BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 15653
[Redacted]	)	
Petitioner	)	DECISION
	)	
	)	

On June 4, 2001, the Tax Discovery Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted]. (hereinafter referred to as "taxpayer" or "[REDACTED]") asserting an Idaho income tax liability in the amount of $2,441 for the 1995, 1997, 1998, and 1999 taxable years. On June 7, 2001, the taxpayer filed a timely appeal and petition for redetermination. An informal conference was requested by the taxpayer and was held on November 27, 2001. The Tax Commission, having reviewed the file, hereby issues its decision upholding the June 4, 2001, Notice of Deficiency Determination.

FACTS AND PROCEDURAL HISTORY

[REDACTED] is a Subchapter S corporation with its principal place of business in [Redacted], Montana. The company publishes, markets, and sells continuing professional education manuals and self-study courses. These manuals are geared towards federal income tax topics. The most widely distributed of these manuals, entitled "Federal Tax Update," provides a detailed discussion of various aspects of the federal income tax laws. The Federal Tax Update manual is marketed to Certified Public Accountants and other tax practitioners as a useful and in-depth resource manual. The company also specifically markets its products to sponsors of continuing professional education (CPE) courses. Sponsors of these courses include state bar associations, state CPA societies, and real estate professional organizations.

In conjunction with its CPE manuals, the taxpayer also offers a variety of continuing professional education seminars. The purpose of the seminar is to provide live training and instruction on the materials discussed in the manual. Although not entirely clear from the information that has been presented to the Commission, it appears that the seminars are conducted by a variety of individuals, most of whom are independent representatives of [REDACTED]. The seminars are held in-person. Therefore, if a seminar is held in Boise, Idaho, the taxpayer will have one or more of its representatives in Boise to conduct the seminar.

In most cases, the seminar will include a short presentation by [Redacted] presentation is designed to give a very general overview of the materials contained in the CPE manual.

As indicated above, the CPE manuals offered by the taxpayer can be purchased either as a stand-alone "self-study" CPE course, or in conjunction with a CPE seminar. The record before the Tax Commission does not indicate how much the taxpayer charges for the Federal Tax Update manual, or any of the other CPE manuals it offers, when purchased as a stand-alone product. However, the price charged for the Federal Tax Update manual when sold in conjunction with the seminar ranges between $100 to $220. For example, in its most recent pricing policy (2001 – 2002 Pricing Policy) the company charged $109 per Federal Tax Update manual if ordered in connection with a 1-day seminar, and $218 per manual if ordered in connection with a 2-day seminar. [Redacted] solicits its products through the mail, and the products are then shipped to the customer or to the CPE sponsor via U.S. mail or UPS. In those cases where the manual is sold in conjunction with a CPE seminar, the CPE sponsors will either provide the manual as part of the cost of the continuing education course, or sell it separately to the course participants.

During the years under review (1995 through 1999) the taxpayer would normally conduct two or three seminars per year in Idaho. According to the taxpayer, the company was physically within Idaho for the purpose of conducting CPE seminars for the following number of days during 1995 through 1999:

1995	3 days
1996	0 days
1997	4 days
1998	5 days
1999	6 days

Based on federal income tax information obtained from the Internal Revenue Service, the Tax Discovery Bureau was able to estimate the amount of the taxpayer's net income that was attributable to Idaho under the Idaho version of the Uniform Division of Income for Tax Purposes Act. See Idaho Code § 63-3027. The Notice of Deficiency Determination that is the subject matter of this administrative protest was then issued based on this estimated tax liability.

ISSUES PROTESTED

In the letter of protest and subsequent Brief in Support of Protest filed on behalf of the taxpayer, three issues have been raised. Those issues are:

1. Nexus with the state of Idaho. [REDACTED] asserts that its physical activity in Idaho is *de minimis* and not sufficient to create nexus with the state under the standard established in Quill Corp. v. North Dakota.

2. Taxable event. [REDACTED] asserts that "no taxable event" has occurred within Idaho from which an income tax filing requirement can be imposed.

3. Lack of uniform application. [REDACTED] asserts that the Idaho State Tax Commission is not applying the income tax statutes in a uniform manner since the Commission does not assert the Idaho income tax against lawyers, CPAs, and other professionals that enter Idaho for business purposes for only a few days during the year.

This Decision will address each of these arguments in turn.

ANALYSIS

A. Nexus with the State of Idaho.

Under the Due Process Clause and the Commerce Clause of the United States Constitution, a taxpayer must have certain minimum contacts or connections with a state before that taxpayer is required to obey the laws, including the tax laws, of that state. This minimum connection is often referred to as "nexus." In many cases it is relatively easy to determine if the required nexus exists. For example, a corporation that has a warehouse or a manufacturing plant within a state will undoubtedly have nexus and, as a result, will be required to comply with the corporate income tax laws, income tax withholding laws, and other tax laws of the state. There are also easy cases on the other extreme where it is clear that no nexus exists. As an example, a company that does not manufacture, market, or sell any of its products or services within a state will not have nexus and will not be required to comply with the tax laws of that state. The present administrative protest falls somewhere in between. While [REDACTED] does not have a warehouse or permanent facility within Idaho, it does sell its products and services to Idaho customers. The first issue raised by [REDACTED] is whether this activity gives it sufficient nexus to require it to file a corporate income tax return.

[REDACTED] argues that this case is controlled by the "physical presence" nexus standard set out in <u>Quill Corp. v. North Dakota</u>, 504 U.S. 298, 112 S.Ct. 1904 (1992). In <u>Quill</u> the United States Supreme Court held that Quill Corporation was not required to collect North Dakota sales or use tax on products it sold to North Dakota customers because Quill had no physical presence within the state of North Dakota during the taxable periods under review. In reaching that holding the Court first determined that the minimum connection required under the

Due Process Clause and the Commerce Clause were not necessarily the same. According to the Court, "although we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct." Quill at 305, 112 S.Ct. at 1909. "Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connection with a State are substantial enough to legitimate the State's exercise of power over him. . . . In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." Id. at 312, 112 S.Ct. at 1913. Thus, under the Due Process Clause, the focus is on whether the taxpayer has directed his activities at the taxing state so that it is reasonable and fair to require that taxpayer to comply with the state's tax laws. Physical presence of the taxpayer within the taxing state is not a requirement under the Due Process test. "[I]f a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's *in personam* jurisdiction even if it has no physical presence in the State." Id. at 307, 112 S.Ct. at 1910. The Court then went on to find that "there is no question that Quill has purposefully directed its activities at North Dakota residents [and] that the magnitude of those contacts are more than sufficient for due process purposes . . . ." Id. at 308, 112 S.Ct. at 1911.

After determining that Quill Corporation had sufficient nexus with North Dakota for Due Process purposes, the Court then turned its attention to the Commerce Clause requirement. The Commerce Clause is an express grant to Congress to regulate commerce between the various states. See U.S. Const., Art. I, § 8, cl. 3 ("The congress shall have power . . . To regulate commerce . . . among the several states . . . ."). However, under the so-called "dormant" or "negative" Commerce Clause, the U.S. Supreme Court has determined that there are certain limits placed on state laws even when Congress has not affirmatively acted. In other words, the Commerce Clause by its own force provides certain limits on the ability of the several States to impose laws that affect interstate commerce. With respect to state tax laws, the United States Supreme Court, in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076 (1977), established a four part test that is used to determine the validity of a state tax under the dormant Commerce Clause. The first prong of the Complete Auto Transit four-part test requires that the state tax must be applied to a taxpayer or taxable activity that has a "substantial nexus" with the taxing state. The remaining three parts of the Complete Auto Transit test are that the tax must be fairly apportioned, must not discriminate against interstate commerce, and must be fairly related to the services provided by the state. Id. at 279, 97 S.Ct. at 1079.

While Complete Auto Transit sets out the current analysis used to determine if a state tax will be valid under the dormant Commerce Clause, it is important to note that the sweep of the Supreme Court's dormant Commerce Clause jurisprudence has changed significantly over the years. Because the history of the Supreme Court's dormant Commerce Clause jurisprudence is important in understanding the purpose (and the limits) of the Court's holding in Quill, the Court's discussion of that history is set out at length below:

> Our interpretation of the "negative" or "dormant" Commerce Clause has evolved substantially over the years, particularly as that clause concerns limitations on state taxation powers. Our early cases, beginning with *Brown v. Maryland*, 12 Wheat. 419 (1827), swept broadly, and in *Leloup v. Port of Mobile*, 127 U.S. 640, 648 (1888), we declared that "no State has the right to lay a tax on interstate commerce in any form." We later narrowed that rule and distinguished between direct burdens on interstate commerce, which were prohibited, and indirect burdens, which generally were not. *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 256-258 (1938), and subsequent decisions rejected this formal, categorical analysis and adopted a "multiple-taxation doctrine" that focused not on whether a tax was "direct" or "indirect" but rather on

> whether a tax subjected interstate commerce to a risk of multiple taxation. However, in *Freeman v. Hewit*, 329 U.S. 249, 256 (1946), we embraced again the formal distinction between direct and indirect taxation, invalidating Indiana's imposition of a gross receipts tax on a particular transaction because that application would "impos[e] a direct tax on interstate sales." Most recently, in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 285 (1977), we renounced the *Freeman* approach as "attaching constitutional significance to a semantic difference." We expressly overruled one of *Freeman's* progeny, *Spector Motor Service, Inc. v. O'Connor*, 340 U.S. 602 (1951), which held that a tax on "the privilege of doing interstate business" was unconstitutional, while recognizing that a differently denominated tax with the same economic effect would not be unconstitutional. *Spector*, as we observed in *Railway Express Agency, inc. v. Virginia*, 358 U.S. 434, 441 (1959), created a situation in which "magic words or labels" could "disable an otherwise constitutional levy." *Complete Auto* emphasized the importance of looking past "the formal language of the tax statute [to] its practical effect," and set forth a four-part test that continued to govern the validity of state taxes under the Commerce Clause.

Quill at 309-310, 112 S.Ct. at 1911-1912 (citations and footnotes omitted).

After discussing this convulsive history of the Court's dormant Commerce Clause jurisprudence, the Supreme Court then went on to determine that one of its prior cases, National Bellas Hess v. Illinois, 386 U.S. 753, 87 S.Ct. 1389 (1967), was consistent with the Court's current jurisprudence. In Bellas Hess the state of Illinois had attempted to impose a sales and use tax collection responsibility on an out of state mail-order seller that had no physical presence within Illinois other than the use of the postal service or common carriers to deliver its products to its Illinois customers. In striking down the Illinois law, the Supreme Court held that it was impermissible for a state to "impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States Mail." Bellas Hess at 758, 87 S.Ct. at 1392. As a result, for purposes of imposing a sales or use tax collection responsibility on an out of state seller, Bellas Hess established that something more than delivery via the U.S. mails or common carrier was necessary. In effect, Bellas Hess established a safe-harbor rule for mail order sellers. So long as the seller's only connection within the taxing state was the delivery of its products by common carrier or the United States mail, that seller would not be required to collect or remit sales or use tax on those sales.

In Quill the U.S. Supreme Court recognized and revitalized the safe harbor rule established in Bellas Hess. In so doing the Court commented that "[l]ike other bright-line tests, the *Bellas Hess* rule appears artificial at its edges: Whether or not a State may compel a vendor to collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant, or office." Id. at 315, 112 S.Ct. at 1914. The Court then went on to hold:

> This artificiality, however, is more than offset by the benefits of a clear rule. Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes. . . .
>
> Moreover, a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals. Indeed, it is not unlikely that the mail-order industry's dramatic growth over the last quarter-century is due in part to the bright-line exemption from state taxation created in *Bellas Hess.*

Id. at 315-316, 112 S.Ct. at 1915. After discussing the benefits of the bright-line rule established in Bellas Hess, the Court in Quill found that because "the *Bellas Hess* rule has engendered substantial reliance and has become part of the basic framework of a sizable industry," it was unwise and unnecessary to overrule that case. Id. at 317, 112 S.Ct. at 1915-1916. The Court also emphasized that Congress, through its affirmative Commerce Clause powers, was in a much better position to decide the continuing utility of the Bellas Hess safe harbor rule. Id. at 318, 112 S.Ct. at 1916. In any event, because the Bellas Hess safe harbor still applied, the opinion of the North Dakota Supreme Court (which had held that Bellas Hess was no longer good law) was overruled.

From its context, it is clear that the Supreme Court's holding in Bellas Hess and Quill are limited only to sales and use tax collection cases. Neither of those cases purport to establish a safe-harbor nexus standard for income tax or other tax types. In fact, in Quill the Court specifically stated that "concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement." Quill at 317, 112 S.Ct. at 1916. Under the Court's current dormant Commerce Clause jurisprudence, a corporation with no physical presence in a state could still be found to have substantial nexus with that state. The inquiry is not limited to just the company's physical contacts within the forum state. See Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E.2d (S.C. 1993), *cert. denied*, 114 S.Ct. 550 (1993) (use of an intangible trademark and trade name within the state was sufficient to create substantial nexus.). All of its activity, to the extent it is focused on creating and maintaining a market for its products and services within the state, are to be considered. It is this idea of "in-state market exploitation" that is the touchstone in the Supreme Court's more recent non-use tax cases. See Standard Press Steel Co. v. Dep't of Revenue, 419 U.S. 560, 562, 95 S.Ct. 706, 708 (1975) (use of a single in-state employee "with a full-time job within the State, made possible the realization and continuance of valuable contractual relations between [the taxpayer] and Boeing."); Tyler Pipe Indus., Inc. v. Washington Dep't of Revenue, 483 U.S. 232, 250, 107 S.Ct. 2810, 2821 (1987) ("As the Washington Supreme Court determined, '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 . . . .'"). See also State v. Quantex Mirosystems, Inc., 809 So.2d 246, 251 (La. Ct. App. 2001) ("the crucial factor governing nexus is whether the activities performed in the taxing state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in the taxing state."). See generally, Fatale, State Tax Jurisdiction and the Mythical "Physical Presence" Constitutional Standard, 54 Tax Lawyer 105, 109 (Fall 2000).

Fortunately, we do not have to decide today whether this administrative protest represents a case where a corporation with no physical presence in Idaho nonetheless has substantial nexus with this state for purposes of the dormant Commerce Clause. In the present case there is no question that [REDACTED] had physical presence within Idaho through the CPE seminars that it conducted.[1] The real issue is whether the activities of [REDACTED] that are directed at establishing and maintaining its Idaho market, when taken as a whole, constitute a substantial nexus with this state.

Determining whether a company's Idaho-directed activities are sufficient to satisfy the substantial nexus prong of the Complete Auto Transit four-part test is not an easy challenge. It is important to look not only at the quantity of the company's activities that are directed towards Idaho, but also the quality of those activities. In the present case the analysis is made more difficult because the Tax Commission does not have a complete picture of [REDACTED]'s overall business activities or even of its Idaho business activities. For example, it is not entirely clear how many seminars the taxpayer puts on throughout the country in any given years. Therefore, it is difficult to compare the two or three seminars conducted in Idaho with the total number of seminars conducted everywhere. It is also not known how many representatives [REDACTED] sends to Idaho for each seminar. While it appears that the President of the

[1] Although not raised as an issue, it is also worth noting that the activities of the [REDACTED] representative who put on the seminars within Idaho are non-protected activity under federal Public Law 86-272 (codified at 15 U.S.C. § 381). As a result, the protection of that Public Law is not available. See Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272, Part IV.A. (3rd revision, adopted 7/27/2001) (listing examples of non-protected activities under Public Law 86-272).

Corporation will normally provide a short presentation at each seminar, it is unclear how many other officers or agents of [REDACTED] are engaged in putting on a seminar. The record before the Tax Commission also fails to reflect how many of the CPE manuals [Redacted] has actually sold to Idaho CPE providers or other Idaho customers during the years under review, or how this compares with its overall volume of manuals sold.

These limitations in the factual record notwithstanding, it is clear to the Commission that [Redacted] has affirmatively directed its activities towards establishing and maintaining a market for its products and services within Idaho. While there is no doubt that Idaho is not one of [Redacted]'s most exploited markets, the company does come into Idaho to put on two or three seminars per year, and has at least one representative within this state for that purpose for between three and six days per year. This in-state activity is directly connected with developing and maintaining an economic market for its products and services in Idaho. Contrary to the assertions of the taxpayer in its Brief in Support of Protest, the Tax Commission is not inclined to view this activity as random or *de minimis*. Rather, the Commission believes that the two or three seminars that take place in Idaho represent an important and systematic exploitation of the Idaho market. Therefore, the Tax Commission hereby finds that the taxpayer's activities directed toward establishing and maintaining its Idaho market is sufficient to constitute a substantial nexus with this state.

The first prong of the four-part Complete Auto Transit test has been met. [Redacted] has a substantial nexus with the state of Idaho during each of the 1995, 1997, 1998, and 1999 taxable years. Since the taxpayer has not raised an issue with respect to any of the other three parts of the Complete Auto Transit test, the Commission will not address those other prongs in this Decision.

2. Lack of any Taxable Event.

According to the Brief in Support of Protest that was filed on behalf of the taxpayer, [Redacted] does not conduct an "income taxing event" in Idaho. It is not clear what this means. Apparently the taxpayer is arguing that since none of the research and writing of the CPE manuals took place in Idaho, Idaho cannot tax the profits from the sale of those manuals. This is not a valid argument. [Redacted] derives income from its <u>business operations</u>. Researching and writing the CPE manuals is only part of the taxpayers overall business operations. TEN also markets and sells those manuals, and performs services designed to educate those attending the CPE seminars on the substance of the materials contained within those manuals. The question is whether Idaho is constitutionally and statutorily able to tax a fairly apportioned share of the company's business income.

Because [Redacted] made sales of its CPE manuals to Idaho customers in 1995, 1997, 1998, and 1999, and conducted CPE seminars within Idaho during those years, the company had an Idaho apportionment factor in each of those years under the Idaho version of the Uniform Division of Income for Tax Purposes Act. <u>See</u> Idaho Code § 63-3027. Therefore, there is some business activity (measured by payroll, property, and sales) taking place in Idaho during those taxable years. Under Idaho law, this business activity is sufficient to require [Redacted] to file an Idaho corporate income tax return. <u>See</u> Idaho Code § 63-3030(4) (setting forth the requirement that every S corporation "which is transacting business in this state, or is authorized to transact business in this state" is required to file an Idaho income tax return.) Having filed no Idaho income tax returns, it was entirely appropriate for the Tax Discovery Bureau to issue the Notice of Deficiency Determination that is the subject matter of this administrative protest.

3. Lack of Uniform Application.

The final issue raised in this protest centers on the taxpayer's apparent belief that the Idaho State Tax Commission is not auditing similarly situated taxpayers. Although not entirely clear, it appears that the taxpayer is arguing that the Tax Commission cannot tax [Redacted], President of [Redacted], on income derived from the lectures he conducts within Idaho since the Commission does not uniformly assert the Idaho income tax on other non-resident professionals that come into Idaho to perform services. This argument misses the mark both factually and legally. First, the Notice of Deficiency Determination is not asserting tax against [Redacted] for his personal services conducted within Idaho. Rather, deficiency notice was issued to [Redacted]. and asserted a corporate income tax liability based on that company's Idaho business activities during 1995, 1997, 1998, and 1999. Whether [Redacted] also has an Idaho income tax filing requirement is a separate issue.

Second, the Tax Commission has consistently held that nonresident individuals who earn income from services performed within this state in excess of the minimum filing amount must file an Idaho individual income tax return. See Income Tax Administrative Rule 270, IDAPA 35.01.01.270. In addition, the Tax Commission has consistently taken the position that corporations that engage in business within Idaho and that have income attributable to Idaho under Idaho Code § 63-3027 must file an Idaho corporate income tax return unless protected by federal Public Law 86-272 or a similar federal law. Simply put, there is no merit to the taxpayer's argument that the Tax Commission is not uniform in its application of the tax laws of this state.

CONCLUSION

It was the taxpayer's position throughout this administrative protest that it was not required to file Idaho corporate income tax returns for any of the years under review. As set out above, the Tax Commission disagrees. Furthermore, there has been no showing that the amount of tax calculated by the Commission's audit staff was in error. As a result, the Tax Commission has no alternative but to uphold the Notice of Deficiency Determination as issued. See Albertson's, Inc. v. State, Dept. of Revenue, 106 Idaho 810, 814, 683 P.2d 846, 850 (1984) (The burden of proof is on the taxpayer to prove that the decision of the Tax Commission is incorrect.); Parsons v. Idaho State Tax Commission, 110 Idaho 572, 574-575 n.2, 716 P.2d 1344, 1346-1347 n.2 (Ct. App. 1986) (a State Tax Commission deficiency notice is presumed to be correct and the burden is on the taxpayer to show that the deficiency is erroneous).

WHEREFORE, the Modified Notice of Deficiency Determination dated June 4, 2001, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following taxes, penalty, and interest:

Period	TAX	PENALTY	INTEREST	TOTAL
1995	$430	$108	$211	$749
1997	388	97	124	609
1998	274	69	68	411
1999	546	137	94	777
TOTAL AMOUNT DUE				$2,546

Interest is calculated through June 30, 2002, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is enclosed with this decision.

DATED this ______ day of ____________________, 2002.

IDAHO STATE TAX COMMISSION

____
COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of ________________, 2002, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No. [Redacted]

____
ADMINISTRATIVE ASSISTANT 1