TECHNICAL ASSISTANCE ADVISORY 98-002

SUBJECT: BUSINESS REGISTRATION TAX - BUSINESS FRANCHISE TAX – CORPORATION NET INCOME TAX – COMSUMER SALES AND SERVICE TAX – USE TAX – PERSONAL INCOME TAX – PROPERTY TAX - Regular, systematic and purposeful visits by an employee and continuous presence of substantial tangible personal property create sufficient nexus to impose all applicable taxes. However, not all potentially applicable taxes are applicable for statutory reasons.

This is in response to your letter of November 5, 1997, requesting a technical assistance advisory that an out-of-State corporation ("TP Corp."), which is a customer of an in-State manufacturing facility ("WV Co."), will not have sufficient nexus with the State of West Virginia to make it subject to the West Virginia Consumer Sales and Service Tax or Use Tax, the personal or corporate net income tax, or the West Virginia Business Franchise Tax." Your basis for the requested ruling is:

that the mere ownership by TP Corp. of tooling and assembly equipment located in West Virginia and used by WV Co. for manufacturing stampings and sub-assemblies for TP Corp. and the occasional visits to WV Co.'s West Virginia facilities by representatives of TP Corp. are not sufficient, in and of themselves, to impose a consumer sales and service tax or use collection requirement on TP Corp. and such contacts are insufficient to impose on TP Corp. a duty to file returns and pay West Virginia income or business franchise tax returns. This is because TP Corp., under the facts presented for purposes of this advisory, is not and will not be regularly, systematically and purposefully directing its activities at West Virginia customers for purposes of selling them goods and services.

You have provided the following information and arguments:

FACTS

TP Corp. is a manufacturer of vehicles with manufacturing activities located in another state. TP Corp. manufactures the vehicles under contract to an out-of-State vehicle distributor ("Car Co".) and sells all of its production to

Car Co. All sales destined for points in the United States are immediately resold by Car Co. to a wholesale distributor which in turn immediately sells to local dealerships. All sales occur simultaneously at the time the vehicles leave the marshalling yard by common carrier in another state.

TP Corp. has contracted with WV Co. to obtain sheet metal stampings and sub-assemblies for the vehicles manufactured out-of-State. Under the contracts, WV Co. caused to be developed and manufactured specialized manufacturing production property, as that term is defined in West Virginia Code § 11-6E-1, et seq. ("tooling"), together with assembly equipment which WV Co. uses in the manufacturing of parts to be supplied to TP Corp. During the development and manufacturing of the tooling and the assembly equipment, WV Co. had full responsibility for the actual design and manufacture of the tooling and the assembly equipment. TP Corp. was neither party to nor privy to those contracts. Under the terms of the contracts, this property was owned by WV Co. but conveyed to TP Corp. upon its delivery to WV Co.'s manufacturing facility in West Virginia. It was then immediately bailed to WV Co. for WV Co.'s use in fulfilling its supply contract to TP Corp.

TP Corp. makes no warranty or representation regarding the merchantability, fitness, quality, design, condition, capacity, suitability or performance of the tooling or the assembly equipment and is not responsible for any repairs, service or defects in the tooling or the assembly equipment. TP Corp. reimbursed WV Co. for the costs of developing and manufacturing the tooling. The costs incurred by WV Co. in the development and manufacture of the assembly equipment are amortized and WV Co. recovers a portion of that cost as part of the price that TP Corp. pays WV Co. for each piece of sheet metal stamping and sub-assembly that WV Co. sells to TP Corp.

TP Corp. does not regularly, systematically or purposefully direct its activities at West Virginia customers for purposes of selling them goods or services. TP Corp. makes no sales in the state of West Virginia. TP Corp. has no employees in the state of West Virginia. On a very occasional basis, an employee of TP Corp. will travel to West Virginia for purposes of consulting with employees of WV Co. on manufacturing issues. TP Corp. owns no property in West Virginia except for that property to which it holds legal title and which is described above.

From an economic standpoint, TP Corp. has effectively helped with the financing of a portion of WV Co.'s costs of tooling up to perform the TP Corp. contract and TP Corp. has effectively retained a security interest in the property so financed.

In all material regards, WV Co., and not TP Corp., is the beneficial owner of the tooling and the assembly equipment located in West Virginia. Under the terms of the contracts between TP Corp. and WV Co., WV Co. is entitled to the exclusive use of the tooling and the assembly equipment to fulfill its contractual obligations to TP Corp. for the entire economic life of that property. WV Co., under the terms of the bailment agreement between TP Corp. and WV Co., is responsible for the proper maintenance and repair of the property. WV Co. is responsible, under the contracts between WV Co. and TP Corp., to provide adequate insurance coverage on the property. Under the contracts between TP Corp. and WV Co., WV Co. is ultimately responsible for all property taxes imposed on the property.

TP Corp. retains legal title to the personal property principally for the purpose of being able to recover possession of the personal property in the event that WV Co. breaches the contracts or is otherwise unable to perform its obligations under the contracts.

A Process Engineer has averaged one visit per month for one or two days to verify quality of production process. Now that these processes have been fine tuned, these visits will stop. The Process Engineer estimates that he was in the WV Co. plant for a total of twenty (20) days in 1997.

A Quality Assurance Engineer averages one visit per month for one day to check the quality of parts. These visits should continue indefinitely during the life of the contract.

A Manager for Direct Purchasing visits the WV Co. plant once a year for one or two days for purposes of negotiating prices.

A total of \$ x million worth of equipment procured for the TP Corp. was located at the WV Co. facility as of December 31,

1997. The equipment will remain at the WV Co. facility for the duration of the contract between WV Co. and TP Corp. or for as long as WV Co. continues to fulfill the contract from its facility in West Virginia. The equipment is delivered to WV Co. by common carrier, generally either truck or rail. The tooling is to be removed from West Virginia by TP Corp. at the termination of the contract.

The tooling at all times remains the property of TP Corp. Section Twenty Three of the Tooling Bailment Agreement provides for WV Co. to grant to TP Corp. a purchase money security interest in the tooling.

DISCUSSION

Whether or not sufficient nexus exists for a state to impose applicable taxes is essentially a constitutional¹ question – Is there sufficient nexus for the taxing state to impose the tax at issue to satisfy both the Due Process Clause and Commerce Clause of the United States Constitution? Under the United States Constitution, a state may not impose taxes on activities in interstate commerce if there is insufficient nexus between the activity or taxpayer being taxed and the taxing state. The amount of nexus which is sufficient has not been quantified by the United States Supreme Court, and must be determined on a case-by-case basis. The West Virginia Supreme Court of Appeals recently said of nexus, "That this area of the law is nebulous at best is beyond dispute." <u>Hartley Marine Corp. v. Mierke</u>, 474 S.E.2d 599, 607 (W. Va. 1996) (cert. denied) (inter alia, upholding the continuing validity for nexus purposes of <u>Western Maryland RR Co. v. Goodwin</u>, 167 W. Va. 804, 282 S.E.2d 240 (1981)).

To be sufficient to satisfy the Commerce Clause, nexus must be "substantial," which is more than the minimum contacts required for due process. Physical presence in the State is not required for due process, but physical presence is required under the Commerce Clause, at least for purposes of the Use Tax. <u>See Quill Corp. v. North Dakota</u>, 119 L.Ed.2d 91 (1992). In order for there to be sufficient nexus under the Commerce Clause, the taxpayer's presence in a taxing jurisdiction must be more than the "slightest presence" rejected in <u>National Geographic Society v. California Bd. Of Equalization</u>, 430 U.S. 551, 555-556 (1977).

Although nexus is sometimes discussed in the abstract as though it exists apart from the type of tax and the factual situation, in actuality such is not the case. While the

¹ A basic principle of jurisprudence is that cases should be decided when possible on the basis of statutory construction rather than the constitutionality of the statute. The Tax Commissioner, whose authority to interpret the State and federal constitutions in tax matters derives from his oath to uphold those constitutions, interprets constitutional matters only to the extent necessary. This restraint, together with the constraint of fiscal economy (similar to the doctrine of judicial economy), mean that nexus should be considered only when the tax statutes at issue are arguably applicable to a taxpayer if there is sufficient nexus.

form of the tax is generally inconsequential to questions of nexus ((See Hartley Marine Corp. v. Mierke, supra, FN 13, where one issue was whether the motor fuel tax is a "general revenue tax or otherwise")), it cannot be reasonably concluded that nexus is an all purpose thing which applies in the same manner to all types of taxes in all types of situations. Put another way, the fact that nexus exists for one type of tax does not necessarily mean that nexus exists for all types of taxes, nor does lack of nexus for one type of tax necessarily mean that insufficient nexus exists for all types of taxes. On the other hand, the process of nexus analysis is sufficiently cumbersome that it is not uncommon to make broad generalizations about nexus which are correct when considered in the context of the facts and tax laws of the specific situation; when no nexus exists or there is "nexus aplenty", broad generalizations about the sufficiency of nexus for all applicable taxes are both correct and efficient.

Occasional visits by employees will not in and of themselves create sufficient nexus to impose any tax, although occasional visits together with other types of contacts may do so. "Occasional" is defined as "1.a. occurring from time to time" (See Webster's New Collegiate Dictionary) and "occasionally" is defined as "now and then" (See Merriam Webster's Collegiate Dictionary, 10th ed.). According to the information provided, TP Corp. has a Quality Assurance Engineer who averages one visit per month for one day to check the quality of parts, as well as a Manager for Direct Purchasing who visits the WV Co. plant once or twice a year. While the visits by the Manager are occasional, the monthly visits by the Quality Assurance Engineer are not occasional but regular, systematic and purposeful. True, the visits are not for the purpose of selling goods and services in West Virginia, but sales and use taxes are imposed on persons who purchase goods and services, not on those who sell goods and services (unless they fail to collect those taxes). Sales taxes are transactional taxes, so even a single, brief trip into a taxing jurisdiction creates ample nexus to impose sales tax on any purchase or sale made during the trip, if no exemption or exception applies. Such nexus for sales tax does not continue after the transaction is consummated nor does it create nexus for any other taxes. Conversely, lack of nexus for other taxes does not cause nexus for sales tax to be insufficient. Nevertheless, when nexus is sufficient to impose tax, it does raise a rebuttable presumption that nexus may exist for one or more other taxes.

Despite the fact that at least one TP Corp. employee may have substantial nexus with this State, that employee is not subject to this State's Personal Income Tax because that employee is not a resident and because intermittently supervising production of outputs to be purchased by that employee's out-of-state employer is not carrying on a business, trade, profession or occupation in this State. <u>See</u> W. Va. Code § 11-21-32.

Use tax is the tax most similar to sales tax, but the nexus for use tax may be different than for sales tax, simply because of the nature of the transactions involved. In <u>National Geographic Society v. Bd. Of Equalization</u>, the U.S. Supreme Court "distinguished between a[n indirect tax such as] use tax and a direct tax [such as sales tax] in terms of the level of contacts necessary to sustain each, and concluded that a

nondiscriminatory use tax could be imposed where there were sufficient contacts to satisfy due process standards while a higher commerce clause standard would be required to support the imposition of a direct tax." <u>See J.C. Penney, Inc. v. Hardesty</u>, 264 S.E.2d 604, 609 (W. Va. 1979). (Bracketed material added for emphasis).

The nexus required to impose use tax is built into the tax when the purchaser resides in the state seeking to impose it. The nexus requirement is clearly different when the state seeking to impose it does so by attempting to require an out-of-state company to collect it. Thus, even for a given tax, nexus requirements vary according to the situation.

Nexus does not properly become an issue when the statutory and regulatory scheme for a tax facially does not apply to the taxpayer. For example, the use tax is inapplicable to the auto parts manufactured by WV Co. for TP Corp. because W. Va. Code § 11-15A-1(14) defines "use" in such a way as to expressly exclude such parts: "The term "use" does not include the keeping, retaining or exercising of any right or power over tangible personal property for the purpose of subsequently transporting it outside the state for use thereafter solely outside this state. On the other hand, the rest of that definition might seem to be applicable to the tooling and assembly equipment used in making those parts, because TP Corp. purchased that manufacturing equipment from WV Co. and TP Corp. has the right to direct its disposition:

"Use" means and includes the exercise by any person of any right or power over tangible personal property incident to the ownership, possession or enjoyment of such property, or by any transaction in which possession of or the exercise of any right or power over tangible personal property is acquired for a consideration, including any lease, rental or conditional sale of tangible personal property. As used in this definition, "enjoyment" <u>includes a purchaser's right to</u> <u>direct the disposition of the property</u>, whether or not the <u>purchaser has possession of the property</u>. (Emphasis added).

However, use tax would not apply because the manufacturing equipment was not purchased by TP Corp. in another state and brought into this State, and also because manufacturing equipment is exempt from use tax and sales tax because it is directly used in manufacturing

As indicated in your letter, the tooling and assembly equipment are "specialized manufacturing production property" taxable under W. Va. Code § 11-6E-1. For property tax purposes, sufficient nexus is created by the non-transitory presence of the property in this State on July 1 of the property tax year. Similarly, sufficient nexus is created by the presence of that manufacturing property to render TP Corp. subject to Corporation Net Income Tax if TP Corp. itself were manufacturing auto parts in this State, even if all of those parts were sold out-of-State. Apportionment formulas were created precisely

for such situations. While your letter characterizes WV Co. as the "beneficial² owner" of the equipment, TP Corp. "retains legal title" although "under the contracts between TP Corp. and WV Co., WV Co. is ultimately responsible for all property taxes imposed on the property." The U.S. Supreme Court once stated that "To permit such formal 'contractual shifts' to make a constitutional difference would open the gates to a stampede of tax avoidance." <u>See Scripto v. Carson</u>, 362 U.S. 207, 4 L.Ed.2d 660, 80 S. Ct. 619 (1960) (holding that independent contractors may create sufficient nexus for states to impose use tax collection requirements upon the companies which employ them.)

In short, TP Corp.'s manufacturing production property creates sufficient nexus for property tax purposes, as well as for other applicable taxes. ((See e.g., Western Maryland RR Co. v. Goodwin, FN 3, supra (Cases dealing with property tax nexus are relevant to due process questions of nexus concerning the former carrier income tax.) (To satisfy due process under International Shoe Co. v. Washington) "purposive revenue generating activities in the State are sufficient to render a person liable for taxes. . . ." Id. At 809) (Taxpayers have a heavy burden of proof to overcome the presumption that taxes are constitutional. Id. at 829).)

The presence of more than \$ x million of manufacturing equipment, together with the regular, systematic and purposeful contacts of the Quality Assurance Engineer and the occasional visits of the manager, create sufficient nexus to satisfy both the Commerce Clause and the Due Process Clause. Thus, the primary inquiry hereinafter is whether the Business Franchise Tax and Corporation Net Income Tax are applicable to TP Corp.

The Corporation Net Income Tax and the Business Franchise Tax are imposed on a foreign corporation if it is doing business in this State. For both taxes, "doing business" means "any activity of" the taxpayer "which enjoys the benefits and protection of the government and laws of this State, except" for certain agricultural activities. <u>See</u> W. Va. Code §§ 11-23-3(b)(8) and 11-24-3a(7). These definitions of "doing business" are so broad that they ostensibly encompass not only what would generally be considered to be business activity, but "<u>any</u> activity" which, if it is not unlawful, is protected by government. Because of these broad definitions, certain activities which are not the kind of activities which should be subject to the particular tax are sometimes said to lack sufficient nexus. For example, salespersons merely driving through West Virginia are engaging in activity protected by the government and laws of this State, (thus, they are "doing business" in West Virginia) but their company cannot lawfully be subjected to this State's Corporation Net Income Tax or Business Franchise Tax because of insufficient nexus. The principal reason that such activity creates insufficient

² A "beneficial owner" is the "equitable owner as contrasted with the legal owner." <u>See Black's Law</u> <u>Dictionary</u> (6th ed.) Where, as here, a person has legal title to tangible personal property, and that property is used to produce property for that person, and the production property reverts to that person after manufacturing is completed, that person is unquestionably the legal owner. If anyone were an equitable owner in such a situation, it would be the person in possession of the property, i.e., WV Co.

nexus is that it is not purposeful revenue generating activity and thus fails to satisfy due process. (See Western Maryland RR Co., supra).

According to the information provided, the only activity of TP Corp. in this State relates to its manufacturing contract with WV Co. All of the taxable income from manufacturing auto parts is subject to tax, but it is WV Co. which is taxable on that income. TP Corp. is the source of that income, not the recipient, so it would be multiple taxation if TP Corp. were subject to Corporation Net Income Tax when its only activity in this State relates to manufacturing of parts by WV Co., which is subject to that tax on all of its income from manufacturing. TP Corp.'s activity is not revenue generating activity in West Virginia for TP Corp. but rather for WV Co. Presumably, all purchases by a business are related directly or indirectly to revenue generating activity, but a state may not extend its general taxing jurisdiction beyond its borders merely because of purchases made within its borders, even though those purchases may be taxable. Apart from nexus, it would be bad policy to attempt to subject an out-of-state corporation to all of this State's taxes merely because they patronize one of this State's businesses. Moreover, TP Corp. has no income which is allocable to West Virginia. Under these facts, where no income is earned in West Virginia, TP Corp.'s income should not be apportionable to West Virginia, notwithstanding adequate nexus.

Finally, it should be mentioned that Public Law 86-272, 15 U.S.C. § 381, "The Interstate Commerce Tax Act," which immunizes companies from liability for State and local net income tax under certain limited conditions, does not apply because TP Corp. is not soliciting orders for sales of tangible personal property in West Virginia.

In short, we do not consider the activities of TP Corp. to constitute doing business in this State, and thus conclude that TP Corp. is not subject to Corporation Net Income Tax.

The Business Franchise Tax is an annual tax on the privilege of doing business in this State. However, the tax is imposed not only if a company is "doing business" as defined in W. Va. Code § 11-23-3(b), but if it owns tangible personal property located in West Virginia:

<u>Such tax shall be collected from</u> every domestic corporation, every corporation having its commercial domicile in this state, <u>every foreign</u> or domestic <u>corporation owning</u> or leasing real or <u>tangible personal property located in this state</u> <u>or doing business in this state</u> and from every partnership owning or leasing real or tangible personal property located in this state or doing business in this state, effective on and after the first day of July, one thousand nine hundred eightyseven. <u>See</u> W. Va. Code § 11-23-6(a). (Emphasis added).

As noted above, the definition of "doing business" is essentially the same for the Business Franchise Tax as for the Corporation Net Income Tax (except that the

Business Franchise Tax definition also applies to partnerships.) Thus, we do not believe that TP Corp. is doing business in this State for Business Franchise Tax purposes for the same reasons it is not doing business in this State for Corporation Net Income Tax purposes, despite the substantial nexus created by the presence of its considerable tangible personal property and the regular, systematic and purposeful activity of an employee in this State together with the occasional presence of another employee in this State.

However, because the Business Franchise Tax is imposed on a foreign corporation either if it is doing business in this State <u>or</u> if it owns tangible personal property in this State, and because TP Corp. owns more than \$80 million of manufacturing property in this State, TP Corp. is subject to Business Franchise Tax. This result makes sense because the measure of the Business Franchise Tax is capital or net equity, which are essentially accounting measures of the taxpayer's ownership interest in the business, including all tangible personal property owned by the business. If TP Corp.'s only tangible personal property in this State were the goods it purchases from WV Co., rather than income producing property, then the result might well be different.

The Business Registration Tax is imposed only if a non-exempt person is engaging in business activity or intends³ to do so. "Business activity" is defined⁴ as "all purposeful revenue generating activity engaged in or caused to be engaged in with the object of gain or economic benefit, either direct or indirect. . . . " See W. Va. Code § 11–12–2(b)(2). W. Va. Code § 11-12-4(c) states that: "The filing of an application for business registration certificate (or for renewal thereof) and payment of the tax imposed by section three shall not be construed by the Tax Commissioner or the courts of this state as consent, submission or admission by the registrant to the general taxing jurisdiction of this state, and liability for such other taxes imposed by this state shall depend upon the relevant facts in each case and the applicable law." Because the Business Registration Tax is not a revenue tax, but rather a means of determining whether a potential taxpayer is required to pay revenue taxes such as the Corporation Net Income Tax and the Business Franchise Tax, the business activity required to trigger the Business Registration Tax logically cannot be greater than the activity required for imposition of revenue taxes. As previously discussed, TP Corp. must pay Business Franchise Tax, and thus must register for Business Registration Tax.

³ Because of the unique nature of business registration statutes, the nexus basis for requiring registration before engaging in any activity in this State is prospective, unlike revenue taxes which are retrospective. Moreover, business registration tax is not imposed even when registration is required when the business has gross income from business activity of \$4,000 or less for income tax purposes during the business' tax year prior to the current registration year. See W. Va. Code § 11-12-3(d). At any rate, the \$15 registration tax is a de minimus tax better understood as a fee to defray the costs of registering the business.

⁴ That definition of "business activity" is essentially the same as the definition of "business" for the Business and Occupation Tax, except for the requirement for the activity to be revenue generating. W. Va. Code § 11-13-1(b)(2) defines "business" as including "all activities engaged in or caused to be engaged in with the object of gain or economic benefit, direct or indirect."

SUMMARY OF CONCLUSIONS

In sum, there is sufficient nexus with TP Corp.'s activities in West Virginia for West Virginia to impose any of its taxes which are applicable to TP Corp. TP Corp. is required to register to do business in this State: may be required to pay property tax if WV Co. fails to do so; and is subject to Business Franchise Tax because the statute requires a foreign corporation to pay that tax even if it is not doing business when it owns tangible personal property in this State. On the other hand, TP Corp. is not required to collect sales tax because it makes no sales in this State; is not required to collect or pay sales or use tax on the auto parts manufactured in this State because of the definition of "use"; is not required to pay sales tax or use tax on the property used to manufacture those parts because those parts are directly used in the activity of manufacturing and are thereby exempt; is not required to withhold and remit personal income tax from its employees supervising the manufacturing of auto parts because those employees are not carrying on a business, trade or profession on this State; and is not required to pay Corporation Net Income Tax because WV Co. is liable for that tax on the income of the parts manufactured and sold to TP Corp. and because TP Corp. sells none of those parts or the completed vehicles containing those parts in this State.

The conclusions reached in this technical assistance advisory are based upon the facts and representations submitted and application of current law. In the event there is a material change in the facts, or if it is determined that material facts were omitted or are materially different from those furnished to us for purposes of this ruling, or there is a material change in the applicable law, the conclusions reached in this advisory may no longer apply.

Precedential Value – Under W. Va. Code § 11-10-5r(b), a technical assistance advisory has no precedential value except to the taxpayer who requests the advisory, unless the Tax Commissioner specifically states that it has precedential value. This technical assistance advisory is declared to have precedential value and may be cited by other taxpayers, but shall be considered to be relevant only when the material facts and laws are essentially the same as in this advisory.

Publication – Under W. Va. Code § 11-10-5r(e), the Tax Commissioner is required to release technical assistance advisories to the public after they are modified to delete identifying characteristics, unless the taxpayer waives its right to confidentiality. This technical assistance advisory will be released as Technical Assistance Advisory 98-002.

If you have any question about this advisory, please contact this office.

Issued: July 24, 1998

Richard E. Boyle, Jr., State Tax Commissioner