A UNIFORM JURISDICTIONAL STANDARD

APPLYING THE SUBSTANTIAL PHYSICAL PRESENCE STANDARD TO ELECTRONIC COMMERCE

DEAN ANDAL

MEMBER, U.S. ADVISORY COMMISSION ON ELECTRONIC COMMERCE
VICE CHAIRMAN,CALIFORNIA STATE BOARD OF EQUALIZATION

PRESENTED SEPTEMBER 15, 1999
NEW YORK CITY, NEW YORK

A UNIFORM JURISDICTIONAL STANDARD

APPLYING THE SUBSTANTIAL PHYSICAL PRESENCE STANDARD TO ELECTRONIC COMMERCE

INTRODUCTION

Fellow Commissioners, I offer the following proposal for your consideration. Besides clarity, predictability and uniformity, my proposal has other positive outcomes:

- it does not raise taxes on the Internet;
- it will enable the Internet to continue its remarkable contribution to the economic vitality of our country without the stifling effect of tax uncertainty or burdens; and
- it will avoid years of contentious and unproductive tax litigation in 50 different states over tax "nexus."

My proposal creates a uniform national jurisdictional standard for taxing electronic commerce, based on the substantial physical presence test. This is the test the U.S. Supreme Court has established as the key to applying the Commerce Clause provision of the Constitution.

Even though the Court has recognized this basic standard for years, state and local governments have often attempted to circumvent the standard by asserting aggressive (and, in my view, short-sighted) legal theories. My proposal clarifies the meaning of substantial physical presence in the context of electronic commerce. It will provide the clarity, predictability and uniformity that is the hallmark of a tax system that (a) fairly raises the revenue necessary to fund government, without (b) stifling the economic system that produces the revenue in the first place.

My proposal is to modify Public Law 86-272[1] to incorporate a series of safe harbors that insure the Internet does not become the occasion for state and local governments to attempt to create an ever-expanding list of activities that might arguably create taxable nexus. Instead, my proposal fairly limits tax obligations to those incurred when a person establishes a substantial physical presence within a taxing jurisdiction. This proposal thus applies the standard set forth by the Supreme Court and does so in a way that insures the Internet will continue as an engine of economic growth - which ultimately benefits everyone, taxpayers and taxing authorities alike.

[1] Although P.L. 86-272 has been codified in 15 USC §§ 381-384, it is still generally referred to as "P.L. 86-272" and I shall do so as well.

TITLE 15 - COMMERCE AND TRADE
CHAPTER 10B - STATE TAXATION OF ~~INCOME FROM~~ INTERSTATE COMMERCE
SUBCHAPTER I - ~~NET INCOME TAXES~~JURISDICTIONAL STANDARDS

Sec. 381. Imposition of ~~net income tax~~ State and Local Tax Obligations.

(a) Minimum standards. No State~~, or political subdivision thereof,~~ shall have power to impose, for any taxable year ending after ~~September 14, 1959~~ the effective date of this Act, a ~~net income~~ business activity tax (including a duty to collect a sales or use tax) on ~~the income derived within such State by~~ any person~~ from interstate commerce~~, unless such person has a substantial physical presence in such State. A substantial physical presence is not established if the only ~~business~~ activities within such State by or on behalf of such person during such taxable year are ~~either, or both~~ any, or all, of the following:

(1) the solicitation of orders or contracts by such person, or his representative, including activities normally ancillary thereto in such State for sales of tangible or intangible personal property or for the provision of services, which orders or contracts are approved or rejected ~~sent~~ outside the State ~~for approval or rejection,~~and, if approved, are fulfilled by shipment or delivery of property from a point outside the State or the performance of services outside the State; ~~and~~

(2) the solicitation of orders or contracts 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 or contracts by such customer to such person to enable such customer to fill orders or contracts resulting

from such solicitation are orders or contracts described in paragraph(1)~~.~~;

(3) the presence or use of intangible property in such State, including, but not limited to, patents, copyrights, trademarks, logos, electronic or digital signals and web pages, whether or not subject to licenses, franchises or other agreements;

(4) the use of the Internet to create or maintain a World Wide Web site accessible by persons in such State;

(5) the use of an Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services to maintain or take and process orders via a web page or site on a computer that is physically located in such State;

(6) the use of any service provider for transmission of communications, whether by cable, satellite, radio, telecommunications or other similar system;

(7) the affiliation with another entity, unless such entity is the person's agent for purposes of any in-state activity;

(8) the use of an unaffiliated representative or independent contractor in such State for the purpose of performing warranty or repair services with respect to personal property sold by such person.

This section shall not be construed to limit, in any way, constitutional restrictions otherwise existing on state taxing authority.

(b) Domestic corporations; persons domiciled in or residents of a State. The provisions of subsection (a) of this section shall not apply to the imposition of a ~~net income~~ business activity 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) Sales or solicitation of orders for sales by independent contractors. For purposes of subsection (a) of this section, 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 or contracts 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~~, or tangible personal property~~.

(d) Attribution of activities and presence. For purposes of this section, the substantial physical presence of any person shall not be attributed to any other person absent the establishment of a fiduciary or agency relationship between them that results from the consent by both parties that one person act on behalf and subject to the control of the other.

~~**(d)**~~ **(e) Definitions 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~~.~~;
(3) the term "State" means any of the several States, the District of Columbia, or any territory or possession of the United States, or any political subdivision thereof;

(4) the term "Internet" means collectively the myriad of computer and telecommunications facilities, including equipment and operating software, which comprise the interconnected world-wide network of networks that employ the Transmission Control Protocol/Internet Protocol, or any predecessor or successor protocols to such Protocol;

(5) the term "Internet access" means a service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content, information, and other services as a part of a package of services offered to users;

(6) the term "World Wide Web" means a computer server-based file archive accessible, over the Internet, using a hypertext transfer protocol, file transfer protocol, or other similar protocols;

(7) the term "Business Activity Tax" means a tax measured by net income, a business license tax, a franchise tax, a single business tax, a capital stock tax, a business and occupation tax, sales or use tax, or any obligation to collect such a tax, or any similar tax or fee imposed by a State;

(8) for purposes of this chapter, the term "use tax" means any tax imposed on the storage, use, or other consumption of products or services.

Sec. 382. Assessment of ~~net income~~ business activity taxes.

(a) Limitations. No State~~, or political subdivision thereof,~~ shall have power to assess, after the effective date of this Act ~~September 14, 1959~~, any ~~net income~~ business activity 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~~ <u>for activities</u> within such State by any person ~~from~~ <u>that affect</u> interstate commerce, if the imposition of such tax for a taxable year ending after such date is prohibited by section 381 of this title.

(b) Collections. The provisions of subsection (a) of this section shall not be construed -

(1) to invalidate the collection, on or before September 14, 1959, of any net income tax imposed for a taxable year ending on or before such date, or

(2) to prohibit the collection, after September 14, 1959, of any net income tax which was assessed on or before such date for a taxable year ending on or before such date.

<u>**Sec. 383. Termination of Substantial Physical Presence.**</u>
<u>Where a state has imposed a Business Activity Tax on a person as described in Section 381, and the person so obligated no longer has a substantial physical presence in that State, the obligation to pay or collect tax on behalf of that State applies only for the period in which the person has a substantial physical presence</u>

~~**Sec. 383. "Net income tax" defined.**~~
~~For purposes of this chapter, the term "net income tax" means any tax imposed on, or measured by, net income.~~

Sec. 384. Separability.
If any provision of this chapter or the application of such provision to any person or circumstance is held invalid, the remainder of this chapter or the application of such provision to persons or circumstances other than those to which it is held invalid, shall not be affected thereby.

THE CHALLENGE

A. ENCOURAGING E-COMMERCE.

The mission of the Advisory Commission on Electronic Commerce (the Commission) is to "conduct a thorough study of Federal, State and local, and international taxation and tariff treatment of transactions using the Internet and Internet access and other comparable intrastate, interstate, and international sales activities." The Commission has been directed to report its findings to Congress, along with "such legislative recommendations as required to address the findings."

A recommendation presumes a goal toward which our efforts are directed. The above proposal for your study and consideration is directed at a simple goal: promoting the expansion of economic activity through electronic commerce. Achieving that goal does not require abandoning state and local taxing authority, only better defining it. By placing clear parameters on state and local authority to tax interstate commerce, Congress can reduce the threat of taxation in jurisdictions in which a business does not have a substantial physical presence. The U.S. Supreme Court has long recognized that the Commerce Clause requires a physical connection between the taxing jurisdiction and the taxpayer. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). A substantial physical presence provides an identifiable standard that ensures a State's power to tax is limited to taxpayers within its borders. Nothing will do more harm to the growth of electronic commerce than expanding state and local taxing authority beyond their borders.

The threat of taxation is as much an issue as the obligation of taxation itself. The Supreme Court's decisions in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), have not been uniformly adhered to or interpreted. States continually litigate new theories in the hope of expanding their jurisdiction beyond their borders, not just for use taxes but other excise and business activity taxes. The cost

to taxpayers in money and time is substantial. All the while, predictable jurisdictional standards are being eroded. This lack of certainty is the biggest threat to business on the Internet.

The promise of electronic commerce is not just for the Fortune 500. Small businesses are discovering a global marketplace while never leaving their garage. While "big business" tends to make the headlines, the backbone of the American economy and the promise of electronic commerce is small and middle-market businesses. The Internet is the quintessential small business tool because it provides access to a global marketplace without having to go to the market. The more unique the product or service, the more the Internet facilitates the finding of a market. If we settle for a tax system in which only the very large can afford to navigate, the promise of freedom and economic independence that the Internet brings will be lost. Such a loss may mean that the next Dell Computers or Amazon.com will never move beyond the entrepreneur’s garage.

America was founded on the belief that states are sovereign within their own borders. The exportation of taxation, which many state and local governments now propose, was the very trigger upon which this nation began a revolution. Federalism does not stand for the proposition that Congress should ratify the states exporting their tax obligations to persons located in other states, but to protect the citizens of one state from the overreaching of another. States are free to tax persons in their own jurisdictions as they choose. But taxing an individual who has no presence in a state and no voice in that state’s political process is unconscionable, regardless of its simplicity.

But, of course, the Internet is not just an American phenomenon. The Internet is a global marketplace and the world is watching. If we endorse the exportation of tax obligations among our own, other nations will follow. This Commission will be followed by others on which we as a nation are but a single voice and they will ask that American business meet the same standards. Soon, that small businessperson who has miraculously found a buyer in another country for his or her product will be faced with complying with that nation’s transaction taxes and activity taxes. In the face of such an obstacle for a

small business, the sale will likely just be abandoned. Then who loses?

B. ENCOURAGING EXPANSION OF E-COMMERCE BY IMPROVING CERTAINTY OF STATE AND LOCAL TAX RESPONSIBILITIES.

One of the biggest hurdles facing businesses engaged in interstate commerce is simply knowing *which* tax agencies are involved. For the on-line business, the uncertainty is positively mind-boggling because the technology itself poses new questions in jurisdictional standards. Can an ISP that facilitates the processing of data cause its customers to have tax obligations in the state, county and city of the ISP? Does the mere fact that a customer can order via your web page subject your company to taxation in the state of the consumer? What about the in-state use of a license or copyrighted material?

With the exception of P.L. 86-272, which relates strictly to state income taxes and to sellers of tangible personal property, Congress has left the question of the limits of state taxing authority to the courts. The courts, however, have failed to solve the problem. Each decision is the subject of subsequent dispute and argument over its proper application. New theories are developed and more time and energy spent litigating for certainty and predictability.

The principal limitations on state taxation of interstate commerce are the Due Process and Commerce Clauses of the U.S. Constitution. Due Process is primarily concerned with the fundamental fairness of governmental activity. The question for purposes of Due Process jurisdiction, thus, is "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 Corp. v. North Dakota*, 504 U.S. 298, 312 (1992). For all practical purposes, *Quill* eliminated the Due Process Clause as a protection against a state's taxing jurisdiction for an out-of-state seller who purposefully seeks to make sales into that state. So long as the taxpayer's activities are more than minimal,

the taxpayer has "fair warning" that that state may tax the seller. In the context of electronic commerce, however, additional questions arise. Does simply having a web page create sufficient contacts, even for the lower Due Process purposes?

Historically, the Courts have protected out-of-state persons from the jurisdiction of a state unless the out-of-state actor "purposefully avails himself of the forum jurisdiction." See *World-Wide Volkswagen Corp. v. Woodson* 444 U.S. 286 (1980). In the e-commerce context, the District Court for the Southern District of New York in *Hearst Corp. v. Goldberger* (1997 WL 97097,1 [SD NY, Feb. 26, 1997]) concluded that New York did not have jurisdiction under the Due Process Clause when a person's only contact with that state was the establishment of a web site that could be accessed by people all over the world, including New York. In this case, the defendant had not sold any products or services to individuals in New York at the time of the suit. *See also Bensusan Restaurant Corp. v. King*, 937 F.Supp. 295 (S.D. N.Y. 1996); *Millennium Enterprises, Inc. v. Millenium Music, LP*, 33 F.Supp.2d 907 (D. Ore. 1999).

In contrast is *Inset Systems, Inc. v. Instruction Set Inc.*, 937 F.Supp. 161 (D.Conn. 1996), where that court for all practical purposes concluded that the mere existence of a web page was sufficient under the Due Process Clause. Here the defendant had not even targeted the state in question, but conducted its advertising activities on a ubiquitously accessible web page on the Internet and via its toll-free numbers. *See also Zippo Manufacturing Co v. Zippo Dot Com. Inc.* 952 F.Supp 1119 (W.D. Pa. 1997) (subscription service via Internet is sufficient for Due Process purposes).

Since the decision of the Court in *Quill*, the Commerce Clause has been viewed as creating a distinct and higher standard for determining whether a state has sufficient authority to tax an out-of-state person. In contrast to the Due Process Clause, "the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and

suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills." *Quill, supra*, at 312. The criteria to tax interstate transactions was established in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), under the judicially-created "dormant commerce clause" limitation. *Complete Auto Transit* provides that a state tax must meet four standards under the dormant commerce clause: (1) the tax must be applied to an activity with a **substantial nexus** with the taxing state; (2) be **fairly apportioned**; (3) **cannot discriminate** against interstate commerce; and (4) be **fairly related** to the services provided by the state seeking to impose the tax.

The definition of "substantial nexus" is most often the subject of dispute. Some decisions suggest that it applies differently depending on the type of tax. While the Supreme Court in *Quill* reiterated the standard of a "substantial physical presence" articulated in the 1967 decision of *National Bellas Hess*, 386 U.S. 753, some states argue their standard only applies to the collection obligation under the use tax, and not, for example, to income taxes. *See Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993), *cert. den.*, 510 U.S. 992 (1993) (foreign corporation's licensing of its Toys 'R Us trademark in the taxing state and the royalties generated from it established nexus even without a physical presence).

The indirect establishment of a substantial presence on the part of the out-of-state person is another fruitful ground of controversy. Over the last decade, the states have attempted to expand the theory of "attributional nexus," which attributes the substantial physical presence of one person to that of another either by way of agency or corporate affiliation. Does advertising by an out-of-state company on a web page that happens to be on a server located in the taxing state suffice? What about a logo on a web page "hot-linked" to an out-of-state vendor? What about the in-state presence of a telecommunications service provider's equipment used by an in-state resident to order from an out-of-state vendor with whom the telecommunications company contracts for services? For example, Texas has asserted that a web

site on a Texas server creates nexus for an ISP's out-of-state customer.

Only by eliminating the uncertainty as to whether selling goods or services in interstate commerce creates taxable nexus will e-commerce develop to its potential.

C. ENCOURAGING TAX COLLECTION BY MINIMIZING COMPLIANCE BURDEN.

Even if one assumes that jurisdiction to tax exists, the next layer of uncertainty is *what* is subject to tax (tax base) and the appropriate rate to apply. Computing the proper tax liability is the most intrusive aspect of taxation and in many cases the most burdensome aspect of taxation. The more tax agencies involved, the more burdensome compliance becomes.

The problem is most notable and most often discussed in the context of the use tax, but applies equally to other business activity taxes. For purposes of the use tax, just determining the rate can be a challenge. With thousands of taxing jurisdictions, some of which have the authority to set not only the rate, but also the base of taxable goods or services, the implication for small business is grim. But the substantive taxable/non-taxable question is what causes the most uncertainty. In California, we have a uniform tax base, but that still does not remove the uncertainty. For example, we exempt "food for human consumption" from the sales and use tax, but the definition of what constitutes "food for human consumption" is hundreds of pages and is constantly evolving. Know the difference between an ostrich and an emu? What about a sport drink and a "sport energy drink"? How about an herbal tea and an herbal tea that claims some medicinal value? Believe it or not, each of these examples juxtaposes taxable and non-taxable food items in California. The same is true of other states. How can we expect small businesses to know the answer to these rules in all of the taxing jurisdictions in the country?

Unlike the bricks and mortar business that state and local governments so often argue are being discriminated against, the out-of-state retailer is asked to do that

which the in-state retailer is not: determine the place of use for *each* of its customers. For example, the brick and mortar retailer doesn't ask if I'm taking my purchase and going back to my home which is in a different taxing jurisdiction. They don't care. The sales tax treats the place of purchase as the place of consumption. However, if the same transaction occurred online via the company's web page, different standards would apply. If the store is in my home state, most likely the sales tax would once again apply but the seller would first have to determine the destination of the sale. If the seller was in a different state, the use tax applies and the seller would have to identify the destination of the sale and collect and remit based on the rules and rates for that local jurisdiction assuming the company has nexus (reliance on zip codes is not legally sufficient as many zip codes cross taxing jurisdictions). In the purely digital world, where both the consummation of the agreement and the exchange of the product or service occurs on-line, location is not just irrelevant; it can be impossible to determine. The use tax is not a surrogate consumption tax as some would suggest. It was a device conceived to protect in-state merchants.

Most states impose a business tax measured by net income (whether in the nature of an excise tax or a privilege tax or a net income tax). Computation of the tax is generally based on the federal taxable income and each state provides for its own series of limitations on expenditures, special exemptions, exclusions, and credits. Doing business in more than one state (having nexus in more than one state) means that the taxpayer's income is subject to "fair apportionment." Not all the states have adopted the Uniform Division of Income for Tax Purposes Act (UDITPA). Even among those states that have, they are not consistently applying it. Some states have adopted - or, as the case was with California, attempted to adopt - special apportionment laws related specifically to telecommunications and electronic commerce. If the states argue that their jurisdiction to tax is not limited to persons with a substantial physical presence, how are small businesses supposed to cope with this level of complexity? Even for big business, how specialized apportionment laws apply to their hybrid

activities can create substantial complexities and uncertainty.

The physical presence standard not only ensures ease of administration, it properly respects state borders. The basic purpose of taxation is to raise money for government services and programs. Why should a business, having no physical presence in a state, be obligated to contribute to the programs and services in that state? The argument of a "maintenance of a market" for the out-of-state business mistakes the nature of that market. The market exists because of the people, not the government (while such might be true in a centrally planned economy, it is not the case in America). And clearly, out of their own self-interest, the people who live in the jurisdiction properly pay the taxes necessary to support the roads, education and other infrastructure to meet the needs of that market.

Subjecting taxpayers to the intricacies of the tax codes of the jurisdiction in which they are physically present is not an insignificant burden, but subjecting taxpayers to all the tax codes in all the jurisdictions of their customers would create an insurmountable burden to all but the largest businesses.

D. STRENGTHENING FEDERALISM.

The lack of jurisdictional predictability is an outgrowth of our federal system. At the time of the Constitutional Convention, the Articles of Confederation had proved stifling to the free flow of commerce among the states. As described by Hamilton in the Federalist Papers (No. 7 and 11), the convention was uniformly concerned that the absolute sovereign authority of the states over commerce threatened the life of the union. Their response was to create a system of government with several checks and balances between both the national government and the States. The intent was not solely to secure power in the States as opposed to the federal government. Instead, the Founders sought to provide a system of checks to the arbitrary and overreaching powers of *both.*

The primary check on overreaching state actions was the power granted to Congress to regulate commerce between the several States. This specific grant of power was adopted primarily in response to the economic problems the nation experienced under the Articles of Confederation. The Confederation specifically prohibited the national government from regulating trade among the States. As a result, individual states began imposing taxes on goods from other states. Both Madison and Hamilton were concerned this controversy could lead to armed conflict among the States or permit the meddling of other nations threatening the nation's security. The Commerce Clause was written as a cure to these structural impediments to the nation's development. Regrettably, over the past 200 years, Congress has generally left to the courts the responsibility for limiting state action in the area of interstate commerce.

The resurgence in Congress of the ideals of federalism and returning program responsibility to the States is sorely needed. States that argue that this federalism protects their unrestrained regulation (and taxation) of interstate commerce are clearly misreading the Constitution and the writings of both Hamilton and Madison. The model of unchecked State power in the regulation and taxation of interstate commerce was the Articles of Confederation. Although promoted with artful fervor by the "Anti-federalists" during the period of the Constitutional Convention and by the Confederates during the time of the Civil War, ultimately their idea of unlimited State power was decisively rejected.

DISCUSSION OF AMENDMENTS TO P.L. 86-272

The proposed language is intended to create a single uniform jurisdictional standard for taxing interstate commerce: substantial physical presence. To clarify the meaning of substantial physical presence and limit the ever expanding theories of attributional nexus, I offer the following amendments to P.L. 86-272:

SECTION 381(a):

- The jurisdictional limitations are applied not just to states, but state and local governments (see subdivision (e)(3) defining "State").
- This proposal is not intended to "reach back", but to apply prospectively.
- The changes would apply jurisdictional limits to all business activity taxes and any obligation to collect an excise tax or similar tax on transactions.

Subsections (1&2): Expands the protection of solicitation to sales of intangibles and services as well as recognizes the Supreme Court's decision in *Wrigley* that some ancillary activities do not rise to the level of substantial physical presence.

Subsection (3): The exercise of taxing authority with the mere presence of intangible assets in a state is contrary to a substantial physical presence standard. The provision is directed at the South Carolina decision of *Geoffrey, Inc. v. South Carolina Tax Commission*, which has caused substantial confusion among taxpayers and taxing authorities.

Subsection (4): The technology exists today for a company to have access to its web page *dynamically* spread across a national network of computers. Thus a company can contract with a service provider to dynamically manage access to its web site so as to spread resource demands across an entire network of computers. While a user might think his or her access to a web page is coming from the company's headquarters, the web site that the user actually visits is probably hosted by a

contractor and may actually be located in any number of states in which the contractor has located a server so as to distribute usage among the contractors' network (or a network which the contractor leases from another supplier). Moreover, different aspects of the "page" might be "physically" located on different servers in different states. Should each state on which a "page" of html is located have a stake in the transaction between this user and the seller or the income the seller derives from that or other transactions?

Subsection (5): Protecting usage of an ISP, or similar access provider, to maintain or take and process orders via a web page or site on a computer is grounded on the same basic premise as (a)(4). While, theoretically, code of some kind may exist on a given computer, it is not easily identified and is certainly easy to relocate. The impediment to the free flow of commerce that would result from the difficulties of attempting to track such activity would be substantial.

Subsection (6): Communications services, whether via telephone, cable, satellite, or other similar systems likewise, should be protected from being treated as a source of attributing nexus to customers.

Subsection (7): Affiliation is a novel area of nexus which proposes to assert taxing authority on a business based not on the activities of a business, but based on its affiliation with another company that is present in the taxing state.

Subsection (8): This section represents the standard adopted in California to clarify the Multistate Tax Commission's Bulletin 95-1. Unless an in-state warranty repair service provider has an agency relationship with the out-of-state retailer, the provision of warranty repair service by that instate representative does not create nexus.

SECTION 381(d):

The states continue to use the theory of agency nexus to expand their authority beyond the physical presence requirements of *Quill*. Taken to its logical extreme, the

states would propose that any degree of service provided on behalf of a corporation in a taxing state is sufficient to warrant taxation. This section is intended to clarify that only an actual agent, one subject to the control of the contracting company, can subject a taxpayer to the jurisdictional reach of a state.

SECTION 383:

This section is intended to make clear that a state's taxing jurisdiction is limited to activity that occurs during the period of physical presence. Thus, a taxpayer who has a physical presence for a period of time cannot continue to be subjected to taxation after nexus has been terminated. The State would retain its authority to pursue taxes owed after nexus has been terminated, but the scope of taxable activity is limited to the period in which a physical presence was established.