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MEMORANDUM

November 25, 2002

TO: Cox Communications of Las Vegas

FROM: Gardner F. Gillespie
Paul A. Burkett

RE: **Proposed DBS Tax – Nexus and Characterization Issues**

You have asked us to address two questions related to the proposed Nevada tax on DBS – (1) whether a DBS provider would have sufficient “nexus” with Nevada to be subject to tax there, and (2) whether the tax would be characterized as a “net income” tax from which a DBS provider may be exempt under applicable federal law.

Nexus. Under the Commerce Clause of the United States Constitution, an out-of-state retailer must have a physical presence in a state to be liable to collect sales and use taxes on sales in the state. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the United States Supreme Court held that a mail order company that had no employees who worked or resided in a state, that owned no more than insignificant amounts of tangible property in the state, that solicited business in the state only through catalogs and flyers, advertisements in national periodicals, and telephone calls, and that delivered all of its merchandise to customers by mail or common carrier from out-of-state locations was not subject to the state’s taxing jurisdiction. The company, therefore, could not be held liable to collect and pay over to the state any sales or use taxes on the merchandise the company sold to customers in the state. See *id.*

The Court then stated that whether this physical presence test is met “may turn on the presence in the taxing State of a small sales force, plant or office.” *Id.* The Court cited with approval *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). In *Scripto, Inc. v. Carson*, the Court had held that a Georgia corporation

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that used independent contractors to solicit orders in Florida that were accepted and processed in Georgia was required to collect and pay the Florida sales tax on these orders. 362 U.S. 207 (1960). See also *Tyler Pipe Indus., Inc. v. Washington State Dep't of Rev.*, 483 U.S. 232 (1987) (out-of-state seller that used one in-state independent contractor to follow the Washington market and solicit orders from Washington customers was not exempt from a direct tax on wholesale transactions under the Commerce Clause). Based on these decisions, it is apparent that the use of independent contractors (such as Best Buy or Sears) in Nevada to solicit orders for DBS service that are processed out-of-state by the DBS provider will subject the DBS provider to Nevada's taxing jurisdiction with respect to these orders. It is our understanding that both national DBS operators, Direct TV and Echostar, use such contractors to provide equipment to DBS subscribers and to sell DBS service.

Minimum contacts for net income taxes. Federal law (P.L. 86-272, codified at 15 U.S.C. §§ 381-384) prohibits states from imposing net income taxes on an out-of-state company if the company's only contacts with the taxing state involve "solicitation of orders. . . for sales of tangible property." The purpose of the statute was to relieve out-of-state retailers from having to learn the complexities of multiple states' income tax regimes where the retailers' contacts with the states were minimal. See S. Rep. No. 86-658 (1959), reprinted in 1959 U.S.C.C.A.N. 2548, 2549-50. The Supreme Court considered the scope of this exception from state income taxation in *Wisconsin Dep't of Rev. v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992). Specifically, *Wrigley* analyzed what activities do and do not constitute "solicitation" under P.L. 86-272. That question should not be at issue with respect to the proposed tax on DBS.

Although we do not believe that the proposed DBS tax would qualify as a "tax on net income," the short answer to the applicability of this statute is simpler. The business activities of the DBS providers in Nevada manifestly do not solely involve soliciting orders for "sales of tangible property." DBS's independent contractors do sell tangible property in the form of antennas and related equipment, and the DBS companies do occasionally provide equipment free with an order for the service. But the primary purpose of the DBS companies is to sell a service -- the right to receive electronic signals. The statute does not apply in such a situation.

Please let us know if we can answer any more questions about the legality of the proposed DBS tax.