

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING 05-25**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Whether an out-of-state company has sufficient nexus with Tennessee to require it to collect and remit its sales and use taxes.

SCOPE

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

FACTS

Company operates an online website which allows users to access a database it internally created to search for various documents that are of interest to the users. In addition, individuals can create and maintain their own website. On Company's website, the Company sells various items such as computer software, books, periodicals and other miscellaneous tangible personal property related to the database they have created. Company charges customers for using the information on its website. This charge is normally a monthly, semi-annual or an annual fee paid by users. For this charge users get access to various parts of its database on the website. Users can print various documents if they wish. The general service Company provides is the provision of information services with some sales of shrink-wrapped software and other hard goods.

During [YEAR], Company acquired Subsidiary as a 100%-owned subsidiary in exchange for company stock. Subsidiary maintains internet message boards for information related to the same general business sector as Company. Subsidiary had employees located throughout the United States. Subsidiary had very little income and was not operating at a profit and was about to cease operations prior to Company's acquisition. The revenue Subsidiary recorded was a result of the sale of banner advertising located on its website. Subsidiary did have a loyal user base and was popular among users. Company's driving

factor in the purchase of Subsidiary was to increase interest in the business sector in which Company currently operates.

During the past [NUMBER] years Company has continued to fund the operational expenses of Subsidiary. In exchange for operating funding, Company posted links to its website on the Subsidiary's message board. Sometime after the purchase of Subsidiary, all of the employees of Subsidiary, for the ease of payroll administration only, began being reported on the payroll reports of Company. Although Subsidiary continues to have these employees who are dedicated to the operation of Subsidiary's message board, these employees are listed on the payroll reports of Company. Company's overall management team does provide some minimal supervision. It is Company's intention to have the Subsidiary message board operate in the same manner it did prior to the acquisition.

Subsidiary's operations in Tennessee are limited to one employee who assists in maintaining the Subsidiary message board and website. Subsidiary does not own any fixed assets located in Tennessee. The employee in Tennessee works from home on an employee-owned computer. Company has no other employees in Tennessee. The Company employee in Tennessee accesses, via a secure network, Subsidiary's servers located outside of Tennessee to perform the function of ensuring the computer code used on the website is functioning properly. This individual could perform his job duties anywhere in the world. The employee has no interaction or interface with Company's customers and does not solicit sales from banner advertisers for Subsidiary. Outside of this one employee, neither Company nor Subsidiary has any other physical presence in Tennessee (e.g., employees, offices, equipment, inventory, agents). Company's total annual sales in Tennessee are approximately [NUMBER]. Of this amount, approximately [NUMBER] is from sales of tangible personal property and the rest is from digital goods and information services. Company has approximately 100,000 customers in Tennessee.

QUESTIONS

1. Is Company liable for collecting sales and use tax in Tennessee?
2. If there is nexus, how long after the nexus creating circumstances cease is Company required to continue collecting sales and use tax?

RULINGS

1. Yes, Company is liable for collecting sales and use tax in Tennessee because it has nexus with this State.
2. Company's responsibility to collect sales and use tax ceases as soon as the nexus creating circumstances no longer exist.

ANALYSIS

1. The Commerce Clause provides that “Congress shall have the power... To regulate Commerce with foreign Nations, and among the several States. . . .” U.S. Const. art. I, sec. 8, cl. 3. States have a legitimate interest in raising revenues through taxes and in regulating commercial activity within their boundaries but in so doing may not erect barriers to interstate commerce. In an attempt to balance the interests of the national government and the states the U.S. Supreme Court in 1977 enunciated four requirements on the imposition of state taxes in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). The Court stated that for a state tax to be valid the tax must be applied to an activity with a substantial nexus with the taxing state, be fairly apportioned, not discriminate against interstate commerce, and be fairly related to the services provided by the state. *Id.*, 430 U.S. at 279.

The Due Process Clause provides that “No State shall . . . deprive any person of life, liberty, or property, without due process of law. . . .” U.S. Const. amend. XIV, sec. 1. This clause places two restrictions on the power of the states to tax income. First, there must be some minimal connection or link between the taxable activities and the taxing state, and second, the revenue sought to be taxed must be reasonably related to activities in the state. The requirements of the Due Process Clause overlap the Commerce Clause requirements of substantial nexus, fair apportionment, and fair relation to services provided by the state.

The question is essentially whether the Taxpayer has a sufficient connection with Tennessee for this state to require it to collect and remit Tennessee sales and use taxes. For purposes of imposing sales and use tax, the Supreme Court has affirmed a bright-line, physical presence requirement, first set forth in *National Bellas Hess v. Department of Revenue of Illinois*, 386 U.S. 753 (1967) (holding that a vendor whose only contacts with the taxing state are by mail and common carrier does not have substantial nexus under the Commerce Clause) as necessary to meet the substantial nexus part of the Commerce Clause analysis. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (holding that Quill’s licensing of software in the taxing state and the resulting presence of “a few floppy diskettes” owned by it did not constitute substantial nexus under the Commerce Clause).

The Court has made it clear that when a sales and use tax is at issue, physical presence is always required in order to establish substantial nexus. *Quill Corp.*, 504 U.S. at 318. This presence must be more than the slightest presence, but it need not be substantial physical presence. See *Brown’s Furniture v. Wagner*, 665 N.E.2d 795, 803 (Ill. 1996) (finding substantial physical presence where a furniture company made numerous deliveries in the taxing jurisdiction) and *Orvis Co. v. Tax Appeals Tribunal*, 654 N.E.2d 954, 960-61 (N.Y. 1995) (finding substantial physical presence where employees visited customers in the taxing jurisdiction on numerous occasions). Generally in determining whether physical presence is sufficient to confer nexus, courts will look for employees or representatives of the taxpayer actually coming into the taxing jurisdiction for a business related purpose. *Id.*

Company clearly has a physical presence in Tennessee because it has an employee in Tennessee. It is immaterial whether the employee contributes to sales made by Company in Tennessee. In a recent Supreme Court case involving sales and use tax, the Court determined that a company in California had nexus with the state even though there was no relationship between the company's two California offices and the company's sales activity in California. *National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 560, 97 S.Ct. 1386, 1392 (1977). Furthermore, the physical presence is not slight because the employee is benefiting from public roads, police protection, a judicial system and all the other protections and services provided by the State.

Company's sales activities in Tennessee also satisfy the minimum contacts requirement of the Due Process Clause because Company has purposefully directed its activities to Tennessee residents. Company has approximately 100,000 customers in Tennessee, sells at least [NUMBER] worth of tangible personal property in Tennessee each year, and has total annual sales of almost [NUMBER] dollars in this State.

The Company has nexus with Tennessee because it satisfies the physical presence requirement of the Commerce Clause; the Company also satisfies the minimum contacts requirement of the Due Process Clause; therefore, the Company has the responsibility to collect sales and use tax on its sales in Tennessee.

2. Company's responsibility to collect sales and use tax ceases as soon as the nexus creating circumstances no longer exist. Specifically, if the employee in Tennessee is the only basis for nexus with Tennessee, then Company's responsibility to collect sales and use tax ceases as soon as that employee permanently leaves the State.

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Date: 12/19/2005