PHILIP CROSBY ASSOCIATES, INC. § STATE OF ALABAMA
3260 University Boulevard, Suite 175 DEPARTMENT OF REVENUE
Winter Park, Florida 32792, § ADMINISTRATIVE LAW DIVISION

Taxpayer, § DOCKET NO. U. 96-143

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed State, Marshall County, Lauderdale County, Talladega County, Houston County, and local city use tax against Philip Crobsy Associates, Inc. ("Taxpayer") for the period January 1989 through December 1994. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on October 2, 1996. Steve Hitchcock represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

The Taxpayer operates a management consulting business and is headquartered in Winter Park, Florida. The Taxpayer also sells books, videos, and other items that are used for training purposes related to its consulting business.

The Taxpayer sold the above tangible items to Alabama-based customers at retail outside of Alabama during the audit period. The items were delivered into and used by the customers in Alabama. The Department assessed the Taxpayer for Alabama use tax on those items. The issue is whether the Department is prohibited from taxing the Taxpayer by the Due Process Clause or the Commerce Clause of the United States Constitution.[1] That issue turns on

[1]The Due Process Clause is found in the Fourteenth Amendment.

whether the Taxpayer had "substantial nexus" with Alabama during the period in question.

The Taxpayer solicited customers in Alabama through telemarketing during the audit period. If a potential customer showed interest, the Taxpayer followed up with an individual sales presentation in Alabama.

If a business contracted for the Taxpayer's services, the Taxpayer trained a small group of the business's management personnel at a training seminar. The seminars were regularly conducted outside of Alabama, although at least one special seminar was conducted in Alabama during the audit period for a large corporate customer.

The individuals trained at a seminar returned to Alabama and trained the business's other employees. The businesses were also required to purchase books, videos, and other materials from the Taxpayer that were used to train the other employees. It is those tangible items that are being taxed in this case.

The Taxpayer also conducted follow-up consulting and business review services in Alabama. The extent of the Taxpayer's activities in Alabama is detailed below. The Taxpayer derived approximately 50 percent of its revenues during the audit period from the management seminars, 40 percent from the sale of the

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The Commerce Clause is at Art. 1, § 8, cl. 3.

training books, videos, etc., and 10 percent from follow-up consulting and business review services.

The Multistate Tax Commission ("MTC") audited the Taxpayer for sales and use tax purposes on behalf of Alabama and its other member states.[2] The Department used the MTC audit report to assess the tax in issue.

The Taxpayer does not dispute the amounts established by the MTC audit. Rather, it argues that it is not liable for Alabama use tax because its activities in Alabama during the audit period were not sufficient to establish nexus with Alabama.

The Taxpayer's activities in Alabama during the audit period were as follows. See, MTC audit, Dept. Exhibit 1.

The Taxpayer sold training books, videos, etc. to Alabama customers that were shipped into Alabama on 104 occasions from 1992 through 1994. A like number of sales to Alabama customers were projected over the period 1989 through 1991. The Taxpayer sold

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[2]The MTC is a national quasi-governmental organization with 36 member or associate states. The function of the MTC is to promote fair, efficient, and uniform state tax systems. The MTC was created in 1967. Alabama became a member state in 1977. See, State, Dept. of Revenue v. MGH Management, Inc., 627 So.2d 408 (Ala.Civ.App. 1993).

$1,223,120 worth of tangible items to Alabama customers during the audit period.

The Taxpayer's employees solicited sales and helped customers in Alabama on 26 occasions from December 1993 through 1994. (Schedule NI-1). The Taxpayer also provided follow-up consulting services or on-site training in Alabama on 69 occasions from October 1992 through January 1994. (Schedule NI-2). A consulting or training trip usually involved a one night stay in Alabama by one employee, although occasionally a team of two to five employees worked in Alabama for up to five days. The Taxpayer concedes that its activities in Alabama during 1992 through 1994 were typical of the entire audit period.

The Alabama use tax is complementary to the Alabama sales tax and is levied on tangible personal property purchased at retail outside of Alabama that is subsequently used, stored, or consumed in Alabama. Ex parte Fleming Foods of Alabama, Inc., 648 So.2d 577 (Ala. 1994), cert. denied, _____ U.S. _____, 115 S.Ct. 1690 (1995). The tangible items in issue are subject to Alabama use tax because they were purchased outside of Alabama and subsequently used by the Taxpayer's customers in Alabama.

Use tax is levied against the individual or business that uses, stores, or consumes the property in Alabama. However, because of the impracticability of collecting use tax from the individual user, the out-of-state seller is required to collect and remit the tax to the Department. Code of Ala. 1975, §40-23-67.

Code of Ala. 1975, §40-23-68(b) lists various activities in

Alabama that would subject an out-of-state retailer to Alabama use tax. However, §40-23-68(b)(9) is controlling. That catch-all section provides in substance that an out-of-state retailer that sells property for use in Alabama is liable for Alabama use tax if it has sufficient nexus with Alabama under the Due Process Clause and Commerce Clause of the United States Constitution.

The United States Supreme Court addressed the nexus issue in the following cases:

In National Bellas Hess, Inc. v. Dept. of Revenue, 386 U.S. 757, 87 S.Ct. 1389 (1967), the Supreme Court, without distinguishing between Due Process Clause and Commerce Clause nexus, established a bright-line physical presence test that a state cannot tax an out-of-state mail order business that only delivers its goods into the state by common carrier or mail.

In Complete Auto Transit, Inc. v. Brady, 430 U.S. 280, 97 S.Ct. 1076 (1977), the Court declared that an out-of-state business can be taxed without violating the Commerce Clause, but only if the tax (1) is applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state. Complete Auto, at p. 1079.

In Quill Corporation v. North Dakota, 504 U.S. 298, 112 S.Ct. 1912 (1992), the Court revisited the Bellas Hess issue of whether a state can tax an out-of-state mail order business that only delivered its products into the state by mail and common carrier. In deciding the case, the Supreme Court for the first time

distinguished between Due Process Clause nexus and Commerce Clause nexus.

The Court rejected the Bellas Hess physical presence test for due process purposes, and held that a state could tax an out-of-state seller if the seller "purposefully avails itself of the benefits of an economic market" in the state. Quill, at p. 1910. Due process is satisfied if the taxpayer is given "notice" or "fair warning" that it may be subject to tax in the taxing state. Quill, at p. 1913. The Taxpayer in this case clearly availed itself of Alabama's economic market, and thus had nexus with Alabama for due process purposes.

However, the Court affirmed Bellas Hess that some physical presence in the state is necessary for Commerce Clause nexus. Unfortunately, the Court failed to specify how much physical presence or activity in a state is sufficient to constitute "substantial nexus" for Commerce Clause purposes.

Quill had also retained title to "a few floppy diskettes" in North Dakota. The Court rejected the diskettes as not establishing substantial nexus, noting that it had previously rejected the "slightest presence" nexus standard in National Geographic Society v. California Board of Equalization, 430 U.S. 551, 97 S.Ct. 1386 (1977). Quill, at p. 1914. The issue then is what beyond slightest presence constitutes "substantial nexus" necessary to satisfy the Commerce Clause. As illustrated below, that issue must be decided on a case-by-case basis.

In the following pre-Quill Supreme Court cases, sufficient

nexus was established by the activities of an out-of-state business's employees or independent contractors in the taxing state:

A Minnesota retailer that sent an unidentified number of traveling salesmen to solicit sales in Iowa established sufficient nexus with and was thus liable for Iowa use tax. General Trading Company v. State Tax Commission of Iowa, 322 U.S. 335, 64 S.Ct. 1029 (1944).

A Georgia retailer established sufficient nexus with Florida when it hired ten non-exclusive salesmen to solicit sales on its behalf in Florida. Scripto, Inc. v. Carson, 362 U.S. 207, 80 S.Ct. 619 (1960).

The presence of one resident employee in Washington was sufficient to subject an out-of-state retailer to Washington tax. The employee consulted with customers in Washington and handled any problems with the taxpayer's products in the State. Standard Pressed Steel Co. v. Washington Dept. of Revenue, 419 U.S. 33, 95 S.Ct. 706 (1975).

Finally, the Court found sufficient nexus where an out-of-state retailer solicited sales in Washington through independent contractors located in Washington. Tyler Pipe Industry v. Washington State Dept. of Revenue, 483 U.S. 251, 107 S.Ct. 2810 (1987).

The issue of substantial nexus has also been much-litigated in

the states since Quill. The following is a sampling of post-Quill state cases:

In Orvis Company v. Tax Appeals Tribunal, 654 N.E.2d 954, (N.Y.), cert denied, 116 S.Ct. 518 (1995), the New York Court of Appeals ruled that Orvis, a Vermont computer company, had sufficient nexus with New York because its nonresident salesmen visited New York customers periodically over a three year audit period. Orvis claimed in affidavits that its salesmen visited New York only 12 times over the 3 year period. The Court rejected those affidavits, however, stating that the evidence suggested "systematic visitation to all of its as many as 19 wholesale customers on the average of four times a year." Orvis, at p. 962.

The Court also held in Orvis that another Vermont-based company, Vermont Information Processing ("VIP"), also had nexus with New York. VIP's employees visited New York approximately 41 times during the audit period to install its products or to handle customer complaints and problems. The Court found that those "visits enhanced sales and significantly contributed to VIP's ability to establish and maintain a market . . . in New York. VIP's activities in New York were, thus, definite and of greater significance than merely a slightest presence . . . ." Orvis, at p. 962.

However, in a post-Orvis New York case, an administrative law judge ruled that substantial nexus was not established by a Virginia company that hired 2 independent contractors to solicit

sales in New York. The company's employees also visited New York approximately 20 times during a 3 year audit period, primarily to attend seminars. In the Matter of NADA Services Corp., DTA No. 810592, State of New York - Division of Tax Appeals, 1996 N.Y. Tax Lexis 45 (1996).

The ALJ viewed the trips by NADA's employees into New York "as inconsequential in effect and/or unrelated to the matter at hand." NADA, at p. 43.

The ALJ conceded that the two independent contractors that periodically solicited sales for NADA in New York were a closer question. He ruled, however, that the nature and totality of NADA's activities in New York "simply was too small and too far removed from petitioner and from the transactions upon which the use tax collection obligation is sought to be imposed, to constitute something 'demonstrably more' than the 'slightest physical presence' in the State." NADA, at p. 46.

In Brown's Furniture, Inc. v. Wagner, 665 N.E.2d 795 (1996), cert. denied, _____ S.Ct. _____ (1996), a Missouri retailer located 15 miles from Illinois advertised extensively in Illinois and made 942 deliveries to customers in Illinois over a 10 month audit period. The retailer had no property or permanent employees in Illinois.

After a careful analysis of Quill and Orvis, the Illinois Supreme Court declared that the Missouri retailer had substantial nexus with Illinois and was thus liable for Illinois tax.

Finally, in Florida Department of Revenue v. Share International, Inc., 667 So.2d 226 (Fla. App. 1 Dist. 1995), two employees of a Texas mail order business advertised the company's products and solicited sales at a three day seminar in Florida once a year for five years. The Florida District Court of Appeals concluded that the employees' activities did not establish substantial nexus with Florida under the Commerce Clause. The issue was certified to the Florida Supreme Court, which affirmed. See, Share International, 676 So.2d 1362 (1996).

Other cases on point are Carapace, Inc. v. Joanne Limbach, Case No. 90-R-825, State of Ohio - Board of Tax Appeals, 1993 Ohio Tax Lexis 950 (1993) (sufficient nexus established by one representative in Ohio that assisted retailers that sold the out-of-state taxpayer's products in Ohio); In re: * * *, Hearing No. 32,349, Comptroller of Public Accounts of the State of Texas, 1995 Tex. Tax Lexis 38 (1995) (Florida computer retailer had sufficient nexus with Texas because it sent its employees into Texas for two or three day training seminars); Care Computer Systems, Inc. v. Arizona Department of Revenue, Docket No. 1049-93-S, Arizona Board of Tax Appeals, 1995 Ariz. Tax Lexis 24 (1995) (nexus not established by 1 salesperson visit into Arizona per year, 21 days of customer training in Arizona per year by nonresident personnel, and 180 transactions in Arizona during the subject period which generated $385,000 in income).

Justice White recognized in Quill that "Reasonable minds

surely can, and will, differ over what showing is required to make out a physical presence adequate" to constitute nexus. Quill, at p. 1921. (White, J., concurring in part and dissenting in part). I do not necessarily agree with Orvis, but using that case and the other cases discussed above as a guideline, I find that the Taxpayer in this case established substantial nexus with Alabama based on its employee's regular and repeated trips into Alabama for business-related activities.

The Taxpayer's employees traveled to Alabama 26 times for direct sales and other revenue-related activities from mid-December 1993 to mid-December 1994, and at least 69 other times from mid-1993 to mid-1994 for consulting, on-site training, and other business-related activities. Those activities were typical of the entire audit period, which translates into approximately 500 business-related trips into Alabama by the Taxpayer's employees over the 6 year audit period. Those trips allowed the Taxpayer to establish and maintain a market for its consulting services and for the use of its tangible products in Alabama. Such extensive in-state activity was "substantial," especially when compared with the other cases cited above in which nexus was found.

Arguably, some of the employee trips into Alabama were not directly related to the training books, videos, and other tangible items that are being taxed. However, transactional nexus is not required. To establish nexus, an out-of-state taxpayer's activities in Alabama need not necessarily be directly related to

the activity or property being taxed. National Geographic Society, at p. 1392.

At least two commentators have argued that nexus is established only if the out-of-state taxpayer has some permanent presence in the state.[3] But while the employees and independent contractors that established nexus in Scripto, Standard Pressed Steel, and Tyler Pipe apparently resided in the taxing state, their permanent in-state residence was not cited as a factor by the Supreme Court, and that Court has not otherwise established permanent in-state presence as a bright-line test for nexus.

To the contrary, nexus was established without a permanent presence in General Trading when a Minnesota company sent traveling salesmen into Iowa to solicit sales. There was also no permanent in-state presence in Orvis or Brown's Furniture. The Court in Share International, at page 230, stated that "The Department correctly notes that the (United States) Supreme Court has never required permanent presence in the state to establish 'substantial

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[3] See, Maryann B. Gall and Rick J. Gibson. "An Exegesis of the Multistate Tax Commission Nexus Guideline: The Physical Presence Requirement." The Tax Executive July - August 1996: 290.

nexus' for purposes of the Commerce Clause."

Continuous or regular activity by an employee in a state may be a factor. But as a practical matter, it is irrelevant whether an employee conducting in-state business for an out-of-state taxpayer also resides in the taxing state. Certainly it was irrelevant whether the Brown's Furniture employees that delivered furniture from Missouri into Illinois lived in Missouri or Illinois. Rather, it is the amount and nature of the business-related activities conducted by the employee in the taxing state on behalf of the out-of-state taxpayer that is determinative. "The test is simply the nature and extent of the activities of the appellant in (the taxing state)." Scripto, at p. 622. Where the employee happens to live is immaterial, or at least not controlling.

The remaining three prongs of the Complete Auto test are also satisfied in this case:

(1) The Alabama use tax is fairly apportioned because a credit is allowed by Alabama if sales tax is paid on the property to another state. Code of Ala. 1975, §40-23-65; D.H. Holmes Co., Ltd. v. McNamara, 486 U.S. 24, 108 S.Ct. 1619 (1988). There is also no evidence that the Taxpayer paid sales or use tax on the subject property to Florida or any other state.

(2) The Alabama use tax does not discriminate against interstate commerce because there is an equal sales tax levied on property sold in Alabama. Code of Ala. 1975, §40-23-2; D.H. Holmes, at p. 1624.

(3) Finally, the tax is fairly related to benefits provided by Alabama. An exact accounting of the services provided by Alabama is not required. Oklahoma Tax Commission v. Jefferson Lines, Inc., 115 S.Ct. 1331, 1345 (1995). Rather, the providing of police, fire, highways, "along with the usual and usually forgotten advantages conferred by the State's maintenance of a civilized society, are justification enough for the imposition of a tax." Jefferson Lines, at p. 1346.

The Taxpayer is liable for Alabama use tax on the materials in issue, and Alabama is not prohibited by the Due Process Clause or the Commerce Clause from requiring the Taxpayer to collect and remit the tax to the Department. The final assessments are accordingly affirmed.

Judgment is entered against the Taxpayer for State use tax of $77,069.39, local cities use tax of $8,723.72, Lauderdale County use tax of $342.16, Marshall County use tax of $250.17, Talladega County use tax of $87.59, and Houston County use tax of $2,688.48, plus applicable interest.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered December 4, 1996.

BILL THOMPSON
Chief Administrative Law Judge