

Texas: Ohio corporation had nexus with the Lone Star State



David M. Kall | Thursday, November 9, 2017

In a [decision](#) that the Texas Comptroller of Public Accounts released in late October, an Ohio-based corporation was liable for \$36,000 of unpaid sales and use taxes, plus a 10 percent late-filing penalty, and accrued interest.

Background facts

The Business Activity Research Team of the Comptroller group conducted an audit on the petitioner/Ohio corporation (Petitioner), pursuant to which it sought completion of a nexus questionnaire. The Petitioner failed to respond, so the team determined its Texas sales and use tax liabilities for the period Feb. 1, 2010, through Feb. 28, 2013.

The Petitioner asked for redetermination, on several grounds:

1. It did not have sales and use tax nexus with Texas in the period at issue, and therefore was not required to have a sales tax permit, collect sales tax, or keep sales tax records.
2. Alternatively, the services the Petitioner sold are not taxable.
3. BART's estimate incorrectly taxed services that were not provided by Petitioner, or that were already taxed.

The Petitioner also requested a waiver of the penalty and interest assessments.

The Administrative Law Judge (ALJ) concluded that BART's proposed assessment was not erroneous, and

affirmed the assessment of tax, penalty, and interest.

In considering the Petitioner's position, the ALJ examined, among other things, information on the Petitioner's own website, as well as agreements and invoices that the Petitioner utilized in its business dealings. In so doing, the judge ascertained that the Petitioner performed its repair and maintenance services to retail chains nationwide, including store locations in Texas. The store needing the Petitioner's help would contact the Petitioner, who would then arrange for one of its independent contractors to go to the location and perform the work. There was a work order for each job detailing the labor to be performed, and the maximum amount the contractor could charge the Petitioner.

The independent contractors would invoice the Petitioner, and in turn, the Petitioner would invoice the customers for that work plus an additional fee. Under the terms of the Independent Contractor Agreement, the Petitioner was not required to pay an independent contractor's invoice until after the Petitioner's customer had paid the Petitioner's invoice.

Testimony revealed that the local independent contractors were responsible for collecting and remitting any sales tax due on the services, and that these contractors remitted all the sales taxes that they collected from customers to the state.

The crux of the state's position was that the events triggering sales tax nexus stemmed from the agreements between the Petitioner and the independent contractors, calling for the latter to perform taxable repair and maintenance services at several Texas locations. The ALJ reasoned that this gave the Petitioner sales tax nexus with Texas, and that it should have been collecting and remitting tax from its Texas customers on the services that it provided.

More specifically, the ALJ cited the nexus statute providing that an out-of-state retailer who is engaged in business in Texas and who sells a taxable item for storage, use, or consumption in Texas is required to collect sales and use tax from the purchaser. It was also understood that the state's authority to tax out-of-state entities may not conflict with the Texas Constitution or the United States Constitution.

In this case, the Petitioner contracted with Texas vendors to perform services in Texas and, therefore, was found to be engaged in business in Texas during the examination period. Citing various United States Supreme Court precedents, including the 1992 case *Quill Corporation v. North Dakota*, the Petitioner argued that it lacked the minimum contacts and substantial nexus with Texas that the Due Process and Commerce Clauses of the United States Constitution requires.

Due Process

The Petitioner asserted that because it never targeted its services to Texas, has never actively solicited customers in Texas, and does not have customers in Texas, it does not have the necessary minimum contacts with the state that the Due Process clause demands. The ALJ disagreed, highlighting the following:

1. The Petitioner entered into agreements to perform repair and maintenance services for retail chain stores, some of which had locations in Texas.
2. The Petitioner contracted with Texas customers and paid Texas contractors to perform repair and maintenance services in Texas.
3. The Petitioner billed Texas customers for the services, collected payments, and bore the risk of defaults.

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Each of these activities demonstrated to the ALJ that the Petitioner met the Due Process' minimum contacts requirement.

Commerce Clause

The ALJ looked to the Supreme Court's four-part test used for examining the permissibility of state taxation under the Commerce Clause. As long as the tax:

1. Is applied to a person with a substantial nexus with the taxing state.
2. Is fairly apportioned.
3. Does not discriminate against interstate commerce.
4. Is fairly related to the services provided by the state, the state tax statute does not offend the dormant Commerce Clause doctrine.

The Petitioner argued that because its only contract with the state of Texas was through independent contractors, and not by way of owning property or employing workers, it had insufficient physical presence to trigger substantial nexus.

The ALJ relied on *Quill* and other cases for the proposition that when franchisees, licensees, or independent contractors act on a corporation's behalf in certain ways, the physical presence standard is satisfied. For instance, in 1960, in *Scripto, Inc. v. Carson*, the United States Supreme Court held that the solicitation of orders within Florida by independent brokers formed sufficient nexus. In another, the 1986 case *Tyler Pipe Industries v. Department of Revenue*, the Court held that when an employee, agent or independent contractor engages in activities for an out of state seller, including maintaining and improving the name recognition, market share, goodwill, and individual customer relations of the out of state entity, there is nexus sufficient to trigger tax liabilities.

On this and related authority, the judge justified the result that the Petitioner had a physical presence in Texas:

Due to the nature of its business and the use of independent contractors across Texas, Petitioner was able to establish, operate, and maintain a consistent presence in Texas without the presence of property, employees, or representatives. In providing those services, Petitioner was engaged with Texas customer locations and its independent contractors on a regular and systematic basis and generated revenue from the provision of repair and maintenance services.

Remaining points

The judge disputed the Petitioner's other arguments. First, as for the Petitioner's non-taxability-of services-contention that because it was Petitioner's independent contractors, and not Petitioner itself that performed the work, it should not owe any taxes: the ALJ opined that because Petitioner provided repair and maintenance services to its customers locations in Texas, even if by contracting with independent contractors to perform the services, the Petitioner did not meet its burden of proof.

Second, even if the services were taxable, the Petitioner posited, it was the independent contractors that should be liable. To this, the ALJ looked to various agreements stating that it was the Petitioner that was providing the taxable services. Thus, the Petitioner was liable for the taxes.

In the end, the Petitioner was unable to convince the state that it should not be taxed in the first instance; or that the tax was incorrect or otherwise unreasonable, excessive, arbitrary, and capricious. Likewise, the ALJ determined that the penalty and interest were both warranted, based on the Petitioner's dearth of supporting evidence, and its failure to respond.



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