Income Tax Nexus: No Physical Presence Necessary

Jay Forester and Mike Drumm

> *[B]ut in this world nothing can be said to be certain, except death and taxes.*—BENJAMIN FRANKLIN

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Although death and taxes may be certain, to whom you are required to pay those taxes is not quite as certain. States have been increasing their reach in an attempt to collect taxes from out-of-state entities. As most franchised companies operate in more than one state (and most hope to operate in all states), this issue is a primary concern for franchisors and is becoming increasingly more troublesome. States are progressively challenging longstanding federal law in an effort to gain more revenue from more businesses with minimal connection to a state. What used to be primarily a question of physical location of a business, employees, or tangible assets now encompasses directing activity or "doing business" in a state under the ever-expanding theories of "factor presence" and "economic presence," both with varied applications among states.

I. Overview and History

> *Taxation with representation ain't so hot either.*—GERALD BARZAN

Nexus is the minimum contact a jurisdiction must establish before subjecting a business to its taxing authority. Trial lawyers should be familiar with concept as it is analogous to minimum contacts needed to establish personal jurisdiction. States extend the authority to impose tax on a business as far as constitutional foundations allow and, in some cases, further. The pri-

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mary constitutional clauses mapping the boundaries of the states' taxing authority are the Due Process Clause and the Commerce Clause.

A. *Due Process*

> *It's a very frightening time when something as basic as due process is seen as somehow radical.*—John Cusack

The Fourteenth Amendment to the U.S. Constitution prohibits states from denying any person "life, liberty, or property, without due process of law." Because a tax is a deprivation of a property right, states must overcome due process hurdles before subjecting a business to tax. There must be a minimum connection and some rational relationship between a taxpayer and a state.[1] Historically, the requisite "minimum connection" required was "physical presence" in a taxing jurisdiction. The primary consideration of due process is one of fundamental fairness: does the tax satisfy "traditional notions of fair play and substantial justice"? "That test is whether property was taken without due process of law, or if we must paraphrase, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities, and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return."[2]

In 1992, the Supreme Court in *Quill Corp. v. North Dakota* essentially eliminated the traditional "physical presence" due process requirement, declaring that as long as an out-of-state business purposefully directs solicitation toward residents of a state, the state may subject the business to its taxing authority.[3] The chief due process consideration in light of the *Quill* decision became does a taxpayer "purposefully avail itself of the benefits of an economic market" in the state, irrespective of a physical presence in the taxing state.[4]

B. *Commerce Clause*

> *Money, not morality, is the principle commerce of civilized nations.*
> —Thomas Jefferson

The second constitutional provision limiting the taxing authority of states is the Commerce Clause, which states, "Congress shall have the power to regulate Commerce with foreign Nations, and among the several states, and with the Indian tribes."[5] A central authority of the Commerce Clause is its limitation through the Dormant Commerce Clause on the states' ability to interfere with commerce in areas where Congress has not acted. Under

1. Quill v. North Dakota, 504 U.S. 298 (1992) (citing Miller Brothers v. Maryland, 347 U.S. 340, 344–45 (1954)); *see also* Wisconsin v. J.C Penney, 311 U.S. 435, 444 (1940).
2. *J.C Penney*, 311 U.S. at 444.
3. *Quill*, 504 U.S. at 307.
4. *Id.* at 308.
5. U.S. Const., art. 1, § 8, cl. 3.

the Dormant Commerce Clause principle, taxes that unduly burden interstate commerce have been declared unconstitutional.[6] The crux of Commerce Clause analysis is not that states are prohibited from imposing a burden on interstate commerce itself; rather, determining if a tax provides a direct commercial advantage to local businesses or creates multiple taxation on interstate commerce.[7]

The Supreme Court in *National Bellas Hess v. Illinois Department of Revenue* limited the expansive reach of a state tax on a reseller with no physical presence in a state.[8] National's only connection with Illinois was the semi-annual mailing of catalogs to customers residing in the state. The Court stated,

> it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved. And if the power of Illinois to impose use tax burdens upon National were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. . . . The very purpose of the Commerce Clause [is] to ensure a national economy free from such unjustifiable local entanglements.[9]

Commerce Clause nexus was further defined by the Supreme Court in *Complete Auto Transit, Inc. v. Brady*, which provided a four-prong approach to determine whether a state tax on interstate commerce is constitutional.[10] First, the tax must be applied to an activity with substantial nexus with the taxing state; second, the tax must be fairly apportioned; third, the tax must not discriminate against foreign commerce; and fourth, the tax must be fairly related to services provided by the taxing state.[11] The first and fourth prongs require a substantial nexus and a relationship between the tax and the state activity as to not burden interstate commerce, while the second and third prongs require fair apportionment and nondiscrimination to inhibit states from placing an unfair tax burden on interstate commerce.[12]

In 1992, the *Quill* Court reaffirmed the physical presence requirement to satisfy Commerce Clause nexus. The Court concluded that a bright line, physical presence standard "firmly establishes the boundaries of legitimate state authority," "reduces litigation," "encourages settled expectations," and serves the "interest in stability and orderly development of the law that undergirds the doctrine of *stare decisis*."[13] It is important to note the *Quill* physical presence requirement was in response to a use tax imposed on out-of-state mail order sales.[14] The targeted decision recognized a deterioration of a bright line test for nexus and such test's inability to apply to

6. Brian L. Hazen, *Rethinking the Dormant Commerce Clause: The Supreme Court as a Catalyst for Spurring Legislative Gridlock in State Income Tax Reform*, 2013 BYU L. Rev. 1021, 1027 (2014).
7. *See generally* Nw. States Portland Cement Co. v. Minnesota, 348 U.S. 450 (1959).
8. 386 U.S. 753 (1967).
9. *Id.* at 759–60.
10. 430 U.S. 274 (1977).
11. *Id.* at 279.
12. Quill v. North Dakota, 504 U.S. 298, 313 (1992).
13. *Id.* at 315–17.
14. *Id.* at 316.

taxes beyond sales and use tax.[15] Perhaps this specificity has created, or at least contributed to, the mélange of state nexus criterion for corporate income, franchise, and other taxes on business activity.[16]

C. *Public Law 86-272*

There is no safe haven in today's markets.—Paul Singer

Congress enacted the most important and salient income tax nexus imperative in 1959. Public Law 86-272 was enacted over concerns of the far-reaching decision in *Northwestern Cement Co. v. Minnesota*, which allowed states to impose nondiscriminatory, fairly apportioned income taxes on interstate businesses with a limited presence in a state.[17] The essence of P.L. 86-272 is to provide interstate businesses a safe-haven for certain state activity, and its purpose is to prohibit a state from imposing a tax on net income if a company has minimal presence in a jurisdiction. P.L. 86-272 prohibits taxation if a company's only activities in a jurisdiction are the solicitation of orders of sales of tangible personal property that are sent outside the state for approval or rejection and, if approved, are shipped or delivered from a point outside the taxing jurisdiction.[18] P.L. 86-272 provides protection only from taxes imposed on, or measured by, net income, so taxes measured by gross receipts such as Ohio's Commercial Activity Tax or Washington's Business and Occupation Tax are not limited by the law.[19] Although P.L. 86-272 does not generally provide significant shelter for the franchise industry, it has shaped current state statutory and judicial nexus criteria.

Prior to the passage of P.L. 86-272, physical presence dictated nexus for state income tax purposes.[20] The *Northwest Cement* decision and the subsequent enactment of P.L. 86-272 underscored the concerns of this standard for multistate businesses: the uncertainty of the amount of state activity that gives rise to nexus, how to properly apportion income among all states, and the potential for multiple jurisdictions to tax the same revenue. Congress had no intention of P.L. 86-272 becoming the long-term solution; rather, its enactment was to serve as a "stopgap" while additional options

15. "In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright line, physical presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes." *Id.* at 317.

16. The Court in *Quill* noted that Commerce Clause jurisprudence favors a more flexible approach to determining nexus and agreed with the state court's assessment of the evolution of nexus. The Court also noted that its review of other types of taxes has not sustained the physical presence requirement established by *Bellas Hess*, but the lack of articulation does not imply a repudiation of the standard for other tax types. *Id.* at 314.

17. 358 U.S. 450 (1959).

18. Pub. L. No. 86-272, 15 U.S.C. §§ 381–384.

19. Pub. L. No. 86-272, § 103.

20. *See generally* Nw. Cement Co., 358 U.S. 450; *see also* Miller Bros. v. Maryland, 347 U.S. 340, 344–45 (1954); Ott v. Miss. Valley Barge Line, 336 U.S. 169 (1949); Int'l Shoe Co. v. Washington, 326 U.S. 310 (1945); West Publ'g Co. v. McColgan, 328 U.S. 823 (1946).

were explored.[21] With no additional federal action, states, like children left unsupervised by their parents, have begun to make their own often irreconcilable nexus rules.

II. Nexus-Creating Activities

A. *Intangibles*

> *The intangible represents the real power of the universe. It is the seed of the tangible.*—Bruce Lee

In 1993, the South Carolina Supreme Court ruled a taxpayer licensing intangibles, with no physical presence in the state, satisfied the requisite minimum contact for the state to impose tax.[22] Toys "R" Us, Inc. created an intangible holding company named Geoffrey LLC, which held trademarks and trade names for Toys "R" Us subsidiaries in many states, including South Carolina. The subsidiaries paid a royalty to Geoffrey for use of the intangible property in South Carolina. Citing *Quill*, the court stated, "the nexus requirement of the Due Process Clause can be satisfied even where the corporation has no physical presence in the taxing state if the corporation has purposefully directed its activity at the state's economic forum."[23] Additionally, the court stated the "minimum connection" required by Due Process is nevertheless satisfied by the presence of Geoffrey's intangible property in South Carolina.[24] Courts in Louisiana, Massachusetts, and Oklahoma also concluded Geoffrey's activity in their state was sufficient to create nexus.[25]

Geoffrey exemplifies the expansion of the Due Process "minimum connection" nexus requirement. In *Geoffrey*, the court extended the standard, at least in an income tax context, to include the presence of an intangible in a state, thus allowing a state to tax any entity with an intangible in its state, regardless of any traditional physical presence. States were quick to implement the principle of establishing nexus with no physical presence but with "economic presence."

B. *Economic and Factor Presence*

> *Presence is more than just being there.*—Malcolm Forbes

Since the *Quill* and *Geoffrey* decisions, states are arbitrarily broadening nexus standards and implementing their own version of economic presence,

21. S. Rep. No. 658 (1959).
22. Geoffrey, Inc. v. South Carolina Tax Comm'n, 437 S.E.2d 13 (S.C. 1993).
23. *Id.* at 19.
24. *Id.* at 19–20; *see also* Wheeling Steel Corp v. Fox, 298 U.S. 193 (1936) (intangibles may acquire a situs for taxation other than at the domicile of the owner if they have become integral parts of some local business).
25. Bridges v. Geoffrey, Inc., 984 So. 2d 115, 126 (La. Ct. App. 2008); Geoffrey Inc. v. Comm'r, 899 N.E.2d 87, 91 (Mass. 2009); Geoffrey, Inc. v. Tax Comm'n, 132 P.3d 632 (Okla. Civ. App. 2005).

maintaining that the physical presence requirement of *Quill* is limited to sales and use tax.[26] The challenge from a compliance perspective is determining what states operate under what standard, and within a standard, what does a particular state consider substantial economic activity giving rise to nexus. The Multistate Tax Commission (MTC), which is an intergovernmental state tax agency working on behalf of states and taxpayers to equitably administer state tax laws, attempted to resolve the lack of uniformity on what constitutes substantial activity for income tax nexus by adopting a uniform proposal in 2002.[27] The proposal, "Factor Presence Nexus Standard for Business Activity Taxes," implements both a physical presence and economic presence standard to determine nexus and provides an out-of-state entity with a bright-line standard to determine income tax nexus with a jurisdiction. Factor presence nexus exists if any of the following thresholds are exceeded in a taxing jurisdiction during a tax period:

- $50,000 of property,
- $50,000 of payroll,
- $500,000 of sales, or
- Twenty-five percent of total property, payroll, or sales.[28]

The goal of the proposal was to simplify the standard for the imposition of state tax by defining reasonable amounts of economic or physical activity to justify nexus with a state.[29] The effect has been less than desirable: a limited number of states have implemented the factor presence standard, and the thresholds vary greatly among the states applying the standard.

Ohio was the first state to codify a factor presence standard when it implemented its Commercial Activity Tax (CAT) in 2005.[30] However, the CAT is imposed on gross receipts rather than net income, which affords the state less concern with the burdens of challenging P.L. 86-272. As of January 1, 2016, Alabama, California, Colorado, Connecticut, Michigan, New York, Tennessee, and Washington utilize a factor presence standard. However, not all states follow the MTC model rule: Alabama, California, Colorado, Tennessee, and Washington mostly follow the MTC model statute,

26. Maryland Comptroller of the Treas. v. Syl Inc., 825 A.2d 399 (Md. 2003); A&F Trademark Inc. v. Tolson, 605 S.E.2d 187 (N.C. Ct. App. 2004); Gen. Motors Corp. v. Seattle, 25 P.3d 1022 (Wash. Ct. App. 2001); Kmart Props., Inc. v. N.M. Tax & Rev. Dep't, 131 P.3d 27 (N.M. Ct. App. 2001); Lanco Inc. v. N.J. Div. of Taxation, 908 A.2d 176 (N.J. 2006); *Geoffrey Inc.*, 132 P.3d 632.

27. Multistate Tax Commission, *The Commission*, www.mtc.gov.

28. Multistate Tax Commission, *Factor Presence Nexus Standard for Business Activity Taxes*," at (B)(1) (Oct. 17, 2002), http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FactorPresenceNexusStandardBusinessActTaxes.pdf.

29. Bloomberg BNA, *2015 Survey of State Tax Departments* (Apr. 24, 2015).

30. Ohio Rev. Code Ann. § 5751.01(H).

while Connecticut, Michigan, and New York vary slightly in their application of factor presence.[31]

Although the few factor presence states offer helpful and measurable standards for nexus-creating activities, the majority of states implementing a nexus policy under economic presence do not offer clear guidance. As of 2015, thirty-seven states and Washington, D.C., reported the use of an economic presence standard in determining nexus.[32] Unfortunately, state statutory language routinely fails to clearly state what activity sufficiently creates an economic presence, leaving franchisors with little guidance or certainty in determining a filing obligation. States and taxpayers continue to dispute the legislation, and resolution often centers on nuanced factual differences.

In *Lanco, Inc. v. New Jersey Division of Taxation*, the taxpayer licensed intellectual property to a retailer in New Jersey in exchange for royalty payments.[33] Lanco had no offices, employees, or tangible property in New Jersey, but the court stated the premise "that the physical presence of the taxpayer or its employee(s), agent(s), or tangible property in a jurisdiction has been and remains a necessary element for a finding of substantial nexus under the Commerce Clause of the United States Constitution. We respectfully disagree."[34] The division argued that abandoning the physical presence requirement recognized that a business can engage in a significant level of commercial activity in a state without ever "setting foot" in a state.[35] Provided a state can establish that a business derives substantial benefits from an economic activity in a state, there is no principled reason why physical presence should be required to justify taxation.[36] The court explained that Lanco availed itself of numerous benefits provided by New Jersey. The protection of New Jersey courts and police and fire department protection over the physical property utilizing Lanco's trademarks was sufficient activity to create "substantial nexus."[37] The fundamental conclusion of the *Lanco*

31. ALA. CODE § 40-18-31.2(a); CAL. REV. & TAX. CODE § 23101(b) (California's standard amounts are indexed for inflation—for the 2016 tax year the standards are $547,711, $54,771, and $54,771, respectively); COLO. CODE REGS. § 22-301.1(2)(b); CONNECTICUT INFORMATION PUB. IP 2010 (29.1) (Connecticut has a bright line $500,000 of sales as the only criteria for factor presence); MICH. COMP. LAWS § 206.621(1) (Michigan has a gross receipts threshold of $350,000); N.Y. TAX LAW § 209(1)(b), (1)(d)(i) (New York has two bright line factor based thresholds, receipts of $1 million or more or, for corporate members of a unitary group, if a member has $10,000 or more of gross receipts in New York, and the combined group equals or exceeds $1 million); TENN. CODE ANN. § 67-4-2004; WASH. REV. CODE § 82.04.067, *as amended by* 2015 WASH. S.B. 6138, *effective* Sept. 1, 2015 (Washington implements a $267,000 sales threshold).

32. *2015 Survey of State Tax Departments*, *supra* note 27. Four states surveyed failed to respond to the question, and four additional states do not impose a corporate income tax.

33. 879 A.2d 1234 (N.J. Super. Ct. App. Div. 2005).

34. *Id.* at 1241.

35. *Id.* at 1237.

36. *Id.*

37. *Id.* at 1237–38.

holding was that the Supreme Court in *Quill* simply did not intend to "create a universal physical presence requirement for state taxation under the Commerce Clause."[38]

A recent ruling specifically involving franchisors is the 2010 case of *KFC Corp. v. Iowa Department of Revenue*.[39] KFC is a Delaware corporation with its principal place of business in Kentucky. KFC licensed the KFC trademark and related system to independent franchisees. All KFC locations in Iowa were owned by franchisees, and KFC had no property or employees located in the state.[40] KFC owned, managed, protected, and licensed all KFC materials. Additionally, KFC received a monthly four percent royalty from the franchises in Iowa; required franchisees to maintain specific KFC standards for menu items, advertising, marketing, and facilities; and mandated the use of KFC approved vendors for procurement of equipment, supplies, and food.[41]

The court concluded that physical presence is not required for a state to impose an income tax.[42] The franchise right to operate in the state bestowed a direct connection to Iowa upon KFC, and taxing KFC's activity in Iowa did not place an undue burden on commerce, "but rather a payment to government that provided the economic climate for the business to prosper."[43] The court noted "[W]hile 'physical presence' may have been a significant feature, if not a requirement, in the Supreme Court's Dormant Commerce Clause analysis in early sales and use tax cases, 'physical presence' in the narrow sense does not appear as an important factor in cases involving state income taxation."[44] The court further suggested that a physical presence standard for income tax would create a huge loophole in tax structure and would provide incentive for "entity isolation" where taxpayers would create affiliates without physical presence to avoid taxation.[45] A fundamental concept of law the court considered is the substance-over-form approach embraced by the Supreme Court in most modern cases involving the Dormant Commerce Clause.[46] The *KFC* decision removes all doubt, at least in the State of Iowa, that physical presence is no longer a requirement under the Commerce Clause for the state to subject an out-of-state taxpayer to tax.[47] The *KFC* court revealed that cases involving income tax do not look to a bright line

38. Lanco, Inc. v. N.J. Div. of Taxation, 908 A.2d 176, 177 (N.J. 2006).
39. 792 N.W.2d 308 (Iowa 2010).
40. *Id.* at 310.
41. *Id.* at 311.
42. The court determined that the intellectual property had a substantial nexus with Iowa because it produced significant royalty income for KFC, and therefore, the presence of the intellectual property was the functional equivalent to "physical presence." *Id.* at 323–24.
43. *Id.* at 311.
44. *Id.* at 314 (citing Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 464 (1940)).
45. *KFC*, 792 N.W.2d at 328.
46. *Id.* at 313.
47. *Id.* at 328.

"physical presence" standard to determine nexus, but rather a flexible approach focusing on economic reality and the nature of the activity giving rise to the income the state seeks to tax.[48]

A more recent decision furthered the holding in *KFC* and arguably expanded nexus-creating activities for intangible holding companies. *Jack Daniels Properties, Inc. v. Iowa Department of Revenue* contains similar facts to *KFC*; however, Jack Daniels attempted to differentiate itself from KFC in three ways. First, the appellant did not operate any stores in Iowa; second, the activity in Iowa was negligible compared to the overall business of the company; and third, the appellant did not receive the benefit of "orderly society" in Iowa.[49] The administrative law judge concluded the differences to be without distinction. While the appellant did not directly operate under agreements with locally owned businesses, the use of a wholly owned subsidiary was not sufficient to shield the entity from tax.[50] Additionally, the administrative law judge found merely having sales in Iowa afforded the company the benefits of "orderly society"; the state provided infrastructure, a regulatory scheme, and legal protection, all of which supported the company and its ability to sell and conduct business in the state.[51]

A more favorable decision for taxpayers occurred in the 2012 case of *Scioto Insurance Co. v. Oklahoma Tax Commission*.[52] Scioto Insurance Company owned the intellectual property of Wendy's International through its interest in a single member LLC. Vermont-based Scioto licensed the intellectual property to Wendy's International, which sublicensed the property to restaurants and franchises in Oklahoma. Payments for the use of trademarks, trade names, and operating practices were based on individual restaurant sales and paid by Wendy's International to Scioto. Scioto licensed directly with Wendy's International and had no determination in the restaurant locations nor did Scioto have any direct licensing arrangement with individual restaurants. The Oklahoma Supreme Court declared "Oklahoma simply has no connection to or power to regulate the licensing agreement between Scioto and Wendy's International."[53] The court distinguished Scioto from *Geoffrey* since Scioto is not a "shell" entity, and the licensing agreement between Scioto and Wendy's does not merely exist to create a tax deduction in Oklahoma.[54] The payments were due to Scioto irrespective of the Oklahoma

48. *Id.*at 314. *See* Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 464 (1959); Int'l Harvester Co. v. Wis. Dep't of Taxation, 322 U.S. 435, 441 (1944); Wisconsin v. J.C Penney, 311 U.S. 435, 444 (1940); New York *ex rel.* Whitney v. Graves, 299 U.S. 366, 372 (1937).

49. Jack Daniels Props., Inc. v. Iowa Dep't of Revenue, Nos. 09DORFC002:004 (Iowa Dep't of Inspections and Appeals Mar. 7, 2012).

50. *Id.*

51. *Id.* The "orderly society" is a term used by the court in *KFC*, which the appellant used to distinguish itself from KFC.

52. 279 P.3d 782 (Okla. 2012).

53. *Id.* at 783.

54. The court noted, "in the case at hand due process is offended by Oklahoma's attempt to tax an out of state corporation that has no contact with Oklahoma other than receiving payments from on Oklahoma taxpayer. . . ." *Id.* at 784.

restaurants payments to Wendy's International, the payments were a part of its income as an insurance company, and none of that business was conducted in Oklahoma.[55]

Similarly, the West Virginia Supreme Court in *Griffith v. ConAgra Brands, Inc.* affirmed the finding that ConAgra did not have sufficient contacts with the state to satisfy the Due Process or Commerce Clause nexus requirements.[56] ConAgra owned trademarks for a variety of food and drink products, which were licensed to numerous licensees in West Virginia. ConAgra manufactured all products and performed all business operations entirely outside of the state. Additionally, ConAgra did not maintain any offices, facilities, inventory, employees, or agents in West Virginia.[57] The Commerce Clause analysis centered on a "significant economic presence" test, which "incorporates due process 'purposeful direction towards a state while examining the degree to which a company has exploited a local market.'[58] Further, '[a] substantial economic presence analysis involves an examination of both the quality and quantity of the company's economic presence.'[59] Finally, under this test, '[p]urposeful direction towards a state is analyzed as it is for Due Process Clause purposes,' and the Commerce Clause analysis requires the additional examination of the 'frequency, quantity and systematic nature of a taxpayer's economic contacts with a state.'"[60]

The court held that although physical presence is not a requirement for nexus, a significant economic presence must exist to subject an out-of-state taxpayer to West Virginia tax.[61] West Virginia previously determined continuous and systematic direct mailing and telephone solicitation satisfies "significant economic presence" criteria, but ConAgra's activity in West Virginia did not rise to the same level of purposeful direction. ConAgra did not direct or dictate how licensees distributed the products bearing the ConAgra trademarks and trade names or purposefully direct its products to West Virginia.[62] Additionally, ConAgra did not distribute any of its products in West Virginia or provide any services in the state.[63] The court concluded ConAgra's royalties earned from the licensing of food industry trademarks did not satisfy "purposeful direction" under the Due Process Clause or "significant economic presence" under the Commerce Clause.[64]

55. *Id.*
56. 728 S.E.2d 74 (W. Va. 2012).
57. *Id.* at 76.
58. *Id.* at 81 (quoting Christina R. Edson, *Quill's Constitutional Jurisprudence and Tax Nexus Standards in an Age of Electronic Commerce*, 49 Tax Lawyer 893, 943 (Summer 1996)).
59. *Id.* (quoting *Quill's Constitutional Jurisprudence*, *supra* note 58, at 944).
60. *Id.* (quoting *Quill's Constitutional Jurisprudence*, supra note 58, at 945).
61. *ConAgra*, 728 S.E.2d at 84; *see also* W. Va. Tax Comm'r v. MBNA Am. Bank, 640 S.E.2d 226, 227 (W. Va. 2006) ("the Court indicated that an entity's physical presence, required to meet the 'substantial nexus' prong of *Complete Auto*, applies only to 'state sales and use taxes' and not to corporation net income and business franchise taxes").
62. *MBNA*, 640 S.E.2d at 234.
63. W. Va. Tax Comm'r v. ConAgra Brands, Inc., 728 S.E.2d 74, 76 (W. Va. 2012).
64. *Id.* at 84.

Conclusion

> *Today, it takes more brains and effort to make out the income-tax form than it does to make the income.*—ALFRED E. NEUMAN

The expanding case law on economic presence indicates trends in determining nexus for multistate businesses and franchises. "Shell" intangible holding companies issuing licenses, marketing, merchandising skills, and advertising with brick-and-mortar storefronts can constitute purposeful direction and establish the "minimum contacts" and "substantial nexus" requisite for Due Process and Commerce Clause income tax nexus.[65] Additionally, the licensing of an intangible and a "related system," including purchasing requirements to be implemented by franchisors within a state, will likely establish an economic presence.[66] However, the licensing of an intangible with no direct policy or regulation of how the license will be used or how sales or distribution will occur fails to create "purposeful direction" or a "significant economic presence" within a jurisdiction.[67] Distinguishing the differences is undoubtedly an arduous task and inhibits the ability of franchisors to understand the full scope of state nexus requirements. However, being aware of what state taxing authorities consider when determining nexus provides a franchisor the ability to recognize when out-of-state activity may require professional tax guidance.

Navigating nexus thresholds for franchisors can be an overly burdensome and potentially unreasonable compliance responsibility. The U.S. Supreme Court's refusal to consider matters of economic nexus coupled with growing constraints on state budgets is likely to foster further expansion of economic and factor presence principles. The landscape of taxability is dramatically shifting to a prospect where physical presence no longer competently determines nexus. Franchisors and practitioners must scrutinize the structure of franchise agreements, state sales volume, and all contact within a state to determine if economic presence exists. Once nexus is determined, a franchisor is faced with either the choice of compliance, which can be unmanageable, or playing the audit lottery, which can entangle a franchise in costly and lengthy litigation.

Most states offer participation in voluntary disclosure programs where taxpayers can anonymously request to remit outstanding taxes. The benefit of these programs is a limited look-back period for liabilities and a waiver of penalties. Lastly, states periodically offer amnesty programs, which allow for the remittance of outstanding tax with less scrutiny and penalty.

65. *Id. See generally* Geoffrey, Inc. v. South Carolina Tax Comm'n, 437 S.E.2d 13 (S.C. 1993); Bridges v. Geoffrey, Inc., 984 So. 2d 115, 126 (La. Ct. App. 2008); Geoffrey Inc. v. Comm'r, 899 N.E.2d 87, 91 (Mass. 2009); Geoffrey, Inc. v. Tax Comm'n, 132 P.3d 632 (Okla. Civ. App. 2005).

66. *ConAgra*, 728 S.E.2d at 84. *See generally* KFC Corp. v. Iowa Dep't of Revenue, 792 N.W.2d 308 (Iowa 2010).

67. *See generally* Scioto Ins. Co. v. Okla. Tax Comm'n, 279 P.3d 782 (Okla. 2012); *ConAgra*, 728 S.E.2d 74.