



SALT To Taste

State and Local Tax Items of Interest

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How Minimal is Substantial?

The Washington Supreme Court recently determined in *Lamtec*^[1] that several visits to Washington customers created a sufficient level of contact to satisfy the “substantial nexus” requirement put forth by *Complete Auto Transit*.^[2] According to the facts presented, Lamtec Corporation (“Lamtec”) had no physical presence in Washington, except for occasional visits to preexisting customers. Since Washington’s Business and Occupation (“B&O”) tax is not an “income” tax, Public Law 86-272 purportedly provides no protection for Lamtec’s activities. As of this writing, the *Lamtec* decision is on appeal to the U.S. Supreme Court, which has been asked to determine if *Quill*’s^[3] physical presence requirement applies to other than sales and use taxes, and if physical presence is not required, to determine if Lamtec meets the substantial nexus requirement. Given the recent reluctance of the U.S. Supreme Court to readdress its *Quill* decision and state tax cases in general, it may be prudent for taxpayers to take note of the nexus creating activities discussed in the *Lamtec* decision.

As stated in the case, Lamtec had “no permanent facilities, office, address, phone number, or employees in Washington.”^[4] Its only contact with Washington was two or three visits per year to Lamtec’s 12 customers for the purpose of answering questions, providing information on products and, in general, maintaining good client relations. In total, Lamtec employees made approximately 50 to 70 customer visits between 1997 and 2003, and made no direct solicitation of sales during these visits. Apparently, due to its minimal contact with Washington State, Lamtec did not allege a due process argument, but instead maintained a lack of substantial nexus under the commerce clause. Quoting in part from *Complete Auto Transit*, the commerce clause nexus requirements were described as follows:

Under modern dormant commerce clause jurisprudence, in order for a state to tax an out-of-state corporation, the tax must be (1) ‘applied to an activity with a **substantial nexus** with the taxing State,’ (2) ‘fairly apportioned,’ (3) nondiscriminatory with respect to interstate commerce, and (4) ‘fairly related to the services provided by the State.’^[5] [Emphasis added]

In its analysis, the Washington Supreme Court rejected Lamtec’s argument that the U.S. Supreme Court requires a “continuous local solicitation” to establish substantial nexus. Per the Washington Court, “continuous local solicitation” is a factor in establishing substantial nexus as discussed in *Scripto*^[6], but it is not a requirement. The Washington Court instead turned its attention to its own *Tyler Pipe*^[7] decision, which was affirmed in part by the U.S. Supreme Court. According to the U.S.

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Supreme Court decision in *Tyler Pipe*:

As the Washington Supreme Court determined, ‘the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are **significantly** associated with the taxpayer’s ability to **establish and maintain** a market in this state for the sales.’ The court found this standard was satisfied because Tyler’s ‘sales representatives perform **any local activities necessary** for maintenance of Tyler Pipe’s market and protection of interests . . .’ We agree that the activities of Tyler’s sales representatives adequately support the State’s jurisdiction to impose its wholesale tax on Tyler.^[8] [Emphasis added]

Again, any *Tyler Pipe* analysis depends on the significance of the taxpayer’s activities in both establishing and maintaining a market in Washington. Since Lamtec only met with previously established clients, it seems an argument could be made that its periodic visits, even if determined to be significant, did not satisfy both requirements. Additionally, Lamtec employees were not performing “any local activities necessary”^[9] to maintain a market. These employees performed only one minor activity, which could generally be described as making periodic goodwill visits. Ultimately, the Washington Supreme Court rejected all of Lamtec’s arguments and held that its activities were in fact “significantly associated with its ability to establish and maintain its market”^[10] in Washington.

If not heard and overturned by the U.S. Supreme Court, this seemingly minimal “substantial nexus” criteria established by *Lamtec* could pose serious problems for taxpayers across the nation. As Lamtec admitted, its employees engaged in activities to maintain a market in Washington, but they did not solicit or accept any orders in Washington. Their employees merely listened to and answered customer questions and, in general, maintained good client relations. Although Lamtec is a manufacturer, this decision could also impact service providers, including attorneys, accountants and consultants, who routinely visit out-of-state clients to conduct meetings and to maintain client relations. Many of these out-of-state visits are most likely in states where these service providers currently proclaim a lack of nexus. Furthermore, while Lamtec did not have Public Law 86-272 protection from Washington’s B&O tax, service providers generally have no protection under Public Law 86-272 *in any state*. Therefore, if the *Lamtec* criteria for determining nexus is applied in all states, many taxpayers, and in particular many service providers, may find they now have minimal, but substantial nexus in several additional jurisdictions.

The U.S. Supreme Court has until July 7, 2011 to determine if it will hear the *Lamtec* case. With many states and taxpayers still trying to determine if *Quill* applies to other than sales and use taxes and what constitutes substantial nexus, additional guidance from a case like *Lamtec* could be beneficial. However, by all indications, the U.S. Supreme Court would rather have Congress provide further clarification of the nexus standards. Unfortunately, without additional guidance from Congress or the U.S. Supreme Court, many states will likely follow Washington State and conclude that companies meet the substantial nexus threshold based on a very minimal level of activity.

If you have any questions regarding this newsletter or if you would like to discuss your specific circumstances in more detail, please contact Geoff Christian at 864-241-2009, gchristian@dlptax.com or Russell Padgett at 864-241-2006, rpadgett@dlptax.com.

¹ *Lamtec Corp. v. Dep’t of Revenue*, 246 P.3d 788 (Wash. 2011).

² *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

³ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

⁴ *Lamtec Corp. v. Dep’t of Revenue*, 246 P.3d at 790.

⁵ *Id.* at 791-92.

⁶ *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960).

⁷ *Tyler Pipe Industries v. Department of Revenue*, 105 Wn.2d 318 (1986).

⁸ *Tyler Pipe Industries, Inc. v. Wash. State Dept. of Revenue*, 483 U.S. 232, 250-51 (1987).

⁹ *Lamtec Corp. v. Dep't of Revenue*, 246 P.3d at 795.

¹⁰ *Id.*

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