

## *Ruling 95-04*

Vermont Department of Taxes

Date: April 25, 1995

Written By: John M. Bagwell, Attorney for the Department

Approved By: Betsy Anderson, Commissioner of Taxes

You have requested a ruling on whether those activities described in your letter of February 10, 1995, create "nexus" between the corporate clients of (Corporation) and the State of Vermont which would subject those clients to Vermont's corporate income tax jurisdiction. This ruling relies on the facts contained in your letter of February 10, 1995, and facts conveyed subsequently by you in our telephone conference.

Facts: [Corporation] is a corporation doing business in the State of Vermont. [Corporation] represents corporate clients. Most of these clients are not Vermont corporations and do not possess certificates of authority to do business in Vermont. There are four operations that (Corporation) performs within the State of Vermont on behalf of its clients: (1) duplication of tapes, (2) accounting and revenue processing, (3) storage and shipping, and (4) order capture. These activities are more particularly described below.

[Corporation's] duties are generally specified by written agreement with each client. The agreements provide that [Corporation] does not act as an agent on behalf of its clients with respect to the duplicated tapes, but do not otherwise specify the nature of its legal relationship with its clients.

Duplication: [Corporation] receives master tapes owned by its clients. It uses the master tapes to electronically create multiple copies. The duplicated tapes are the property of the clients for whom the tapes are duplicated.

Accounting and Revenue Processing: [Corporations] employees deposit checks, and cause to be deposited receipts from credit cards. These checks and credit card receipts are revenues from clients, sales. [Corporation] coordinates the flow of funds through a Vermont bank and deposits funds into Vermont bank accounts held by its clients. (Corporation's) accountants provide reconciled reports to its clients, detailing sales and cash flows.

Physical Storage and shipping: In many cases after tapes have been duplicated, [Corporation] will ship the duplicated tapes to another location in Vermont where the tapes will be stored in space leased by [Corporation]. The tapes are stored until such time as they are sold. [Corporation's] employees remove the tapes from storage, package them, and ship them to the clients' customers by common carrier.

Order Capture: [Corporations] employees answer telephone calls and/or open mail. Retail orders are filled by [Corporation] on behalf of its clients in Vermont without prior client approval, provided there is sufficient inventory on hand to fill the orders. If sufficient inventory to fill an order is not on hand, client approval to produce sufficient additional inventory is obtained prior to filling the order. Client approval is always obtained prior to filling orders from wholesale clients. [Corporation's] employees also enter data into a computer system and handle customer complaints and questions. [Corporation's] contacts with client customers are generated by client advertising and other means, and [Corporation] responds as instructed by its clients.

## Issues

1. Do the corporate clients of [Corporation] have, under the facts described above, sufficient connection (nexus) with the State of Vermont so as to be subject to Vermont's corporate income tax?
2. If clients have nexus under the facts outlined above so as to be subject to Vermont's corporate income tax, what combination of the activities, as described above, if any, can the clients engage in without creating nexus?

## Ruling

Issue 1: Do the corporate clients of [Corporation] have, under the facts described above, sufficient connection (nexus) with the State of Vermont so as to be subject to Vermont's corporate income tax? Vermont's statutes provide that a foreign corporation, even though not possessing a certificate of authority to do business in Vermont, is subject to Vermont's income tax jurisdiction if it has income derived from any "trade, business or activity" conducted within Vermont. 32 V.S.A. Sections 5811(15) and 5833(a). The United States Supreme Court has held that a foreign corporation has nexus with Vermont for income tax purposes "...if the corporation avails itself of the substantial privileges of carrying on business, within the State..." *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980). Vermont's Supreme Court has held that a foreign corporation must have certain minimum contacts with Vermont so that payment of the tax does not offend traditional notions of fair play and substantial justice. *Jacob Ruppert v. Commissioner of Taxes*, 117 Vt. 83, 85 A.2d 584 (1952). These general principles underlie the conclusions set forth below.

The facts outlined above indicate that [Corporation's] activities are performed in the capacity of an agent for and on behalf of its clients. [Corporation] has the power and authority to alter the legal relations between its clients and third persons by, for example, filling orders, storing and shipping merchandise, and depositing funds into client bank accounts. It acts as a fiduciary with respect to its clients by, for example, receiving and depositing sales receipts and handling client inventories. [Corporation's] clients control [Corporation's] conduct with respect to matters entrusted to it through their agreements with [Corporation], which outline the duties [Corporation] will perform.

These features indicate a principal-agent relationship. Restatement, Agency 2d. § 12-14 and 14N.

The activities of a corporation through its agents as well as its employees are taken into account for the purpose of determining nexus. *Scripto, Inc. v. Carson, et al.*, 362 U.S. 207 (1960); *Jacob Ruppert v. Commissioner of Taxes*, supra. It is irrelevant, insofar as the issue of determining nexus is concerned, whether the agent acted as an independent contractor or servant, or whether the agent worked for several principals. The focus of the test is the nature and extent of the activities undertaken by the agent and not the agent's legal relationship to the principal. *Scripto, Inc. v. Carson*, supra. The parties' characterization of their relationship does not determine whether an agency relationship exists. "The existence of an agency relationship does not depend on the label the parties give it, but may be demonstrated from the circumstances of the particular situation or the conduct of the parties. (citation omitted) Formality is not essential to the creation of the relationship, which can arise by verbal agreement or be implied from the circumstances, and can arise from a single transaction." *Bills v. Wardsboro School District*, 150 Vt. 541, 554 A.2d 673 (1988).

The facts presented above indicate that [Corporation's] clients through [Corporation], their agent, engage in the following activities within Vermont: handle customer complaints and customer questions, answer telephone calls and open mail with respect to customer orders, maintain Vermont bank accounts, deposit customer checks and credit card receipts into Vermont bank accounts, generate reconciled reports detailing sales and cash flows, remove inventory from storage, package it, and deliver it to customers by common carrier. They also own income producing property in Vermont in the form of master tapes and inventory which is stored in Vermont until sold.

These facts indicate that [Corporation's] clients have a presence in Vermont sufficient to establish nexus for Vermont income tax purposes and are thus subject to Vermont's corporate income tax. P.L. 86-272, discussed below, does not afford income tax immunity because the scope of their activities exceeds those allowable under this statute.

P.L. 86-272, codified at 15 U.S.C.A. § 381(a)(1), provides that a state does not have the power to impose a net income tax on income of a foreign seller derived within the state from interstate commerce if the seller's only business activity within the state is the solicitation of orders by the seller or his representative of sales of tangible personal property and delivery into the state by common carrier. However, such orders must be sent outside the state for approval and, if approved, must be filled by shipment or delivery from outside the state. Even if the activities of the foreign seller are carried out by an independent contractor, those activities must be confined to sales or soliciting orders for sales in order to claim P.L. 86-272 protection. 15 U.S.C.A. S 381(c).

Whether or not [Corporation] is an independent contractor within the meaning of P.L. 86-272, the activities conducted in Vermont on behalf of its clients, as described above, exceed the scope of activity permitted by the statute. Therefore, the statute's immunity provisions do not apply. *Wisconsin Department of Revenue v. Wrigley Co.*, 505 U.S. (1992).

Issue 2: If clients have nexus under the facts outlined above so as to be subject to Vermont's corporate income tax, what combination of the activities described above, if any, can the clients engage in without creating nexus?

1. Order capture plus accounting and revenue processing. Nexus is established with Vermont for income tax purposes through the activities described above under the categories entitled "order capture" and "accounting and revenue processing. Nexus is established even though none of the activities described in the categories entitled "duplication" and physical storage and shipping are undertaken within Vermont.

The United States Supreme Court found that there was sufficient nexus to impose a tax upon a corporation's gross receipts where the corporation's primary contact with the taxing state was through a single employee working out of his home. The employee was a consultant who regularly consulted with the corporation's sole in-state client concerning anticipated needs for products and difficulties with products after delivery. The employee did not take orders, which were filled and shipped directly to the customer from out-of-state. Payments for orders were sent directly to the corporation's out-of-state office. The corporation had no in-state assets. This degree of activity was held sufficient to create nexus. *Standard Pressed Steel Co. v. State of Washington Department of Revenue*, 419 U.S. 560 (1975).

The United States Supreme Court also held that a company established nexus for income tax purposes where it maintained an in-state sales office from which a salesman solicited orders both within and outside the state, and at which a secretary performed clerical work and facilitated communications with the home office. The company, however, stored no inventory in-state, and owned no property within the state other than office furniture. Orders were filled and shipped outside the state. These activities were characterized by the Court as substantial income-producing activities within the taxing state on which it was entitled to impose tax. *Northwestern States Portland Cement Company v. State of Minnesota and T.V. Williams v. Stockham Valves & Fittings, Inc.*, 358 U.S. 450 (1959).

The activities described as "order capture", coupled with "accounting and revenue processing activities are sufficient to establish nexus. *Northwestern States Portland Cement Company v. State of Minnesota and T.V. Williams v. Stockham Valves & Fittings, Inc.*, supra.

The immunity provisions of P.L. 86-272 are not available because the activities described in the "order capture" plus the ,accounting and revenue processing categories exceed the scope of the activities permitted under this statute. *Wisconsin Department of Revenue v. Wrigley*, supra.

However, if [Corporation's] activities are limited to sales or the solicitation of orders for sales of tangible personal property on behalf of its clients, this activity may fall within the immunity provisions of P.L. 86-272, as discussed above. 15 U.S.C.A. § 381. "Sales" activities must be limited to accepting orders on behalf of the clients thereby binding the clients to contracts of sale. 1959 U.S. Code Cong. & Ad. News 2554. If [Corporation] is an "independent contractor" within the meaning of P.L. 86-

272, it may engage in sales activities within Vermont. An "independent contractor" is an independent contractor who holds itself out as being engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal. 15 U.S.C.A. § 381(d)(1). Immunity under P.L. 86-272 is lost if other activities occur within Vermont, such as "duplication", "accounting and revenue processing", and "physical storage and shipping". *Wisconsin Department of Revenue v. Wrigley Co.*, supra.

2. Duplication plus physical storage and shipping. Nexus is established with Vermont for income tax purposes through the activities described above under the categories entitled "duplication" and "physical storage and shipping". Nexus is established even though none of the activities described in the categories entitled "accounting and revenue processing" and "order capture" are undertaken within Vermont.

Nexus has been found to exist with respect to other states solely through the presence of property located within the state from which the income subject to tax was derived. For example, Oregon was held to have jurisdiction to impose an income tax on a foreign corporation whose only contact with the state was through railroad cars which it had leased to railroads operating inside and outside the state. *American Refrigerator Transit Company v. State Tax Commission, Ore.*, 395 P.2d 127 (1964). See also *Commissioner of Revenues v. Pacific Fruit Express Co.*, Ark., 296

S.W.2d 676 (1957), a case decided on facts similar to *American Refrigerator*, supra. Oklahoma was held to have the right to tax income where the foreign corporation's only contact with the state was through merchandise which was shipped into the state for sale by a consignee, and the foreign corporation retained title to the merchandise until sold by the consignee. *Chain Belt Co. v. Oklahoma Tax Commission*, Okla., 116 P.2d 899 (1941).

Activities described under the "duplication" category coupled with the activities described under the "physical storage and shipping" category establish the minimum connections necessary to establish nexus. If activities were limited within Vermont to those described above under the "duplication" category it is questionable whether Vermont would assert nexus for income tax purposes, provided the duplicated tapes were not kept in Vermont for any purpose other than delivery to the client. Storage pending sale to wholesale or retail consumers or for other purposes would indicate that inventory is maintained within the state which would provide a basis for nexus.

P.L. 86-272 does not afford immunity from Vermont income tax with respect to the activities described in either of these categories. *Wisconsin Department of Revenue v. Wrigley*, supra. None of these activities constitute "sales" or the "solicitation of orders for sales" under the statute. However, as discussed above, "duplication" activities, without more, may not be sufficient to establish nexus for income tax purposes.

3. Duplication plus physical storage and shipping plus accounting and revenue processing. As discussed above, nexus is established with Vermont for income tax

purposes through the combined activities described under the categories entitled "duplication", "physical storage and shipping" and "accounting and revenue processing". Nexus is established even though none of the activities under the category entitled "order capture" are undertaken in Vermont.

P.L. 86-272 does not afford immunity from Vermont income tax with respect to the activities described in any of these categories. None of these activities constitute "sales" or the "solicitation of orders for sales" under the statute. Wisconsin Department of Revenue v. Wrigley Co., supra. As discussed above, "duplication" activities, without more, may not be sufficient to establish nexus for income tax purposes.

4. Order capture plus physical storage and shipping. As discussed above, nexus is established with Vermont for income tax purposes through the combined activities described under the categories entitled "order capture" and physical storage and shipping". Nexus is established even though none of the activities under the categories entitled "duplication" and accounting and revenue processing" are undertaken in Vermont.

P.L. 86-272 does not afford immunity because the activities described in the Border capture" and "physical storage and shipping" categories exceed the scope of the activities permitted under this statute. Wisconsin Department of Revenue v. Wrigley Co., supra. As discussed above, sales or solicitation for sales may be immune under certain circumstances.

This ruling is issued solely to your firm and is limited to the facts presented as affected by current statutes and regulations. Other taxpayers may refer to this ruling to determine the Department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statute or regulations.