

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 99-09**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Determination of nexus of corporation for sales and use tax and franchise, excise tax.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[THE TAXPAYER] is a retailer of tangible personal property. In the past, the Taxpayer has operated retail stores and sales offices located throughout the United States and Canada, including Tennessee. The Taxpayer has also employed direct salespeople who solicited sales from corporate, government, and educational organizations. These salespeople were based throughout the

country, including in Tennessee, and made sales calls to companies in Tennessee. In addition, the Taxpayer sells its products via mail order and solicits mail order sales primarily through catalogs and other promotional materials that are sent directly to consumers. Mail order sales are also accepted through the Taxpayer's web site. All items sold through the mail order division are delivered to customers by common carrier. All orders are accepted at its corporate headquarters located in another state and are delivered from inventory stored in a warehouse also in another state. The Taxpayer is currently registered with the Department for sales and use, and franchise, excise tax purposes.

The Taxpayer has recently announced plans to close numerous retail stores throughout the country. As a result, the Taxpayer will close the only retail store that it operates in Tennessee. The Taxpayer is attempting to terminate its lease with the landlord of the store prior to the lease's expiration in [DATE]. The Taxpayer may sublease the store if it is unable to come to a termination agreement with the landlord. If a settlement is reached, the Taxpayer intends to terminate the lease immediately.

Prior to the closure of the retail store, the Taxpayer sold its direct sales division effective [DATE]. As a result, the Taxpayer no longer operates a sales office (other than its corporate headquarters in another state) or employs direct salespeople and has not employed direct salespeople or independent sales representatives since [DATE].

With the closure of the retail store, the Taxpayer will no longer have tangible personal property, inventory, employees, independent contractors, real property, business offices, or subsidiaries in Tennessee.

The Taxpayer will continue to operate its mail order business and anticipates that sales into Tennessee may exceed [DOLLAR AMOUNT] annually. However, these mail order sales will be solicited only through catalogs or other promotional mailings or through its web site. All mail order sales will be delivered via common carrier or electronically via the Internet.

ISSUE

Whether, after the closure of the retail store, the Taxpayer will have nexus in Tennessee for sales and use tax, and franchise, excise tax.

RULING

After the closure of the retail store, the Taxpayer will have nexus for sales and use tax and franchise, excise tax if the Taxpayer subleases the retail store. There will be no nexus if the Taxpayer terminates its leases.

ANALYSIS

Tennessee's jurisdiction to impose sales and use and franchise, excise taxes is governed by the Due Process Clause and the Commerce Clause of the United States Constitution as interpreted by the U.S. Supreme Court. These two Constitutional requirements impose distinct limits on the taxing powers of states. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed. 2d 91 (1992).

The Due Process Clause requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," and that the "income attributed to the state for tax purposes must be rationally related to values connected with the taxing State." *Quill Corp.*, 504 U.S. at 308, 112 S.Ct. at 1909 -10 (1992). A tax is rationally related to values connected with the taxing state if the taxpayer's local activities are plainly accorded the protection and services of the taxing state. *Id.* The inquiry is whether the taxing state has given anything, such as fire protection, police protection, protection of state courts, opportunities or benefits, for which it may ask taxes in return. See *Asarco, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103, 73 L.Ed. 2d 787 (1992).

In *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E. 2d 13, 18 (S.C. 1993), *cert. den'd.* 510 U.S. 992, 114 S.Ct. 550, 126 L.Ed. 2d 451 (1993), the court held that, under certain circumstances, the providing of an orderly society in which to do business and earn income from within a state was sufficient to meet the protections and benefits requirement of the Due Process Clause. The nexus requirement of the Due Process Clause can be satisfied if a corporation has purposefully directed its activity at a state's economic forum. *Quill Corp. v. North Dakota*, 504 U.S. 298, 308, 112 S.Ct. 1904, 1910 (1992).

A tax will survive challenge under the Commerce Clause so long as it (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 Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed. 2d 326 (1977).

Sales and Use Tax

The first Due Process requirement is determinative in this case: whether the Taxpayer has connections with Tennessee which are substantial enough to legitimate Tennessee's exercise of power over it. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed. 2d 91 (1992); *National Geographic Society, v. California Bd. of Equalization*, 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977). The determination of nexus is based on the relevant facts and circumstances of a specific taxpayer. The Taxpayer is headquartered outside of Tennessee and upon the closing of the last retail outlet, will have no office, employees, agents, inventory, or other business location in Tennessee.

Shipping in goods by common carrier is insufficient to establish nexus for sales and use tax purposes. *Quill Corp., supra*. Maintaining web sites accessible by Tennessee residents is no different than any other mail order business and would also, absent all other indicators, fail to rise to the level of nexus. Accordingly, once the Taxpayer ceases maintaining a physical location or leasehold interest in Tennessee, it will not longer be required to collect and remit sales tax.

Although the maintenance of a leasehold interest in commercial realty is not a business location that is related to its sale of tangible personal property, the Taxpayer will nonetheless maintain a physical location in Tennessee as long as the lease is in effect. The Supreme Court held that it is not necessary to have a relationship between the in-state presence and the sales activity to establish nexus and justify the imposition of the duty to collect sales and use taxes. *National Geographic Society, v. California Bd. of Equalization*, 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977). Although the taxpayer in *National Geographic* maintained two offices in state that solicited advertising and had no direct involvement with the taxpayer's mail order business, the court held that nexus had been established. *National Geographic Society*, 430 U.S. at 552, 97 S.Ct. at 1388.

The Taxpayer's leasehold interest in real property, whether occupied by the Taxpayer or subleased, provides a sufficient physical presence in Tennessee to give rise to nexus for sales and use tax purposes. Accordingly, if the Taxpayer subleases its retail stores in Tennessee, the Taxpayer will have nexus for sales and use tax purposes.

Franchise, Excise Tax

Tennessee corporate franchise, excise taxes are imposed on corporations for the privilege of doing business in Tennessee in corporate form. Tenn. Code Ann. §§ 67-4-806 and 67-4-903. The term "doing business" was recently defined as "any activity purposefully engaged in, within Tennessee, by any business entity named in §§ 67-4-806 and 67-4-903, with the object of gain, benefit, or advantage, consistent with the intent of the General Assembly to subject such entities to the Tennessee franchise, excise tax" to the extent permitted by state and federal constitutions. Chapter 1092 of Public Acts, 1998. 15 U.S.C. §§ 381-384, better known as Public Law 86-272, limits Tennessee's ability to impose a tax based on income upon corporations, however, when their Tennessee business activities do not go beyond the solicitation of sales of tangible personal property by employees or independent contractors for out-of-state acceptance and shipment.

Assuming the Taxpayer can terminate its lease, the Taxpayer will have no tangible personal property, inventory, employees, real property, or business offices in Tennessee after the closure of the retail store. The Taxpayer will not be doing business in Tennessee within the definition of Chapter 1092 of Public

Acts of 1998. Accordingly, there would be insufficient nexus to require the Taxpayer to remit franchise, excise taxes.

If the Taxpayer subleases its Tennessee realty, however, then the Taxpayer will have business property from which it is deriving business earnings and will be doing business in Tennessee. The maintenance of a sublease of realty in Tennessee is sufficient to establish nexus and provide a basis for subjecting the Taxpayer to franchise, excise taxes.

The nexus determinations of this binding Letter Ruling are based solely on the facts provided; any changes to the underlying facts as stated above may make this Letter Ruling inapplicable.

Caroline R. Krivacka, Tax Counsel

APPROVED: Ruth E. Johnson, Commissioner

DATE: March 17, 1999