The Independent Rep And "Nexus"

by **JOHN SATAGAJ**

If a state wants to assert jurisdiction over an individual or business so that the state may require the individual or business to collect, remit, or pay taxes, the individual or business must have a "nexus" to the state, that is, some kind of connection or presence in the state. Webster's Dictionary defines nexus as a means of connection, link or tie, or a connected series or group. When the individual resides in a state or a business has a physical location in the state, the determination is a relatively easy one — the state has jurisdiction. Determining whether there is enough "presence" for a state to claim jurisdiction over a "remote" seller is the tougher question. Over the last 50 years, as interstate commerce and technology have shifted, the concepts of what constitutes nexus have also shifted. Unfortunately, despite the intervention of the United States Supreme Court and the United States Congress, the determination of what constitutes "nexus" is still largely a matter of state law. The result is that there is more than one interpretation.

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The notion of "nexus" comes in several different contexts. There can be a determination of "nexus" for the purpose of sales and use taxes on a good or service. Currently 45 states have sales and use taxes. For the purposes of nexus over a remote seller, the issue is generally the collection and remittance of a "use" tax which, for the most part, is the mirror image of the "sales" tax collected in-state.

An almost equal number of (but different) states have a net income or a franchise tax that they impose on businesses. Some of these taxes are based on "doing business" in the state, some are based on the income derived from the sale of goods and services. There are also capital stock taxes.

There are a couple of states, such as Washington with its business and occupation tax, that have taxes considered to be outside the definition of an income tax or a franchise tax. I know that, if you are like me, your head is already starting to swim, and I have not even gotten to the heart of the issue.

Nexus and the Rep

For the manufacturers' representative, the issue is whether the state can get nexus over the manufacturer because of the activities of the manufacturers' representative. In tax circles they call this "attributional" nexus. In tax auditor circles, "if they've got you, they've got the principal."

Let's deal with the net income taxes first. If a manufacturer that does not have a location in the state sells a product to someone in the state, there are generally three points at which it potentially establishes nexus with the state:

- The sale.
- The delivery.
- The post-sale service.

The manufacturers' representative could be involved in all three.

Congress tried to set the record straight with respect to the sales nexus for a state income tax in 1959. It attempted to exclude the solicitation of sales as an activity that would create nexus. It passed a law that permits 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. (See Public Law 86-272 below.)

PUBLIC LAW 86-272 — Imposition of Net Income Tax

a) Minimum standards

No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a 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 customer to 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) of this section 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) of this section, 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, or 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.

Editor's note: This last item is a definition for the purposes of subsections (a) (1) and (2), it is not a reference to the broadly used term "manufacturers' representative." This sometimes causes confusion.

Congress even went a step further with respect to a manufacturers' representative and included specific language that a manufacturer may engage an in-state independent contractor, even with an office, without creating nexus for the manufacturer. Congress indicated that an independent representative could even accept the order, something a manufacturer's own employee could not do.

"Tainted" Immunity

It bears repeating that in order for a manufacturer and the manufacturers' representative to stay within the protection of Public Law 86-272, the order must be filled by shipment or delivery from a point outside the state. I will not get into the details here, but there are state cases involving the delivery and/or installation of a product by the independent contractor in which the participation of the manufacturers' representative has "tainted" the nexus immunity. Also, there is still some considerable debate about how you determine whether the manufacturers' representative is truly an independent contractor for the purposes of Public Law 86-272.

Despite Congress' swift action in 1959, it was not

A. UNPROTECTED ACTIVITIES:

The following in-state activities (assuming they are not of a de minimis level) should not be considered as either solicitation of orders or ancillary thereto or otherwise protected under P.L. 86-272 and will cause otherwise protected sales to lose their protection under the Public Law:

1. Making repairs or providing maintenance or service to the property sold or to be sold.
2. Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.
3. Investigating credit worthiness.
4. Installation or supervision of installation at or after shipment or delivery.
5. Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation.
6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders.
7. Investigating, handling or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is to ingratiate the sales personnel with the customer.
8. Approving or accepting orders.
9. Repossessing property.
10. Securing deposits on sales.
11. Picking up or replacing damaged or returned property.
12. Hiring, training or supervising personnel, other than personnel involved only in solicitation.
13. Using agency stock checks or any other instrument or process by which sales are made within this state by sales personnel.
14. Maintaining a sample or display room in excess of two weeks (14 days) at any one location within the state during the tax year.
15. Carrying samples for sale, exchange or distribution in any manner for consideration or other value.
16. Owning, leasing, using or maintaining any of the following facilities or property in-state:
    a. Repair shop.
    b. Parts department.
    c. Any kind of office other than an in-home office as described as permitted under Section A.18 and Section B.2.
    d. Warehouse.
    e. Meeting place for directors, officers or employees.
    f. Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.
    g. Telephone answering service that is publicly attributed to the company or to employees or agent(s) of the company in their representative status.

until 1992 that a case made its way to the United States Supreme Court that tried to flesh out what activities constitute "solicitation of sales" and what did not. The case was the Wisconsin Department of Revenue vs. Wrigley.

In Wrigley, the Supreme Court rejected a narrow construction of the term "solicitation of orders" limited to just a request for the order. It did not, however, accept a broad construction that would have allowed ordinary and necessary business activities accompanying the solicitation process or that are routinely associated with deploying a sales force.

You guessed it. The Supreme Court struck a middle ground. The court concluded solicitation of orders covers more than what is strictly essential to making requests for purchases. It said the line must be drawn between those activities that are entirely ancillary to the request for purchases — those that serve no independent business function apart from their connection to the soliciting or order — and those activities that the company would have reasons to engage in

As you might imagine, states all have their own notion of where to draw the line.

h. Mobile stores, i.e., vehicles with drivers who are sales personnel making sales from the vehicles.

i. Real property or fixtures to real property of any kind.

17. Consigning stock of goods or other tangible personal property to any person, including an independent contractor, for sale.
18. Maintaining, by any employee or other representative, an office or place of business of any kind (other than an in-home office located within the residence of the employee or representative that (i) is not publicly attributed to the company or to the employee or representative of the company in an employee or representative capacity, and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers; for transmitting such orders outside the state for acceptance or rejection by the company; or for such other activities that are protected under Public Law 86-272 or under Section B. of this Statement).

    A telephone listing, or other public listing, within the state for the company or for an employee or representative of the company in such capacity or other indications through advertising or business literature that the company or its employee or representative can be contacted at a specific address within the state, shall normally be determined as the company maintaining within this state an office or place of business attributable to the company or to its employee or representative in a representative capacity. However, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the company shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the company or its employee or representative.

    The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described above shall, by itself, cause the loss of protection under this Statement.

    For the purpose of this subsection it is not relevant whether the company pays directly, indirectly, or not at all for the cost of maintaining such in-home office.
19. Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchisor or licensor to its franchisee or licensee within the state.
20. [RESERVED.]
21. Conducting any activity not listed in Section B. (Protected Activities listed on page 26) which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases.

anyway, but choose to allocate to its in-state sales force.

As you might imagine, states all have their own notion of where to draw the line. There is not enough space in this magazine to tell you what you can and cannot do, depending upon the state. There is an advisory state tax group called the Multistate Tax Commission. It issued a set of guidelines. The guidelines are by no means mandatory, but they will give you some idea of what the "experts" consider to be protected and unprotected activities in light of the Wrigley decision. (See box below and on previous pages.)

It also should be noted that the Supreme Court said that a "de minimis" amount of unprotected activities would not jeopardize the immunity.

State Income Taxes

As noted, Public Law 86-272 applies in the case of state net income taxes. In the case of other state taxes, the states have tended to fall back to a broad concept of doing business in the state. A reading of the cases indicates that some of the activities that

B. PROTECTED ACTIVITIES:

The following in-state activities should not cause the loss of protection for otherwise protected sales:

1. Soliciting orders for sales by any type of advertising.
2. Soliciting of orders by an in-state resident employee or representative of the company, so long as such person does not maintain or use any office or other place of business in the state other than an "in-home" office as described in Section A.18. (page 25).
3. Carrying samples and promotional materials only for display or distribution without charge or other consideration.
4. Furnishing and setting up display racks and advising customers on the display of the company's products without charge or other consideration.
5. Providing automobiles to sales personnel for their use in conducting protected activities.
6. Passing orders, inquiries and complaints on to the home office.
7. Missionary sales activities; i.e., the solicitation of indirect customers for the company's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers would be protected if such solicitation activities are otherwise immune.
8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.
9. Checking of customers' inventories without a charge therefor (for re-order, but not for other purposes such as quality control).
10. Maintaining a sample or display room for two weeks (14 days) or less at any one location within the state during the tax year.
11. Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel.
12. Mediating direct customer complaints when the purpose thereof is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.
13. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile that is solely limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software that is limited to the carrying on of protected solicitation and activity entirely ancillary to such solicitation or permitted by this Statement under Section B. shall not, by itself, remove the protection under this Statement.

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might be protected under Public Law 86-272 and the Wrigley case may cause the creation of nexus in the context of other state taxes.

One of the leading cases is another United States Supreme Court decision, Tyler Pipe Industries vs. Washington Department of Revenue. In that case, the activities of a manufacturers' representative were determined sufficient to establish nexus over the manufacturer. The court stated, "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." In the case the independent contractor acted daily on the manufacturer's behalf to solicit sales, call on customers, and maintain and improve the seller's name recognition, good will, and individual customer relations.

I will raise one more issue that you should be aware of. Some states assert that while they might not have nexus over the manufacturer as the result of the activities of the manufacturers' representative, they argue that the manufacturers' representative owes a tax on the representative's activities. Sometimes this gets complicated as the state and the representative try to separate what constitutes the representative's income from the sale.

As to whether a state can compel a manufacturer to collect and remit a use tax on the basis of independent contractor sales activity, a number of states have relied on the Tyler case and another United States Supreme Court decision, Scripto Inc. vs. Carson, to say "yes they can." The quote-worthy phrase from the Scripto case that comes up frequently is "whether Scripto's in-state representatives were characterized as 'employees' or 'independent contractors' was a fine distinction without constitutional significance." Of course, a state's rules for the application of sales or use tax still apply, and therefore, for example, whether a product is being sold to the end user or sold for resale still determines whether a tax is owed by the buyer.

In conclusion, what is remarkable about the state of the law with respect to nexus is despite the fact Congress and the courts have been grappling with this issue since the 1950s, there are few bright lines, and it is still a matter of state litigation. It would be prudent for a manufacturers' representative to be aware of exactly what type of taxes are imposed by the states in which you conduct business, and how the state and its courts have interpreted the leading cases. Finally, it would seem prudent for manufacturers' representatives to be aware of the activities that are generally perceived to be protected and unprotected and to evaluate regularly whether all of its activities are necessary or appropriate. ❒

(This article is not to be relied on as legal advice. It is for information purposes only.)

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