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Connecticut Sales and Use Tax Nexus: Symptoms, Diagnosis and Treatment

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Overview:

What is it?

Do you have it?

Can you avoid it?

Can you get rid of it?

Nexus – What is it?

- Nexus is
 - The determination of whether a taxpayer can be taxed by a taxing authority, or
 - In the case of sales and use tax, be required to collect use tax from its customers.

Congressional Action on Nexus

- Congress passed P.L. 86-272, which provides that nexus will not be created for *income* tax purposes by an employee or independent contractor if they only solicit sales of tangible personal property and the sales orders are accepted and fulfilled from outside the state.
- Could pass laws related to sales tax based upon its right to regulate interstate commerce.
 - Would still have to address Constitutional issues, but Supreme Court has indicated that Congress should decide.
- Sales tax and income tax Nexus could be different.

Use Tax

- Use tax is due from the purchaser of any taxable goods or services for use within Connecticut.
- Purchasers are *very* bad at self-reporting use tax.
- For 2010, CT collected \$13.4 million in use tax, which was less than 0.5% of sales tax revenue.
- Connecticut estimates Amazon will collect and remit \$15M annually.
- Politically more appealing to have retailer collect than have State enforce.

Nexus Symptoms, or “What is it?”

- Defined by state statute
 - State Legislatures are the walk-in clinic
 - Long list of symptoms
 - May nor may not mean nexus
- Statute is only valid if it satisfies constitutional requirements
 - Courts are the specialists, have the final say
 - Nexus under Due Process Clause
 - Nexus under Commerce Clause

Nexus – What is it?

- Only one Sales and Use Tax statute mentions “Nexus”
 - § 12-411b -- Collection of use tax by certain state contractors.
 - (a) For any contract for provision of tangible personal property to the state . . . [the] contractor shall agree, on its own behalf and on behalf of each affiliate . . . to collect and remit to the state on behalf of its customers any use tax due to the state . . .for items of tangible personal property sold by the contractor or by any of its affiliates in the same manner **as if** the contractor and its affiliates were engaged in the business of selling tangible personal property for use in this state and had sufficient nexus with this state to be required to collect use tax due to the state.
 - Nexus at a price.

Do you have it?

- To determine whether a taxpayer has nexus, you must
 - Review state statute that imposes the tax
 - Determine if the state statute violates Constitutional requirements:
 - Due Process Clause Nexus – 14th Amendment
 - Commerce Clause Nexus – Art. 1, Sec. 3, Clause 8
 - Very fact-specific inquiry

Do you have it?

Supreme Court baseline 1945

- Nexus - Due Process Clause
 - States cannot deprive taxpayers of property without due process of law
- International Shoe v. Washington, 326 U.S. 310 (1945)
 - U.S. Supreme Court holds jurisdiction to sue and jurisdiction to tax are the same
 - Washington state can tax out of state company under due process clause because:
 - Activities were “systematic and continuous”
 - Not irregular or casual
 - Large volume of business
 - Benefits and protections of state law
 - Such as right to sue in court

Supreme Court baseline 1967

- Nexus requires **physical presence**.
- National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967)
 - United States Supreme Court determined that constitutional constraints limit the authority of a state to impose sales and use tax liability upon an out-of-state seller.
 - Mail order business must have physical presence in a state, in order for the state to have authority to tax.
 - Nexus must satisfy two Constitutional tests:
 - Due Process Clause and
 - Commerce Clause

Supreme Court baseline 1967

- National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967)
- Due Process Clause Nexus
 - For a state to collect tax, taxpayer must have some “minimum contacts.”
 - Physical presence probably required.
- Commerce Clause Nexus
 - Congress charged with protecting and encouraging interstate commerce.
 - States cannot impede interstate commerce through taxation.
 - Physical presence required.

Statutory definition of “Retailer”

- Same principle as statutory definition of “engaged in business.” CGS § 12-407(a)(15)
- Traditional nexus, CGS § 12-407(a)(12)
 - (A) Every person engaged in the business of making sales at retail . . . of tangible personal property owned by the person or others;
 - (B) every person engaged in the business of making sales for storage, use or other consumption. . .
 - (D) ...every seller rendering any [enumerated] service;
 - (E) every person under whom any **salesman, representative, peddler or canvasser operates in this state**, or from whom such salesman, representative, peddler or canvasser obtains the tangible personal property that is sold;
 - (F) every person with whose assistance any seller is enabled to solicit orders within this state;

Statutory definition of “Retailer” – cont’d

- (G) every person making retail sales from outside this state to a destination within this state and not maintaining a place of business in this state who engages in **regular or systematic solicitation of sales** of tangible personal property in this state
 - (i) by the display of advertisements on billboards or other outdoor advertising in this state,
- In 1965, amended statute to include
 - (ii) by the distribution of catalogs, periodicals, advertising flyers or other advertising by means of print, radio or television media, or
- In 1989, amended statute to include
 - (iii) by mail, telegraphy, telephone, computer data base, cable, optic, microwave or other communication system, for the purpose of effecting retail sales of tangible personal property, provided such person has made one hundred or more retail sales from outside this state to destinations within this state during the twelve-month period ended on the September thirtieth immediately preceding the monthly or quarterly period with respect to which such person's liability for tax under this chapter is determined;

Nexus – Can you avoid it?

- Mail order companies – primary driver
- Nexus seems to require some in-state presence
- Taxpayers plan and structure transactions to avoid nexus
 - Minimize state contacts
 - Isolate state contacts into specific entities
- States plan and legislate to establish nexus
 - Try to expand nexus to reach affiliates

Nexus in Connecticut

- Cally Curtis Co. v. Groppo, 214 Conn. 292 , 572 A.2d 302, (cert. denied, 111 S. Ct. 77, 112 L. Ed. 2d 50 (1990)).
 - "Such a collection burden when placed upon an out-of-state seller triggers due process concerns as well as imposes a restraint upon interstate commerce."
 - Where the only nexus between Connecticut and the corporation was the in-state presence for three days of video tapes leased by the out-of-state corporation to its in- state customers, an insufficient nexus existed to warrant the imposition of the Connecticut use tax.
 - See also L.L. Bean, Inc. v. Department of Revenue, 516 A.2d 820, 824 (Pa. Commw. 1986).

SFA Folio v. Bannon (1991)

- “[S]imple but controlling question is whether the state has given anything for which it can ask return.” *National Bellas Hess, Inc. v. Department of Revenue*, *supra*, quoting *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444, 61 S. Ct. 246, 85 L. Ed. 267 (1940).
- Because Congress has the exclusive authority to regulate interstate commerce, “[s]tate taxation falling on interstate commerce ... can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys.” *National Bellas Hess, Inc. v. Department of Revenue*, *supra*, 756, quoting *Freeman v. Hewit*, 329 U.S. 249, 253, 67 S. Ct. 274, 91 L. Ed. 265 (1946); see also *Cally Curtis Co. v. Groppo*.

Connecticut Nexus 1991

- In *SFA Folio v. Bannon*, the Connecticut Supreme Court set forth the test for sales tax nexus:
 - The relevant legal inquiry in reviewing the constitutionality of imposing the duty of collection of such a tax upon an out-of-state seller is whether there exists " 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.' " *National Bellas Hess, Inc. v. Department of Revenue*, *supra*, quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45, 74 S. Ct. 535, 98 L. Ed. 744 (1954); see also *Cally Curtis Co. v. Groppo*.
 - "The existence of such a link or nexus will turn upon the individual facts of each case." *Cally Curtis Co. v. Groppo*, *supra*.

Statutory definition of “Retailer” – cont’d

- 1990 added
 - (H) any person owned or controlled, either directly or indirectly, by a retailer engaged in business in this state which is the same as or similar to the line of business in which such person so owned or controlled is engaged;
 - (I) any person owned or controlled, either directly or indirectly, by the same interests that own or control, either directly or indirectly, a retailer engaged in business in this state which is the same as or similar to the line of business in which such person so owned or controlled is engaged;
- 1991 added
 - (J) any assignee of a person engaged in the business of leasing tangible personal property to others, where leased property of such person which is subject to taxation under this chapter is situated within this state and such assignee has a security interest, as defined in subdivision (35) of subsection (b) of section 42a-1-201, in such property;

U.S. Supreme Court 1992

- Quill Corp. v. North Dakota, 112 S. Ct. 1904 (1992)
 - State seeks to require mail order seller to collect and remit sales tax
 - Quill has no representatives or outlets in state
 - Court holds Quill has due process nexus
 - Purposefully directed activities – catalogs and phone calls, advertisements
 - Magnitude of contacts
 - Tax related to economic benefits received from access to marketplace
 - Court holds Quill does not have commerce clause nexus
 - **Physical presence required**
 - Does not exist when only contacts are US Mail or common carrier

Connecticut DRS 1992

- DRS Special Notice 92(19) addresses Quill
 - Connecticut DRS will not enforce
 - 1989 legislation imposed tax collection obligation on “every person making retail sales from outside Connecticut to a destination within Connecticut and not maintaining a place of business in Connecticut but engaging in regular or systematic solicitation of sales . . . In Connecticut by means of print, radio or television media or by mail as a retailer required to collect Connecticut use tax on sales to a Connecticut destination, provided such person made 100 or more retail sales from outside Connecticut to destinations within Connecticut during a twelve-month period”
 - Mere “economic presence” is not sufficient to pass constitutional muster

Connecticut - 1997

- Sharper Image v. Commissioner, 692 A2d 774 240 Conn. 531, (1997).
- Issue was whether Sharper Image owed use tax on its catalogs distributed in Connecticut
 - The substantial nexus in this case that provides the factual underpinning to support the constitutional imposition of the use tax on Sharper Image was the business and name recognition generated at its Connecticut stores as a result of the distribution of its catalogs in Connecticut. See D. H. Holmes Co., Ltd. v. McNamara, 486 U.S. 24, 31, 108 S. Ct. 1619, 100 L. Ed. 2d 21 (1988) .

Statutory definition of “Retailer” – cont’d

- 1998
 - (K) every person making retail sales of items of tangible personal property from outside this state to a destination within this state and not maintaining a place of business in this state who repairs or services such items, under a warranty, in this state, either directly or indirectly through an agent, independent contractor or subsidiary; and

Hypothetical Exercise

- Facts:
- P (Taxpayer) does not
 - own or lease any real or personal property in CT
 - Have a principal place of business, temporary facility, office, telephone number, mailing address or bank accounts in CT
 - Have any employees, independent contractors, salesmen, agents, canvassers, solicitors or other personnel in the state.
 - advertise in local media or engage in direct advertising to CT customers
 - communicate with residents of CT other than by mail or Internet from locations outside the state

Hypothetical – cont'd

- P (Taxpayer) does not
 - use state or local government services such as fire or police
 - use CT vendors to design, prepare, print, store or mail its catalogs.
 - Have any franchisees or licensees in CT
 - retain any security interest in products sold to CT customers.
 - conduct credit investigations or collection activities in CT
 - solicit orders by telephone, computer, cable or other communication systems in CT.

Hypothetical – cont'd

- P (Taxpayer) conducts is business by
 - Mailing monthly catalogs to school classrooms
 - Teachers receive catalog with flyers to be distributed to students and “Teacher memo”
 - Teacher memo states “no agency relationship between Teacher and P”
 - Teacher decides whether or not to participate
 - Teacher earns bonus points based on order
 - Bonus points redeemable for electronics – “for classroom use only”
 - Books delivered to Teachers by common carrier.
 - Teacher distributes to students
 - If order cannot be filled or damaged goods, Teacher receives refund check

Hypothetical: Issues?

- Is there Nexus?
- Do the Teachers create Nexus?
- Are the Teachers “representatives”?
 - (E) every person under whom any **salesman, representative, peddler or canvasser operates in this state**, or from whom such salesman, representative, peddler or canvasser obtains the tangible personal property that is sold
CGS § 12-407(a)(12)

Hypothetical: Outcome

- Trial court finds no nexus
 - Concludes Teachers are acting “in loco parentis” and are not representatives
- Scholastic Book Clubs, Inc. v. Comm’r, 304 Conn. 204, 38 A3d 1183 (cert. den. US S.Ct. Dkt. No. 11-1532 (10/09/12)). Connecticut Supreme Court finds Nexus does exist, and Taxpayer is required to collect and remit tax
 - Concludes Teachers are “representatives” for “the purpose of selling, delivering or taking orders” for children’s books
 - Notes “representative” is not defined
 - Teachers are, in fact, order-takers
 - Teachers’ motivation does not matter
 - Teachers’ in-state activities are significantly associated with P’s ability to establish and maintain a market in CT for sale of its products = Substantial Nexus under Commerce Clause test

Statutory definition of “Retailer” – cont’d

Amazon

- 2011
 - (L) every person making sales of tangible personal property or services through an agreement with another person located in this state under which such person located in this state, for a commission or other consideration that is based upon the sale of tangible personal property or services by the retailer, directly or indirectly refers potential customers, whether by a link on an Internet web site or otherwise, to the retailer, provided the cumulative gross receipts from sales by the retailer to customers in the state who are referred to the retailer by all such persons with this type of an agreement with the retailer, is in excess of two thousand dollars during the preceding four quarterly periods ending on the last day of March, June, September and December.
 - See also subsection (G)(iii) – 100 retail sales

Amazon Law – Internet Sellers as CT Retailers

- Effective July 1, 2011
 - Those who makes sales of tangible personal property or services:
 - Through an independent contractor or other representative who is a resident of this state,
 - If there is an agreement with the resident that provides the resident with a commission or other consideration for referring customers, and
 - If the retailer has cumulative gross receipts in excess of \$2,000 from sales by the retailer to customers in the state who are referred to the retailer by all residents with this type of an agreement with the retailer, is during the preceding four quarterly periods.

Amazon Law – Effect

- Nexus exists and retailer is required to collect and remit sales and use taxes based upon a link on the website of a Connecticut resident.
- Amazon
 - ends its Affiliates program in Connecticut in June, 2011.
 - February, 2013 Amazon will collect tax beginning November 1, 2013; will build \$50 million Connecticut facility that employs 300 without state incentives

Nexus – Can you get rid of it?

- Probably, break nexus factors.
- Take a position.
- However, states are getting better at making it an expensive proposition.
 - Connecticut's \$2,000 threshold is lowest of all states with similar statutes.
 - Rhode Island - \$5,000
 - Arkansas, Illinois, New York and North Carolina - \$10,000
 - California - \$500,000

Affiliate/Attribution/Economic Nexus – Constitutional?

- U.S. Supreme Court will need to decide
 - No pending Connecticut cases
 - New York – Constitutional
 - Overstock.com, Inc. v. NY Dep't Tax. And Fin., N.Y., Nos. 33 and 34, 3/28/13, 2013 NY Slip Op. 2102, 2013 WL 1234823, aff'g Amazon.com, LLC v. NY Dep't Tax. And Fin., 81 App. Div. 3d 183, 913 NYS2d 129 (1st Dept., 2010)
 - Illinois - Unconstitutional
 - Performance Marketing Association, Inc. v. Hamer, III, Cir. Ct. of Cook Cty, No. 2011-CH-226333, 5/7/12, as amended 5/11/12, 2012 WL 1986181 (on appeal to Ill. Sup. Ct.)

Other Considerations, or “Is There a Cure?”

- Marketplace Fairness Act
- Streamlined Sales Tax
- Trailing nexus
 - [Washington State: L. 2011, H1346, effective 08/23/2011](#) , clarifies that a person who has substantial nexus with Washington in any tax year is deemed to have substantial nexus with the state for the following tax year.

Recent Congressional Action

- Main Street Fairness Act, most recently introduced by Sen. Dick Durbin, would tax online sales.
 - Amazon supports.
 - Passed by Senate 2013, stalled in House.
- H. Res. 95 supporting “Preservation of Internet Entrepreneurs and Small Businesses” stated that Congress would not give states “the authority to impose unfair tax collecting requirements on small online businesses.”
 - eBay supports.
- Right now, *Quill* still stands.

States Band Together

- Streamlined Sales and Use Tax Agreement
 - Congress could pass a law requiring remote sellers to collect use tax.
 - Congress, in looking at this issue, has indicated that it would be more inclined to require collection if state and local governments simplified the sales tax code.
 - Streamlined Sales Tax Project created in 2000.
 - Streamlined Sales and Use Tax Agreement was submitted to states for adoption in 2002.

Query: Status of certain Connecticut nexus provisions

- Engage in “regular or systemic solicitation of sales of tangible personal property in this state” making 100 or more retail sales into the state during the preceding fiscal year ending September 30
 - Not enforced by DRS, based on Quill. SN 92(19)
 - Quill is still good law
- Hold a security interest in leased tangible personal property that is located within the state
 - Cally Curtis is still good law.
- Perform warranty or repair services directly or indirectly
 - What about nexus based on services provided indirectly?
- Amazon/click through nexus
 - Opposing decisions in New York and Illinois on constitutionality of click-through nexus

The End

- Thank you!

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