Interstate Transactions and Application of Sales and Use Tax to Businesses in Utah

Prepared by:
Steven P. Young
Holland & Hart LLP

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INTERSTATE TRANSACTIONS AND APPLICATION OF SALES AND USE TAX TO BUSINESSES

A. Nexus Requirements. "Nexus" is a term used to describe that level of activity within a state that subjects the person to certain statutory requirements. One such requirement is to collect and remit sales tax. Nexus also refers to that level of activity that subjects one to the state franchise or income tax. The rules that determine nexus for sales and use tax, however, may not be the same as the rules that determine nexus for corporate franchise or income tax.

Obviously, a Utah taxpayer doing business in Utah has nexus. The issue of nexus arises when a non-Utah taxpayer conducts some measure of activity within the state; or conversely, when Utah taxpayers conduct business in other states. In Quill Corp. v. North Dakota, 504 U.S. 298 (1992), the U.S. Supreme Court declared that nexus was not created unless a seller had some "physical presence" in a state, such as employees or property.

In 1997, the Utah Court of Appeals considered a similar issue, and determined that under Utah law, the "repetition" of activity of an out-of-state company was important, regardless of its "fixed" or "predictable" nature. B.L. Key v. Tax Comm'n, 934 P.2d 1164 (Utah Ct. App. 1997). B.L. Key was thus responsible to collect tax on sales of concrete weights and coatings for pipelines where B.L. Key had a representative in Utah for 4 of the 8 months of the project and hired several local workers to pour concrete. Id.

B. Property Entering Utah.

1. Instrumentalities of Interstate Commerce. Prior to Complete Auto Transit v. Brady, 430 U.S. 274 (1977), many aspects of interstate commerce were per se deemed off limits to state taxing authorities. In Complete Auto, 430 U.S. at 279, the U.S. Supreme Court overruled such per se limitations and permitted state taxation of interstate commerce if it meets a four-prong test:

(1) the tax "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 services provided by the state."

In 1995, the U.S. Supreme Court further held that states could impose taxes on interstate movements of people. See Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175 (1995). Shortly thereafter, Congress passed 49 U.S.C. § 14505, which prevents states from imposing such taxes. Accordingly, states now likely only have authority to impose taxes on interstate movements of freight via common carrier and on property that is purchased outside the state and delivered to the state.

In UCA § 59-12-104(33), the Utah Legislature chose not to apportion tax on vehicles used in interstate commerce. Pursuant to this subsection, if an "authorized carrier" purchases a particular vehicle for use in interstate commerce, the entire purchase, including tangible personal property installed in the vehicle, is exempt from sales and use tax. An authorized carrier is a holder of a certificate issued by the United States Surface Transportation Board, a holder of a Federal Aviation Administration operating certificate or air carrier's operating certificate, or a holder of credentials indicating that the vehicle is operated pursuant to the International Registration Plan and the International Fuel Tax Agreement.

2. Mail Order & Online Transactions. Purchases of items through mail order or online suppliers have long been a concern for state taxing authorities because states have lacked the authority to require collection of the tax. A landmark case handed down by the U.S. Supreme Court concerning this issue was National Bellas Hess v. Department of Revenue, 386 U.S. 753 (1967). National Bellas Hess was a mail order house located in Missouri and licensed to do business only in Missouri and Delaware where it was incorporated. Illinois attempted to require Bellas Hess to collect Illinois use tax on sales to Illinois residents. Bellas Hess had no office, distribution house, sales house, warehouse, or any place of business in Illinois. It had no agent, salesman, canvasser, solicitor or other type of representative to sell or take orders, to deliver merchandise, to accept payments, or to service merchandise. It also had no property in Illinois, no telephone listing, and did not advertise in newspapers, on billboards, or by radio or television in Illinois.

Its only contacts with Illinois were by U.S. mail or common carrier. Twice a year it mailed catalogs to active or recent customers throughout the country. These catalogs were supplemented by advertising flyers that were occasionally mailed to past and potential customers. All orders for merchandise were mailed to Missouri and all goods were sent to the customers by mail or common carrier.

The U.S. Supreme Court held that Illinois could not constitutionally require Bellas Hess to collect Illinois use tax when its only contact with the state was (1) mailing catalogs and flyers into the state and (2) shipping goods into the state by means of the mail or a common carrier.

The Court made a sharp distinction between mail order sellers with retail outlets, sales solicitors, or property within a state and those who do no more than communicate with customers in the state by mail or common carrier as part of a general interstate business. It made no difference that Bellas Hess may have mailed millions of pieces of advertising into the state and shipped millions of dollars in merchandise into the state. The Court ruled that the manner in which business was done, as opposed to the quantity of business that was done in Illinois, determined whether Bellas Hess had nexus.

A challenge to repeal National Bellas Hess was unsuccessful in 1992. The United States Supreme Court ruled in Quill Corp. v. North Dakota, 504 U.S. 298 (1992) that the Due Process Clause of the United States Constitution does not preclude the states from asserting jurisdiction over out-of-state sellers. The Court observed, however, that the imposition of a use tax may place an unfair burden on interstate commerce, and under the current law, a "substantial nexus" or "physical presence" in the market state is required before the state may assert tax jurisdiction. The Court's distinction between the Due Process Clause and Interstate Commerce Clause is important because Congress has the authority to regulate interstate commerce and to decide if a burden is permissible or not. Accordingly, Congress could enact federal legislation that would allow the states to tax out-of-state sellers, but it has chosen not to do so as of this date (one exception is the insurance industry).

Recently, states such as New York, Rhode Island, North Carolina, and Colorado have enacted laws dubbed as "Amazon Laws" that have the intent of overcoming online retailer's lack of nexus. These laws come in two forms. The New York version, found constitutional by the NY Appellate Division, provides that if online retailers enter into a business referral agreement with a resident of the state (known as an affiliate) who receives a commission based on the sales generated by its active solicitations in any medium, then such sales are taxable. The Colorado version, which the Colorado Federal District Court recently enjoined (but only preliminarily) as unconstitutional under the Commerce Clause, provides that out-of-state retailers with no nexus to Colorado must still report all sales made to individuals in Colorado. The Court indicated that the statute violated the Commerce Clause by putting regulatory and disclosure burdens on out-of-state vendors that were not present on in-state vendors.

In spite of the constitutional concerns surrounding the Colorado version, the Multistate Tax Commission has drafted a model statute very similar to the Colorado version.

The State of Utah can still recover the use tax associated with mail order purchases. Utah requires taxpayers to voluntarily report on their individual income tax returns and pay the use tax on mail order purchases and other out-of-state purchases.

a. <u>Utah Nexus Expansion</u>. In 2012, Utah expanded the reach of its sales tax statutes. H.B. 384 (2012) provides that a company selling products remotely without physical presence in Utah will have nexus in Utah and be required to collect and remit sales tax if: (1) the company directly or indirectly owns, or is owned by, a subsidiary or affiliate (10% or greater) ("related seller") that sells the same or a substantially similar line of products under a substantially similar name; or (2) the related seller's place of business is used to advertise, promote, or facilitate sales by the seller. This latter provision would create nexus for out-of-state sellers who utilize separate but related corporate entities to service and install their products or to warehouse their products.

C. Marketplace Fairness Act. The Marketplace Fairness Act is legislation pending before Congress addressing the collection of sales tax on remote sales transacted via the internet. The Marketplace Fairness Act would supercede the Quill "physical presence" requirement to allow states to tax out-of-state sellers.

D. Property Leaving Utah. Utah sales tax does not apply to gross receipts from sales in which the seller is obligated to make physical delivery of the goods sold from a point within Utah to a point outside the state if the goods are not to be returned to a point within the state. The Utah seller, however, may be obligated to collect tax for the foreign state.

Utah sales tax does not apply to interstate sales of property leaving Utah if the seller (1) makes delivery of the goods by means of his own employees or vehicles, (2) places them in the possession of a common carrier for transportation outside Utah, or (3) places them with the United States Postal Service for delivery by mail outside the state. It is also immaterial whether such goods are sold f.o.b. point of origin or f.o.b. destination. This general rule is based on the doctrine enunciated by the U.S. Supreme Court in the case of J.D. Adams Manufacturing Co. v. Storen, 304 U.S. 307 (1938), which prohibited taxation of sales in both the state where the goods are sold as well as those states in which they are manufactured.

The mere fact, however, that commodities purchased in Utah are transported beyond its boundaries is not enough to constitute the transaction of a sale in interstate commerce. Where the commodity is delivered to the buyer in this state, even though the buyer is not a resident of the state and intends to transport the property to a point outside the state, the sale is not in interstate commerce and is subject to tax.

In determining whether a sale is made in interstate commerce, certain general principles apply. These principles are outlined in Utah Admin. Code R865-19S-44. A sale does not occur in interstate commerce unless there is a movement of a subject of commerce from a point within the territorial jurisdiction of one state across the boundary line to a point within the territorial jurisdiction of another. Each of the following three rules must be complied with to constitute interstate commerce:

a. The transaction must involve actual and physical movement of the property sold across the state line;

b. Such movement must be essential and not an incidental part of the sale; and

c. The seller must be obligated by the express or unavoidable implied terms of the sale, or contract to sell, to make physical delivery of the property across a state boundary line to the buyer.

When tangible personal property is located within the State of Utah at the time of sale and is delivered within the State of Utah, such sale is taxable irrespective of where the parties to the contract of sale are located and where the contract was made or accepted or the funds paid. Where tangible personal property is located within the State of Utah at the time of sale, however, but delivery of the article sold is made at a destination outside Utah, and where the seller of the article retains actual physical possession after the sale either in person or through an agent until such property is delivered to the purchaser at a destination beyond the Utah boundary, such sale shall be deemed to have been made in interstate commerce and exempt from Utah sales tax.

Where delivery is made by the seller to a common carrier for transportation to the buyer outside Utah, the common carrier shall be deemed to be the agent of the Seller, regardless of who is responsible for the payment of the freight charges. But see Union Pacific R.R. Co. v. Utah State Tax Comm'n, 842 P.2d 876 (Utah 1992). In Union Pacific, a common carrier purchased ballast and diesel fuel for its own use outside of Utah. When the common carrier received the goods in Utah, the Court held that delivery was complete and the carrier was subject to sales tax because it was not acting as a common carrier for the seller but rather it was acting as the purchaser. Thus, tangible personal property purchased in Utah by a nonresident, to be transported out-of-state in his equipment, is subject to the sales tax, since the passage of title and delivery of the property to the purchaser took place within Utah.