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NO. 37516-8-11

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COURT OF APPEALS
DIVISION II
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STATE OF WASHINGTON
BY CM
DEPUTY

COURT OF APPEALS,
DIVISION II
OF THE STATE OF WASHINGTON

LAMTEC CORPORATION,

Appellants,

v.

DEPARTMENT OF REVENUE OF THE STATE OF WASHINGTON,

Respondent.

STATEMENT OF ADDITIONAL AUTHORITIES

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ORIGINAL

Lamtec submits the following statement of additional authorities under RAP 10.8:

1. *Association of Washington Business v. State of Washington Dep't of Revenue*, 155 Wn.2d 430, 120 P.3d 46 (2005) (attached) (Department of Revenue's interpretative rules are not binding on the Court). This case is offered for issues of whether the Department of Revenue (the "Department") may impose Washington B&O tax on Lamtec, and whether doing so violates the Commerce Clause.

2. Public Law 86-272. A photocopy is attached, but because it is difficult to read, it is quoted here in relevant part:

Sec. 101. (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the state; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such

solicitation are orders described in paragraph (1).

(b) The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to-

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) For purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

This is a statement of Congress's intention to limit the imposition of income tax. This statute is offered as persuasive authority because, by analogy, it addresses whether Lamtec has a sufficient nexus with Washington to impose B&O tax.

3. *Dell Catalog Sales, L.P. v. Commissioner of Revenue Services*, 834 A.2d 812 (2003) (attached). This case is offered as persuasive authority because it addresses the issue of whether Lamtec has a sufficient nexus with Washington to impose B&O tax.

4. *J.C Penney National Bank v. Johnson*, 19 S.W.3d 831 (2000) (attached). This case is offered as persuasive authority because it addresses the issue of whether Lamtec has a sufficient nexus with Washington to impose B&O tax.

RESPECTFULLY SUBMITTED 20th day of March, 2009.

Respectfully submitted,

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Respectfully submitted,

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Westlaw

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Supreme Court of Washington,
 En Banc.
 ASSOCIATION OF WASHINGTON
 BUSINESS, Petitioner,
 v.
 STATE OF WASHINGTON, DEPART-
 MENT OF REVENUE, Respondent.
 No. 75623-6.

Argued May 17, 2005.
 Decided Sept. 22, 2005.

Background: Association sought declaratory and injunctive relief to invalidate three of the State Department of Revenue's tax code rules. The Superior Court, Thurston County, Gary Tabor, J., granted relief and invalidated the three rules. The Court of Appeals, 121 Wash.App. 766, 90 P.3d 1128, reversed. Association petitioned for review.

Holding: The Supreme Court, Sanders, J., held that Department of Revenue had authority to adopt interpretive regulations explaining specific sections of tax code.

Affirmed as modified.

Alexander, C.J., filed a concurring opinion in which Chambers and J.M. Johnson, JJ., joined.

West Headnotes

[1] Administrative Law and Procedure
15A ↪390.1

15A Administrative Law and Procedure
 15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
 15AIV(C) Rules and Regulations

15Ak390 Validity

15Ak390.1 k. In General.
 Most Cited Cases
 The Supreme Court may declare an agency rule invalid if it: (1) violates constitutional provisions, (2) exceeds statutory authority of the agency, (3) was adopted without compliance to statutory rule-making procedures, or (4) is arbitrary and capricious.

[2] Administrative Law and Procedure
15A ↪797

15A Administrative Law and Procedure
 15AV Judicial Review of Administrative Decisions
 15AV(E) Particular Questions, Review of
 15Ak797 k. Legislative Questions; Rule-Making. Most Cited Cases
 Determining the extent of an agency's rule-making authority is a question of law which is reviewed de novo.

[3] Administrative Law and Procedure
15A ↪305

15A Administrative Law and Procedure
 15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
 15AIV(A) In General
 15Ak303 Powers in General
 15Ak305 k. Statutory Basis and Limitation. Most Cited Cases

Administrative Law and Procedure 15A
↪325

15A Administrative Law and Procedure
 15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
 15AIV(A) In General
 15Ak325 k. Implied Powers. Most Cited Cases
 Administrative agencies have those powers

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expressly granted to them and those necessarily implied from their statutory delegation of authority.

[4] Administrative Law and Procedure
15A ◊325

15A Administrative Law and Procedure
 15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
 15AIV(A) In General
 15Ak325 k. Implied Powers.
 Most Cited Cases

Agencies have implied authority to carry out their legislatively mandated purposes; when a power is granted to an agency, everything lawful and necessary to the effectual execution of the power is also granted by implication of law.

[5] Administrative Law and Procedure
15A ◊325

15A Administrative Law and Procedure
 15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
 15AIV(A) In General
 15Ak325 k. Implied Powers.
 Most Cited Cases

Implied authority is found where an agency is charged with a specific duty but the means of accomplishing that duty are not set forth by the Legislature, and agencies have implied authority to determine specific factors necessary to meet a legislatively mandated general standard.

[6] Taxation 371 ◊3635

371 Taxation
 371IX Sales, Use, Service, and Gross Receipts Taxes
 371IX(B) Regulations
 371k3635 k. Administrative Agencies and Regulation. Most Cited Cases

State Department of Revenue had authority to adopt interpretive regulations explaining specific sections of tax code; statutes authorized department to make and publish rules of procedure and legislative rules, and since department was charged with enforcing the tax code, it had the authority to interpret it. West's RCWA 34.05.230(1), 42.17.250, 82.01.060(2), 82.32.300.

[7] Administrative Law and Procedure
15A ◊386

15A Administrative Law and Procedure
 15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
 15AIV(C) Rules and Regulations
 15Ak385 Power to Make
 15Ak386 k. Statutory Basis.
 Most Cited Cases

An agency charged with the administration and enforcement of a statute may interpret ambiguities within the statutory language through the rule making process.

[8] Administrative Law and Procedure
15A ◊325

15A Administrative Law and Procedure
 15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
 15AIV(A) In General
 15Ak325 k. Implied Powers.
 Most Cited Cases

Legislative authorization for an agency to interpret the law under which the agency operates and to make known to the public its interpretation of that law is normally implied from the powers expressly granted to the agency by the legislature.

[9] Administrative Law and Procedure
15A ◊416.1

15A Administrative Law and Procedure
 15AIV Powers and Proceedings of Ad-

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ministrative Agencies, Officers and Agents
 15AIV(C) Rules and Regulations
 15Ak416 Effect
 15Ak416.1 k. In General.
 Most Cited Cases
 Legislative rules **bind** the court if they are within the agency's delegated authority, are reasonable, and were adopted using the proper procedure; interpretive rules, however, are not **binding** on the courts at all.

[10] Administrative Law and Procedure
15A ↪416.1

15A Administrative Law and Procedure
 15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
 15AIV(C) Rules and Regulations
 15Ak416 Effect
 15Ak416.1 k. In General.
 Most Cited Cases
 Interpretive rules are not **binding** on the public, and they serve merely as advance notice of the agency's position should a dispute arise and the matter results in litigation; the public cannot be penalized or sanctioned for breaking them, and they are not **binding** on the courts and are afforded no deference other than the power of persuasion.

[11] Administrative Law and Procedure
15A ↪382.1

15A Administrative Law and Procedure
 15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
 15AIV(C) Rules and Regulations
 15Ak382 Nature and Scope
 15Ak382.1 k. In General.
 Most Cited Cases
 An agency's interpretive rules are not required to clearly state they are interpretive.

[12] Statutes 361 ↪223.1

361 Statutes
 361VI Construction and Operation
 361VI(A) General Rules of Construction
 361k223 Construction with Reference to Other Statutes
 361k223.1 k. In General. Most Cited Cases
 The later statute governs when two statutes conflict.
 **47 Franklin G. Dinces, Gig Harbor, Geoffrey P. Knudsen, Seattle, for Petitioner.

Donald F. Cofer, Attorney General's Ofc./Revenue Div., Maureen Hart, Jeffrey David Goltz, Olympia, for Respondent.

SANDERS, J.

*434 ¶ 1 The Association of Washington Business (AWB) seeks reversal of a published Court of Appeals opinion holding the Department of Revenue (DOR) has the inherent authority to issue nonbinding interpretive rules. We hold DOR has that authority, and we define the purpose and scope of interpretive rules.

FACTS AND PROCEDURAL HISTORY

¶ 2 In April 2001 AWB filed a lawsuit in Thurston County Superior Court challenging three DOR regulations published in the **Washington Administrative Code (WAC)**. AWB alleged the regulations ^{FN1} were invalid because DOR did not have the statutory authority to adopt them. Specifically, AWB alleged the regulatory reform act of 1995 revoked DOR's rule making authority under RCW 82.01.060 and that RCW 82.32.300 did not authorize interpretive rules. RCW 82.32.300 is the cited statutory authority for the WACs at issue. AWB prayed for a declaratory judgment

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that RCW 82.32.300 does not grant DOR the authority to issue the three WACs, that the WACs are invalid, and it sought an injunction to prevent DOR from adopting any other interpretive rules under that statute.

FN1. The three WACs are: (1) WAC 458-20-238 (sale of watercraft to nonresidents), (2) WAC 458-20-136 (manufacturing, processing for hire, fabricating), and (3) WAC 458-20-13601 (sales and use exemption for machinery and equipment).

¶ 3 DOR admitted the three rules are interpretive as defined by RCW 34.05.328(5)(c)(ii).^{FN2} It admitted adopting or amending the three rules after the effective date of the *435 regulatory reform act of 1995 (July 23, 1995) and that RCW 82.32.300 is the only statutory authority cited for the rules, but denied it is the *only* statutory authority. The other primary statutes DOR claims support its authority are RCW 82.01.060 and RCW 82.32A.010.

FN2. RCW 34.05.328(5)(c)(ii) provides: "An 'interpretive rule' is a rule, the violation of which does not subject a person to a penalty or sanction, that sets forth the agency's interpretation of statutory provisions it administers."

¶ 4 The superior court held a hearing in 2002 at which AWB presented testimony that the public was misled by DOR into believing the rules were **binding** rather than merely interpretive. Two officers of AWB, Thomas Dooley and Michael Bernard, testified of their belief, induced by DOR, the three WACs had the force and effect of law. Bernard in particular said he would have challenged the rules in department ap-

peals processes and claimed larger exemptions had he known the rules were non-binding.

¶ 5 The court issued an oral ruling. The court clarified that it was not ruling on the **48 question of whether the rules accurately reflected the underlying statutes. The court ruled that DOR had the authority to issue rules under RCW 82.32.300, but not nonbinding interpretive rules. The court determined the rules impaired the rights of AWB since the rules were nonbinding but were still called "rules" and found the rules misleading because other avenues existed to inform the public of the department's interpretation of statutes.

¶ 6 The court made the following findings of fact:

1. The Association of Washington Business contested the Department of Revenue's authority to adopt three rules, WAC 458-20-136, WAC 458-20-13601 and WAC 458-20-238, "the Rules".

2. The Department of Revenue argues to the Court that the Rules do not and are not intended to have the force of law because the Department believed the rules are interpretive rules.

3. The Rules are for nonbinding informational purposes only. The Rules do not have the force of law.

4. The public has been misled by prelitigation, Department of Revenue actions to believe that the Rules have the force of law.

*436 5. The Plaintiff, and its members, have been substantially prejudiced by the adoption of the Rules and the Department of Revenue's prelitigation actions.

6. The Rules and their applications improv-

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erly interfere with and/or impair the legal rights of Plaintiff and its members.

7. Plaintiff has proved that it and its members have standing to challenge the Department of Revenue's authority to adopt the Rules.

Clerk's Papers (CP) at 80. The court also entered the following conclusions of law:

1. This Court has jurisdiction over the Parties and the claims decided herein under RCW 34.05.514 and RCW 34.05.570(2). In the alternative, this Court would have jurisdiction to decide this matter under RCW 34.05.514 and RCW 34.05.570(4) or The Declaratory Judgment Act, RCW 7.24.

2. Paragraph two of RCW 82.32.300 provides certain authority to the Department of Revenue to adopt rules having the force of statutory law.

3. RCW 82.32.300 does not provide authority to adopt rules that are for nonbinding informational purposes that lack the force of law.

4. The Department of Revenue lacks authority to adopt rules that are for nonbinding informational purposes if the rules do not expressly inform the public of their nonbinding nature and purpose.

5. The Court expresses no opinion whether the Department of Revenue has the authority to adopt rules that are for nonbinding informational purposes if the rules do expressly inform the public of their nature and purpose.

6. The Department of Revenue lacks the authority to lead the public to believe that a nonbinding informational rule has the force of law.

7. Any finding of fact that is more properly

characterized as a conclusion of law shall be considered to be included herein.

8. The Court hereby incorporates its oral ruling of October 3, 2002.

CP at 80-81. The court entered judgment in favor of AWB and declared the three rules invalid. DOR appealed.

*437 ¶ 7 The Court of Appeals reversed in a published opinion. *Ass'n of Wash. Bus. v. Dep't of Revenue*, 121 Wash.App. 766, 90 P.3d 1128 (2004). The court held DOR has the inherent authority to adopt interpretive rules and that interpretive rules do not need to state they are interpretive. *Id.* at 772, 775, 90 P.3d 1128. The court refused to opine on DOR's misrepresentations of the rules as **binding**, saying that interpretive rules are **binding** on the public. *Id.* at 774-75, 90 P.3d 1128. Further, even if the rules were misrepresented as law, that is not a sufficient reason to invalidate the rules under the statute. *Id.* at 775-76, 90 P.3d 1128.

¶ 8 AWB petitioned this court for review, which we granted.

**49 STANDARD OF REVIEW

[1][2] ¶ 9 The party challenging a rule has the burden to prove it is invalid. RCW 34.05.570(1)(a); *Wash. Pub. Ports Ass'n v. Dep't of Revenue*, 148 Wash.2d 637, 645, 62 P.3d 462 (2003). "This court may declare an agency rule invalid if it: (1) violates constitutional provisions, (2) exceeds statutory authority of the agency, (3) was adopted without compliance to statutory rule-making procedures, or (4) is arbitrary and capricious." *Id.* at 645, 62 P.3d 462 (citing RCW 34.05.570(2)(c)). "Determining the extent of DOR's rule-making authority is a question of law"

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which is reviewed de novo. *Id.* AWB only alleges the rules exceed DOR's statutory authority.

1382 (quoting *State ex rel. Puget Sound Navigation Co. v. Dep't of Transp.*, 33 Wash.2d 448, 481 206 P.2d 456 (1949)).

ANALYSIS

I. DOR Has the Authority to Adopt Interpretive Regulations

[3][4][5][6] ¶ 10 "Administrative agencies have those powers expressly granted to them and those necessarily implied from their statutory delegation of authority." *Tuerk v. Dep't of Licensing*, 123 Wash.2d 120, 124-25, 864 P.2d 1382 (1994) (citing *438 *Municipality of Metro. Seattle v. Pub. Employment Relations Comm'n*, 118 Wash.2d 621, 633, 826 P.2d 158 (1992)).^{FN3} DOR argues it has both express and implied authority to adopt interpretive rules, citing various statutes to support its position.

FN3. *Tuerk* also lists general rules on agency authority that are helpful:

Agencies have implied authority to carry out their legislatively mandated purposes. When a power is granted to an agency, "everything lawful and necessary to the effectual execution of the power" is also granted by implication of law. Likewise, implied authority is found where an agency is charged with a specific duty, but the means of accomplishing that duty are not set forth by the Legislature. Agencies also have implied authority to determine specific factors necessary to meet a legislatively mandated general standard.

123 Wash.2d at 125, 864 P.2d

A. RCW 82.32.300 and Its Proper Interpretation

¶ 11 The first statute is RCW 82.32.300, which reads in relevant part:

The administration of this and chapters 82.04 through 82.27 RCW of this title is vested in the department of revenue which shall prescribe forms and *rules of procedure* for the determination of the taxable status of any person, for the making of returns and for the ascertainment, assessment and collection of **taxes** and penalties imposed thereunder.

The department of revenue shall make and publish *rules and regulations*, not inconsistent therewith, *necessary to enforce* provisions of this chapter and chapters 82.02 through 82.23B and 82.27 RCW, *...which shall have the same force and effect as if specifically included* therein, unless declared invalid by the judgment of a court of record not appealed from.

(Emphasis added.) The first paragraph clearly grants DOR the authority to adopt rules of procedure, which are not at issue here. The second paragraph refers to legislative rules.^{FN4} Legislative rules must be consistent**50 with the statutes*439 DOR is charged with administering and have the "same force and effect" as the statutes themselves. Such rules clearly cannot be merely interpretive, which by definition means nonbinding in the sense that violating the rule does *not* result in sanctions. See RCW 34.05.328(5)(c)(ii). Thus, RCW 82.32.300 *expressly* authorizes rules of procedure and legislative rules.^{FN5}

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FN4. The Administrative Procedure Act (APA) defines the terms “procedural rule,” “interpretive rule,” and “significant legislative rule,” requiring certain additional measures be taken when adopting the last category of rules. RCW 34.05.328(1), (5). The statutory definitions are:

For purposes of this subsection:

(i) A “procedural rule” is a rule that adopts, amends, or repeals (A) any procedure, practice, or requirement relating to any agency hearings; (B) any filing or related process requirement for making application to an agency for a license or permit; or (C) any policy statement pertaining to the consistent internal operations of an agency.

(ii) An “interpretive rule” is a rule, the violation of which does not subject a person to a penalty or sanction, that sets forth the agency's interpretation of statutory provisions it administers.

(iii) A “significant legislative rule” is a rule other than a procedural or interpretive rule that (A) adopts substantive provisions of law pursuant to delegated legislative authority, the violation of which subjects a violator of such rule to a penalty or sanction; (B) establishes, alters, or revokes any qualification or standard for the issuance, suspension, or revocation of a license or permit; or (C) adopts a new, or makes significant amendments to, a policy or regulatory program.

RCW 34.05.328(5)(c). Again, it is important to note these definitions are given in the context of specific requirements for legislative rules as opposed to the other two kinds.

FN5. AWB also argues the second paragraph of RCW 82.32.300 only authorizes rules necessary to enforce the tax laws. It further postulates the interpretive rules are never necessary to enforce the laws, and thus that statute does not authorize such rules. In light of the above conclusion, we need not consider this argument.

[7] ¶ 12 DOR argues interpretive rule making authority is implied from the vesting of the tax code's administration and enforcement in DOR. As the enforcer of the revenue statutes, DOR of necessity makes interpretive decisions about those statutes. *See United States v. Mead Corp.*, 533 U.S. 218, 227, 121 S.Ct. 2164, 150 L.Ed.2d 292 (2001) (“[W]hether or not they enjoy any express delegation of authority on a particular question, agencies charged with applying a statute necessarily make all sorts of interpretive choices....”). It was our holding that “[a]n agency charged with the administration and enforcement of a statute may interpret ambiguities within the statutory language through the rule making process.” *Edelman v. State ex rel. Pub. Disclosure Comm'n*, 152 Wash.2d 584, 590, 99 P.3d 386 (2004).

[8] *440 ¶ 13 DOR is charged with enforcing the tax code ^{FN6} and hence has the authority to interpret it. Interpreting statutes is consistent with administering and enforcing the statutes. As one treatise says, “Legislative authorization for an agency to interpret the law under which the agency

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operates and to make known to the public its interpretation of that law is normally implied from the powers expressly granted to the agency by the legislature. Every legislature wants agencies to determine the meaning of the law they must enforce and to inform the public of their interpretations so that members of the public may follow the law." Arthur Earl Bonfield, STATE ADMINISTRATIVE RULE MAKING § 6.9.1, at 280 (1986) (footnote omitted).^{FN7} Interpreting a statute, however, is not necessarily the same as adopting an interpretive rule.

FN6. RCW 82.32.300 ("The administration of this and chapters 82.04 through 82.27 RCW of this title is vested in the department of revenue...."); RCW 82.01.060(1) ("The director of revenue ... shall: (1) Assess and collect all taxes and administer all programs relating to taxes....").

FN7. The treatise also notes an interpretive "rule" that merely restates the statute's plain meaning is not a rule, but only a statement. Bonfield, *supra*, at 129-30 (Supp.1993). This is consistent with our statement in *Edelman* that agencies may interpret ambiguous statutes with rules. See 152 Wash.2d at 590, 99 P.3d 386. While the treatise cites to case law from another state, we are charged to interpret our APA consistently with other states. See RCW 34.05.001.

¶ 14 DOR also argues the authority to adopt legislative rules implies the lesser authority to adopt interpretive rules. DOR cites *Tuerk* to support its position. In *Tuerk*, we noted DOR was "charged with governing the activities of real estate

brokers through the issuance and enforcement of rules and regulations." 123 Wash.2d at 125, 864 P.2d 1382. We then stated that the power to interpret regulations is implied from the authority to enforce them. *Id.* at 126, 864 P.2d 1382 ("Within other relevant statutory constraints, the power to enforce a *regulation* implies the concomitant authority to interpret that *regulation*." (emphasis added)). However, we there spoke of interpreting *regulations*, not statutes, which is the subject of the current inquiry, and so this case is of little help in deciding whether DOR has the *441 authority to adopt regulations interpreting statutes rather than merely the authority to interpret its own regulations.^{FN8}

FN8. DOR also cites *State v. Crown Zellerbach Corp.*, 92 Wash.2d 894, 602 P.2d 1172 (1979), in which we held the power to disapprove a permit application implies the power to approve with conditions. That may be true, but it does not illuminate how the power to enact legislative rules implies the power to adopt interpretive rules.

¶ 15 AWB notes two decisions stating RCW 82.32.300 authorizes only procedural rules. See **51 *Coast Pac. Trading Co. v. Dep't of Revenue*, 105 Wash.2d 912, 719 P.2d 541 (1986); *Fidelity Title Co. v. Dep't of Revenue*, 49 Wash.App. 662, 745 P.2d 530 (1987). In *Coast Pacific*, we stated "the Legislature has allocated to the Department the authority only to establish procedural rules." 105 Wash.2d at 917, 719 P.2d 541. We cited RCW 82.32.300 for support, but only the first paragraph of it. We did not discuss the second paragraph of RCW 82.32.300 and its separate grant of rule making authority. Also, in *Coast Pa-*

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cific we disallowed an export exemption from the state B & O tax because it was based on a regulation that attempted to expand tax immunity beyond what the underlying statute and constitution required. 105 Wash.2d at 917, 719 P.2d 541.^{FN9} Our concern was an agency rule that amended a statute, not one that interpreted it. The statement about rule making authority in RCW 82.32.300 limited to procedural rules is accurate only if limited to the first paragraph of the statute. The second paragraph clearly grants DOR the authority to adopt legislative rules that are consistent with the statutory scheme.^{FN10}

FN9. DOR had abandoned relying on the rule during litigation because it was based on United States Supreme Court precedent that the Court had modified since the rule issued. The rule was thus inconsistent with the updated analysis on the constitutionality of import/export taxation. See *Coast Pac.*, 105 Wash.2d at 916-17, 719 P.2d 541.

FN10. DOR also argues the statute's legislative history precludes the narrow interpretation offered by AWB. The language of the statute is clear enough that resort to legislative history is unnecessary. See, e.g., *Greenen v. Wash. State Bd. of Accountancy*, 126 Wash.App. 824, 839, 110 P.3d 224 (2005) ("It is not appropriate to resort to aids of construction, such as legislative history, until we have examined the plain meaning and found the statute ambiguous or susceptible to more than one reasonable meaning.").

¶ 16 Likewise, in *Fidelity Title* the court made only a passing reference to RCW 82.32.300 and cited *Coast Pacific* *442 for

the proposition that DOR has the authority to adopt only procedural rules. 49 Wash.App. at 666, 745 P.2d 530. This issue was not before the court, however; the real issue was how the legislature intended to classify Fidelity Title for business and occupation tax purposes. The answer to that question depended on statutory analysis, not DOR's rule making authority.^{FN11} Again, the court was concerned with WACs that attempted to amend statutes, not interpret them.

FN11. DOR also argues the language in these opinions relating to RCW 82.32.300 is dicta since it was not an issue before the courts. This interpretation is plausible since the statements were made in passing and not directly related to the holdings in either case. If so the language is not **binding** on this court. See, e.g., *State v. Potter*, 68 Wash.App. 134, 150 n. 7, 842 P.2d 481 (1992) ("Statements in a case that do not relate to an issue before the court and are unnecessary to decide the case constitute orbiter dictum, and need not be followed.") (citing *City of Bellevue v. Acrey*, 103 Wash.2d 203, 207, 691 P.2d 957 (1984)). Even if the language is not dicta, it is questionable in light of the statute's plain meaning.

¶ 17 Neither of these two cases discusses RCW 82.32.300 at length, barely even mentioning it to make a point only tangentially related to the case at hand. Further, they do not analyze the second paragraph of the statute, which grants additional rule making authority to DOR. In short, these two cases are properly confined to the grant of procedural rule making authority in the first paragraph of RCW 82.32.300,

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and as such are of little help in this case, especially since they do not discuss the vesting of the tax code's administration and enforcement in DOR, which is the claimed source of DOR's interpretive rule making authority.

B. Other Statutes Support DOR's Interpretive Rule Making Authority

¶ 18 While RCW 82.32.300 alone may be insufficient to support DOR's interpretive rule making authority, other statutes do support it. One such statute is RCW 34.05.230(1), which grants agencies the authority to adopt interpretive statements, which are advisory only.^{FN12} The *443 statute **52 then says, "To better inform and involve the public, an agency is encouraged to convert longstanding interpretive and policy statements into rules." *Id.* Further, the statute allows a person to petition the agency to turn interpretive statements into rules. RCW 34.05.230(2). Clearly, the legislature intended agencies to adopt interpretive rules or they simply could not comply with this statute.

FN12. RCW 34.05.230 reads in relevant part:

(1) An agency is encouraged to advise the public of its current opinions, approaches, and likely courses of action by means of interpretive or policy statements. Current interpretive and policy statements are advisory only. To better inform and involve the public, an agency is encouraged to convert long-standing interpretive and policy statements into rules.

(2) A person may petition an agency requesting the conversion

of interpretive and policy statements into rules. Upon submission, the agency shall notify the joint administrative rules review committee of the petition. Within sixty days after the submission of a petition, the agency shall either deny the petition in writing, stating its reasons for the denial, or initiate rule-making proceedings in accordance with this chapter.

¶ 19RCW 42.17.250 corroborates this view.^{FN13} This statute requires agencies to publish in the WAC, among other items, "[s]ubstantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency." RCW 42.17.250(1)(d). Only rules adopted through the rule making procedure can be published in the WAC. *See* RCW 34.05.210, .345, .390. Abstracts of interpretive statements are published in the Washington State Register with contact information to guide an interested person to the agency for a copy. RCW 34.05.230(4). Again, interpretive statements cannot be published in the WAC without first surviving the rule making process, implying authority to make such rules.

FN13. RCW 42.17.250(1) reads in relevant part:

(1) Each state agency shall separately state and currently publish in the **Washington Administrative Code** and each local agency shall prominently display and make available for inspection and copying at the central office of such local agency, for guidance of the public:

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....

(c) Rules of procedure;

(d) Substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency; and

(e) Each amendment or revision to, or repeal of any of the foregoing.

*444 ¶ 20 DOR also argues it has express statutory authority to adopt interpretive rules. It first points to RCW 82.32A.010, which grants DOR administrative duties over the chapter and the power to adopt rules "as may be necessary to fully implement this chapter and the rights established under this chapter." Further, taxpayers have a "right to review, upon request, clear and current tax instructions, rules, procedures, forms, and other tax information." RCW 82.32A.020(5). Further still, DOR has the responsibility to publish "written bulletins, instructions, current revenue laws, rules, court decisions, and interpretive rulings of the department of revenue," making all of these items available to the public. RCW 82.32A.050(3).

¶ 21 DOR argues it must adopt interpretive rules to fully implement these mandates. But the statutes do not say the interpretive policies must be rules as opposed to statements. These statutes do not expressly grant the authority to adopt interpretive rules, and it cannot even be implied since other ways of fulfilling the statutes are available, such as interpretive statements.

¶ 22 Second, DOR cites RCW

, which says:

The director of revenue ... shall:

....

(2) Make, adopt and publish such rules as he or she may deem necessary or desirable to carry out the powers and duties imposed upon him or her or the department by the legislature: PROVIDED, That the director may not adopt rules after July 23, 1995, that are based solely on a section of law stating a statute's intent or purpose, on the enabling provisions of the statute establishing the agency, or on any combination of such provisions, for statutory authority to adopt any rule....

RCW 82.01.060(2). AWB and DOR agree this is a very broad grant of rule making authority. However, AWB contends the regulatory reform act of 1995, which added the proviso, effectively revoked DOR's rule making authority under this *445 statute.^{FN14} While **53 it is true the proviso limits DOR's authority, it does not eliminate that authority. The proviso forbids rules based *solely* on the intent sections of statutes, "enabling provisions of statutes establishing the agency, or any combination of such provisions." RCW 82.01.060(2). Any interpretive rule is based on the statute it is interpreting and the statutory mandate to administer and enforce that statute, not *solely* on a general grant of rule making authority. If there is no underlying statute, there is nothing to interpret. Further, the Court of Appeals correctly held the regulatory reform act of 1995 applies only to legislative rules. See Laws of 1995, ch. 403, §§ 1, 201. Hence, RCW 82.01.060(2), while part of the enabling legislation that established DOR, provides authority for DOR to make interpretive rules.^{FN15}

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FN14. AWB also claims the same act revokes any rule making authority under RCW 82.32.300 because that statute is part of the enabling legislation that established DOR. This argument is wrong. RCW 82.32.300 was originally enacted in 1935 to grant rule making authority to the tax commission (precursor of DOR). Law of 1935, ch. 180, § 208. The tax commission was founded in 1927, and DOR was founded in 1967. See Laws of 1927, ch. 280; Laws of 1967, Ex.Sess., ch. 26. RCW 82.32.300 was not part of the enabling legislation establishing either agency, and so is unaffected by the proviso added to RCW 82.01.060(2) or by RCW 34.05.322, which applies the same proviso to rules based on statutes enacted after July 23, 1995. None of the statutes underlying the WACs at issue here were enacted after that date, making RCW 34.05.322 inapplicable.

FN15. DOR also argues from legislative history that AWB's interpretation is false. The argument from the statutory language alleviates the need for this analysis. See *Greenen*, 126 Wash.App. at 839, 110 P.3d 224.

II. The Force and Effect of Interpretive Rules

¶ 23 In light of the foregoing, it is apparent that DOR has interpretive rule making authority. The Court of Appeals erred at this point since it concluded DOR has the *inherent* authority to issue interpretive rules. 121 Wash.App. at 772, 90 P.3d 1128. Agencies have only express or implied authority, not inherent authority, and al-

though the difference between inherent and implied authority may be mostly semantic, we prefer the latter as a more accurate statement of the law. See *Tuerk*, 123 Wash.2d at 124-25, 864 P.2d 1382 (“Administrative agencies have those powers expressly granted to them and *446 those necessarily implied from their statutory delegation of authority.”).

¶ 24 The trial court's conclusions 4, 5, and 6, are more interesting. See *supra* at 48. There the court concluded DOR does not have the authority to adopt interpretive rules *that do not say* they are interpretive. The court did not opine on interpretive rules that are so labeled, but did conclude DOR does not have the authority to mislead the public by representing interpretive rules as **binding**. These conclusions raise the question of the nature of interpretive rules and their force and effect on the public.

¶ 25 DOR argues interpretive rules are valid rules of law. They derive their force, DOR asserts, not from themselves but from the statutes they interpret. Legislative rules, on the other hand, do have the force of law in themselves. DOR dismisses the nonbinding nature of interpretive rules as a false issue, one for academicians to dispute. The public must follow these rules because they reflect statutory law.

[9] ¶ 26 The above cited treatise is helpful at this point. It notes that courts treat interpretive and legislative rules differently:

“In the case of an interpretative rule, the inquiry is not into validity but is into correctness or propriety. The legislative body has not delegated power to make a rule which will be **binding** upon the court if it is valid. The statute does not prevent the reviewing court from substituting its judg-

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ment on questions of desirability or wisdom. The law is embodied in the statute, and the court is free to interpret the statute as it sees fit.”

Bonfield, *supra*, at 281 (quoting 1 Kenneth Culp Davis, *Administrative Law Treatise* § 5.05, at 315 (1958)). Therein lies the true difference between interpretive and legislative rules: their effect on the courts.^{FN16} Legislative rules **bind** the court if they are within the agency's delegated authority, *447 are reasonable, and were adopted using the proper **54 procedure. See *Weyerhaeuser Co. v. Dep't of Ecology*, 86 Wash.2d 310, 314-15, 545 P.2d 5 (1976). Interpretive rules, however, are not **binding** on the courts at all: “Reviewing courts are not required to give any deference whatsoever to the agencies' views on that subject [correctness and desirability of the agencies' interpretations]. Legislative rules therefore have greater finality than interpretive rules because courts are bound to give some deference to agency judgments embodied in the former, but they need not defer to agency judgments embodied in the latter.” Bonfield, *supra*, at 281-82. We have said as much.^{FN17}

FN16. At the federal level another difference is important: unlike Washington state agencies, federal agencies can adopt interpretive rules without using the notice-and-comment process. See 5 U.S.C. § 553(b).

FN17. *Edelman*, 152 Wash.2d at 590, 99 P.3d 386 (“[W]e accord no deference to an agency's rule where no ambiguity exists. Courts retain the ultimate authority to interpret a statute.”). When a statute is ambiguous (i.e., subject to more than one reasonable interpretation), the

agency's adoption of one of the possible reasonable choices is entitled to some deference. See *Weyerhaeuser Co.*, 86 Wash.2d at 315, 545 P.2d 5. Even so, the agency's interpretation is not **binding** on the courts. *Id.*

[10] ¶ 27 Technically, interpretive rules are not **binding** on the public. They serve merely as advance notice of the agency's position should a dispute arise and the matter result in litigation. The public cannot be penalized or sanctioned for breaking them. They are not **binding** on the courts and are afforded no deference other than the power of persuasion. Accuracy and logic are the only clout interpretive rules wield. If the public violates an interpretive rule that accurately reflects the underlying statute, the public may be sanctioned and punished, not by authority of the rule, but *by authority of the statute*. This is the nature of interpretive rules.

[11] ¶ 28 AWB applauds, and DOR contests, the trial court's conclusion that DOR has no authority to adopt interpretive rules that do not clearly state they are interpretive. DOR says no statute requires interpretive rules to be so labeled, nor does AWB cite any other authority. In the final analysis, it does not really matter how the rules are labeled. DOR will stick by its rules (whether interpretive, procedural, or legislative) unless and until they are stricken by a court. For interpretive rules in particular, DOR will *448 maintain it interpreted the underlying statutes correctly, and any taxpayer who disagrees will have to persuade a court otherwise. For legislative rules, a taxpayer who thinks the agency went too far in implementing the authorizing statutes will pursue precisely the same course: a lawsuit. Agency rules are de facto authorit-

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ative for the public until the public challenges them in court and the court agrees. Thus, how the rules are labeled does not affect the public's response to the rules.^{FN18}

FN18. Additionally, the public will know DOR's view of a proposed interpretive rule. RCW 34.05.328(5)(d) requires the agency to state in the notice of proposed rule making if the rule is a significant legislative rule with its concomitant procedures. Here for two of the WACs DOR noted RCW 34.05.328 did not apply because the rules were interpretive. *See* Admin. R. at 35 (DOR's official rule making files for WAC 458-20-136 and WAC 458-20-13601). DOR did not need to meet this criterion for WAC 458-20-238 because it filed the notice for proposed rule making before RCW 34.05.328 became effective on July 23, 1995.

¶ 29 This argument answers AWB's claim the public was misled by DOR's representations of the rules as having the force and effect of law. If there is no requirement that interpretive rules be clearly labeled, they represent the agency's interpretation of the statutory law and coerce public behavior unless a taxpayer convinces the court a different interpretation is more accurate. Accurate interpretive rules reflect statutory authority, and thus have a legal effect on the public. In some sense, whether DOR misrepresented the force and effect of interpretive rules is a question of word games, as is the trial court's related finding of prejudice.^{FN19}

FN19. As the Court of Appeals noted, it would be improper to invalidate the WACs because of department misrepresentations about

their force and effect. RCW 34.05.570(2)(c) allows a court to strike down a rule only for specific reasons, none of which is an agency's alleged misrepresentations about the rule. *See supra*, at 48.

¶ 30 There is also some confusion over whether interpretive rules can be "rules" as defined by the APA. The definition of a "rule" in RCW 34.05.010(16) is an agency regulation of general applicability (1) the violation of which results in a penalty, (2) which establishes or alters the procedures for hearings, (3) which establishes or alters the enjoyment of benefits or privileges conferred by law, (4) establishes or alters licenses, and (5) effects manufacturing standards.^{FN20} The Court of Appeals pigeonholed interpretive rules in category (3). 121 Wash.App. at 773, 90 P.3d 1128. This conclusion is wrong since interpretive rules are nonbinding and cannot establish, amend, or revoke anything. Thus, interpretive rules don't seem to fit the definition of "rule."

FN20. RCW 34.05.010(16) reads as follows:

(16) "Rule" means any agency order, directive, or regulation of general applicability (a) the violation of which subjects a person to a penalty or administrative sanction; (b) which establishes, alters, or revokes any procedure, practice, or requirement relating to agency hearings; (c) which establishes, alters, or revokes any qualification or requirement relating to the enjoyment of benefits or privileges conferred by law; (d) which establishes, alters, or revokes any qualifications or standards for the issuance, suspension,

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or revocation of licenses to pursue any commercial activity, trade, or profession; or (e) which establishes, alters, or revokes any mandatory standards for any product or material which must be met before distribution or sale. The term includes the amendment or repeal of a prior rule, but does not include (i) statements concerning only the internal management of an agency and not affecting private rights or procedures available to the public, (ii) declaratory rulings issued pursuant to RCW 34.05.240, (iii) traffic restrictions for motor vehicles, bicyclists, and pedestrians established by the secretary of transportation or his designee where notice of such restrictions is given by official traffic control devices, or (iv) rules of institutions of higher education involving standards of admission, academic advancement, academic credit, graduation and the granting of degrees, employment relationships, or fiscal processes.

[12] ¶ 31 However, the legislature probably intended agencies to adopt interpretive rules, but failed to change the definition of rule. RCW 34.05.230, which encourages agencies to turn interpretive statements into rules, was adopted in its current form in 2001, *see* Laws of 2001, ch. 25, § 1, whereas the definition of rule was adopted in 1988, *see* Laws of 1988, ch. 288, § 101 (codified at RCW 34.05.010(16)). The later statute governs when the two conflict. *Bailey v. Allstate Ins. Co.*, 73 Wash.App. 442, 446, 869 P.2d 1110 (1994) (“Another general rule of statutory construction gives preference to the later-adopted statute and

to the more specific statute if two statutes appear to conflict.”). In light of this history, interpretive rules are proper. *See also* RCW 34.05.328(5)(c)(ii) (defining interpretive rules) (adopted in 1995).

*450 ¶ 32 Finally, AWB argues the constitutional right of due process is implicated by DOR's misrepresentations. However, AWB does not elaborate on this argument, making it an insufficient basis for invalidating the rules. *See In re Disciplinary Proceeding Against Schafer*, 149 Wash.2d 148, 168, 66 P.3d 1036 (2003) (“ ‘[N]aked castings into the constitutional sea are not sufficient to command judicial consideration and discussion.’ ”) (quoting *State v. Blilie*, 132 Wash.2d 484, 493 n. 2, 939 P.2d 691 (1997) (internal quotation marks omitted)).

CONCLUSION

¶ 33 The three interpretive WACs at issue are properly within DOR's rule making authority. We therefore affirm the Court of Appeals as modified by the above reasoning.

C. JOHNSON, MADSEN, BRIDGE, and OWENS, JJ. and BECKER, J.P. T., concur. ALEXANDER, C.J. (concurring).

¶ 34 I agree with the majority's conclusion that the Department of Revenue has the authority to issue interpretative rules. I write separately simply to express my view that an agency's interpretative rules should be clearly differentiated from its legislative rules.

¶ 35 As the majority observes, an agency's interpretation of a statute, whether or not codified as an interpretive rule, is not authoritative. Majority at 53-54. Courts are not bound by an agency's interpretive rules. *Id.* Legislative rules, on the other hand, if

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properly promulgated, are **binding** on the courts. *Id.* (citing *Weyerhaeuser Co. v. Dep't of Ecology*, 86 Wash.2d 310, 314-15, 545 P.2d 5 (1976)). Thus, the legal effect of an interpretative**56 rule is quite different from the legal effect of a legislative rule.

¶ 36 Where interpretive rules are formatted in the same manner and published alongside legislative rules, they are *451 indistinguishable. The failure to differentiate interpretive rules from substantive rules very likely misleads the reader, particularly those without training or experience in the law, into believing that interpretative rules have the same legal effect as legislative rules. I believe, therefore, that the better practice for the Department of Revenue would be to label its interpretative rules as just that. While we cannot compel the department to do so, I urge it to consider taking such a positive and sensible step.

CHAMBERS and J.M. JOHNSON, JJ.,
concur.
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SEC. 2. There are hereby authorized to be appropriated such sums, in addition to the sum of \$6,339,000 authorized to be appropriated for the Crooked River Federal reclamation project in section 5 of the Act of August 6, 1956 (70 Stat. 1058), as may be required to carry out the purposes of this Act.

Approved September 14, 1959.

Appropriation.

43 USC 615j.

Public Law 86-272

AN ACT

Relating to the power of the States to impose net income taxes on income derived from interstate commerce, and authorizing studies by congressional committees of matters pertaining thereto.

September 14, 1959
[S. 2524]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Taxes.
Income derived
from interstate
commerce.

TITLE I—IMPOSITION OF MINIMUM STANDARD

SEC. 101. (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to—

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) For purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) For purposes of this section—

(1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

Definitions.

Restrictions.

SEC. 102. (a) No State, or political subdivision thereof, shall have power to assess, after the date of the enactment of this Act, any net income tax which was imposed by such State or political subdivision, as the case may be, for any taxable year ending on or before such date, on the income derived within such State by any person from interstate commerce, if the imposition of such tax for a taxable year ending after such date is prohibited by section 101.

(b) The provisions of subsection (a) shall not be construed—

(1) to invalidate the collection, on or before the date of the enactment of this Act, of any net income tax imposed for a taxable year ending on or before such date, or

(2) to prohibit the collection, after the date of the enactment of this Act, of any net income tax which was assessed on or before such date for a taxable year ending on or before such date.

Definition.

SEC. 103. For purposes of this title, the term "net income tax" means any tax imposed on, or measured by, net income.

Savings provision.

SEC. 104. If any provision of this title or the application of such provision to any person or circumstance is held invalid, the remainder of this title or the application of such provision to persons or circumstances other than those to which it is held invalid, shall not be affected thereby.

TITLE II—STUDY AND REPORT BY CONGRESSIONAL COMMITTEES

SEC. 201. The Committee on the Judiciary of the House of Representatives and the Committee on Finance of the United States Senate, acting separately or jointly, or both, or any duly authorized subcommittees thereof, shall make full and complete studies of all matters pertaining to the taxation by the States of income derived within the States from the conduct of business activities which are exclusively in furtherance of interstate commerce or which are a part of interstate commerce, for the purpose of recommending to the Congress proposed legislation providing uniform standards to be observed by the States in imposing income taxes on income so derived.

SEC. 202. The Committees shall report to their respective Houses the results of such studies together with their proposals for legislation on or before July 1, 1962.

Approved September 14, 1959.

Public Law 86-273

September 14, 1959
[H. R. 6781]

AN ACT

To authorize the Secretary of the Interior to acquire certain additional property to be included within the Independence National Historical Park.

Independence
National Historical
Park.
Additional land.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of the Interior is authorized to acquire by donation or with donated funds, or to acquire by purchase, from the Redevelopment Authority of the City of Philadelphia the land and interests in land immediately adjacent to, but not including, the Old Saint Joseph's Church property in the city of Philadelphia, Pennsylvania, which land and interests in land are identified on the records of the city of Philadelphia as 324, 326, 328, 330, 332, 334 and 336 Walnut Street, for inclusion in the Independence National Historical Park: *Provided,* That the Secretary shall first enter into an agreement with the proprietor or proprietors

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Superior Court of Connecticut,
 Judicial District of New Britain.
DELL CATALOG SALES, L.P.

v.

COMMISSIONER OF REVENUE SERVICES.
 No. CV-00 0503146S.

July 10, 2003.

Out-of-state computer seller appealed from a decision by tax commissioner imposing a duty on seller to collect sales and use taxes on sale of computers to purchasers in state. The Superior Court, Judicial District of New Britain, Aronson, Judge Trial Referee, held that relationship between seller and company that provided on-site repair services to computer purchasers did not establish that seller had sufficient nexus with state as to justify state's imposition of duty to collect taxes.

Reversed.

West Headnotes

[1] Taxation 371 ↪3670

371 Taxation

371IX Sales, Use, Service, and Gross Receipts
 Taxes

371IX(D) Persons Subject to or Liable for Tax
 371k3670 k. Nonresidents and Foreign
 Corporations. Most Cited Cases
 (Formerly 371k1270)

In context of state's imposition of tax on out-of-state vendor, "nexus" means the connection or physical contacts which an out-of-state vendor has with a state to justify that state's imposition of a duty upon the out-of-state vendor to collect a use tax from purchasers.

[2] Taxation 371 ↪3670

371 Taxation

371IX Sales, Use, Service, and Gross Receipts
 Taxes

371IX(D) Persons Subject to or Liable for Tax
 371k3670 k. Nonresidents and Foreign
 Corporations. Most Cited Cases
 (Formerly 371k1270)

Relationship between out-of-state computer seller and company that provided on-site repair services to computer purchasers, pursuant to service contracts sold by seller in connection with computer sales, did not establish that seller had sufficient nexus with state as to justify state's imposition of a duty on seller to collect sales and use taxes on computer sales; seller had no physical presence in state, tax commissioner stipulated that service provider was not seller's agent, and record did not establish the number or frequency of service provider's service visits to purchasers in state pursuant to service contracts.

[3] Taxation 371 ↪3670

371 Taxation

371IX Sales, Use, Service, and Gross Receipts
 Taxes

371IX(D) Persons Subject to or Liable for Tax
 371k3670 k. Nonresidents and Foreign
 Corporations. Most Cited Cases
 (Formerly 371k1270)

The bright line test for determining whether an out-of-state vendor is subject to the imposition of sales and use taxes is substantial physical presence in the taxing state.

[4] Taxation 371 ↪3670

371 Taxation

371IX Sales, Use, Service, and Gross Receipts
 Taxes

371IX(D) Persons Subject to or Liable for Tax

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371k3670 k. Nonresidents and Foreign Corporations. Most Cited Cases
 (Formerly 371k1270)

A slight physical presence by an out-of-state vendor in a state is not sufficient to establish a substantial nexus, for purposes of justifying the state's imposition of sales and use taxes on the out-of-state vendor.

[5] Taxation 371  3670

371 Taxation

371IX Sales, Use, Service, and Gross Receipts Taxes

371IX(D) Persons Subject to or Liable for Tax
 371k3670 k. Nonresidents and Foreign Corporations. Most Cited Cases
 (Formerly 371k1270)

Isolated and sporadic physical contacts between an out-of-state vendor and a state are insufficient to establish a substantial nexus between the vendor and the state so as to support the state's imposition of sales and use taxes on the vendor.

[6] Taxation 371  3692

371 Taxation

371IX Sales, Use, Service, and Gross Receipts Taxes

371IX(G) Levy and Assessment
 371k3690 Evidence
 371k3692 k. Presumptions and Burden of Proof. Most Cited Cases
 (Formerly 371k1316)

Tax commissioner had burden to establish that out-of-state vendor had sufficient substantive physical contacts in state to warrant the involuntary imposition of a tax.

[7] Taxation 371  3638

371 Taxation

371IX Sales, Use, Service, and Gross Receipts Taxes

371IX(C) Transactions Taxable in General

371k3637 Subjects and Exemptions in General

371k3638 k. In General. Most Cited Cases

(Formerly 371k1231.1)

When the issue is the imposition of a tax, rather than a claimed right to an exemption or a deduction, the governing authorities must be strictly construed against the commissioner and in favor of the taxpayer.

[8] Taxation 371  3695

371 Taxation

371IX Sales, Use, Service, and Gross Receipts Taxes

371IX(G) Levy and Assessment
 371k3695 k. Judicial Review and Relief Against Assessments. Most Cited Cases
 (Formerly 371k1319)

A tax appeal is a trial de novo.

**813 Cummings & Lockwood, Hartford, for the plaintiff.

Paul M. Scimonelli, assistant attorney general, with whom was Richard Blumenthal, attorney general, for the defendant.

ARONSON, Judge Trial Referee.

The plaintiff, Dell Catalog Sales, L.P. (Dell Catalog Sales), filed this appeal pursuant to General Statutes § 12-422 from a decision by the defendant, the commissioner of revenue services (commissioner), sustaining assessments of sales and use tax against Dell Catalog Sales *171 Sales. The commissioner, after an audit, assessed a sales and use tax against Dell Catalog Sales for the period November 1, 1993 through December 31, 1998 based on a finding that Dell Catalog Sales had a physical presence or nexus in Connecticut for the purpose of collecting a sales or use tax from its customers in this state.

Dell Catalog Sales claims that it conducts a national mail order business that operates exclusively through interstate commerce and, therefore, it can-

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not be compelled to collect a sales or use tax on mail order sales made to residents of a state in which the seller has no physical presence. Dell Catalog Sales cites *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), *National Bellas Hess v. Dept. of Revenue*, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967) and *SFA Folio Collections, Inc. v. Bannon*, 217 Conn. 220, 585 A.2d 666, cert. denied, 501 U.S. 1223, 111 S.Ct. 2839, 115 L.Ed.2d 1008 (1991) in support of its claim of nontaxability. Dell Catalog Sales claims that the commissioner concedes that Dell Catalog Sales has no physical presence in Connecticut, and that the commissioner's nexus argument is premised solely on the physical presence in Connecticut of a company called BancTec.

[1] As used in the present case, nexus means the connection or physical contacts which an out-of-state vendor has with a state to justify that state's imposition of a duty upon the out-of-state vendor to collect a use tax from purchasers. 2 J. Hellerstein & W. Hellerstein, *State Taxation* (3d Ed. 2000) ¶ 19.02[1], p. 19-7; see also *Quill Corp. v. North Dakota*, supra, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91.

****814** The issue here is whether Dell Catalog Sales, as an out-of-state vendor of computers, with no physical contacts within the state of Connecticut, can be said to have a nexus to Connecticut by having BancTec provide ***172** a service to Dell Catalog Sales customers under a contract between the customer and BancTec.

Dell Corporation is a holding company with subsidiaries that carry on its day to day business. Three of the subsidiaries involved in the present case are Dell Products, L.P., the aforementioned Dell Catalog Sales and Dell USA, L.P. Dell Products, L.P. manufactures computers. Dell Catalog Sales sells the computers manufactured by Dell Products, L.P., and Dell USA, L.P. provides the administrative support for both Dell Products, L.P. and Dell Catalog Sales. Together, these three entities are known as the Dell affiliates.^{FN1} Each Dell affiliate de-

scribes itself as "Dell." For the purpose of this memorandum of decision, "Dell" refers only to the holding company.

FN1. An "affiliate" has been defined as "a company effectively controlled by another or associated with others under common ownership or control." *Lombardo's Ravioli Kitchen, Inc. v. Ryan*, 47 Conn.Supp. 540, 547, 815 A.2d 302 (2002).

From 1992 to 1994, Dell, through a subsidiary, Dell Marketing, L.P., sold computers to the government and to businesses at retail. This was not profitable. At the beginning of the 1990s, the personal computer market began exploding. Dell saw that individual consumers had a need different from corporate business users. Dell had a segmented strategy to form new entities to service specific customers. Dell split sales to large business entities from sales to the individual consumer. The reason for this split of business was that the individual consumer was interested in games, graphics and high fidelity audio in addition to normal computer uses. Large business customers wanted to pay for computers on invoices and discounted bills, and individual consumers wanted to pay with credit cards.

The early individual consumers in the computer field were knowledgeable about using computers. In the ***173** early 1990s, less knowledgeable consumers began purchasing more computers. Dell, recognizing that inexperienced consumers would not be comfortable doing their own computer repairs, saw a need to develop a system to service the problems that purchasers would have in the operation of their computers. Dell originally considered servicing the computers it sold to individual consumers, but decided not to go this route since it meant setting up a whole organization to service customers in every state with the attendant problems of purchasing vehicles, equipment, hiring employees and managing a service business nationwide different from selling computers. Dell then considered looking for a business that could service computers on a nationwide basis. From 1989 to 1992, Dell entered

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into an agreement with Xerox Corporation (Xerox) to service the computers sold by Dell to individual consumers. Dell sold service contracts to consumers under which Xerox would do the repairs. Dell received a commission from Xerox on the sale of these contracts. The servicing of Dell computers was not, however, profitable to Xerox and Xerox walked away from its agreement with Dell.

Dell recognized that in order to enhance its sales, it had to stand behind its product and to provide service to its customers when needed. The ability to provide service to its individual customers was one factor in Dell's growth in the early 1990s. At this point, it is important to set forth additional facts in the present case based on the stipulation of the parties. Dell **815 Catalog Sales was organized in October, 1993, and is a Texas limited partnership with its principal place of business in Round Rock, Texas. As a limited partnership, Dell Catalog Sales has no subsidiaries. Dell is a national mail order business that operates through interstate commerce. Dell sells computers and related products nationwide from outside the state of Connecticut. Dell purchases computers, computer peripherals and *174 related accessories manufactured by Dell Products, L.P. and other companies such as Hewlett Packard and Iomega, and resells them via national media advertising and mail order catalog from facilities in Round Rock, Texas. Dell Products, L.P. maintains an inventory in Austin, Texas, not in Connecticut.

During the audit period from November 1, 1993 to December 31, 1998, Dell Catalog Sales conducted and coordinated all of its activities exclusively from Texas. It solicited orders through national media advertising and by sending catalogs to prospective customers nationwide, including customers in Connecticut. These catalogs were not designed, prepared, printed, published, or mailed from Connecticut. Customers placed orders by contacting Dell Catalog Sales directly in Round Rock, Texas, through the Internet or by telephone, facsimile, mail or e-mail. Customer orders are accepted by

Dell Catalog Sales in Round Rock and then shipped from Texas by common carrier or the United States Postal Service. Dell Catalog Sales made no local deliveries in Connecticut, nor did it drop ship merchandise from Connecticut manufacturers. Dell Catalog Sales did not own or operate retail stores anywhere, including Connecticut. Dell Catalog Sales did not have or maintain within the state of Connecticut, directly or by a subsidiary, an office, distribution house, sales house, warehouse or other place of business. Dell Catalog Sales did not own or lease real or personal property in Connecticut. Dell Catalog Sales did not conduct credit investigations or collections in Connecticut.

Dell Catalog Sales had no employees in Connecticut, nor did it solicit sales by employees, independent contractors, agents, or other representatives in Connecticut. Dell Catalog Sales did not solicit orders for tangible personal property by means of telephone, telegraph, computer data base, cable, optic, microwave or other communication system located in Connecticut. Dell *175 Catalog Sales did not enter into contracts with cable television operators located in Connecticut nor did it advertise only in Connecticut via cable television.

Dell Catalog Sales did not have bank accounts in Connecticut; its credit card clearinghouse is located in Florida. Dell Catalog Sales did not retain security interests in any products sold to Connecticut residents. Dell Catalog Sales did not use Connecticut vendors to design, prepare, print, store, or mail catalogs. Dell Catalog Sales did not enter Connecticut to purchase, place, or display advertising for itself or others. Dell Catalog Sales did not advertise, pursuant to a contract with radio or television media or a newspaper or magazine publisher located in Connecticut. Dell Catalog Sales did not send orders to a Connecticut manufacturer, processor, repairer, or printer to be processed and stored in completed form awaiting shipment to customers. Dell Catalog Sales did not have local telephone service in Connecticut with local listings; nor did Dell have any franchisee or licensee operating under its trade

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name in Connecticut.

Since Dell Catalog Sales is not a manufacturer, it does not provide any warranties on its sales of computers and related products. The manufacturers of computer and related products such as Dell Products,**816 L.P., Hewlett-Packard and Iomega provide their own manufacturers' warranties.

In addition to the warranty by the manufacturer, customers of Dell Catalog Sales are given the opportunity to purchase, through Dell Catalog Sales, a service contract to be performed by BancTec USA, Inc. (BancTec), a Delaware corporation with its principal place of business in Dallas, Texas. During the audit period, BancTec was a wholly-owned subsidiary of BancTec, Inc., a New York Stock Exchange company headquartered in Dallas, Texas. Neither Dell Catalog Sales nor any other *176 Dell affiliate entity had any ownership interest in BancTec, nor did BancTec have any interest in any Dell affiliate.

BancTec was a small, unknown service company with prior experience servicing bank ATMs and repairing computers, looking for national exposure. Dell was a company that could provide BancTec national exposure as well as giving it credibility. BancTec wanted the exclusive right to repair Dell computers, but also wanted the right to service computers of other companies besides Dell. Dell, however, wanted the exclusive services of BancTec. Dell did not want BancTec to contract with its competitors in the market. Both BancTec and Dell worked out an agreement to deal with each other's concerns expressed in service contract sales brokerage agreements entered into in 1991, 1995 and 1998.

BancTec performed on-site service repairs made under a service contract sold by Dell Catalog Sales throughout the United States and upon dispatch from Dell Tech Support.^{FN2} The process for obtaining service under a BankTec service contract was as follows: The customer of Dell Catalog Sales called in the problem to a toll-free number at Dell

Tech Support for diagnosis of the problem. At that point, a determination was made on how to handle the problem. If the problem was not one that could be corrected over the telephone, Tech Support logged a service call to BancTec. Once Tech Support contacted BancTec, BancTec was responsible for resolving the problem. Depending on the problem, however, BancTec might contact Tech Support and a technician would assist BancTec. If a customer was not satisfied with the services performed by BancTec, the *177 customer would contact Tech Support. Tech Support would then take the information and send it to BancTec management, who would then be responsible for resolving the issue with the customer.

FN2. In those situations in which a product manufactured by Dell Products, L.P. did not work properly, the customer was directed to call Dell Customer Technical Support (Dell Tech Support) in Round Rock, Texas.

Dell Catalog Sales customers were not required to purchase a service contract. Approximately 75 percent of its customers, however, did purchase such contracts. A Dell Catalog Sales customer who wanted to purchase a service contract could do so at the same time the customer purchased a Dell computer or, for an increased price, purchase a service contract from Dell Catalog Sales at any time after the purchase of a computer. When a Connecticut customer decided to purchase the service contract, Dell Catalog Sales added the price of the service contract to the customer's invoice, calculated Connecticut sales tax thereon, and collected the price and tax from the customer. Dell Catalog Sales remitted the sales tax on the sale of the service contract to the department of revenue services.

Pursuant to the terms of the service contract sales brokerage agreements of December 18, 1991, July 1, 1995 and September**817 1, 1998, Dell Catalog Sales retained as a commission the difference between the net revenue and the retail price charged to the customer for each service contract sold. "Net

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revenue" means the amount of money that is payable to BancTec from the proceeds of the sale of a service contract to a customer on BancTec's behalf, net of credits. "Net of credits" means returned computer merchandise (on which BancTec service contracts were purchased) or canceled BancTec service contracts.

Dell Catalog Sales did not sell service contracts as a stand-alone product. Customers could only purchase such contracts when buying a Dell Catalog Sales computer product.

*178 The parties have further stipulated that the terms of the service contract sales brokerage agreements provided that Dell Catalog Sales would act as BancTec's agent and broker in marketing BancTec's service contracts, and Dell entities would provide certain technical assistance to BancTec in connection with BancTec's service contracts, in exchange for the contract commission.

The parties have also stipulated that the service contract sales brokerage agreements provided that the amount of revenue received by BancTec on each service contract sold was determined by a Dell formula, which, among other things, took into account the number of on-site service calls actually made by BancTec during the previous ninety day period. After Dell USA, L.P. calculated this amount, Dell USA, L.P. provided such amount to BancTec in a monthly lump sum payment. For the period from January 1996, through December 1997, BancTec received approximately 10 to 11 percent of the gross revenue collected by Dell Catalog Sales and Dell Catalog Sales received approximately 90 percent of the gross revenue collected.

Although Dell Catalog Sales was licensed to do business only in Texas, Florida, Kentucky and Nevada, the defendant commissioner took it upon himself to register Dell Catalog Sales for a tax registration number and had a tax registration number assigned to Dell Catalog Sales in Connecticut. Dell Catalog Sales protested the involuntary registration by the commissioner and has never voluntarily re-

gistered itself to do business in Connecticut.

The sales and use tax assessment made by the commissioner for the entire audit period was an estimate based on sales figures for Connecticut obtained from Dell Catalog Sales for approximately one month from December 28, 1996 to January 25, 1997.

[2] *179 The commissioner argues that BancTec acted as a representative of Dell Catalog Sales. With BancTec acting as a representative of Dell Catalog Sales in Connecticut to service Dell computers, the commissioner concluded that Dell Catalog Sales had a nexus to Connecticut sufficient to require Dell Catalog Sales to collect sales and use taxes from its customers on the purchase of computers and related products and to remit these taxes to the commissioner. The commissioner relies on the holding in *Scripto v. Carson*, 362 U.S. 207, 211, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960) that the characterization of the representative is of no "constitutional significance," be it agent, employer, or independent contractor.

The commissioner's position is supported by the stand taken by the Multistate Tax Commission. "At the end of 1995, the Multistate Tax Commission (MTC), working together with 26 states, issued Nexus Program Bulletin 95-1. The bulletin set forth the position that an out-of-state vendor of computers generally has nexus for sales and use tax and income tax **818 purposes with the market state if the vendor contracts with a third party to provide the purchasers with repair services for their computers under the vendor's warranty." R. Pomp & M. McIntyre, "State Taxation of Mail-Order Sales of Computers After Quill: An Evaluation of MTC Bulletin 95-1," 2 State and Local Taxation (R. Pomp & O. Oldman eds., 3d Ed. Rev. 2000) p. 9-58.

Professors Pomp & McIntyre see the issue posed by the stand of the Multistate Tax Commission as "whether an independent enterprise constitutes a service representative of a seller of computers if that enterprise provides repair services for the

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seller's in-state customers under a contractual arrangement with the seller." Id.

Two United States Supreme Court cases, *Scripto v. Carson*, supra, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 and *180 *Tyler Pipe Industries v. Washington State Dept. of Revenue*, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987), "make it clear that nexus over an out-of-state seller may be established by the activities of unrelated third parties who act on behalf of the seller in the state. What remains unclear is the extent to which activities of independent contractors in a state will subject an out-of-state seller to use tax collection responsibilities." 2 J. Hellerstein & W. Hellerstein, supra, ¶ 19.02[2][a], p. 19-11. Both Hellerstein and the commissioner focus on the activities of the independent contractor located in the taxing state acting on behalf of the out-of-state retailer as a basis for finding nexus in the taxing state. This focus is consistent with the holding in *Quill Corp. v. North Dakota*, supra, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91.

In *Scripto v. Carson*, supra, 362 U.S. at 211, 80 S.Ct. 619, the plaintiff, Scripto, Inc., had "ten wholesalers, jobbers or 'salesmen' conducting continuous local solicitation in Florida and forwarding the resulting orders from that State to Atlanta for shipment of the ordered goods. The only incidence of this sales transaction that is nonlocal is the acceptance of the order." As in the present case, the contract between Scripto and the "salesmen" specifically provided that the intention of the parties was to create the relationship of independent contractor. Id., at 209, 80 S.Ct. 619. The *Scripto* court found the nexus requiring Scripto to pay a use tax to Florida to be the activities of the ten "salesmen," even though the "salesmen" were considered independent contractors. Id., at 211, 80 S.Ct. 619. Whether the ten were salesmen or independent contractors, the *Scripto* court concluded "that such a fine distinction is without constitutional significance.... To permit such formal 'contractual shifts' to make a constitutional difference would open the

gates to a stampede of tax avoidance." Id.

The interaction between Dell Catalog Sales and BancTec was based on service contract sales brokerage agreements. Under these agreements, Dell Catalog *181 Sales, as an affiliate of Dell USA, L.P., was authorized to offer for sale the BancTec service contracts to Dell Catalog Sales customers either at the time of the sale of the computer or at any time thereafter at an increase in price. As the parties have stipulated, Dell Catalog Sales acted as BancTec's broker in marketing BancTec's service contracts, and Dell entities provided certain technical assistance to BancTec in connection with BancTec's service contracts, in exchange for the contract commission. BancTec in turn agreed to enter into service contracts with those customers who purchased computers from Dell Catalog Sales.^{FN3} In the sale of the service contracts**819 on behalf of BancTec, Dell Catalog Sales set the price of the service contracts and retained as a commission, the difference between the retail price charged to the customer for each BancTec service contract sold by Dell Catalog Sales, and the amount due to BancTec for that contract. Dell Catalog Sales acknowledged that the sale of service contracts by BancTec to Connecticut customers was subject to the Connecticut sales tax. Dell Catalog Sales calculated and collected the Connecticut sales tax on the price of a service contract when a Dell Catalog Sales customer decided to purchase a Dell computer and a BancTec service contract. Dell Catalog Sales remitted the sales tax to the department of revenue services.

FN3. Although not raised by the parties, it does appear that the service contract sales brokerage agreements were, in general concept, an outsourcing agreement. "Outsourcing agreement" is defined as "[a]n agreement to handle substantially all of a party's business requirements, esp. in the areas of data processing and information management." Black's Law Dictionary (7th Ed. 1999) 1129.

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Although it appears that BancTec was operating in Connecticut on Dell's behalf, the parties have, in fact, stipulated that BancTec was an independent computer service provider throughout the United States, and that on-site service was performed solely by BancTec or its subcontractors. This stipulation of the parties negates *182 the claim of the commissioner that BancTec was the agent of the plaintiff in Connecticut. By stipulating that BancTec was an independent service provider, the commissioner acknowledged that Dell had no right to direct and control the work of BancTec. See *Beckenstein v. Potter & Carrier, Inc.*, 191 Conn. 120, 132-33, 464 A.2d 6 (1983). The court also finds credible the testimony of Michael Burns, vice president of sales and marketing of BancTec, that servicing computers was their expertise and that Dell did not control or interfere in BancTec's dealings with the customer. This lack of control by Dell substantiates the stipulation of the parties that BancTec was not an agent for Dell.

In the actual operation of the service contract, the fulfillment of the contract required a significant effort by Dell Tech Support to correct the consumer's problem. For this effort, Dell received a major portion of the charge for the contract. BancTec, on the other hand, received a small portion of the charge for the contract, indicating that BancTec's effort in going on-site in Connecticut to service the consumer's computer had to be minimal. No evidence was presented as to the number of service calls, if any, that were made by BancTec's representatives on direction from Dell Tech Support. The court cannot assume that BancTec had a Connecticut representative in Connecticut, or that the representative resided in another state and made service calls in Connecticut when directed.

The court notes that Dell provides service to the consumer under the terms of the service contract only by telephone in Texas, and BancTec, for its part, performs only on-site service to the consumer in Connecticut. The court notes further that Dell markets and sells the service contract to its own

customer at the time that it sells the customer a computer; that Dell sets the price of the contract to the consumer; that Dell earns a substantial portion of the cost of the contract; and, *183 that Dell performs a substantial part of the service required under the terms of the service contract. Although Dell's name does not appear on the service contract as a contracting party, Dell is an integral part and a major ingredient in the performance of the contract. Cases dealing with the issue of whether the use of independent service **820 representatives provides the in-state physical contacts required to establish a nexus by an out-of-state seller focus on the extent of the activities of the in-state independent service representative. In *Scripto*, ten independent service representatives conducting continuous local solicitation in Florida and forwarding the orders to the out-of-state seller for acceptance of the orders was a sufficient nexus for the state of Florida to require the out-of-state seller to collect a state use tax upon the sale of the goods shipped to customers in Florida. *Scripto v. Carson*, supra, 362 U.S. at 210-211, 80 S.Ct. 619. In *Tyler Pipe Industries v. Dept. of Revenue*, supra, 483 U.S. at 251, 107 S.Ct. 2810, the United States Supreme Court held that having resident sales representatives in the taxing jurisdiction to establish and maintain the seller's market constituted physical contacts that established a sufficient nexus to impose a business and occupation tax on sales upon the out-of-state seller. The *Tyler* court stated: "[T]he crucial factor governing nexus is whether the activities performed [in Washington] on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." (Internal quotation marks omitted.) *Id.*, at 250-51, 107 S.Ct. 2810. *Tyler* was a direct tax case, not a sales and use tax case, but one sees that the principle of nexus associated with the extent of the in-state activity applies with equal force to cases involving sales and use taxes.

The Kansas Supreme Court, in deciding *In re the Appeal of InterCard*, 270 Kan. 346, 14 P.3d 1111 (2000)(*InterCard*), did an extensive review of the

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following *184 United States Supreme Court cases and state supreme court cases dealing with the issue of nexus: *Quill Corp. v. North Dakota*, supra, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91; *Tyler Pipe Industries v. Dept. of Revenue*, supra, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199; *National Geographic v. California Equalization Board*, 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977); *National Bellas Hess v. Dept. of Revenue*, supra, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505; *Scripto v. Carson*, supra, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660; *Dept. of Revenue v. Care Computer Systems, Inc.*, 197 Ariz. 414, 4 P.3d 469 (Ct.App.2000); *Town Crier, Inc. v. Dept. of Revenue*, 315 Ill.App.3d 286, 248 Ill.Dec. 105, 733 N.E.2d 780 (2000); *In re Tax Appeal of Scholastic Book Clubs, Inc.*, 260 Kan. 528, 920 P.2d 947 (1996); *Magnetek Cotrols, Inc. v. Treasury Dept.* 221 Mich.App. 400, 562 N.W.2d 219 (1997); *Orvis Co. v. Tax Appeals Tribunal*, 86 N.Y.2d 165, 654 N.E.2d 954, 630 N.Y.S.2d 680 (1995); *Koch Fuels, Inc. v. Clark*, 676 A.2d 330 (R.I.1996).

The *Intercard* court, after analyzing the aforementioned cases, stated: "In summary, the Commerce Clause requires a taxing state to have substantial nexus with an out-of-state business to impose use tax collection and remittance duties. See *Complete Auto [Transit, Inc. v. Brady*, supra, 430 U.S. at] 279, 97 S.Ct. 1076. Substantial nexus requires a finding of physical presence in the taxing state. [*National Bellas Hess v. Dept. of Revenue*, supra, 386 U.S. at] 758, 87 S.Ct. 1389. The continuous physical presence of offices and employees in a taxing state is sufficient to impose a use tax collection duty even though the in-state presence is unrelated to the transaction being taxed. *National Geographic [v. California Equalization Board*, supra, 430 U.S. at] 560, 97 S.Ct. 1386. Mail-order sales without more are a 'safe harbor' for out-of-state vendors. [*National Bellas Hess v. Dept. of Revenue*, supra, 386 U.S. at] 758, 87 S.Ct. 1389. A slightest presence is not sufficient to establish**821 a

substantial nexus[; *National Geographic v. California Equalization Board*, supra 430 U.S. at 556, 97 S.Ct. 1386;] *185 but some states have found that 'more than a slightest presence' is sufficient. *Orvis [Co. v. Tax Tribunal*, supra, 86 N.Y.2d at] 178, 630 N.Y.S.2d 680, 654 N.E.2d 954. The physical presence requirement may turn on the presence in the taxing state of a small sales force, plant, or office. *Quill [Corp. v. North Dakota*, supra, 504 U.S. at] 315, 112 S.Ct. 1904." *In re the Appeal of Intercard*, supra, 270 Kan. at 364, 14 P.3d 1111.

In *Intercard*, Intercard's technicians made eleven visits to Kinko's stores in Kansas to install electronic data card readers purchased from Intercard. The eleven contacts occurred during a three month period and totaled forty-four hours. The court in *Intercard*, noted that, "[t]he parties stipulated that Intercard was not incorporated or registered as a foreign corporation doing business in Kansas; all contracts and sales occurred outside of Kansas; and Intercard had no offices or employees in Kansas." *In re the Appeal of Intercard*, supra, 270 Kan. at 364, 14 P.3d 1111. The Kansas Supreme Court agreed with the findings of the Kansas Board of Tax Appeals in *Intercard*, that the eleven "incursions to install cardreaders in Kansas were isolated, sporadic, and insufficient to establish a substantial nexus to Kansas." *Id.*

The Kansas Supreme Court recently came to a contrary conclusion to that of *Intercard*, and reversed the board of tax appeals' finding of no nexus in a commerce clause case. *In the Matter of the Appeal of Family of Eagles*, 275 Kan. 479, 66 P.3d 858 (2003)(*Family of Eagles*).

In *Family of Eagles*, two subsidiaries operated as selling branches for Family of Eagles, Ltd., a wholesaler. The wholesaler did not own property in Kansas and had no physical presence in Kansas except independent service representatives who were Kansas residents. The wholesaler purchased coins, jewelry, and other products at wholesale and resold these items through commissioned independent service representatives. There *186 was no solicitation

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in Kansas by the wholesaler through advertising, telemarketing or catalogs. The independent service representatives solicited retail purchase orders from Kansas residents on a one-on-one basis and sent purchase order forms with payment to the wholesaler in Texas for acceptance and shipping of the product to the customer by common carrier. An independent service representative could represent other companies and product lines and could sell to customers in any state.

The Kansas Supreme Court in *Family of Eagles* found that the facts in that case were similar to the salesmen in *Scripto* who took orders in Florida for a Georgia corporation. *In the Matter of the Appeal of Family of Eagles*, supra, 275 Kan. at 490, 66 P.3d 858.

While *Intercard* was decided on the fact that eleven incursions into Kansas by Intercard technicians to install cardreaders were not sufficient to establish a substantial nexus under *Quill*, substantial nexus was found in *Family of Eagles*, even though "the record lacks clarity regarding the extent or amount of sales by Kansas [independent service representatives] to Kansas residents [and] no one has suggested that the Kansas [independent service representatives] never sell to Kansas residents. The [independent service representatives] do sell to Kansas residents and in doing so help to develop [the wholesaler's] Kansas market." *Id.*, at 864. The court in *Family of Eagles* did not explain how the wholesaler could develop a market in Kansas without knowing the extent or amount of sales it said was lacking from **822 the record. It would seem that the Kansas court in *Family of Eagles* considered a sales force of independent service representatives in Kansas to be comparable to the sales force of independent service representatives in Florida under *Scripto* as the linchpin for finding nexus.

*187 In the present case, Dell Catalog Sales, as the parties have stipulated, had no physical presence in Connecticut. From the standpoint of physical presence in Connecticut, between BancTec and Dell Catalog Sales customers, it was only the service

contract that required BancTec to make an on-site service call to the customer in Connecticut. One cannot escape the fact, however, that BancTec served an important need of Dell Catalog Sales to service the Dell customers in Connecticut. Dell Catalog Sales benefitted financially from the sales of the service contracts as well as the ability to have an outsourced repair service attend to the needs of its customers in Connecticut. See 2 R. Pomp & O. Oldman, supra, p. 9-63. The missing ingredient in determining whether BancTec's on-site service established nexus in Connecticut as a representative of Dell would be the frequency, if any, of the number of on-site service calls.

The present case is akin to the facts in *Intercard* where the issue was whether the eleven service contacts during a three month period were sufficient to establish a substantial nexus. For the most part, the facts in the present case were developed by a stipulation of the parties. The stipulation of facts contains no information regarding the extent of BancTec's activities in Connecticut. One may infer, however, that since Dell earned 90 percent of the price of the service contract and BancTec earned 10 percent in Connecticut, the number of on-site calls must have been minimal.

[3][4][5] Under *Quill v. North Dakota*, supra, 504 U.S. at 317, 112 S.Ct. 1904, the bright line test is substantial physical presence in the taxing state. A slight presence is not sufficient to establish a substantial nexus. *National Geographic v. California Equalization Board*, supra, 430 U.S. at 556, 97 S.Ct. 1386. Isolated and sporadic physical contacts are insufficient to establish a substantial nexus to Connecticut. *In re the Appeal of Intercard*, supra, 270 Kan. at 364, 14 P.3d 1111. This leads to the question of who has the burden to show the frequency of on-site service calls in Connecticut.

[6][7][8] *188 The commissioner initially determined that Dell Catalog Sales had sufficient physical contacts in Connecticut through the activities of BancTec to register Dell Catalog Sales in Connecticut involuntarily for the purpose of collecting a

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sales or use tax on the sale of computers to its Connecticut customers. Dell Catalog Sales has brought the present action challenging the commissioner's determination. The court is mindful of the general tax concept that: " '[W]hen the issue is the imposition of a tax, rather than a claimed right to an exemption or a deduction, the governing authorities must be strictly construed against the commissioner and in favor of the taxpayer.' " *Leonard v. Commissioner of Revenue Services*, 264 Conn. 286, 295, 823 A.2d 1184 (2003), citing *Andersen Consulting, LLP v. Gavin*, 255 Conn. 498, 511, 767 A.2d 692 (2001). With this concept in mind, and recognizing that a tax appeal is a trial de novo; *Jones v. Crystal*, 242 Conn. 599, 601, 699 A.2d 961 (1997); the burden is placed upon the commissioner to establish that Dell Catalog Sales had sufficient substantive physical contacts in this state to warrant the involuntary imposition of a tax. Since the court finds no facts to support the commissioner's claim that BancTec had sufficient, substantive**823 physical presence in the state of Connecticut, the plaintiff's appeal must be sustained.

Accordingly, judgment may enter in favor of the plaintiff sustaining this appeal without costs to either party.

Conn.Super.,2003.
Dell Catalog Sales, L.P. v. Commissioner of Revenue Services
48 Conn.Supp. 170, 834 A.2d 812

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Court of Appeals of Tennessee,
 Western Section, at Nashville.
 J.C. PENNEY NATIONAL BANK, Plaintiff/Appellant,

v.

Ruth E. JOHNSON, Commissioner of Revenue,
 State of Tennessee, Defendant/Appellee.

Dec. 17, 1999.

Application for Permission to Appeal Denied by
 Supreme Court May 8, 2000.

Out-of-state bank brought action against the Commissioner of Revenue to challenge the constitutionality of franchise and excise taxes on its credit card business. The Chancery Court, Davidson County, Ernest Pellegrin, Special Chancellor, upheld the taxes. Bank appealed. The Court of Appeals, Highers, J., held that: (1) the bank was not physically present in the state and, thus, lacked a substantial nexus necessary for the taxes to satisfy the Commerce Clause, and (2) the taxes satisfied the Due Process Clause.

Reversed.

West Headnotes

[1] Commerce 83 ⚡62.71

83 Commerce

83II Application to Particular Subjects and
 Methods of Regulation

83II(E) Licenses and Taxes

83k62.70 Taxation in General

83k62.71 k. In General. Most Cited

Cases

Constitutional Law 92 ⚡4135

92 Constitutional Law

92XXVII Due Process

92XXVII(G) Particular Issues and Applications

92XXVII(G)6 Taxation

92k4135 k. In General. Most Cited
 (Formerly 92k281.5)

A state's power to tax may be sustained under the Due Process Clause, but imposition of the tax may nonetheless violate the Commerce Clause. U.S.C.A. Const. Art. 1, § 8, cl. 3; U.S.C.A. Const.Amend. 14.

[2] Constitutional Law 92 ⚡4135

92 Constitutional Law

92XXVII Due Process

92XXVII(G) Particular Issues and Applications

92XXVII(G)6 Taxation

92k4135 k. In General. Most Cited
 (Formerly 92k281.5)

Constitutional Law 92 ⚡4137

92 Constitutional Law

92XXVII Due Process

92XXVII(G) Particular Issues and Applications

92XXVII(G)6 Taxation

92k4136 Property Taxes

92k4137 k. In General. Most Cited

Cases

(Formerly 92k281.5)

The Due Process Clause requires some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax. U.S.C.A. Const.Amend. 14.

[3] Constitutional Law 92 ⚡4140

92 Constitutional Law

92XXVII Due Process

92XXVII(G) Particular Issues and Applications

92XXVII(G)6 Taxation

92k4140 k. Franchise Taxes. Most Cited Cases

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(Formerly 92k283)

Constitutional Law 92 ↪4141

92 Constitutional Law
 92XXVII Due Process
 92XXVII(G) Particular Issues and Applications

92XXVII(G)6 Taxation
 92k4141 k. Excise Taxes. Most Cited

Cases
 (Formerly 92k283)

Taxation 371 ↪2242

371 Taxation
 371III Property Taxes
 371III(D) Corporations and Corporate Stock and Property
 371k2242 k. Financial Institutions. Most Cited Cases
 (Formerly 371k165)

Taxation 371 ↪3486

371 Taxation
 371VIII Income Taxes
 371VIII(D) Persons Liable
 371k3486 k. Foreign Corporations. Most Cited Cases
 (Formerly 371k165)

Imposing franchise and excise taxes on out-of-state bank did not violate due process despite the bank's lack of a physical presence in the state. U.S.C.A. Const.Amend. 14.

[4] Commerce 83 ↪12

83 Commerce
 83I Power to Regulate in General
 83k11 Powers Remaining in States, and Limitations Thereon
 83k12 k. In General. Most Cited Cases
 Under the negative or dormant Commerce Clause, the grant of specific power to Congress to regulate interstate commerce necessarily carries the negative implication that the states may not act to interfere

with interstate commerce. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[5] Constitutional Law 92 ↪4145

92 Constitutional Law
 92XXVII Due Process
 92XXVII(G) Particular Issues and Applications

92XXVII(G)6 Taxation
 92k4145 k. Sales and Use Taxes. Most

Cited Cases
 (Formerly 92k281.5)

An out-of-state seller's substantial nexus with a taxing state under the Commerce Clause is not the same as minimum contacts under the Due Process Clause. U.S.C.A. Const. Art. 1, § 8, cl. 3; U.S.C.A. Const.Amend. 14.

[6] Commerce 83 ↪62.71

83 Commerce
 83II Application to Particular Subjects and Methods of Regulation
 83II(E) Licenses and Taxes
 83k62.70 Taxation in General
 83k62.71 k. In General. Most Cited Cases

Constitutional Law 92 ↪4145

92 Constitutional Law
 92XXVII Due Process
 92XXVII(G) Particular Issues and Applications

92XXVII(G)6 Taxation
 92k4145 k. Sales and Use Taxes. Most

Cited Cases
 (Formerly 92k281.5)

The Commerce Clause imposes a greater limitation on a state's right to tax an out-of-state seller than does the Due Process Clause. U.S.C.A. Const. Art. 1, § 8, cl. 3; U.S.C.A. Const.Amend. 14.

[7] Commerce 83 ↪63.10

83 Commerce

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83II Application to Particular Subjects and Methods of Regulation
 83II(E) Licenses and Taxes
 83k63 Licenses and Privilege Taxes
 83k63.10 k. Particular Subjects and Taxes. Most Cited Cases

Taxation 371 ↪2242

371 Taxation
 371III Property Taxes
 371III(D) Corporations and Corporate Stock and Property
 371k2242 k. Financial Institutions. Most Cited Cases
 (Formerly 371k165)

Taxation 371 ↪3486

371 Taxation
 371VIII Income Taxes
 371VIII(D) Persons Liable
 371k3486 k. Foreign Corporations. Most Cited Cases
 (Formerly 371k165)
 Out-of-state bank's presence had to be more than merely doing business in the state in order for franchise and excise taxes to satisfy the Commerce Clause. U.S.C.A. Const. Art. 1, § 8, cl. 3; T.C.A. §§ 67-4-806(d)(2), 67-4-903(f)(2) (Repealed).

[8] Commerce 83 ↪63.10

83 Commerce
 83II Application to Particular Subjects and Methods of Regulation
 83II(E) Licenses and Taxes
 83k63 Licenses and Privilege Taxes
 83k63.10 k. Particular Subjects and Taxes. Most Cited Cases

Taxation 371 ↪2242

371 Taxation
 371III Property Taxes
 371III(D) Corporations and Corporate Stock and Property

371k2242 k. Financial Institutions. Most Cited Cases
 (Formerly 371k165)

Taxation 371 ↪3486

371 Taxation
 371VIII Income Taxes
 371VIII(D) Persons Liable
 371k3486 k. Foreign Corporations. Most Cited Cases
 (Formerly 371k165)

Out-of-state bank that issued credit cards to state residents was not physically present in the state and, thus, lacked a substantial nexus necessary for franchise and excise taxes to satisfy the Commerce Clause, even though the bank owned the cards, its parent corporation owned retail stores in the state, and affiliates solicited business through the mail; the accounts in another state, not the cards, were the real assets, the stores were not affiliated with the credit card operations, and the bank had no offices or agents in the state. U.S.C.A. Const. Art. 1, §8, cl. 3.

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HIGHERS, J.

The J.C. Penney National Bank appeals from the Chancery Court of Davidson County, which upheld the imposition of franchise and excise taxes against the Bank by the Tennessee Department of Revenue. For the reasons stated herein, we reverse the decision of the trial court.

Facts and Procedural History

At all relevant times, the J.C. Penney National Bank ^{FN1} (“the National Bank” or “JCPNB”) was a federally chartered national banking association incorporated under the laws of Delaware with its principal place of business and commercial domicile in Harrington, Delaware. Ruth E. Johnson (“Commissioner”) was the Commissioner of Revenue for the State of Tennessee and was named in this case in her official capacity. The present appeal arises from the Commissioner’s imposition of franchise and excise taxes against JCPNB on income allegedly generated by JCPNB’s credit card activities in the State of Tennessee. In order to clarify the positions of the respective parties, we find it necessary briefly to describe, perhaps to the point of oversimplification, the various entities and procedures involved in JCPNB’s credit card business.

FN1. The National Bank was acquired by the J.C. Penney Company, Inc. in 1983.

Through its Delaware offices, JCPNB offers consumer banking services such as deposit accounts, home mortgage lending, general consumer loans, and automated teller machine (“ATM”) services. In addition to the normal banking services which it provides, JCPNB engages in credit card lending through the issuance of Visa and MasterCard credit cards.^{FN2} JCPNB has *833 been issuing Visa credit cards since 1983, and MasterCard credit cards since 1984.

FN2. We stress, as does the appellant, that JCPNB’s Visa and MasterCard credit card business exists independent of the J.C.

Penney Company’s “proprietary card business.” Visa and MasterCard are membership corporations consisting of member banks throughout the United States and the world, formed to facilitate the use of credit cards. While the Visa and MasterCard cards issued by JCPNB may be used at many locations, the proprietary card issued by J.C. Penney may only be used at J.C. Penney retail stores.

JCPNB contracted with the J.C. Penney Company, its parent company, to perform various marketing and processing services that were necessary to create and maintain JCPNB’s credit card business. Under that contract, the J.C. Penney Company agreed to provide services such as credit card solicitation, marketing, statement and payment processing, customer service, and collection. The J.C. Penney Company, in turn, contracted with other companies to provide many of these services.

The J.C. Penney Company contracted with Maryland Bank National Association (“MBNA”), an unrelated corporation domiciled in Texas, to provide the data processing related to the National Bank’s credit card business. MBNA is a company that offers credit card processing services to a variety of banks. As transactions were received through the Visa or MasterCard network, MBNA posted them to the appropriate cardholder account. MBNA was also responsible for sending out account statements each month.

The J.C. Penney Company also contracted with Business Services, Inc. (“BSI”), a wholly owned subsidiary, to provide general marketing and payment processing services.^{FN3} After MBNA sent monthly statements to the cardholders, the cardholders would send their payments to a BSI payment processing center in San Antonio, Texas. Also, as part of its marketing responsibilities, BSI solicited credit card accounts on behalf of JCPNB. These solicitations were sent via U.S. Mail to potential customers throughout the United States, including Tennessee.^{FN4} As the first step in the soli-

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citation process, BSI obtained the names of possible customers. Some names were obtained from a list of people who had a prior credit history with the J.C. Penney Company. BSI also obtained potential customer names through the use of mailing lists from various credit bureaus.^{FN5} BSI would then submit the list of potential cardholders to a national credit bureau who would select those people having a credit profile consistent with the criteria established by JCPNB. The selected people would then receive an offer to apply for a credit account with the National Bank.

FN3. In 1996, BSI was sold to an unrelated third party and became Alliance Data Systems, Inc. After the sale, Alliance continued to provide the same services for JCPNB at the same prices and on the same terms.

FN4. There was, however, no solicitation which specifically targeted Tennessee residents.

FN5. Local credit bureaus in Tennessee are operated as for-profit corporations or as non-profit corporations formed by local merchants for the purpose of assembling necessary credit information for the merchants to engage in credit transactions. Local merchants who are members of a credit bureau provide their credit files to the local credit bureau of which they are a member. The local bureau is usually an affiliate of one of the three national automated consumer reporting agencies (Transunion, TRW, or Equifax). The local credit bureau forwards the local creditors' account information to its national consumer reporting affiliate. The national agency incorporates this credit information into its existing credit files. When JCPNB contracted with national credit reporting agencies, it did so through contracts negotiated with the agencies' national offices, which were outside of Tennessee.

None of the activities described above occurred in the State of Tennessee, other than the solicitations being mailed to Tennessee residents. Also, all of the entities involved in the National Bank's credit card operation were located outside the State of Tennessee.^{FN6} JCPNB itself maintained no offices or places of business in Tennessee, nor did it have any employees in the State.

FN6. The J.C. Penney Company does own and operate the J.C. Penney retail stores that are located in Tennessee. However, as will be dealt with in more detail later, those stores were not involved in the National Bank's credit card business.

The Visa and MasterCard credit cards issued by the National Bank were "universal cards." This name derives from the *834 fact that these cards could be used to purchase goods and services throughout the world from any retailer who displayed the Visa or MasterCard logo.^{FN7} A credit card purchase may be made in two ways. The most common transaction occurs when the cardholder presents the card to a merchant and the merchant swipes the card through a point of sale terminal. The terminal reads the magnetic strip on the back of the card and transmits a request for authorization to the issuing bank. Another type of transaction can occur when the cardholder provides a merchant with his or her account number and expiration date, but does not physically present the card to the merchant. This type of transaction generally occurs when purchases are being made over the telephone or, in today's world, via the internet. In either case, a sales slip is generated which the merchant submits to a merchant bank with whom the merchant has a contract.^{FN8} The merchant bank will then remit the transaction amount to the merchant minus a discount. The merchant bank may be located inside or outside Tennessee.

FN7. The cards may also be used to secure cash advances at participating Automated Teller Machines ("ATM's").

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FN8. Merchant banks can be divided into two groups. One group is comprised of those banks which have entered into national contracts which cover all locations of a merchant throughout the United States. The other group of merchant banks is comprised of banks which have entered into contracts with individual Tennessee merchants to accept charge slips from Visa and MasterCard credit card transactions. JCPNB serves as a merchant bank for some merchants with store locations throughout the United States, including Tennessee. Under these agreements, each merchant has agreed to accept the Visa or MasterCard credit cards for purchases and JCPNB has agreed to accept the charge slips from these transactions for payment to the merchant's account. These agreements were negotiated between JCPNB and the merchant's corporate headquarters, rather than with a local outlet of a merchant. No such merchant had their corporate headquarters in Tennessee.

The merchant bank records the information from the sales slip and transmits the information to a VISA (USA) Inc. or MasterCard International, Inc. interchange center for the purpose of obtaining payment of the face amount of the slip, less an interchange fee, from the bank that issued the credit card, which, in this case, was JCPNB. Visa and MasterCard regularly inform JCPNB of the amount owed by it with respect to sales slips which have been submitted by all merchant banks. From Delaware, the National Bank transfers funds to pay these amounts.

The J.C. Penney National Bank charged an annual fee on most Visa and MasterCard credit card accounts, as well as interest and other fees in connection with the account. The National Bank then paid an income tax to the State of Delaware based upon 100% of the National Bank's net income. JCPNB had never filed a franchise or excise tax return with

the Tennessee Department of Revenue, nor had it ever paid any franchise or excise taxes to the State of Tennessee. However, the Field Audit Division of the Tennessee Department of Revenue audited JCPNB in 1995 for the period of February 1990 through January 1994. On November 1, 1995, the Department of Revenue issued an assessment to the National Bank in the amount of \$178,314, which included: \$111,725 in franchise and excise taxes, \$27,932 in penalties, and \$38,657 in interest. The assessment was based on the determination that JCPNB was a "financial institution" as defined in T.C.A. § 67-4-804(a)(8) and was subject to franchise and excise taxation under T.C.A. §§ 67-4-806 and 67-4-903. In calculating the taxes, the Department of Revenue applied the single-factor, gross receipts apportionment formula applicable to financial institutions found in T.C.A. §§ 67-4-815 and 67-4-919.

In accordance with T.C.A. § 67-1-1801, the National Bank filed this action contesting the assessment of the franchise and excise taxes on three grounds: (1) the assessment violated the Commerce Clause *835 of the United States Constitution; (2) the assessment violated the Due Process Clause of the United States Constitution; and (3) basing the assessment upon the single receipts factor apportionment formula violated the Due Process Clause of the United States Constitution. The case was tried in the Chancery Court of Davidson County on February 9 and 10, 1998. The chancellor issued a memorandum opinion on October 16, 1998 upholding the assessment. The chancellor concluded that the assessment was not violative of the requirements of the Due Process Clause of the United States Constitution, and a sufficient nexus existed between the State of Tennessee and JCPNB to satisfy the requirements of the Commerce Clause. The Commissioner filed a motion to alter or amend the order because it did not provide for a judgment against JCPNB for the disputed tax liability and did not provide for an award of attorney's fees and expenses pursuant to T.C.A. § 67-1-1803(d). The chancellor entered a final order on December 7,

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1998, awarding judgment in favor of the Commissioner in the amount of \$178,314, as well as awarding attorney's fees and expenses to the Commissioner as the prevailing party. This appeal followed.

On appeal, JCPNB presents a single question for review. That question is whether JCPNB's relationship with the State of Tennessee satisfies the "substantial nexus" requirement of the Commerce Clause.

Law and Analysis

Financial institutions "doing business" in the State of Tennessee are subject to excise and franchise taxes pursuant to T.C.A. §§ 67-4-806(d)(2)^{FN9} and 67-4-903(f)(2)^{FN10}. The Commissioner contends that JCPNB's credit card activities come within the terms of the statutory provisions because JCPNB: (1) regularly solicits business from customers in Tennessee; (2) provides credit card services to its customers; (3) engages in transactions in which it extends credit to these customers; and (4) receives interest income and fee income from these transactions and loans. Appellee's Brief at p. 10. JCPNB, however, does not challenge the statutes pursuant to which the taxes were imposed. Rather, JCPNB contends that its contacts with the State of Tennessee, even if sufficient under the Tennessee statutory scheme, do not provide a sufficient nexus under the Commerce Clause of the United States Constitution to uphold the assessment.

FN9. (2) Additionally, a financial institution shall be deemed to be doing business in this state if the institution:

- (A) Maintains an office in this state;
- (B) Has an employee, representative or independent contractor conducting business in this state;
- (C) Regularly sells products or services of any kind or nature to customers in this state that receive the product or service

in this state;

(D) Regularly solicits business from potential customers in this state;

(E) Regularly performs services outside this state which are consumed in this state;

(F) Regularly engages in transactions with customers in this state that involve intangible property, including loans, and result in receipts flowing to the taxpayer from within this state;

(G) Owns or leases property located in this state; or

(H) Regularly solicits and receives deposits from customers in this state.

FN10. The language of this section is identical to T.C.A. § 67-4-806(d)(2).

I.

This case presents a question regarding the limits of Tennessee's power to tax out-of-state sellers. Constitutional limitations on this power are found in both the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of article 1, § 8. In the trial court, JCPNB challenged the franchise and excise taxes as a violation of both constitutional provisions. On this appeal, JCPNB has limited its question presented to consideration of whether the taxes imposed by the State of Tennessee violates the Commerce Clause. *836 However, JCPNB also claims that the Commissioner has "blurred the line" between Due Process and Commerce Clause analysis.

Some of the Commissioner's arguments do, in fact, confuse the analysis between the Commerce Clause and the Due Process Clause. For example, in arguing that JCPNB has a substantial nexus with the State of Tennessee, the Appellee's brief states:

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“[JCPNB] is exercising the substantial privilege of doing business in Tennessee. On this basis, sufficient nexus exists and JCPNB is receiving the protections which establish a basis for finding of nexus.” The Commissioner makes this statement after quoting a passage from *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510 (1980).^{FN11} However, the phrase “substantial privilege of doing business” is traditionally used in the area of due process. Additionally, the *Mobil Oil* case specifically used the language which Appellee quotes in the context of a Due Process analysis.^{FN12} Therefore, recognizing the confusion that may exist between the parties, we find it necessary to clarify the specific limitations imposed by both Due Process and the Commerce Clause.

FN11. The quote, as it appears in Appellee's Brief, states:

The requisite “nexus” is supplied if the corporation avails itself of the “substantial privilege of carrying on business” within the State; and “[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus with such a tax and transactions within a state for which the tax is an exaction.

FN12. The section in which the quoted language appears begins with the following statement: “For a state to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: ...” *Mobil Oil*, 445 U.S. at 436, 100 S.Ct. 1223.

[1] In *Quill Corp. v. North Dakota*, the United States Supreme Court considered the constitutional limitations on a state's power to tax imposed by both the Due Process Clause and the Commerce Clause. 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992). The Court began by noting that the “two claims are closely related.” *Id.* (quoting *National*

Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967)). However, the Court also pointed out that the two Clauses each pose distinct limits on the taxing power of the States. *Quill*, 504 U.S. at 305, 112 S.Ct. 1904. Therefore, a State's power to tax may be sustained under the Due Process Clause, but imposition of the tax may nonetheless violate the Commerce Clause.^{FN13} *Id.* (citing *Tyler Pipe Indus., Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987)).

FN13. In fact, the tax in *Quill* was struck down as violative of the Commerce Clause even though the Court found that the tax did not violate the requirements of the Due Process Clause.

II.

The due process analysis in the area of state taxation of interstate commerce derives from the rules for *in personam* jurisdiction expressed in *International Shoe Co. v. Washington*, and its progeny. 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945). *International Shoe*, the seminal case in the modern due process era, allows a state to assert personal jurisdiction if the defendant has minimum contacts with the jurisdiction “such that the maintenance of the suit does not offend ‘traditional notions of fair play and substantial justice.’” *International Shoe*, 326 U.S. at 316, 66 S.Ct. 154 (quoting *Milliken v. Meyer*, 311 U.S. 457, 463, 61 S.Ct. 339, 343, 85 L.Ed. 278 (1940)). Subsequent cases made clear the point that physical presence in the jurisdiction is not necessary for “minimum contacts” to exist. *See, e.g., Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 105 S.Ct. 2174, 85 L.Ed.2d 528 (1985).

*837 [2] In the context of state taxation, the Due Process Clause “requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.” *Quill*, 504 U.S. at 306, 112 S.Ct. 1904 (quoting *Miller*

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Brothers Co. v. Maryland, 347 U.S. 340, 344-345, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1954)). Prior to the 1967 decision in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), the Supreme Court had found that "definite link" to exist in several cases involving state use taxes. However, the taxpayer in all those cases had some type of physical presence in the taxing state. *Quill* 504 U.S. at 306, 112 S.Ct. 1904. The *Quill* Court noted that the *Bellas Hess* decision suggested that physical presence in the State was *necessary* to sustain jurisdiction under the Due Process Clause. See *Quill* 504 U.S. at 306-307, 112 S.Ct. 1904. Applying the reasoning from the *International Shoe* and *Burger King* decisions, the *Quill* court rejected the notion that due process mandated the physical presence of an out-of-state seller before a state could tax that seller. The Court held that the Due Process Clause does not operate to bar enforcement of a use tax against a mail-order house "that is engaged in continuous and widespread solicitation of business within a state." *Quill*, 504 U.S. at 308, 112 S.Ct. 1904. In other words, if the contacts were sufficient to subject the corporation to personal jurisdiction in the forum state, then imposition of a use tax on the corporation's business in the state would be sustained in the face of a Due Process challenge. Physical presence in the state is not necessary. In so holding, the *Quill* Court noted the policy concerns that drive due process analysis. Specifically, the Court stated:

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 connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytic touchstone of due process nexus analysis.

Quill, 504 U.S. at 312, 112 S.Ct. 1904.

[3] In the present case, the National Bank's relation-

ship with the State of Tennessee was such that the imposition of the franchise and excise taxes was not precluded by due process considerations. The lack of a physical presence in Tennessee does not mandate a finding to the contrary. The following passage from *Burger King Corp. v. Rudzewicz*, cited by the *Quill* Court, is equally applicable in the present case:

Jurisdiction in these circumstances may not be avoided merely because the defendant did not physically enter the forum State. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there.

Burger King, 471 U.S. at 476, 105 S.Ct. 2174. JCPNB has reached out to the citizens of the State of Tennessee through the solicitations for credit cards that were sent on its behalf. Moreover, JCPNB has purposefully availed itself of the substantial privilege of doing business in the State of Tennessee. See *id.* Clearly, the franchise and excise taxes assessed against JCPNB are not violative of the rights guaranteed under the Due Process Clause.

The Due Process Clause, however, is only the first consideration in determining *838 whether a state may tax an out-of-state seller. Having recognized that the Due Process Clause does not preclude imposition of the franchise and excise taxes on JCPNB, we must consider the limitations imposed by the Commerce Clause.

III.

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[4] The Commerce Clause expressly authorizes Congress to “regulate Commerce with foreign Nations, and among the several States.” U.S. CONST. art. I, § 8, cl. 3. In addition to this affirmative grant of power, the “negative” or “dormant” Commerce Clause also serves to prohibit state actions that interfere with interstate commerce. *See Quill*, 504 U.S. at 309, 112 S.Ct. 1904 (citing *South Carolina State Highway Dept. v. Barnwell Bros., Inc.* 303 U.S. 177, 185, 58 S.Ct. 510, 514, 82 L.Ed. 734 (1938)). Simply stated, the fact that the Commerce Clause grants Congress the specific power to regulate interstate commerce necessarily carries the negative implication that the states may not act to interfere with interstate commerce.

The earliest cases in this area strictly limited the state's rights to tax interstate sales. *See, e.g., Leloup v. Port of Mobile*, 127 U.S. 640, 648, 8 S.Ct. 1380, 1384, 32 L.Ed. 311 (1888) (“no state has the right to lay a tax on interstate commerce in any form”). Subsequent decisions by the Court moved away from the absolute limits imposed on state taxation and began to distinguish between “direct” and “indirect” burdens on interstate commerce. This line of cases culminated with the decision in *Freeman v. Hewit*, 329 U.S. 249, 67 S.Ct. 274, 91 L.Ed. 265 (1946), in which the Court formally embraced the distinction and struck down an Indiana tax as a direct tax on interstate sales.

Dormant Commerce Clause jurisprudence in the area of state taxation changed dramatically with the decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). The *Complete Auto* decision rejected the line of cases which had held impermissible the direct taxation of interstate commerce by the states.^{FN14} *Complete Auto* enunciated a four-part test, which provided that a state tax on an out-of-state seller will be sustained so long as 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 Transit, Inc.* 430 U.S. at 279, 97 S.Ct. 1076.

FN14. As stated in *Quill*, the *Complete Auto* decision “renounced the *Freeman* approach as ‘attaching constitutional significance to a semantic difference.’” *Quill*, 504 U.S. at 310, 112 S.Ct. 1904.

[5][6] The question in the present case is whether JCPNB's relationship with the State of Tennessee satisfies the “substantial nexus” requirement found in the first prong of the *Complete Auto* test. That question, in turn, raises the question of what is meant by the term “substantial nexus.” As an initial matter, we can say that substantial nexus under the Commerce Clause is not the same as minimum contacts under the Due Process Clause. *See Quill*, 504 U.S. at 313, 112 S.Ct. 1904 (“Thus, the ‘substantial nexus’ requirement is not, like due process’ ‘minimum contacts’ requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce”). Although stating that proposition in the abstract seems to be simple enough, the actual analysis can be much more confusing. The problem is that phrases such as “minimum contacts” and “substantial nexus” do not really mean anything. There is no definitive line that marks a minimum contact, nor is there a specific point at which a substantial nexus exists. The analysis in this area is necessarily done on a case-by-case basis. However, we are guided by the recognition that the Commerce Clause imposes a greater limitation on Tennessee's right to tax JCPNB than does the Due Process Clause. *839 With the distinctions between the two clauses in mind, we turn to the question of whether a substantial nexus exists to sustain the franchise and excise taxes imposed by the Commissioner.

IV.

[7] We do not consider the fact that JCPNB was “doing business” in Tennessee to be dispositive of the present issue. If that were the case, we would

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have obliterated the distinction between the Due Process Clause and the Commerce Clause. Instead, we must attempt to delineate that level of “presence” in the State of Tennessee that will justify the imposition of the types of taxes that are the subject of this appeal. This “presence” must, in order to satisfy the Commerce Clause, be more than merely “doing business” in the State of Tennessee. JCPNB relies on *Bellas Hess* and *Quill* to argue that physical presence is required. The Commissioner, on the other hand, argues that physical presence is not a formal requirement and the validity of a state tax should be determined under the *Complete Auto* test. The Commissioner refers to this as “contemporary Commerce Clause jurisprudence.” The fundamental flaw in the Commissioner’s argument is that *Complete Auto* does not set a different standard than that contemplated in *Bellas Hess* and *Quill*. Rather, *Bellas Hess* and *Quill* specifically address the first prong, or the substantial nexus requirement, of the *Complete Auto* test. See *Quill*, 504 U.S. at 311, 112 S.Ct. 1904. In that regard, the *Bellas Hess/ Quill* decisions are entirely consistent with the *Complete Auto* test. Both *Bellas Hess* and *Quill* are clear in their holding that in the context of a use tax, physical presence is required in order to satisfy the substantial nexus requirement of *Complete Auto*.

The only real issue is whether there is any reason to distinguish the present case from *Bellas Hess* and *Quill*. The Commissioner argues that those cases are distinguishable because they involved use taxes, whereas the present case involves franchise and excise taxes. We must reject the Commissioner’s argument. While it is true that the *Bellas Hess* and *Quill* decisions focused on use taxes, we find no basis for concluding that the analysis should be different in the present case. In fact, the Commissioner is unable to provide any authority as to why the analysis should be different for franchise and excise taxes.^{FN15} It is certainly true that the *Quill* Court expressed some reservations about the vitality of the *Bellas Hess* decision. See *Quill*, 504 U.S. at 311, 112 S.Ct. 1904 (stating that the *Bellas Hess*

decision might be different were the issue to arise for the first time today). However, we are not in a position to speculate as to how the Supreme Court might decide future cases. We are only able to rely on past decisions. Any constitutional distinctions between the franchise and excise taxes presented here and the use taxes contemplated in *Bellas Hess* and *Quill* are not within the purview of this court to discern. As such, we feel that the outcome of this case is governed by *Bellas Hess* and *Quill*, as those decisions interpret the first prong of the *Complete Auto* test.

FN15. The Commissioner’s brief merely states that it is JCPNB’s burden to show why the *Bellas Hess* rule should be followed in the present case and that they have failed to meet that burden.

[8] JCPNB argues that the present case is “almost identical” to the facts in *Quill*. In many respects, that assertion is correct. JCPNB is a Delaware corporation with no offices or agents in Tennessee, just as the taxpayer in *Quill* had no offices or employees in North Dakota. See *Quill*, 504 U.S. at 302, 112 S.Ct. 1904. Also, JCPNB did not physically engage in any activities in Tennessee connected with its credit card business. Similarly, *Quill* solicited business in North Dakota through catalogs, flyers, and other advertisements and delivered those goods via mail or common-carrier, thereby having no physical presence in North Dakota. *Id.*

*840 In response to JCPNB, the Commissioner asserts several arguments in support of finding that JCPNB does, in fact, have a substantial nexus with Tennessee. First, she argues that the credit cards which JCPNB issued were tangible physical property over which JCPNB maintained ownership, thereby giving JCPNB a physical presence in Tennessee through those cards.^{FN16} Additionally, she argues that the presence of the J.C. Penney retail stores in Tennessee provides the requisite substantial nexus. We will deal with each of these arguments in turn.

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FN16. In making this argument, we do not understand the Commissioner to concede that physical presence is *necessary* for a finding of substantial nexus.

During the tax years in question, JCPNB had between 11,000 and 17,000 accounts with Tennessee residents. The chancellor found that the actual credit cards constituted "tangible property for substantial nexus purposes." In reaching that decision, the chancellor found it persuasive that the cards remained the property of JCPNB. While we agree that a credit card is tangible in that it can be seen and touched, we do not agree that the presence of the credit cards in Tennessee is constitutionally significant. Additionally, we do not find it relevant that JCPNB retained ownership of the cards.

Credit cards, in and of themselves, are virtually worthless. The "value" of these cards is found in the right which the card represents, namely the credit account. The card is merely representative of the customer's right to charge goods and services. The actual card is not even necessary to the transaction.^{FN17} It merely serves as a convenient article on which to record the necessary information regarding the customer's account. As the chancellor correctly determined, the real asset is the intangible account which the card represents. Those accounts were located, for tax purposes, in the State of Delaware and not subject to a Tennessee tax. Therefore, we do not agree with the chancellor's determination that the physical presence of the JCPNB credit cards constituted a basis for finding substantial nexus.^{FN18}

FN17. While it may be common practice to physically present the card when making a purchase, that fact seems to be more of a practical requirement than anything else. The card contains information which identifies the account-holder. Perhaps, it would be much simpler and cost-effective to assign a card-holder his or her account number and allow purchases to be made simply by the verbal recitation of that account

number. However, such a procedure would beg problems. There would be no way to determine whether the person presenting the account number is, in fact, the authorized user. It is certainly conceivable that the cards exist merely to prevent fraud or unauthorized usage.

FN18. Contrary to the chancellor's decision, we find it constitutionally insignificant that the credit cards remained the property of JCPNB. It seems entirely reasonable that the retained ownership merely gave JCPNB the right to end the credit relationship with a customer. After the relationship ended, the actual cards were of little or no value to JCPNB, therefore making ownership of no consequence. In fact, evidence in the record indicates that cards that have been returned by customers are destroyed.

The Commissioner also argues that JCPNB had a physical presence in Tennessee by virtue of the fact the J.C. Penney Company, JCPNB's parent, owned and operated the J.C. Penney retail stores in Tennessee. This argument lacks merit because the retail stores were not affiliated with JCPNB's Visa and MasterCard credit card operations.^{FN19} The retail stores *841 conducted no activities which assisted JCPNB in maintaining its credit card business in Tennessee. The record shows that one could not apply for the JCPNB credit cards at the J.C. Penney retail stores, nor could individuals make a payment on their Visa or MasterCard account at the retail stores. Therefore, we reject the Commissioner's arguments which contend that a substantial nexus exists based on the presence of the J.C. Penney retail stores in Tennessee.

FN19. We note that many of the potential customers for JCPNB credit cards were identified through a list of individuals who had a previous credit history with the J.C. Penney Company. We summarily reject the argument that this was sufficient to

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provide a substantial nexus. There is no evidence to show that the retail stores had anything to do with this information. Every indication is that the J.C. Penney company conducted all of these activities from its corporate offices in Texas. Moreover, JCPNB also obtained the names of potential customers through independent credit reporting agencies. We find no basis for concluding that the use of credit information subjects the user of that information to a tax in the provider's home state. Under this theory, JCPNB would be subject to a tax in any state in which a credit reporting agency with whom JCPNB dealt was located. We believe this theory exemplifies the very sort of state taxation of interstate commerce that the Commerce Clause serves to prevent.

Finally, the chancellor concluded that a substantial nexus existed based on "the activities of the affiliates and third parties working on JCPNB's behalf." In reaching this conclusion, the chancellor relied on *Tyler Pipe Indus. v. Washington State Dep't of Rev.*, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987) and *Scripto v. Carson*, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960). We are unable to agree with the chancellor's reasoning. Both *Tyler Pipe* and *Scripto* involved one crucial element which is absent in the present case. In those cases, activities were being conducted in the taxing state that substantially contributed to the taxpayer's ability to maintain operations in the taxing state. Simply put, the taxpayer in those cases had a physical presence in the taxing state that is lacking in the present case.

In *Scripto*, the Georgia taxpayer employed independent contractors who solicited business in the State of Florida, the taxing state. *See Scripto*, 362 U.S. at 211, 80 S.Ct. 619 ("Each salesman ... is actively engaged in Florida as a representative of *Scripto* for the purpose of attracting, soliciting and obtaining Florida customers"). The real issue in

Scripto was whether it made any constitutional difference that the individuals hired to solicit business were employed as "independent contractors" rather than as regular employees. The court refused to find any meaningful difference between the labels used to describe the employees. *See id.* at 211, 80 S.Ct. 619 (holding the distinction between regular employees and independent contractors to be without constitutional significance).

Similarly, in *Tyler Pipe*, the Supreme Court found that a substantial nexus existed to justify the imposition of a business and occupation tax by the State of Washington.^{FN20} In *Tyler*, the solicitation was "directed by executives who maintain their offices out-of-state and by an *independent contractor located in Seattle.*" *Tyler Pipe*, 483 U.S. at 249, 107 S.Ct. 2810 (emphasis added). The Court, agreeing with the Washington Supreme Court, found the crucial factor to be the fact that the activities which allowed the taxpayer to establish and maintain a market actually took place *in the State of Washington.* *Id.* at 250, 107 S.Ct. 2810 (emphasis added). The Court concluded by stating, "the activities of Tyler's sales representatives adequately support the State's jurisdiction to impose its wholesale tax on Tyler." *Id.* at 251, 107 S.Ct. 2810. Here, as in *Scripto*, the distinguishing factor was the physical presence of the taxpayer in the taxing state.

FN20. The Supreme Court actually vacated the judgment and remanded the case to the state court based on an issue unrelated to the question of substantial nexus.

A review of the facts of the present case convinces this court that JCPNB did not have a physical presence in Tennessee through its affiliates. Neither BSI nor MBNA actually performed any services on behalf of JCPNB in the State of Tennessee. The solicitation, which was the most important function in allowing JCPNB to maintain its business, took place through the U.S. Mail, which, under the holding in *Quill*, does not allow a finding of substantial nexus. In short, the activities which allowed JCPNB to conduct its credit card operation did not occur in

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the State of *842 Tennessee.^{FN21} As such, we believe the chancellor's reliance on *Scripto* and *Tyler Pipe* was misplaced as those cases are clearly distinguishable.

FN21. There is an indication in the record that one of JCPNB's affiliates used a Tennessee collection agency in order to recover moneys owed to JCPNB. Apparently, these collection efforts were aided through the use of the Tennessee court system. This may be the closest that JCPNB comes to having a physical presence in Tennessee. However, we do not believe that the actions of a party so far removed from JCPNB are sufficient to allow the State of Tennessee to levy taxes on JCPNB. The relationship is far too attenuated to confer a physical presence on JCPNB.

It is not our purpose to decide whether "physical presence" is required under the Commerce Clause. However, the Commissioner has pointed to no case in which the Supreme Court of the United States has upheld a state tax where the out-of-state taxpayer had absolutely no physical presence in the taxing state. The Commerce Clause requires a greater relationship than does the Due Process Clause. If we were to uphold the tax assessment against JCPNB, we believe that we would be unjustifiably overlapping the two clauses. While we are confident that the tax assessment satisfies due process, we fail to see the substantial nexus necessary to sustain the tax under the Commerce Clause. *Scripto, Inc. v. Carson*, is, by the Supreme Court's own words, the furthest extension of a state's right to tax an out-of-state seller. However, *Scripto* involved facts that are not present in this case. Specifically, the Georgia company in *Scripto* employed individuals in the State of Florida, the taxing state, to solicit business. Therefore, if *Scripto* is the furthest reach of a state's power to tax, and there is even less of a relationship in this case than was present in *Scripto*, we conclude that a substantial nexus is lacking to uphold the tax assessment against JCPNB.

Conclusion

For the reasons stated herein, we reverse and dismiss the decision of the trial court, which upheld the imposition of franchise and excise taxes against JCPNB. Costs of this appeal are taxed to the appellee, Ruth E. Johnson, Commissioner of Revenue, State of Tennessee, for which execution may issue if necessary.

FARMER and LILLARD, JJ., concur.
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STATE OF WASHINGTON

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No. 37516-8-II

COURT OF APPEALS,
DIVISION II,
OF THE STATE OF WASHINGTON

LAMTEC CORPORATION

Appellant,

v.

DEPT. OF REVENUE, STATE OF WA,

Respondent.

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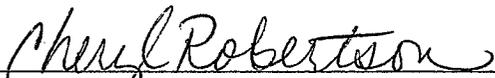
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I hereby certify under penalty of perjury under the laws of the State of Washington that I served a copy of the Reply Brief of Appellant on March 20, 2009, pursuant to RAP 18.6(c), via U.S. Mail and email as follows:

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