
Features:

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Voluntary registration may not mean nexus but closer scrutiny, oversights could follow

Does voluntary registration in a state necessarily cause nexus there? Probably not, experts say. However, encouraging court decisions in some states are offset by more ominous ones. Rules in certain states frame voluntary registration as consenting to nexus. Additionally, the act of voluntarily registering may invite a host of other difficulties such as closer scrutiny by state tax officials and possible wrinkles later on when converting from voluntary to required registration.

"It's important to review a state's voluntary registration rules to ensure your company has not created a use tax obligation when one did not exist and to recognize that voluntary registration of a sales tax vendor may give rise to nexus for other types of taxes," warns **Debra L. Silverman**, of Roberts & Holland in New York.

Silverman notes that the U.S. Supreme Court's decision in *Quill* (1992) forced many states to change their views toward nexus created by voluntary registration. *Quill* established a bright-line test where physical presence is necessary to establish nexus. Absent offices, outlets, property or employees of a company in a state, tax officials could not force out-of-state vendors to collect use tax.

"It's really because of *Quill*'s enunciation of physical presence as the nexus standard required under the U.S. Constitution for sales and use tax purposes for a state to be able to tax a transaction that states had to go back and revisit registration by itself creating nexus to a state," Silverman says. She points to *Franklin Mint Corp. v. Tully* (1984), a New York Court of Appeals decision, as an example of a pre-*Quill* case in this area, but adds that the case is still important today due to its finding of nexus on an affiliate nexus theory.

Slightest presence

New Milford Tractor Co. Inc. (1994), a New York Tax Appeals Tribunal decision, holds that the retailer's voluntary registration as a New York sales tax vendor by itself did not create sufficient nexus to impose the burden to collect local use taxes. The tribunal decided that a Connecticut John Deere dealer was improperly required to collect use tax on sales into New York in violation of the Commerce Clause of the U.S. Constitution. New Milford Tractor had no office or salesmen in New York. Delivery was by common carrier. Although the taxpayer performed approximately 60 repairs in New York annually, the repairs were deemed incidental to the dealership's principal activity. Nexus was not established though title to equipment passed in New York.

New Milford Tractor had registered at the advice of the John Deere Co. so the dealership could accept delivery of equipment at Syracuse with a sales tax resale certificate instead of paying sales tax.

"This case illustrates instances where companies are often compelled to 'voluntarily' register as a vendor for business reasons when they otherwise would have no reason to do so," Silverman says.

"The bottom line was, voluntary registration in itself is not enough to substantiate nexus."

In *Orvis Company Inc.; Vermont Information Processing* (1995), the New York Court of Appeals found necessary a minimum physical presence threshold of *demonstrably more than a slightest presence*. Two Vermont vendors had sufficient presence in New York to be required to collect New York use tax on retail sales to New York customers. Orvis, a mail-order fishing tackle company, also sent employees into New York to periodically visit retailers. Vermont Information Processing, which delivered by common carrier, sent employees into New York to solve computer software and hardware problems for customers and to offer instructions. *Orvis* makes clear that a certain level of physical presence is necessary for a company to have nexus, thereby supporting the tribunal's *New Milford* decision.

The New York State Dept. of Taxation and Finance has taken the position in a technical advisory opinion, TSB-A-94(53)S, that voluntary registration as a vendor will not by itself give rise to nexus with New York, but if a corporation voluntarily decides to incorporate in the state and mandate in its bylaws that officers must reside there, then the corporation may be deemed to have nexus. In this technical advisory opinion, the required New York residency of a volunteer secretary was enough, Silverman adds.

She also points to *Rylander v. Bandag Licensing Corp.* (2000), a Texas Appeals Court franchise tax case which invalidated a franchise tax provision establishing that a corporation had nexus with Texas because of a certificate of authority to transact business in the state.

But states like North Dakota, Ohio and Oklahoma view voluntary registration as a matter of consent. "If you voluntarily register in these states, the state will view the registration as consent to collect and remit as if you did business in the state," Silverman says.

Check out Ohio's ST 2001-01 Use Tax Information Release and Oklahoma Regulation, Rule 710:65-21-5. In Vermont, a voluntary registrant may have to file a bond to cover any potential taxes.

Voluntary registration's significant risks

Nonetheless, while voluntary registration may not mean a constitutional obligation to collect, it may have other ramifications. Significant risks exist with voluntary registration, says **Diane Yetter**, of Yetter Consulting Services Inc. in Chicago. With fresh information at their fingertips, state tax officials may look long and hard at an application for voluntary registration to see if the taxpayer already has nexus and is subject to required registration.

"If you voluntarily register, it does not make you liable, but it does open you up to scrutiny," Yetter says. "If you attempt to register as a voluntary filer, the state is going to be very stringent on your application."

Taxpayers should first check to make sure no past nexus-triggering activity has occurred, such as a traveling salesman visiting the state or attendance by a company representative at a trade show there.

Future difficulties could occur if your company subsequently steps up business activity in that state. The requirements between voluntary registrants and required registrants differ in some states such as Illinois, for example. Yetter recalls an instance where a client had voluntarily registered in Illinois. Business activity increased dramatically there, but the retailer assumed that since it was already registered voluntarily, it remained compliant. Because of the high dollar volume of sales, the retailer should have been filing weekly instead of monthly. As a voluntary registrant, the retailer

had been able to waive weekly filing.

"The client was hit with a ton of interest and penalties," Yetter says.

The state assessed interest on late payments, and the retailer lost its vendor discount. Yetter was able to negotiate away the penalties, but the interest had to be paid.

Traps abound for unwary

Not all states recognize voluntary registration, she warns. But many states will not hold a voluntary registrant liable for uncollected taxes as long as the taxpayer remits whatever it collects. That could change if a taxpayer later creates a physical presence. As a taxpayer required to register, collect and remit, you could later be subject to an audit. That's why tax managers must put stringent controls in place to carefully monitor activity in states where their company is voluntarily registered. Something as small as an expired resale certificate from a customer could evolve into a hefty assessment later.

Will the Streamlined Sales Tax Project help if it succeeds? The SSTP proposes amnesty for uncollected taxes in certain instances. But status as a voluntary registrant may not be a given.

"As long as the states agree you're a voluntary registrant" the SSTP could be beneficial, Yetter says. "The question is, will the state consider you a voluntary registrant?"

Picking battles

"Voluntary registration is something people do just to avoid having to fight over it," notes **Charles R. Beaudrot Jr.**, of Morris Manning & Martin in Atlanta. "They usually voluntarily register when it's gray, and they don't want to run the risk. Some of the large companies are registering because they don't want to fight. Sometimes it's easier to give in than to fight as a practical matter."

Sometimes, it's easier for business purposes. Customers don't want to file use tax returns, so a business may voluntarily register "as a customer relations thing," he notes.

What if your company chooses to cease doing business in a certain state? Facts could change. Your company may not have the activity in a state that it did three or four years ago. Perhaps your company had a one-time, year-long project in Hawaii. You can surrender the voluntary registration. Yet the state may not want to let go that easily.

"If I'm not required to register, I'm not required to stay registered," Beaudrot adds. "But they're going to assume you have nexus. 'We know where you live,' as they say."

Nexus questionnaires are likely to follow attempts to de-register, along with telephone inquiries.

"Ultimately, it (nexus) is an objective decision," he says.

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