CHAPTER 8

Town Fair Tire Centers, Inc. v. Commissioner of Revenue: The Practical Ramifications

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SYNOPSIS

§ 8.01 INTRODUCTION

Nexus—a word so commonly used and referred to in the sales and use tax arena, but almost always with a focus on the nexus of a taxpayer—that is, does a state or local jurisdiction have the authority to impose its collection burdens on a specific taxpayer. However, nexus can also be referred to on a transactional basis—does a state or local jurisdiction have nexus over the transaction at issue? While both types of nexus must exist before a state can require a taxpayer to collect and or remit sales and use tax on a particular transaction, controversy has historically centered on whether the taxpayer has nexus, and rarely focused on the transaction itself. As sales and use taxes are transaction-based, one must look to the transaction itself to make this determination, unlike income taxes, which are often calculated using some form of apportionment methodology. In many cases, whether the state has nexus over the transaction itself is clear, particularly where property is being shipped into a state or a service is being performed within a state. In those instances, that the state to which the property is being shipped or where the services are being performed has nexus over the transaction. For other types of transactions however, it is not so clear.

On June 9, 2008, the Massachusetts Appellate Tax Board rendered a decision in *Town Fair Tire Centers, Inc. v. Commissioner of Revenue*[1], that centers on the issue of nexus over the transaction. In this case, the taxpayer is appealing an assessment issued by the Commonwealth of Massachusetts in which the Commonwealth is asserting that a taxpayer is required to collect use tax on sales to Massachusetts' residents, where the sale takes place in New Hampshire in a point of sale transaction[2], and title passes to the purchaser at the time of the sale. The case focuses solely on whether the Commonwealth of Massachusetts has jurisdiction over the transaction, and not on whether the Commonwealth of Massachusetts has jurisdiction over the taxpayer.[3] While the Massachusetts Appellate Tax Board held in favor of the Commonwealth, ruling that the tires at issue were purchased for use in the Commonwealth, and that, as

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[1] Town Fair Tire Centers, Inc. v. Commissioner of Revenue, Massachusetts Appellate Tax Board, No. C280607 (6/9/2008).

[2] A point of sale transaction takes place in retail establishments where a purchaser makes a purchase at the local establishment, pays for the purchase at that establishment, and leaves with merchandise in hand.

[3] The decision of the Massachusetts Appellate Tax Board states that Town Fair Tires has 18 stores in the Commonwealth of Massachusetts, all of which are in one legal entity. As such, there is no issue as to whether the Commonwealth has nexus over the taxpayer.

a vendor engaged in business in the Commonwealth, TFT was obligated to collect use tax upon the sale of those tires, Town Fair Tire Centers, Inc. has appealed this decision to the Massachusetts' Supreme Judicial Court.[4]

Retailers are following the outcome of this case closely with the fear that the Supreme Judicial Court will hold in favor of the Commissioner. Such a holding could have far reaching implications for any retailer doing business both within and without Massachusetts, particularly if other states follow suit.

The following discussion highlights the legal arguments at issue, focusing on the practical ramifications to retailers of a holding in favor of the Commonwealth.

§ 8.02 BACKGROUND OF CASE[5]

Town Fair Tire Centers, Inc. ("TFT") is a Connecticut corporation engaged in the retail sale and installation of tires. TFT has sixty stores, located in four states: thirty-four stores in Connecticut; five in Rhode Island; eighteen in Massachusetts; and three in New Hampshire. These stores are all operated in a single legal entity. Each store has a similar layout and operates in the same manner. A typical sales transaction for TFT occurs in the following manner:

- A customer enters a TFT store and proceeds to the front counter to discuss his needs.
- The sales associate informs the customer of his options, and the customer then makes a selection of a tire or tires for purchase.
- The sales associate then processes the invoice for the customer at the front counter, obtaining the following information from the customer: customer's name; telephone number; address; the vehicle make and model; and if payment was made by check, the driver's license number of the individual paying by check.
- The sales associate then provides the customer with a numbered tag to display on the windshield of the customer's vehicle.
- The customer then drives the vehicle to the back of the store.
- TFT technicians retrieve the vehicle based on the tag number, pull the vehicle into the garage bay, install the selected tire(s), and return the vehicle to the front of the store, along with the keys and work order.
- The sales associate then delivers the keys and a copy of the sales receipt to the customer.

In 2003, a Massachusetts sales and use tax audit was initiated of TFT. The audit was conducted using a block sample of transactions. The sample included not only stores in Massachusetts, but also TFT's Manchester, New Hampshire store. The audit resulted in an assessment against the taxpayer in the amount of $220,311.45, including

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[4] Town Fair Tire Centers, Inc. v. Commissioner of Revenue, SJC-10360.

[5] Town Fair Tire Centers, Inc. v. Commissioner of Revenue, Massachusetts Appellate Tax Board, No. C280607 (6/9/2008).

interest and penalties. Of the assessed tax, approximately $108,947 related to 313 sales made at the New Hampshire store, but sold to Massachusetts residents. These sales were identified as sales to Massachusetts residents based on the address noted on the invoice. The auditor asserted that TFT should have collected Massachusetts sales tax on these sales, based on the fact that the sales invoices included Massachusetts addresses. Since the invoices noted Massachusetts addresses, the auditor assumed that the vehicles would be returned to the same Massachusetts address noted on the invoice, and therefore the tires or other tangible personal property affixed to the vehicles by TFT in New Hampshire would be used in Massachusetts.

TFT paid the assessment and timely filed an application for abatement with the Commissioner on March 29, 2005 contesting, among other issues, this portion of the assessment. On April 25, 2005, the Commissioner denied TFT's Application for Abatement. TFT then filed a Petition with the Board of Tax Appeals on June 20, 2005 again contesting, among other issues, this portion of the assessment, asserting that the Commissioner's imposition of use tax collection duties violated TFT's due process rights and its right to equal protection under the U.S. Constitution. The Appellate Tax Board denied TFT's appeal. TFT has since filed an appeal with the Commonwealth of Massachusetts Supreme Judicial Court. As of the draft of this article, the case is tentatively schedule for argument before the Massachusetts Supreme Judicial Court in April, 2009.

§ 8.03 LEGAL ANALYSIS

In order to determine whether the Commonwealth of Massachusetts has the right to impose a use tax collection obligation upon a New Hampshire seller, an analysis of Massachusetts law, as well as the constitutional limitations surrounding the Commonwealth's ability to impose tax on the transactions at issue, is an essential starting point.

[1] Massachusetts' Imposition Statutes

Massachusetts has three imposition statutes surrounding the imposition of sales and use taxes on taxpayers. Two of these provisions directly address the collection responsibility of a seller, while the third focuses on the imposition of use taxes on a purchaser. This section will focus on the first two imposition statutes.

[a] Imposition of Sales Taxes on Sellers

Massachusetts imposes a sales tax collection obligation on sellers as follows:

> An excise is hereby imposed upon sales at retail in the commonwealth, by any vendor, of tangible personal property or of services performed in the commonwealth at the rate of five percent of the gross receipts of the vendor from all such sales of such property or services, except as otherwise provided in this chapter. The excise shall be paid by the vendor to the commissioner at the time provided for filing the return required by section sixteen of chapter sixty-two C.[6]

On its face it is clear that the sales tax imposition statute is inapplicable to the

[6] Mass. Gen. Laws ch. 64H, § 2.

transaction at hand. The statute requires that the retail sale take place "in the Commonwealth" in order to be subject to sales tax. As the sales made by TFT take place in the State of New Hampshire, the sale by TFT is clearly not located "in the Commonwealth" as required by the statute. Thus, Massachusetts' ability to statutorily impose a tax collection obligation on the seller of this transaction rests fully on the imposition statute discussed below.

[b] Imposition of Use Taxes on Sellers

Massachusetts imposes a use tax collection obligation on sellers as follows:

> Every vendor engaged in business in the commonwealth and making sales of tangible personal property or services for storage, use or other consumption in the commonwealth not exempted under this chapter, shall at the time of making the sales, or, if the storage, use or other consumption of the tangible personal property or services is not then taxable hereunder, at the time the storage, use or other consumption becomes taxable, collect the tax from the purchaser and give the purchaser a receipt therefor in the manner and form prescribed by the commissioner. The tax required to be collected by the vendor shall constitute a debt owed by the vendor to the commonwealth. Such vendor shall collect from the purchaser the full amount of the tax imposed by this chapter, or an amount equal as nearly as possible or practicable to the average equivalent thereof; and such tax shall be a debt from the purchaser to the vendor, when so added to the sales price, and shall be recoverable at law in the same manner as other debts.[7]

This imposition statute applies to sales taking place outside the Commonwealth of Massachusetts and requires sellers to collect use tax when the taxable property or service being sold will be used or consumed within the Commonwealth of Massachusetts. While not expressly stated, the statute implies that the vendor must be aware that the property or services purchased will be used within the Commonwealth.

In the case at hand, while it is clear that the tire sales were made outside the Commonwealth of Massachusetts, the issue rests on whether TFT knew or should have known at the time of sale that the tires being purchased would be used or consumed within the Commonwealth.[8] Massachusetts argues that, based on the address information gathered by TFT at the time of sale, TFT was required to collect Massachusetts use tax on all sales invoices that reflected a Massachusetts address, since it knew that the tires would be used or consumed within the Commonwealth.

Sales tax is a transaction tax for which the vendor's liability to collect the tax arises at the time the sale takes place.[9] In the case at hand, the sale takes place entirely in New Hampshire. The sale begins when the customer places the order for his tires, and ends when the customer pays for the order and drives away in his vehicle. At this point,

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[7] Mass. Gen. Laws ch. 64H, § 4.

[8] This analysis is notwithstanding the arguments below addressing the constitutionality of the imposition statute.

[9] Mass. Gen. Laws ch. 64H, § 3(a).

no taxable incidence in Massachusetts has occurred. As a matter of fact, if taxable use occurs in Massachusetts, it is after the sale takes place, when the vehicle enters the Commonwealth. This is the very reason that states have adopted use tax imposition statutes applicable to purchasers, which are complementary to states' sales provisions. A seller cannot assume that the vehicle will be used in another state based on the fact that the individual paying for the tire provides a Massachusetts address. As the seller is under no legal obligation to collect information about the seller's future expected use of the tire, the information gathered cannot be relied upon. Furthermore, once title and possession have passed, the seller has no legal connection to the transaction.

Massachusetts has specifically addressed *when* the sale takes place in a point of sale transaction by way of an example in its regulations:

> Bean goes to a computer store in Massachusetts and buys a personal computer that she then takes to her home in Maine. When Bean takes possession of the computer in Massachusetts, the sale in Massachusetts is complete; the sales tax applies even though Bean transports the computer to Maine for use there.[10]

Massachusetts clearly provides within its regulations that the sale takes place and is complete at the point of sale. By its own admission, Massachusetts concedes that a sale is complete when a customer takes possession of tangible personal property within Massachusetts in a point of sale transaction, regardless of where the goods will ultimately be used. The analysis should be identical if a sale takes place in New Hampshire, such as the sale of tires by TFT, with the customer retaining possession of the tires in New Hampshire, regardless of whether the vehicle will ultimately be transported to Massachusetts.

Furthermore, as discussed above, TFT has no legal responsibility to acquire the customer's address; rather, it does so voluntarily. As a result, there are likely no checks and balances in place by TFT to assure that the address information provided by its customers is accurate, or further, that the information gathered relates to the vehicle being serviced. As a matter of fact, it is entirely possible that the address being provided has no relationship at all to where the vehicle is ultimately being used. By way of example, the individual making the purchase may not be the owner of the vehicle. The vehicle could be that of a friend or of a business, either of which may be located in New Hampshire, and where the vehicle itself may actually be registered. It is also possible that the information provided by the purchaser is simply not accurate. In today's information age, people are more reluctant to share their personal information, when not required by law. It is not uncommon that when asked for a phone number, a customer refuses to provide a number, or simply provides an inaccurate number. If TFT were required to collect use tax on these sales without first substantiating the information from its customer, it would face an increased risk of class action suits for over-collection of use taxes.[11] Furthermore, given current

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[10] Mass. Regs. Code tit. 830, § 64H.6.7, Example 2.

[11] *See* P.J.'s Concrete Pumping Service, Inc. v. Nextel West Corporation, Illinois Appellate Court, Second District, No. 2-02-1219, (1/27/2004).

economic conditions, one wonders whether the effect of such an approach would stifle interstate commerce by discouraging credit purchases of merchandise in favor of cash.

[2] Constitutional Limitations

A state's authority to impose tax or to require the collection and remittance of tax is limited only to the extent prohibited by the United States Constitution.[12] Constitutional limitations on a state's taxing authority can take the form of either direct prohibitions, such as those contained in the Due Process Clause,[13] or implied prohibitions, such as those which have been interpreted by the United States Supreme Court to exist within the Commerce Clause.[14] In determining whether a state's assertion of tax jurisdiction is constitutionally permissible, courts look to whether the potential taxpayer and the transaction sought to be taxed have sufficient connection or "nexus" with the state to justify the imposition of tax under the Due Process and Commerce Clauses.

[a] Due Process Clause

The Due Process Clause, in pertinent part, provides that no "[S]tate [shall] deprive any person of life, liberty, or property, without due process of law. . . ."[15] The U.S. Supreme Court has construed this language to require ". . .some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax,"[16] ruling that the "income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.' "[17] Due Process centers around the principles of "notice" and "fair warning" with respect to government activities. The due process nexus analysis, th2erefore, should begin by looking at whether a taxpayer's connections with a State are enough to allow the government to impose the burden of taxation upon it. This direct limitation on a state's taxing authority is aimed at preventing state assertions of tax jurisdiction over persons or transactions who could not reasonably expect that their activities would subject them to that state's tax.

In determining what level of contact is necessary in order for state assertions of nexus over a taxpayer to survive Due Process scrutiny, the U.S. Supreme Court has held that the presence of either employees or retail outlets in a state would create a sufficient connection to justify the exercise of authority to tax, as such activities are "plainly accorded the protection and services of the taxing State."[18] In both *Miller*

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[12] *See* U.S. Const. Amend. X.

[13] U.S. Const. Amend. XIV, sec.1.

[14] U.S. Const. Art. I, sec. 8, cl. 3.

[15] U.S. Const. Amend. XIV, sec. 1.

[16] Miller Bros. Co. v. Maryland, 347 U.S. 340, 344–345 (1945).

[17] Moorman Mfg. Co. v. Bair, 437 U.S. 267, 273 (1978).

[18] National Bellas Hess, Inc. v. Dept. of Rev. of Ill., 386 U.S. 753 (1967) (*See Also* Felt & Terrant Mfg. Co. v. Gallagher, 306 U.S. 62 (1939) (sales force activity in the State); Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941) (retail stores located in the State)).

Bros. Co. v. Maryland and *Nat'l Geographic Soc. v. California Board of Equalization*, the Court held that a use-tax-collection responsibility existed where the out-of-state taxpayer availed itself of the advantage of certain municipal services, thereby satisfying the definite link and minimum connection requirement to impose such liability. The Court held that "the relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the State, but simply whether the facts demonstrate 'some definite link, some minimum connection, between [the State and] the person. . .it seeks to tax.' "[19]

In the case at hand, there is no question that TFT has some definite link or connection with the Commonwealth of Massachusetts to require it to collect sales and use taxes. TFT maintained stores within the Commonwealth, and was collecting Massachusetts sales taxes on sales occurring at the TFT Massachusetts stores. However, this fact alone does not satisfy due process with respect to the sales involved. The real issue focuses on whether there was some definite link, some minimum connection, between the Commonwealth and the *transaction* the Commonwealth is looking to tax—the sale of tires to a purchaser in New Hampshire that may ultimately be used in Massachusetts, but for which title to the goods sold passes in the State of New Hampshire.

The threshold for determining whether nexus exists over a specific transaction, which is required in the assessment of a use tax, is different than determining whether nexus exists for the purpose of use-tax-collection liability. The California Court of Appeals held in *Montgomery Ward & Co. v. State Board of Equalization*[20] that there must be a jurisdictional basis for the enforcement of a use tax assessment on an out of state transaction. In *Montgomery Ward & Co*., the taxpayer operated retail establishments in both Nevada and Oregon, as well as in California and several other states. The taxpayer collected use tax on all delivery sales made to California residents from stores located outside of California. The California State Board of Equalization assessed Montgomery Ward for sales made on credit to California residents taking place at the Nevada and Oregon stores. The assessment was held to be in violation of the Due Process Clause of the 14th Amendment. The Court held that there was no jurisdictional basis to satisfy the due process requirement that there be a definite link or minimum connection between the taxing state and the person, property or transaction it seeks to tax. The Court reasoned that "the protection afforded and the benefits conferred must have some relationship to the transaction which the state seeks to burden."[21] Furthermore, the Court found that the mere presence of one of the store's regional headquarters in California did not translate to California jurisdiction for the border store. Specifically, the Court stated that:

the tax collecting burden has been imposed on the multi-state operating retailer, it

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[19] National Geographic Society v. California Bd. Of Equalization, 430 U.S. 551, 561 (1977) (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340 (1945).

[20] Montgomery Ward & Co. v. State Board of Equalization, 272 Cal. App. 2d 728 (1969).

[21] Id. at 746.

> has only been authorized for transactions which have involved delivery within the taxing state, and has not been extended to transactions which are completed extraterritorially. California may not burden a foreign corporation's out-of-state business as a condition of permitting it to do business within the state. The protection afforded and the benefits conferred must have some relationship to the transaction which the state seeks to burden.[22]

This Court reasoned that a taxing state must have a direct connection to the transaction it seeks to tax, following the rationale set forth in *Miller Bros*.[23] The Massachusetts Appellate Tax Board, in rendering its decision, expanded the notion of transactional nexus, holding that evidence of use within Massachusetts could be inferred through circumstantial evidence, the address provided by the customer, for which TFT had no known process or procedure to verify the accuracy, as discussed above, unlike *Montgomery Ward*, who had the customer address for purposes of a private label credit card, where it was extremely likely that background checks for accuracy had been performed. However, the Massachusetts Appellate Tax Board overlooks the fact that the New Hampshire store receives no benefits, protection or opportunities from Massachusetts in return for the burden of collecting and remitting a use tax on sales taking place at the New Hampshire stores. As such, imposing a use tax collection responsibility on TFT for these sales is a violation of TFT's right to due process.

[b] Commerce Clause

The Commerce Clause establishes that "Congress shall have the power. . .[t]o regulate commerce. . .among the several States."[24] This affirmative grant of authority to the United States Congress has, over the years, been interpreted by the federal courts to contain an implied prohibition (the "negative" or "dormant" Commerce Clause) barring states from imposing taxes in a manner that would either discriminate against, or otherwise burden interstate commerce.[25] Early U.S. Supreme Court interpretations as to what activities would unduly burden interstate commerce evolved from the absolute that "no State has the right to lay a tax on interstate commerce in any form,"[26] to a more measured approach permitting such taxation to the extent that interstate commerce would not be subjected to a risk of multiple taxation.[27]

While modern Commerce Clause case law has incorporated some of the principles to which these earlier interpretations aspired, the High Court's current approach is far less formalistic. The U.S. Supreme Court in *National Bellas Hess v. Dept. of Revenue*,[28] found no nexus where a mail-order company's only contact with the State

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[22] Id. at 745.

[23] *Id.; Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1945).

[24] U.S. Constitution, Art. I, sec. 8, cl. 3.

[25] *See Generally*, P. Hartman, Federal Limitations on State & Local Taxation §§ 2:9–2:17 (1981).

[26] Brown v. Maryland, 12 Wheat. 419 (1827); Leloup v. Port of Mobile, 127 U.S. 640, 648 (1888). *See Also* Freeman v. Hewit, 329 U.S. 249, 256 (1946).

[27] *See* Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 256–258 (1938).

[28] 386 U.S. 753 (1967).

of Illinois was solicitation of sales by catalogs followed by delivery of goods by mail or common carrier.[29] The *Bellas Hess* Court appears to have established a "bright-line test" requiring physical presence as a practical means of determining whether or not a potential taxpayer has sufficient contact with a state to be subjected to the state's sales and use tax.[30] In *Complete Auto Transit v. Brady*,[31] the Supreme Court developed a more comprehensive four-pronged test that continues to act as the benchmark against which the validity of state taxes is measured under the Commerce Clause.[32] Under the *Complete Auto Transit* four-pronged test, a tax will be upheld against a Commerce Clause challenge as follows:

1. The tax must be applied to an activity with a substantial nexus with the taxing state;
2. The tax must be fairly apportioned;
3. The tax must not discriminate against interstate commerce, and;
4. The tax must be fairly related to the services provided by the state.[33]

The shift from the bright-line physical presence standard in *Bellas Hess* to the more nebulous standard of "substantial nexus" presented in *Complete Auto* led to some uncertainty as to whether the Commerce Clause ruling in *Bellas Hess* remained good law. In 1992, however, the *Quill*[34] Court specifically upheld the validity of both the *Bellas Hess* and *Complete Auto* decisions as complementary to one another and not mutually exclusive.[35]

The *Quill* Court determined that "the second and third prongs of the *Complete Auto* four-part test, requiring fair apportionment and non-discrimination, prohibit taxes that pass an unfair share of the tax burden onto interstate commerce, whereas the first and fourth prongs, which require a substantial nexus and a relationship between the tax and the State-provided services, limit the reach of State taxing authority so as to ensure that State taxation does not unduly burden interstate commerce."[36] The Court noted that the *Bellas Hess* decision concerned the first prong of the *Complete Auto* test in that a catalog mail-order company with no physical presence in the State lacked "substantial nexus" under Commerce Clause scrutiny.[37] The Court went on to state that "undue

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[29] National Bella Hess v. Dept. of Revenue, 386 U.S. 753 (1967).

[30] Id.

[31] 430 U.S. 274, 285 (1977).

[32] Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (*Citing* Complete Auto Transit v. Brady, 430 U.S. 274, 285 (1977)).

[33] Complete Auto Transit v. Brady, 430 U.S. 274, 285 (1977).

[34] Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

[35] *Id*. (*Citing* National Geographic Society v. California Bd. Of Equalization, 430 U.S. 551, 559 (1977); Goldberg v. Sweet, 488 U.S. 252, 263 (1989); D.H. Holmes Co. v. McNamara, 486 U.S. 24, 33 (1988); Commonwealth Edison Co. v. Montana, 453 U.S. 609, 626 (1981)).

[36] Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

[37] *Id*.

burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation."[38]

Thus, in evaluating the current case, it is evident that a holding in favor of Massachusetts would result in an undue burden on interstate commerce. First and foremost, long-standing sales and use tax policy for point of sale transactions is that these transactions are sourced to the point of sale. As a result, vendors, many of whom have invested significant financial resources in their point of sales systems, have programmed these systems to compute tax based on one rate alone—the rate of the jurisdiction in which the store is located. Programming these systems to calculate sales tax for an uncertain and potentially unlimited number of jurisdictions where the product may or may not ultimately be used could result in significant increased costs; particularly considering these systems are set up to traditionally handle sales tax calculations at only one rate.[39] As a matter of fact, sales and use tax laws are generally structured so as to avoid layering or apportioning of taxes between and amongst various jurisdictions through which a product might pass. Consider the impact of intervening uses—the automobile might drive through five states before it arrives in it's principal garage. Would this fact then support an apportioned sales and use tax on the tires?

Also, it should be noted that from the seller's perspective, sales and use taxes are a trust fund tax—a tax that the seller is collecting on behalf of the state to ease the administrative burdens of the state from pursing collection of a use tax from the purchaser, who bears the liability for the tax. In the case at hand, it isn't the transaction to which TFT is party that is being taxed so much as it is some future, indeterminate "use" by the customer for which a TFT is being required to collect. As such, a greater level of scrutiny should be used to determine when the burden is too great on a seller.

Furthermore, a holding in favor of Massachusetts could have significant burdens on similarly situated taxpayers. Massachusetts has chosen to enforce a use tax collection obligation against a seller based on the information voluntarily collected by the seller at the time of the sale. Information that does not necessarily bear any correlation to the ultimate disposition of the property. Thus, this issue is not particular to this type of taxpayer, but to numerous other taxpayers who collect similar information. Sellers often collect address information when the product sold has a warranty or service agreement associated with it, or when a customer is applying for instant credit at the time of the sale. A holding in favor of Massachusetts would require all multi-state vendors with nexus in Massachusetts, that collect similar information (i.e., customer address), to make a potentially wildly inaccurate tax determination based on this

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[38] *Id.*

[39] While Massachusetts imposes a 5% sales and use tax rate on a state wide basis, there are many states that have differing rates for every county and city within the jurisdiction. As a result, the point of sale system may have to calculate tax for at thousands of different sales and use tax rates.

information and possibly collect tax erroneously. By way of example, consider the following facts:

- Seller is a department store with locations in Pennsylvania, as well as Massachusetts.
- A Massachusetts resident visiting Pennsylvania when on business purchases a $500 blazer in Seller's Pennsylvania store.
- Massachusetts resident applies for instant credit, as they will be offered a 20% discount on all purchases made that day. The application requires that the customer furnish his or her home address and provide his drivers license for verification of identity and address. The Massachusetts' resident furnishes his Massachusetts' drivers license, from which the information is verified by the sales clerk.
- Customer receives instant credit, and proceeds to purchase the blazer. As blazers are exempt clothing under Pennsylvania sales and use tax law, no Pennsylvania sales and use tax is imposed.

A holding in favor of Massachusetts would require this retailer, the Pennsylvania Department store, to not only know whether this blazer is taxable under Massachusetts sales and use tax law, which it is, but it would also require the retailer to collect Massachusetts use tax on the sale despite having no reasonable means of discerning whether or not said blazer will ever enter the Commonwealth of Massachusetts. This is a significant change from the manner in which retailers have been doing business in point of sale transactions and presents a chilling vision of a dysfunctional, unadministrable and unauditable tax system wrought with potential liability hazards.

The U.S. Supreme Court addressed a similar issue to the one at hand in rendering its holding in *Miller Brothers*. While the principal issue in Miller Brothers was whether the taxpayer has nexus in the State of Maryland, the Supreme Court specifically commented on the requirement of a seller to collect another states' use tax for a sale taking place entirely out of state:

> The practical and legal effect of the Maryland statute as it has been applied to this Delaware vendor is to make the vendor liable for a use tax due from the purchaser. In economic consequence, it is identical with making him pay a sales tax. The liability arises only because of a Delaware sale and is measured by its proceeds. But at the time of the sale, no one is liable for a Maryland use tax. That liability arises only upon importation of the merchandise to the taxing state, an event which occurs after the sale is complete and one as to which the vendor may have no control or even knowledge, at least as to merchandise carried away by the buyer. The consequence is that liability against the Delaware vendor is predicated upon use of the goods in another state and by another person. We do not understand the State to contend that it could lay a use tax upon mere possession of goods in transit by a carrier or vendor upon entering the State, nor do we see how such a tax could be consistent with the Commerce Clause.
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> We are unable to find in any of our cases a precedent for sustaining the liability

> asserted by Maryland here. In accordance with the principles of earlier cases, it was recently settled that Maryland could not have reached this Delaware vendor with a sales tax on these sales. *McLeod v. Dilworth Co.,* 322 U. S. 327. Can she then make the same Delaware sales a basis for imposing on the vendor liability for use taxes due from her own inhabitants? It would be a strange law that would make appellant more vulnerable to liability for another's tax than to a tax on itself.[40]

The Court's comments here could not be more on point with the facts at issue in this case. Massachusetts is requiring a seller to collect use tax from a Massachusetts' customer where the sales takes place entirely outside the Commonwealth of Massachusetts. As a matter of fact, it is not until the acquired property, in this case the tires, enters the Commonwealth of Massachusetts that the taxable incidence in Massachusetts has occurred. The Seller is not responsible for bringing the acquired property into the Commonwealth, it is the customer who does so only after the sale is complete. Requiring a Seller to make assumptions in order to compute another state's tax is clearly an undue burden on interstate commerce.

[c] Equal Protection Analysis

The Equal Protection Clause, in pertinent part, provides that no "[S]tate [shall] deny any person within its jurisdiction the equal protection of the laws."[41] In the state tax arena, equal protection violations have been found to exist where a state has created more favorable rules for in-state taxpayers versus out-of-state taxpayers or where a tax discriminates against an out of state taxpayer.[42] However, a violation of the equal protection clause could also exist if a state were to participate in selective enforcement of its statutes.

In the case at hand, the fact that Massachusetts is requiring a vendor who voluntarily collects the address of its customers to collect use tax from Massachusetts residents while Massachusetts does not compel collection of such tax by all similarly situated vendors presents a claim of selective enforcement. For the statute at issue to not be in violation of the equal protection clause, Massachusetts would presumably need to enforce this statute against all retailers with nexus in Massachusetts and stores in other states. The Commonwealth's legal standing to compel all nexus vendors to collect such tax would be highly suspect under state and federal constitutional law.

[3] Other Persuasive Authority

As discussed above, there has been a long-established policy in the sales and use tax arena for point of sale transactions—point of sale transactions are sourced to the jurisdiction in which the sale takes place. This policy is followed by many jurisdictions, and has been expressly enacted by many states, particularly those participating in the Streamlined Sales Tax Project.

The Streamlined Sales Tax Project ("SSTP") is an effort by state and local

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[40] *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1945), 345–346.

[41] U.S. Const. Amend. XIV, sec. 1.

[42] See South Cent. Bell Tel. Co. v. Alabama, 119 S.Ct. 1180 (1999).

governments, along with the business community, to create a more uniform and modern sales and use tax system. The project's efforts began in March, 2000. As of January 1, 2009, there are 22 states that have amended their sales and use tax laws to conform to the covenants of the Streamlined Sales and Use Tax Agreement ("SSUTA"). The goal of the SSTP is to find solutions to reduce the burden imposed by sales and use tax systems that prevent the states from being able to require remote sellers to collect tax as a result of the U.S. Supreme Court holdings in *Bellas Hess* and *Quill,* which prohibit states from imposing the burden of sales or use tax collection upon a seller that does not have a physical presence in the state (discussed in detail above). The overall purpose of the Agreement is to simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance.

Under the Agreement, point of sale transactions are sourced as follows:

> When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.[43]

This provision specifically addresses the transactions at issue. The purchaser of TFT tires receives its tires at the New Hampshire stores, and title passes to the purchasers in New Hampshire at the time of sale. Although Massachusetts is not a member of the Governing Board, and has not expressly enacted this provision, it has been an active participant in Streamlined Sales Tax Project meetings for years, including those years in which these sourcing rules were developed. In addition, the Massachusetts Legislature is currently considering legislation that would bring the Commonwealth into compliance with the SSUTA.[44] That legislation would adopt all of the SSUTA provisions, including all sourcing rules. It is expected that the legislation will pass through the Massachusetts Legislature as the Bill is supported by both the Commissioner of Revenue and the Governor. It is also noteworthy that over 22 states have adopted this sourcing provision in order to become members of the Governing Board, thus emphasizing the fact that sourcing these types of transactions in this manner is the most practical solution.

§ 8.04 PRACTICAL RAMIFICATIONS

What are the practical ramifications to sellers if the Supreme Judicial Court of Massachusetts issues a holding in favor of the Commonwealth of Massachusetts? Quite simply, the answer is a compliance nightmare for multi-state retailers. Consider the following:

[1] Application to Other States

Massachusetts is one of 45 states that impose sales and use taxes. In addition, the District of Columbia, Puerto Rico and localities in the State of Alabama, Arizona, Alaska, Colorado and Louisiana impose sales and use taxes at the local level. A holding in favor of the Commonwealth could lead to a slippery slope of similar enforcement in every one of these jurisdictions, assuming these jurisdictions have

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[43] SSUTA § 310(A)(1).

[44] Mass. House Bill No. 2732 (Intro. 1/8/2009).

similar imposition language, making it virtually impossible for a retailer with nexus in multiple jurisdictions to comply. As previously mentioned, there is a long-standing policy by many states that point of sales transactions are sourced to the point of sale when the customer leaves with the item purchased. In fact, as discussed above, Massachusetts law specifically addresses such scenarios within its regulations, indicating that the sale takes place and is complete at the point of sale.[45] However, the regulations' examples focus on instances where a product was purchased in Massachusetts, for use outside the Commonwealth. Now that the facts of the transaction are reversed, and the point of sale takes place outside Massachusetts with a possible use within, the State seems more reluctant to accept its own words as being so clear cut.

If the ruling of the Massachusetts Appellate Tax Board is upheld, the practical ramifications could be disastrous for retailers. Similarly situated states may follow suit in order to increase their sales tax revenues when their residents purchase goods in nearby tax free or lower sales tax jurisdictions, especially in light of the current state of economic affairs. The result would be devastating for multi-state retailers, and would unduly burden these larger sellers who maintain locations throughout the country. To illustrate this point, suppose a Massachusetts resident is vacationing in Alaska, a state which does not impose state-level sales tax. While in Alaska, the vacationer decides to purchase a new video camcorder with a one-year warranty to capture the entire trip on film. He purchases the camcorder at a retail store that has locations across the United States, including within Massachusetts. Because of the additional warranty purchase, the retailer requested the customer's home address and other identifying information for its records. If the *Town Fair Tire* decision is ultimately upheld by the Supreme Judicial Court, the State could eventually tax all such sales to Massachusetts residents who are purchasing goods in no tax/lower tax states from retailers with nexus in Massachusetts, when the customer's address is known at the time of sale. The additional compliance burden this would place on retailers is immeasurable. Again, states with similar imposition statutes' to Massachusetts may also attempt to impose tax on its residents who are purchasing products outside state boundaries, but which may ultimately be used within the State. As will be discussed in further detail below, the retailer may need to revamp its entire computer system to account for the new collection responsibilities, as well as retrain its store associates and tax personnel to remain in proper sales tax compliance. States already impose use taxes which place the burden on the purchaser to determine whether additional tax is due on their ultimate out-of-state purchase. It is the purchaser, and not the retailer, that has the knowledge and means to determine where the product will be used, and thus, where tax should be due.

[2] Training of Sales personnel

Most retailers have programmed their systems and trained their personnel according to the long-standing policy rules related to point of sale transactions. A holding in favor of the Commonwealth would require taxpayers to devote a significant amount of

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[45] Mass. Regs. Code tit. 830, § 64H.6.7.

additional resources into the training of their sales personnel. By way of example, TFT would have to retrain its sales team on the proper method of collecting customer address information, and more importantly, on how to verify the accuracy of this information. Traditionally, the sales person is merely entering the address of the person who is purchasing the tires. The purchaser may live in Massachusetts and provide a Massachusetts address for TFT's records, but the vehicle may be used exclusively for work purposes within New Hampshire. On the other hand, the Massachusetts resident may merely be the driver of the vehicle, which is ultimately used and owned by a New Hampshire resident. Beyond merely entering the customer's address into the system, the sales personnel will need to be educated on the ramifications of the new law to determine where the vehicle will ultimately be used. These companies are under no legal responsibility to collect and verify the address information of its customer's, but do so for business reasons unrelated to tax. TFT could easily change its current practices to assign the purchaser some sort of identifying number to be used for future visits, rather than collecting information which includes the customer's home address.

[3] System Changes

A holding in favor of the Commonwealth may require that any taxpayer with nexus in Massachusetts mandatorily collect a customer's home address information to determine where the goods purchased may ultimately be used. If retailers were subjected to this higher standard of compliance, they would most likely be forced to upgrade their systems to handle the increased responsibilities. Many retailers current systems likely do not possess the means to track a customer's home address, since generally a point of sale transaction ends at the store location. If the ruling by the Massachusetts Supreme Judicial Court held that the new rules apply only to those companies who currently collect such customer-provided information, what legal right would the State have to mandate the continuance of collecting this information? Multi-state retailers would clearly be put at a competitive disadvantage against a competitor who is located solely in one state, and does not have to revamp its current system to comply to the new sales tax laws.

Additionally, the Commonwealth could go as far as to require a taxpayer with nexus in a lower sales tax rate location to collect the rate differential. The current systems would clearly have to be reprogrammed to handle the allocation of sales tax between two states, even though the point of sale transaction clearly takes place in only one state. Collection of tax in other jurisdictions also require that a retailers point of sale system be capable of computing tax for any of the thousands of jurisdictions for which the item purchased will ultimately be used. This is a significant change for most retailers and would impose a significant financial burden on any multi-state retailer.

[4] Planning

Ultimately, it is the multi-state retailer that will be most adversely affected by a decision in favor of the Commonwealth. Companies wholly located in one state do not have nexus outside of their home state, and therefore do not have additional collection and remittance responsibilities. A Massachusetts resident looking to get its tires serviced in New Hampshire would clearly choose a store who does not have nexus

outside of New Hampshire over TFT in order to avoid additional sales tax. This automatically puts TFT at a competitive disadvantage as compared to other similar, but perhaps smaller, tire stores. To maintain its advantage in the marketplace, companies such as TFT would be forced to reorganize its business to implement nexus isolation strategies. Companies would be forced to restructure to segregate nexus on a state-by-state basis. Thus, all TFT Massachusetts stores would be organized under one entity, while all New Hampshire stores would be organized under another, thereby isolating nexus in each individual state. Eventually, a business could strategically restructure its organization to avoid the increased sales tax collection responsibility, but the additional administrative burden this would place on both companies and states may ultimately have the reverse financial affects sought.

§ 8.05 CONCLUSION

Whether a state has jurisdiction to tax a transaction is not a case of first impression, but one rarely reviewed by the courts. However, it is clear from existing transactional nexus jurisprudence that there must be some connection between the taxing state and the transaction it seeks to tax. In the case at hand, such a connection is tenuous at best. While it is true the TFT has nexus in Massachusetts, Massachusetts does not have nexus over the transaction it seeks to tax. The transaction takes place entirely outside the state, and if a taxable incidence occurs in Massachusetts, it is not until after title passes to the consumer. Furthermore, the New Hampshire store receives no benefit for services provided by Massachusetts. Notwithstanding these facts, it is evident that to enforce such a tax collection obligation would be an undue burden on interstate commerce.