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Can Connecticut's Economic Nexus Rule Withstand Judicial Challenge?

By Felicia S. Hoeniger and Richard W. Tomeo

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On August 31, 2009, the Connecticut General Assembly adopted an economic presence standard for determination of nexus both for the corporation business tax and the personal income tax.[1] The new standard is effective for tax years beginning on or after January 1, 2010, and represents one of the more expansive departures from physical presence as a requirement for income tax nexus that has emerged around the nation in recent years.

As applied to the corporation business tax, the new rule provides:

> Any company that derives income from sources within this state, or that has a substantial economic presence within this state, evidenced by a purposeful direction of business toward this state, examined in light of the frequency, quantity and systematic nature of a company's economic contacts with this state, without regard to physical presence, and to the extent permitted by the Constitution of the United States, shall be liable for the tax imposed under chapter 208 of the general statutes.[2]

A similar economic presence rule was adopted for nonresident individual owners of interests in an S corporation or partnership (including limited liability companies treated as partnerships for federal income tax purposes) if the S corporation or partnership has substantial economic presence in Connecticut under the same formulation involving purposeful direction of business toward the state.[3]

Before the enactment of these economic nexus rules, the Connecticut Department of Revenue Services (DRS) had not sought to impose tax on taxpayers lacking a physical nexus to the state, except for the Connecticut-source income of individuals. For example, the corporation business tax regulations addressing what might constitute sufficient contact with Connecticut to constitute "carrying on or doing business" in the state have referred consistently to physical contact through

the maintenance of an office or facility, ownership of property, or presence of employees within the state.[4] Corporation business or personal income tax nexus through participation in a passthrough entity is mandated by statute and requires in each case that the passthrough entity actually conduct business within Connecticut.[5] Statutory exceptions to nexus resulting from the presence of tangible property in the state were provided for companies contracting with commercial printers within the state or those participating in some trade shows.[6] Even in the absence of physical presence, a corporation is subject to the corporation business tax if it obtains a certificate of authority to conduct business in the state.[7]

Although Connecticut sales and use tax law has since 1989 imposed a tax collection obligation on persons or entities engaging in regular and systematic solicitation of sales in the state,[8] the DRS has not, in the wake of *Quill Corp. v. North Dakota*,[9] sought to impose a sales tax collection obligation on a remote seller that does not have physical presence within the state.

The new Connecticut economic nexus rule is part of a national trend in which several states have, by statute or regulation, sought to impose income taxation on corporations and other taxpayers that lack a physical connection to the jurisdiction but derive income from business activities directed there. The Connecticut rule is more expansive and uncertain in its application than many of the other economic nexus regimes that have emerged.

To read the full article, click here.

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1 Conn. Pub. Acts 09-3, sections 90 and 91 (June Special Session).
2 *Id.* at section 90.
3 *Id.* at section 91.
4 See Conn. Agencies Reg. section 12-214-1.
5 See Conn. Gen. Stat. sections 12-214(a)(3) and 12-712.
6 See Conn. Gen. Stat. section 12-213(a)(20)(B) and (C).
7 See Conn. Agencies Reg. section 12-214-1; subject, however, to the overriding protection afforded by Public Law 86-272. See *The Kelly-Springfield Tire Co. v. Bajorski*, 228 Conn. 137 (1993).
8 See Conn. Gen. Stat. section 12-407(a)(15).
9 504 U.S. 301 (1997).

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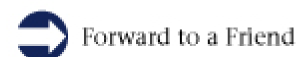

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by Felicia S. Hoeniger and Richard W. Tomeo

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Before the enactment of these economic nexus rules, the Connecticut Department of Revenue Services (DRS) had not sought to impose tax on taxpayers lacking a physical nexus to the state, except for the Connecticut-source income of individuals. For example, the corporation business tax regulations addressing what might constitute sufficient contact with Connecticut to constitute "carrying on or doing business" in the state have referred consistently to physical contact through the maintenance of an office or facility, ownership of property, or presence of employees within the state.[4] Corporation business or personal income tax nexus through participation in a passthrough entity is mandated by statute and requires in each case that the passthrough entity actually conduct business within Connecticut.[5] Statutory exceptions to nexus resulting from the presence of tangible property in the state were provided for companies contracting with commercial printers within the state or those participating in some trade shows.[6] Even in the absence of physical presence, a corporation is subject to the corporation business tax if it obtains a certificate of authority to conduct business in the state.[7]

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The new Connecticut economic nexus rule is part of a national trend in which several states have, by

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[9] 504 U.S. 301 (1997).

statute or regulation, sought to impose income taxation on corporations and other taxpayers that lack a physical connection to the jurisdiction but derive income from business activities directed there. The Connecticut rule is more expansive and uncertain in its application than many of the other economic nexus regimes that have emerged.

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In 2002 the Multistate Tax Commission adopted a proposal for uniform nexus standards that include, as an alternative basis for nexus, deriving more than $500,000 of revenue from a state during a tax year, regardless of whether the taxpayer maintains property, employees, or other physical presence in the state.[10] As a general matter, most of the states that have adopted an economic nexus provision of some sort have prescribed either minimum annual sales thresholds necessary to subject a company to taxation,[11] a minimum number of customers within the state,[12] or a combination of the two.[13] Several states limit application of their economic nexus rules to credit card companies or other financial institutions.[14]

Unlike those states, Connecticut's new economic nexus provision is not limited statutorily to any particular type of business activity and has neither a de minimis sales nor customer threshold for imposition of tax. On its face, *any* purposeful direction of business toward the state will subject a company to taxation regardless of the volume of income derived from the state or the number of customers located there. The only standard prescribed by the statute is that the purposeful direction of business be examined in the light of the "frequency, quantity and systematic nature" of the company's activities so directed. Only the economic nexus rules in New Jersey[15] and Wisconsin[16] are similarly devoid of limitations or an objective threshold.

Initial Administration of the New Connecticut Rule by DRS

As originally proposed to the General Assembly, the economic nexus rule would have been limited to the business activities of credit card companies. However, the legislation that was ultimately adopted is much broader in scope, as discussed above. On September 23 the DRS issued a series of questions and answers in an informational publication (the IP) regarding the economic nexus rules that reflect how it will administer those rules at least initially.[17] Most significantly, the DRS has said that if a business has Connecticut-sourced receipts from business activities of less than $500,000 during a tax year, it will not be subject to the economic nexus rules. In the case of passthrough entities, the determination of whether that receipts threshold is exceeded is to be made at the entity level.

The IP provides three examples of situations in which there would be sufficient purposeful direction of business activities toward Connecticut to result in economic nexus. One example is that of an out-of-state bank that engages in active solicitation of Connecticut residents, another concerns an out-of-state company performing online financial services and soliciting Connecticut customers, and the third involves a company that makes or holds automobile loans issued to customers from dealerships. That nonexclusive list of examples may reflect the original purpose: to focus the economic nexus rules on out-of-state financial institutions such as credit card companies.

The IP indicates that the in-state ownership and use of intangible property by a company will subject it to the economic nexus rule when the intangible property generates gross receipts within the state from a license or franchise. However, if those payments are subject to addback into the taxable income of an affiliated payer,[18] the IP provides that those amounts are not required to be included in the gross income of the out-of-state affiliate to which the

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[10]Multistate Tax Commission, "Factor Presence Nexus Standard for Business Activity Taxes" (2003), *available at* http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FactorPresenceNexusStandardBusinessActTaxes.pdf. The MTC proposal has been adopted legislatively in California (Calif. Revenue and Taxation Code section 23101) and has been proposed for adoption by regulation in Colorado (Colo. Dept. of Revenue prop. reg. section 39-22-301.1).

[11]*See* the California provision, *id.; see also* Mich. Comp. Laws sections 208.1200 and 208.1235 ($350,000); and Ohio Rev. Code Ann. section 5751.01 ($500,000).

[12]Ind. Code Ann. section 6-5.5-1-17 and Minn. Stat. section 290.015 (both 20 or more customers).

[13]Ky. Rev. Stat. Ann. section 136.520 ($100,000 and 20 or more customers); Mass. Gen. Laws ch. 63, section 1 ($500,000 or 100 or more customers); N.Y. Tax Law section 1451 ($1 million sales and 1,000 or more customers); Ore. Rev. Stat. sections 317.010 and 318.20 (examples suggest a range); and W.Va. Code section 11-24-7b ($100,000 or 20 or more customers).

[14]Ind. Code Ann. section 6-5.5-1-17; Ky. Rev. Stat. Ann. section 136.520; Mass. Gen. Laws ch. 63, section 1; N.Y. Tax Law section 1451; and Tenn. Code Ann. sections 67-4-2004, 2007.

[15]N.J. Stat. Ann. section 54:10-A-2.

[16]Wis. Stat. Ann. section 71.22(1r).

[17]IP 2010(29) (Sept. 23, 2010).

[18]*See* Conn. Gen. Stat. section 12-218c.

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economic nexus rules apply. This suggests, however, that that out-of-state licensor of intangible property used in Connecticut would otherwise be subject to the economic nexus rules regarding its other Connecticut income derived from third parties.

As a general matter, the IP indicates that economic nexus will not result from the receipt of income from Connecticut that is passive investment income. Examples provided are income from a bank or investment account at a Connecticut financial institution, and income derived from purchases of stock in a corporation with operations in Connecticut, even if a representative of the entity making the investment sits on the board of the corporation. The suggestion, however, is that other active involvement by the investor entity in a Connecticut business might provide the basis for economic nexus, a result that could be of concern to some venture capital or private equity funds. The IP says that the activity of making or holding mortgage loans to Connecticut borrowers is not a passive investment activity and will result in economic nexus.

The IP identifies two situations in which economic nexus will not result. The first is when the income derived from Connecticut is subject to protection from tax under federal Public Law 86-272, that is, it is derived from the sale of tangible personal property into Connecticut with no more than sales solicitation conducted in the state. That taxpayer may, however, be subject to the tax on capital applicable to corporations. The second exception is for companies that provide services, such as legal and accounting services, to affiliates in Connecticut. That activity by itself will not constitute the conduct of business activities giving rise to economic nexus. The IP does not address whether the DRS will seek to apply the economic nexus rules to non-U.S. business entities that are not otherwise subject to U.S. net income tax, whether by reason of income tax treaty or otherwise.[19]

Although the guidance provided in the IP is welcome, the fact remains that the scope of the Connecticut economic nexus rule remains wide and there continue to be many uncertainties regarding how the DRS will approach audits of taxpayers that do not have traditional nexus connections to Connecticut.

[19]And because the IP does not address that question, it does not provide any guidance on how the Connecticut taxable income of foreign taxpayers will be determined if they are not required to file a Form 1120F with the IRS or file that form with indication of no gross or taxable income. For corporation business tax purposes, the starting point is gross income as defined for federal income tax purposes, which is then reduced by amounts deductible for federal income tax purposes. *See* Conn. Gen. Stat. sections 12-213(a)(9) and 12-217.

The initial approach of the DRS to the economic nexus legislation may reflect the fact that under the Connecticut income apportionment and sourcing rules, as well as the constraints of federal law, the maximum revenue return might best be achieved if the economic nexus rules are first applied to financial service companies, rather than to other categories of activities that would result in a lower percentage of income apportioned to or taxable in Connecticut.

> ***The maximum revenue return might best be achieved if the economic nexus rules are first applied to financial service companies.***

The income of financial service companies subject to taxation in Connecticut under the corporation business tax is generally apportioned under current Connecticut law on a market basis to the location of the customer. For example, the income of an issuer of credit cards is apportioned generally on the basis of the billing address of the cardholder, so that a credit card company with Connecticut customers would have Connecticut taxable income in proportion to its receipts attributable to billing addresses in the state.[20] Similarly, interest and other income derived by a mortgage company would be apportioned in proportion to the location of real property securing its loans,[21] while similar income derived by an automobile finance company would be apportioned on the basis of the location of the borrower.[22] Income in the nature of royalties or fees paid for the right to use intangible property such as trademarks is sourced under the general apportionment rules to the location where that intangible property is used.

Thus, as a general matter, DRS examiners may well apply the economic nexus rules initially to those activities that would result in optimal tax revenue under the corporation business tax from companies that have a Connecticut market but have their physical presence and payroll based elsewhere. In the case of companies that sell tangible products into Connecticut, income would normally be apportioned on a destination basis.[23] However, in the case of a company with no physical presence in the state, taxation under Connecticut's economic nexus rule would normally be precluded by application of P.L. 86-272, assuming that the company refrains from the conduct of any activity in Connecticut that does

[20]Conn. Gen. Stat. section 12-218(j)(2).
[21]Conn. Gen. Stat. section 12-218b(e).
[22]Conn. Gen. Stat. section 12-218b(f).
[23]Conn. Gen. Stat. section 12-218(c).

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not exceed protected solicitation of sales under that rule.[24] In the case of companies that derive income from the performance of services other than those that fall within the ambit of the financial service company apportionment rules, income would be expected to be apportioned on the basis of the location of the company's cost of performance, thus not collecting significant revenue from out-of-state companies.[25]

The initial focus of DRS audits under the economic nexus rules might also include broadcasters of video or audio programming over the airways, by cable or satellite, because under the current corporation business tax apportionment rules the income of those companies is generally apportioned on a market or audience basis.[26]

On the personal income tax side, the potential to gain significant revenue from out-of-state passthrough entities with no physical presence is even further limited by the current rules for the identification of income derived by nonresident individuals from the state (Connecticut-source income). Here the DRS problem results from the current income tax regulations, which provide generally that income derived from a passthrough entity for the performance of services is attributed to an office, branch, agency, or other location of the business, that is, to where the services are actually performed rather than to the customer's location.[27] Unlike the corporation business tax, there is no market-based apportionment regime of the type applicable to financial service companies.

[24]In *The Kelly-Springfield Tire Co. v. Bajorski*, *supra* note 7, the Connecticut Supreme Court made it clear that federal law, including P.L. 86-272, determines in the first instance the limitations on a state's ability to tax the income of interstate corporations.

[25]Receipts for services are generally sourced on the basis of where the services are "performed." Conn. Gen. Stat. section 12-218(c). Note that the DRS has never spelled out how that concept should be administered and, instead, has let the issue evolve through audits and informal settlements within its Appellate Division. Thus, it cannot be said with certainty whether the DRS follows a cost-of-performance approach and, if it does, whether it is that of predominant cost of performance, proportionate costs, or some other method. There is sufficient uncertainty in this area based on past administrative practices that the DRS likely has concluded that absent a legislative change, the new economic nexus rules would not be expected to net substantial revenue if applied to out-of-state service companies with no physical presence or costs incurred within the state.

[26]Conn. Gen. Stat. section 12-218(l).

[27]Conn. Agencies Reg. section 12-711(c)-4(f).

Judicial Reaction to Economic Nexus Around the Country

In *Quill Corp. v. North Dakota*,[28] the U.S. Supreme Court held that there are different constitutional standards for nexus under the due process and commerce clauses but, following its earlier decision in *National Bellas Hess, Inc. v. Department of Revenue*,[29] continued to uphold a requirement of physical presence for purposes of nexus to tax under the commerce clause. As with *National Bellas Hess*, however, the Court in *Quill* addressed the question of nexus only regarding the imposition of a use tax collection obligation on a remote seller — it was not called on to articulate the standard for imposition of tax on net income of a company that lacks physical presence within the taxing jurisdiction. Since the *Quill* decision and, in particular, since the 1993 decision of the South Carolina Supreme Court in *Geoffrey, Inc. v. South Carolina*,[30] tax administrators and state courts have probed the question whether a physical presence bright-line standard is equally applicable to income and other taxes in addition to use tax collection. It is in this context that the state efforts to apply economic nexus rules have been developing without, up to this point, any further involvement of the U.S. Supreme Court.

In *JC Penney Nat'l Bank v. Johnson*,[31] the Tennessee Appeals Court struck down on commerce clause grounds a Tennessee tax on out-of-state issuers of credit cards to customers within the state, indicating that it found no basis for limiting the analysis of *Quill* and *National Bellas Hess* to sales and use taxes. Again in *Acme Royalty Co. v. Director of Revenue*,[32] the Missouri Supreme Court reversed on commerce clause grounds determinations of the Missouri Administrative Hearings Commission that held that *Quill* and *National Bellas Hess* should be confined to the sales and use tax context. Despite those decisions, most state courts and tribunals that have addressed the question have concluded that the bright-line physical presence standard for nexus reflected in *Quill* and *National Bellas Hess* does not

[28]*Supra* note 9.

[29]386 U.S. 753 (1967).

[30]313 S.C. 15, 437 S.E. 2d 13, *cert. denied*, 510 U.S. 992 (1993).

[31]19 SW3d 296 (Tenn. App. 1999), *cert. denied*, 531 U.S. 927.

[32]96 SW3d 72 (Mo. *en banc* 2002).

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extend to state income taxes, and review by the U.S. Supreme Court, when sought, has been denied.[33]

Prospects Before the Connecticut Supreme Court

At some point the Supreme Court will likely revisit the issue of nexus for state taxation of income, but until it does, and absent any intervention by Congress,[34] development of the law will likely continue to occur on a state-by-state basis. That brings us to Connecticut, where there have been instances in which the Connecticut courts have addressed the concept of economic nexus and have, somewhat categorically, rejected that as a sufficient constitutional basis for taxation.

> ***The Connecticut courts have adhered strictly to a substantial physical presence requirement for purposes of use tax collection.***

In a series of decisions dating back to 1990, the Connecticut courts have adhered strictly to a substantial physical presence requirement for purposes of use tax collection and have struck down tax assessments even when the remote seller had a limited physical connection with the state or an affiliate that conducted business in the state. In *Cally Curtis Co. v. Groppo*,[35] the Connecticut Supreme Court held that there was insufficient nexus to require an out-of-state seller/renter of training films to collect use tax despite the presence in the state of films leased on a short-term basis. Relying on *National Bellas Hess*, the court held that such presence did not provide the requisite "minimum connection." In *SFA Folio Collections v. Bannon*,[36] the Connecticut Supreme Court again declined to find nexus for a mail order company, even though it mailed catalogs to residents, operated a toll-free telephone number, placed ads in the print media, and was affiliated with a company that maintained retail stores within the state. The court addressed and squarely rejected the argument that a finding of nexus was appropriate because the taxpayer had an economic presence within the state, represented by the established market for its products. In the words of the court:

> The Commissioner's second claim is that, in light of developments in due process analysis and in the mail-order industry, the nexus requirement of the due process clause is satisfied where an out-of-state corporation, such as Folio, has an "economic presence" in the state. This argument, at its roots, seeks to adopt the minimum contacts standard of personal jurisdiction analysis for state taxation on an out-of-state mail order company by dispelling the need for the company to have some physical connection with the state beyond the use of the United States mail or a common carrier. We decline to adopt such an analysis.[37]

The theme established by the Connecticut Supreme Court in *Cally Curtis* and *SFA Folio Collections* has been continued in later decisions of the Tax Session of the Superior Court. In *Dell Catalog Sales v. Commissioner*,[38] the court held that use tax nexus did not exist in the case of sales of computer products into the state despite the activities within the state of a third-party repair service company. Again, in *Scholastic Book Clubs, Inc. v. Commissioner*,[39] the court declined to find nexus for a mail order seller of books despite the in-state activities of school teachers who facilitated orders on behalf of school children. The court said the activities of the teachers fell short of the minimum connection required by cases such as *National Bellas Hess* and *Tyler Pipe Industries v. Dept. of Revenue*.[40]

As indicated, all the decisions discussed above involved application of a physical presence requirement for purposes of use tax collection, and they do

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[33]*See Lanzi v. Alabama Dep't of Revenue*, No. Inc. 02-721, 2003 WL 22535609 (Ala. Dep't of Revenue, Admin. Law Div. (Sept. 26, 2003), *rev'd on other grounds*, No. CV-2003-2705 (Ala. Cir. Ct., Montgomery City, Nov. 17, 2004); *Borden Chems. & Plastics, LP v. Zehnder*, 312 Ill. App.3d 35 (2000) (dicta); *MBNA Am. Bank, NA v. Indiana Dep't of Revenue*, 895 N.E.2d 140 (Ind. Tax 2008); *KFC Corp. v. Iowa Dep't of Revenue*, No. CV 7466 (Iowa Dist. Ct., Polk City, June 5, 2009); *Revenue Cabinet v. Asworth Corp.*, No. 06-Cl-00288 (Ky. Franklin Circuit Ct., Dec. 4, 2007) (dicta); *Bridges v. Geoffrey*, 984 So.2d 115 (La. App. 2008); *Capital One Bank v. Commissioner of Revenue*, 453 Mass. 17 (2009), *cert. denied*, 129 S. Ct. 2827; *Lanco, Inc. v. Director, Div. of Taxation*, 188 N.J. 380 (2006), *cert. denied*, 551 U.S. 1131; *A&F Trademark Inc. v. Tolson*, 605 S.E.2d 187 (N.C. App. 2004); *Kmart Props, Inc. v. Taxation & Revenue Dep't*, 139 N.M. 177 (2006); *Couchot v. State Lottery Comm'n*, 74 Ohio St.3d 417 (1996) (dicta), *cert. denied*, 519 U.S. 810; *Lamtec Corp. v. Department of Revenue*, 215 P.3d 968 (Wash. App. 2009); and *Tax Comm'r v. MBNA Am. Bank, NA*, 220 W.Va. 163 (2006), *cert. denied*, 551 U.S. 1141.

[34]*See, e.g.*, the Business Activity Simplification Act of 2007, S. 1726 110 Cong. (2007).

[35]214 Conn. 292 (1990).

[36]217 Conn. 220 (1991).

[37]*Id.* at 236.

[38]48 Conn. Supp. 170 (Super. Ct. 2003). For the decision, see *Doc 2003-16734* or *2003 STT 138-6*.

[39]*Scholastic Book Clubs, Inc. v. Comm'r of Revenue Services*, No. CV074013027S (Conn. Super. Ct. filed Apr. 9, 2009) (appeal pending). For the decision, see *Doc 2009-8630* or *2009 STT 72-10*.

[40]483 U.S. 232 (1987).

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not offer any discussion on whether the same standard might apply for income tax purposes. Despite that, the Connecticut Supreme Court in at least two cases has addressed the subject of income tax nexus in a manner that suggests that it views physical presence as a prerequisite and, more importantly, that it does not distinguish between the application of *Quill* in an income tax rather than a use tax context.

The Connecticut Supreme Court in at least two cases has addressed the subject of income tax nexus in a manner that suggests that it views physical presence as a prerequisite.

In *Altray Co., Inc. v. Groppo*,[41] the Connecticut Supreme Court confirmed that the standard for entitlement to apportion the income of a corporation (what tax practitioners refer to as outbound nexus) is the same as that applicable in determining whether an out-of-state corporation is subject to the corporation business tax. In determining that there was sufficient activity in New York to constitute outbound nexus, the court focused solely on the physical presence of a corporate officer in New York and the business activity he conducted there on behalf of the corporation. The court found this degree of out-of-state presence to be consistent with the constitutional constraints on state taxation of income under the commerce clause and, in particular, the U.S. Supreme Court decisions in *Complete Auto Transit, Inc. v. Brady*[42] and *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*.[43] There is no discussion in the opinion regarding whether the corporation had customers, a market, or economic presence in New York.[44]

Probably the clearest indication that the Connecticut Supreme Court has determined that the constitutional prerequisite for nexus to tax income is governed by the principles enunciated by the U.S. Supreme Court in *Quill* is reflected in the decision in *Chase Manhattan Bank, Trustee v. Gavin*,[45] in which the court upheld, in a split decision, the Connecticut income tax rules that define a taxable resident trust. At issue was whether the statutory definitions of a resident testamentary and resident *inter vivos* trust (both taxable on their undistributed income) could withstand challenge under the due process and commerce clauses of the U.S. Constitution.[46]

The analytical steps taken by the court in reaching its decision are not as pertinent to the topic addressed by this article as is the extent to which the court relied on *Quill* as relevant authority in the context of an income tax issue, both for due process and commerce clause purposes. The court first traced the history of due process jurisprudence in the taxation context from *National Bellas Hess* through *Quill*, saying that "in light of this development in the law of due process and taxation, the question in the present case becomes whether the contacts between [the trusts] and Connecticut are sufficient constitutionally for Connecticut to treat the trusts as if they were domiciliaries of the state and, therefore for Connecticut to tax the undistributed income of the trusts. We conclude that they are."[47] Thus, the court used *Quill* as its primary support for the proposition that the "panoply of legal benefits and opportunities" afforded by Connecticut to the testamentary trusts provides contacts with the state sufficiently fiscal in nature to satisfy due process standards for nexus.[48]

Speaking directly to the taxpayer's argument that *Quill* should be confined to its sales and use tax context, the majority wrote:

> We also disagree with the plaintiff's contention that, because *Quill Corp.* involved the collection and payment of a sales tax and the present case involves an income tax, *Quill Corp.* is irrelevant to this case. First, in restating the second part of the two part test for measuring the limitations on taxation imposed by the due process clause, the court in *Quill Corp.* itself referred to the requirement "that the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." [Citation omitted.] Thus, the reference to "income" in the context of a sales tax case suggests that the court, in borrowing

[41]224 Conn. 426 (1993).

[42]430 U.S. 274 , *reh'g denied*, 430 U.S. 976 (1977).

[43]445 U.S. 425 (1980).

[44]Furthermore, given that the court held that the same standards are applicable for both inbound and outbound nexus, the question may now be presented whether corporations taxable in Connecticut that have no physical presence elsewhere will henceforth be entitled to apportion their income because they purposefully direct business activities to customers in other states.

[45]249 Conn. 172 (1999). For the decision, see *Doc 1999-19138* or *1999 STT 105-3*.

[46]A resident testamentary trust is one established by will of a decedent who is a Connecticut resident at the time of death. Conn. Gen. Stat. section 12-701(a)(4)(C). A resident *inter vivos* trust is one consisting of property of a person who is resident in Connecticut at the time of transfer of the property to the trust, if the trust is irrevocable at that time. Conn. Gen. Stat. section 12-701(a)(4)(D).

[47]*Chase Manhattan Bank v. Gavin*, *supra* note 45, at 188.

[48]*Id.* at 200.

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the adjudicative jurisdictional due process analytic rubric, did not intend to confine that analytic model to sales taxes.[49]

The court continued:

> Second, the reasoning of *Quill Corp.* does not suggest that the comparable reasoning that it employed — between due process for adjudicative purposes and due process for tax purposes — was confined only to the sales tax context. Although the application of the test may yield different results depending on the type of tax to which it is applied, *we can perceive no reason why the fundamental due process test itself should vary depending on the type of tax involved*.[50]

Turning to its analysis of the commerce clause issue, the court addressed the "negative sweep" of the so-called dormant commerce clause, which prohibits some activities that interfere with interstate commerce. Again, it cites the decision in *Quill* together with that of the U.S. Supreme Court in *Complete Auto Transit, Inc. v. Brady*[51] for that general principle, reinforcing the conclusion that the Connecticut court regarded *Quill* as relevant in the context of an income tax issue implicating the commerce clause. The court expanded its discussion of the dormant commerce clause as applied to the facts of the case, including the plaintiff's claim of risk of multiple taxation, and concluded that that risk was too remote and speculative to provide a basis to overturn the statutory scheme.

Conclusion

Thus, the current situation in Connecticut is that the General Assembly has enacted an extraordinarily broad economic nexus rule with no objective criteria or qualifications as to how it should be administered. The DRS has announced administratively that it will use an objective standard of a minimum of $500,000 of annual receipts to impose the tax, but has not offered any other detailed guidance beyond a few nonexclusive examples of business arrangements that it will seek to tax under the new economic nexus rules. No comfort is being offered as to limitations on the scope of the nexus rule, except for the overarching, but amorphous, limitations of the U.S. Constitution and federal law.

> ***The Connecticut Supreme Court has also signaled that the bright-line physical presence requirement found in the* Quill *decision should be equally applicable in all tax contexts, not just for sales and use tax collection.***

However, the Connecticut Supreme Court has rejected on constitutional grounds the application of an economic nexus rule in the sales and use tax context and has also signaled that the juridical basis for a bright-line physical presence requirement found in the *Quill* decision should be equally applicable in all tax contexts, not just that involving sales and use tax collection. The future of the Connecticut economic nexus rule will play out over the next few years and will undoubtedly involve the Connecticut courts and revisitation of the physical presence standard for nexus that has been followed by the Connecticut Supreme Court. ✰

[49] *Id.* at 201-202.
[50] *Id.* at 202. Emphasis added.
[51] 430 U.S. 274 (1977).

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