreme Court made a crucial distinction that it was the Arkansas sales tax at issue and not the use tax:

> Though sales and use taxes may secure the same revenue and serve complementary purposes, they are, as we have indicated, taxes on different transactions and for different opportunities afforded by a state.

322 U.S. at 331.

B. Presence of traveling salesmen is sufficient to support use tax collection obligation.

General Trading Co. v. State Tax Commission, 322 U.S. 335 (1944), was a companion case to *Dilworth*. In *General Trading*, Iowa imposed its use tax collection duty on a Minnesota-based vendor.

General Trading had no place of business, employees or property in Iowa. All of its products were sold by traveling salesmen. The salesmen did not have the power to accept the orders; rather those orders were transmitted to the home office where they were accepted and processed. The key distinction between *Dilworth* and *General Trading* was that while Arkansas attempted to impose its sales tax in *Dilworth*, Iowa attempted to impose its use tax on *General Trading*.

The Supreme Court concluded that the presence of the traveling salesmen was sufficient physical presence in the state for the use tax collection duty to be imposed:

> The tax is what it professes to be – a non-discriminatory excise laid on all personal property consumed in Iowa. That property is enjoyed by an Iowa resident simply because the opportunity is given by Iowa to enjoy property no matter when acquired. The exaction is made against the ultimate consumer – the Iowa resident who is paying taxes to sustain his own state government. *To make the distributor the tax collector for the state is a familiar and sanctioned device.*

322 U.S. at 338 (emphasis added).

The decision was 7 to 2, with the dissent observing that Iowa could not have imposed its sales tax on the sales in question but that "we are holding that a state has power to make a tax collector of whom it has no power to tax." 322 U.S. at 399.

The *Dilworth – General Trading* distinction still survives – traveling salesmen in a state will not be sufficient for the state to impose its sales tax but is sufficient for the use tax collection duty.

3.2 Other In-State Presence.

A. In-state employees.

Full or part time employees living and working in the state is sufficient nexus for use tax collection. *See General Trading, supra* (traveling salesmen were employees). *See also Scripto, Inc. v. Carson*¸ 362 U.S. 207 (1960) and *Tyler Pipe Industries, Inc. v. Washington Department of Revenue*, 483 U.S. 232 (1987).

B. Delivery into the state by the out-of-state retailer.

In *Miller Brothers Co. v. Maryland,* 347 U.S. 340, 74 S. Ct. 535 (1954), a department store based in Delaware sold goods to Maryland residents that came into the Miller Brothers store in Delaware. When Maryland residents made their purchases, some took the goods with them, while other items were delivered to the Maryland purchasers by common carrier and still others were delivered by the store's own trucks. Maryland sought to impose the use tax collection duty on Miller Brothers on the basis that it made delivery of goods into Maryland by its own vehicles, that Miller Brothers advertising reached Maryland residents (it was not aimed at Maryland residents but Delaware radio stations were also heard in Maryland), and sales from circulars that were mailed to Maryland customers.

The Supreme Court set out the now familiar test that "due process requires some definite link, some minimum connection,

between a state and the person, property or transaction it seeks to tax." 347 U.S. at 344-345. The Court concluded that such link or connection did not exist between Maryland and Miller Brothers, contrasting the *Miller Brothers* facts with those in *General Trading*:

> "There is a wide gulf between this type of active and aggressive operation within a taxing state [the in-state traveling salesmen in *General Trading*] and the occasional delivery of goods by an out-of-state store with no solicitation other than the incidental effects of general advertising."

347 U. S. at 347.

It should be noted that *Miller Brothers* was decided under the Due Process Clause, with the Commerce Clause not considered.

Nonetheless, in *Brown's Furniture, Inc. v. Wagner,* 171 Ill. 2d 410, 665 N.E. 2d 795 (1996), Brown's Furniture, a retail furniture store located in Palmyra, Missouri, made sales of furniture to Illinois customers, delivering the furniture into Illinois. Palmyra, Missouri is located approximately 15 miles southwest of Quincy, Illinois. Illinois residents frequently patronized Brown's Furniture and their purchases comprised approximately 30% of the store's total sales. On a regular basis, Brown's Furniture delivered items purchased by Illinois residents into Illinois in its own trucks. During the ten month audit period at issue in the case, Brown's Furniture made 942 deliveries of its merchandise, valued at more than $675,000, into Illinois. Brown's Furniture collected neither Illinois nor Missouri sales tax on these sales. The Illinois Supreme Court, on these facts, concluded that the

number of trips in the ten month period satisfied the more than "slightest physical presence" test of *Quill*, and upheld Illinois' use tax collection obligation on Brown's Furniture. The Illinois Supreme Court factually distinguished *Miller Brothers* based on the magnitude and frequency of deliveries made by Brown's Furniture on the one hand and the occasional delivery of goods by Miller Brothers, on the other hand.

Since the *Brown's Furniture* decision, state taxing authorities have consistently ruled that delivering property into the state in company owned vehicles and with employee drivers constitutes nexus, even when the number of deliveries actually made during the audit period are fairly minimal. *E.g.,* Ind. Dep't of Revenue, Ltr. of Findings No. 04-20120449 (Feb. 27, 2013) (nine deliveries in company owned vehicles during four-year audit period was sufficient nexus); *Rhinehart Equip. Corp. v. Fla. Dep't of Revenue*, CCH [Fl-Txrptr] ¶ 205-837 (Mar. 25, 2013) (No. 11-2567) (Georgia mail-order vendor of tractors and heavy equipment had nexus with Florida based on regular deliveries to its customers and pick-ups of returned property in company owned vehicles).

C. Presence of independent contractors in the state is sufficient to establish nexus.

In *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), Florida sought to require Scripto, a Georgia corporation, to collect the use tax on pens which Scripto sold and shipped from Atlanta to Florida residents. The facts were essentially the same as those in *Dilworth* and *General Trading*, except that Scripto's traveling salesmen were not employees, but were instead independent contractors. The Supreme Court held that this distinction did not make a difference, and the presence of

independent contractors in the state is sufficient nexus for the imposition of the use tax collection duty:

> True, the "salesmen" are not regular employees of appellant devoting full time to its service, but we conclude that such a fine distinction is without constitutional significance. The formal shift and the contractual tagging of the salesmen as "independent" neither results in changing his local function of solicitation nor bears upon its effectiveness in security a substantial flow of goods into Florida. To permit such formal "contractual shifts" to make a constitutional difference would open the gates to a stampede of tax avoidance.

362 U.S. at 211.

Additionally, it does not matter if the independent contractors also represent other principals for purposes of nexus.

D. Courts are split on whether or not in-state volunteers create nexus.

Some courts have found that in-state volunteers do not create sufficient nexus. *E.g., Pledger v. Troll Book Clubs, Inc., 871 S.W. 2d 389 (1994); Troll Book Clubs, Inc. v. Tracy*, Ohio BTA, Case No. 92-J-590, 1994 Ohio Tax LEXIS 1374 (August 1994); *Freedom Industries, Inc. v. Tracy*, Ohio BTA Case No. 92-N-597, 1994 Ohio Tax LEXIS 2025 (December 12, 1994); *Scholastic Book Clubs, Inc. v. Mich. Dep't of Treasury*, 567 N.W.2d 692 (Mich. Ct. App. 1997). Other courts have

held the opposite: that in-state volunteers do create sufficient nexus. *E.g., Scholastic Book Clubs, Inc. v. State Board of Equalization*, 207 Cal. App. 3d 734 (1989) (in-state volunteers do create sufficient nexus); *Appeal of Scholastic Book Clubs, Inc.*, 920 P.2d 947 (Kan. Sup. Ct. 1996); *Scholastic Book Clubs, Inc. v. Conn. Comm'r Revenue Servs.*, 2012 WL 917552 (Conn. 2012), *cert. denied* by U.S. Supreme Court on October 9, 2012; *Scholastic Book Clubs, Inc. v. Farr*, 2012 WL 259979 (Tenn. Ct. App. 2012), *cert.* petition filed by taxpayer on September 20, 2012.

In both circumstances, the cases involved teacher/book club. Book clubs normally have teachers sell books to school children. The teachers are volunteers and are not paid employees or independent contractors. Several state courts viewed the teachers as customers or as acting on behalf of the parents and therefore held that the teachers are not agents of the out-of-state book club and thus there is not sufficient nexus. On the other hand, other courts have viewed the teachers as agents or representatives of the out-of-state book clubs and have held that there is sufficient nexus. In the context of these cases, the holding turns on how the courts perceive the teachers' role in the sale.

E. In-state visits by employees of out-of-state retailer.

States have taken differing views of the number of in-state visits by employees of an out-of-state retailer required to find nexus.

Orvis Co., Inc. v. Tax Appeals Tribunal of N.Y., 654 N.E. 2d 954 (N.Y. App. Div. 1995). Orvis was based out-of-state and employees

visited up to 19 New York wholesale customers on the average of four times a year. The Court of Appeals found that to be sufficient nexus.

Vermont Information Processing, Inc. v. Tax Appeals Tribunal of N.Y., 206 A.D.2d 764 (N.Y. Sup. Ct. 1994). VIP employees visited New York customers some 41 times in three years to resolve computer hardware and software problems. The Court of Appeals held this to be sufficient nexus.

Care Computer Systems, Inc. v. Arizona Department of Revenue, 4 P.3d 469 (Ariz. Ct. App. 2000). A computer and software company had sufficient nexus as a result of visits by out-of-state personnel during twenty-one days per year and one out-of-state traveling salesman making seven one-to-two day visits during a seven year audit period. The business further leased a small amount of property in Arizona that occasionally developed into outright sales when the lease term expired.

F. Attendance at conventions and trade shows may create nexus.

Under *Florida Department of Revenue v. Share International, Inc.*, 667 So. 2d 226. (Fla. Dist. Ct. App. 1995), the presence at an in-state convention or trade show does not provide sufficient nexus for use tax collection on mail-order sales into the state. However, any sales made at the trade show were subject to Florida's sales tax. Despite the Florida *Share International* decision, states take very divergent views on whether employees' attendance at trade shows creates sufficient nexus. Some states have addressed this issue through statutes or regulations. For example, Connecticut tax statutes provide that attendance at trade shows does not create nexus, as long

as: (1) no sales are made at the trade show and (2) the vendor attends trade shows within the state less than 14 days per year. Conn. Gen. Stat. § 12-407(a)(15)(D). Similarly, California statutes provide that attendance at trade shows does not create nexus if: (1) the vendor does not attend shows more than 14 days per year and its trade show activities generate less than $100,000 in California sales. However, the vendor must pay sales tax on all sales made at the trade shows. Cal. Rev. & Tax Code § 6203(e).

Other states, however, both address the issue through other forms of guidance and take the position that fairly minimal attendance at trade shows creates nexus. *See* Iowa Policy Letter 01300047 (2001) (more than one day's attendance at trade shows is sufficient nexus. Georgia recently added a trade-show safe harbor to its statutes (H.B. 386 2012). Under that bill, a remote vendor does not have nexus if it attends trade shows in Georgia five or fewer days per year and makes less than $10,000 in sales into the state based on its tradeshow activities. However, remote vendors that have contracts to sell tangible personal property to the state government are not eligible for the safe harbor and sales tax is due on any sales made or orders taken at the trade show.