STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

DIVISION OF TAXATION

ADMINISTRATIVE HEARING

FINAL DECISION AND ORDER

#2020-04

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DEPARTMENT OF REVENUE
DVISION OF TAXATION
ONE CAPITOL HILL
PROVIDENCE, RHODE ISLAND 02908

IN THE MATTER OF:	:	**Case No. 19-T-056**
	:	**sales**
Taxpayer.	:	

DECISION

I. INTRODUCTION

The above-entitled matter came before the undersigned as a result of a Notice of Pre-Hearing Conference and Appointment of Hearing Officer ("Notice") dated June 30, 2019 and issued to the above captioned taxpayer ("Taxpayer") by the Division of Taxation ("Division") in response to the Taxpayer's request for hearing filed with the Division. The parties agreed that the matter could be decided on an agreed statement of facts and written briefs. Briefs were timely filed by December 27, 2019.

II. JURISDICTION

The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-1-1 *et seq.*, R.I. Gen. Laws § 44-18-1 *et seq.*, R.I. Gen. Laws § 44-19-1 *et seq.*, 280-RICR-20-00-2, Division of Taxation's *Administrative Hearing Procedures*, and 220-RICR-50-10-2, Department of Administration's *Rules of Procedure for Administrative Hearings.*

III. ISSUE

The parties agreed the issues were as follows: (1) whether the Taxpayer's television services are taxable under the applicable sales and use tax statutes; and (2) whether the Taxpayer

lacked nexus during the years in question with the State of Rhode Island and, as such, was not required to charge, collect and remit sales tax on otherwise taxable sales.

IV. MATERIAL FACTS AND TESTIMONY

The parties entered in an agreed upon statement of facts and exhibits. The agreed facts and exhibits are summarized as follows:

1. The Taxpayer is a foreign limited liability company that does business in the State of Rhode Island with its principal place of business in another state. The Taxpayer registered with the Division as a retailer in July of 2012 and obtained a retail sales permit on or about August 2, 2012. Exhibits One (1) (business application and registration) and Four (4) (sales permit).

2. The Taxpayer did business in Rhode Island between January of 2015 through December of 2016. Exhibits Two (2) and Three (3) (2012 and 2014 articles of amendment).

3. The Taxpayer has routinely and regularly filed, declared, and remitted Rhode Island sales tax with the Division since January of 2015.

4. The Taxpayer does not own or lease any buildings and/or equipment in the State of Rhode Island and the Taxpayer does not hire and/or retain any employees in Rhode Island.

5. The Taxpayer routinely and regularly declares its business to be the application based provision of live television through streaming via the Internet and Taxpayer began its live television service in Rhode Island in 2015.

6. The Taxpayer reports that it refunded Rhode Island sales tax it had charged and collected to its Rhode Island customers between January of 2015 through December of 2016 back to its customers in 2017. On or about December 8, 2017, the Taxpayer filed a sales and use tax refund claim with the Division seeking $ for the tax monies it purportedly returned to its Rhode Island customers. Exhibit Five (5) (refund request).

7. On October 1, 2018 the Division issued a letter denying the Taxpayer's refund claim. On October 25, 2018, the Taxpayer filed a written request with the Division requesting administrative hearing on its refund denial. Exhibits Six (6) and Eight (8).

V. DISCUSSION

A. Legislative Intent

The Rhode Island Supreme Court has consistently held that it effectuates legislative intent by examining a statute in its entirety and giving words their plain and ordinary meaning. *In re Falstaff Brewing Corp.,* 637 A.2d 1047 (R.I. 1994). If a statute is clear and unambiguous, the Court "must interpret the statute literally and must give the words of the statute their plain and ordinary meanings." *Balmouth v. Dolce for Town of Portsmouth*, 794 A.3d 576, 580 (R.I. 2018) (citation omitted). The Supreme Court has also established that it will not interpret legislative enactments in a manner that renders them nugatory or that would produce an unreasonable result. See *Defenders of Animals v. Dept. of Environmental Management,* 553 A.2d 541 (R.I. 1989) (citation omitted). In cases where a statute may contain ambiguous language, the Supreme Court has consistently held that the legislative intent must be considered. *Providence Journal Co. v. Rodgers*, 711 A.2d 1131 (R.I. 1998).

B. Relevant Statutes

Pursuant to R.I. Gen. Laws § 44-18-18,[1] Rhode Island imposes a sales tax of 7% on gross receipts of a retailer. R.I. Gen. Laws § 44-18-20 imposes the corresponding use tax. Pursuant to

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[1] R.I. Gen. Laws § 44-18-8 provides in part as follows:

> Retail sale or sale at retail defined. A "retail sale" or "sale at retail" means any sale, lease, or rentals of tangible personal property, prewritten computer software delivered electronically or by load and leave, vendor-hosted prewritten computer software, or services as defined in § 44-18-7.3 for any purpose other than resale, sublease, or subrent in the regular course of business. The sale of tangible personal property to be used for purposes of rental in the regular course of business is considered to be a sale for resale. ***

R.I. Gen. Laws § 44-18-19, the retailer is responsible for the collection of sales tax. Retailer is defined in R.I. Gen. Laws § 44-18-15.[2] "Engaging in business" is defined in R.I. Gen. Laws § 44-18-23.[3] R.I. Gen. Laws § 44-18-7(1) provides as follows:

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[2] At the time at issue, R.I. Gen. Laws § 44-18-15 provided in part as follows

> "Retailer" defined. – (a) "Retailer" includes:
> (1) Every person engaged in the business of making sales at retail including prewritten computer software delivered electronically or by load and leave, sales of services as defined in § 44-18-7.3 and sales at auction of tangible personal property owned by the person or others.
> (2) Every person making sales of tangible personal property including prewritten computer software delivered electronically or by load and leave, or sales of services as defined in § 44-18-7.3, through an independent contractor or other representative, if the retailer enters into an agreement with a resident of this state, under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an Internet website or otherwise, to the retailer, provided the cumulative gross receipts from sales by the retailer to customers in the state who are referred to the retailer by all residents with this type of an agreement with the retailer, is in excess of five thousand dollars ($5,000) during the preceding four (4) quarterly periods ending on the last day of March, June, September and December. Such retailer shall be presumed to be soliciting business through such independent contractor or other representative, which presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the state on behalf of the retailer that would satisfy the nexus requirement of the United States Constitution during such four (4) quarterly periods.
> (3) Every person engaged in the business of making sales for storage, use, or other consumption of" (1) tangible personal property, (ii) or in the business of making sales at auction of tangible personal property owned by the person or others. prewritten computer software delivered electronically or by load and leave, and (iv) services as defined in § 44-18.7.3.
> ***
> (b) When the tax administrator determines that it is necessary for the proper administration of chapters 18 and 19 of this title to regard any salespersons, representatives, truckers, peddlers, or canvassers as the agents of the dealers, distributors, supervisors, employers, or persons under whom they operate or from whom they obtain the tangible personal property sold by them, irrespective of whether they are making sales on their own behalf or on behalf of the dealers, distributors, supervisors, or employers, the tax administrator may so regard them and may regard the dealers, distributors, supervisors, or employers as retailers for purposes of chapters 18 and 19 of this title.
> P.L. Ch. 12 Art. 241 effective October 1, 2012.

[3] At the time at issue, R.I. Gen. Laws § 44-18-23 provided in part as follows:

> "Engaging in business" defined.
> As used in §§ 44–18–21 and 44–18–22 the term "engaging in business in this state" means the selling or delivering in this state, or any activity in this state related to the selling or delivering in this state of tangible personal property, or prewritten computer software delivered electronically or by load and leave for storage, use, or other consumption in this state; or services as defined in § 44-18-7.3 in this state. This term includes, but is not limited to, the following acts or methods of transacting business:
> (1) Maintaining, occupying, or using in this state permanently or temporarily, directly or indirectly or through a subsidiary, representative, or agent by whatever name called and whether or not qualified to do business in this state, any office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business;
> (2) Having any subsidiary, representative, agent, salesperson, canvasser, or solicitor permanently or temporarily, and whether or not the subsidiary, representative, or agent is qualified to do business in this

"Sales" means and includes: (1) Any transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means of tangible personal property for a consideration. "Transfer of possession", (sic) "lease", (sic) or "rental" includes transactions found by the tax administrator to be in lieu of a transfer of title, exchange, or barter.

Sales and Use Tax Regulation SU 95-89 *Television Service, Telegraph, Water, Gas Electricity, and Steam* ("SU 95-98") (effective January 1, 1995 to August 3, 2018) provided in part as follows:

A. Sales of natural and artificial gas, electricity, steam, water, and sales of telegraph, community antenna television, cable and subscription television services are subject to sales tax except in those cases wherein the purchaser is entitled to exemption as specifically provided in the sales and use tax law. "Subscription television" means television programming services provided to consumers for a fee via satellite transmission or any other means.

Sales and Use Regulation SU 11-25 *Computers, Software, and Related Systems* ("SU 11-25") (effective from October 1, 2011 to July 31, 2018) provided in part as follows:

RULE 5. DEFINITIONS

"Computer" means an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions, and shall include but is not limited to desk top computers, laptop computers, smart phones, and other similar devices.

"Computer software" means a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task.

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state, operate in this state for the purpose of selling, delivering, or the taking of orders for any tangible personal property, or prewritten computer software delivered electronically or by load and leave, or services as defined in § 44-18-7.3;

(3) The regular or systematic solicitation of sales of tangible personal property, or prewritten computer software delivered electronically or by load and leave, or services as defined in § 44-18-7.3 in this state by means of:

(i) Advertising in newspapers, magazines, and other periodicals published in this state, sold over the counter in this state or sold by subscription to residents of this state, billboards located in this state, airborne advertising messages produced or transported in the air space above this state, display cards and posters on common carriers or any other means of public conveyance incorporated or operating primarily in this state, brochures, catalogs, circulars, coupons, pamphlets, samples, and similar advertising material mailed to, or distributed within this state to residents of this state;

(ii) Telephone;

(iii) Computer-assisted shopping networks; and

(iv) Television, radio or any other electronic media, which is intended to be broadcast to consumers located in this state.

P.L. Ch. 12 Art. 241 effective October 1, 2012.

"Custom software" means a program created specifically for one user and prepared to the special order of that user.

"Delivered electronically" means delivered to the purchaser by means other than tangible storage media.

"Electronic" means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

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"Prewritten computer software" means computer software, including prewritten upgrades, which is not designed and developed by the author or other creator to the specifications of a specific purchaser. The combining of two or more prewritten computer software programs or prewritten portions thereof does not cause the combination to be other than prewritten computer software. Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the specific purchaser. Where a person modifies or enhances computer software of which the person is not the author or creator, the person shall be deemed to be the author or creator only of such person's modifications or enhancements. Prewritten computer software or a prewritten portion thereof that is modified or enhanced to any degree, where such modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software; provided, however, that where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such modification or enhancement, such modification or enhancement shall not constitute "prewritten computer software."

"Specified digital products" means electronically transferred:

(a) "Digital Audio-Visual Works" which means a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any:

(b) "Digital Audio Works" which means works that result from the fixation of a series of musical, spoken, or other sounds, including ringtones. For purposes of the definition of "digital audio works", (sic) "ringtones" means digitized sound files that are downloaded onto a device and that may be used to alert the customer with respect to a communication.

(c) "Digital Books" which means works that are generally recognized in the ordinary and usual sense as "books". (sic).

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RULE 7 COMPUTER SOFTWARE

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(6) Specified digital products such as digital audio visual works, digital audio works, digital books, movies, music downloads, and ringtones which are delivered electronically, are not subject to tax, as they are not considered to be prewritten computer software.

C. Arguments

The Division argued the Taxpayer's subscription television service is taxable according to SU-95-89 which defines subscription television as television programming services provided to consumers for a fee via satellite transmission or any other means. The Division argued that the Taxpayer is not providing digital products under SU-11-25 since those are for specified digital products. E.g. digital books, movie downloads, and ringtones. The Division argued that under the law of tax exemptions, the statute must provide a specific tax exemption which it does not.

The Division argued that the appropriate nexus standard for this matter is *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076 (1977) since the Taxpayer is providing a service and not the sale of goods. The Division argued that the physical substantial nexus test of *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904 (1992) and *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S.Ct. 1389 (1967) dealt specifically with the sales of goods by either mail-order or on-line purchasing so did not directly address the direct sales of subscription services by vendors to customers in taxing states. The Division argued that the Taxpayer has substantial business nexus with Rhode Island in the form of business registration, collection of sales and use taxes, advertising, use of telecommunications infrastructure in Rhode Island, and by engaging in business in the state.

The Taxpayer agreed it provides subscription television but argued that streaming television also falls under the specified digital good definition in SU 11-25 so is exempted from taxation. The Taxpayer argued that streaming television was not thought of in 2011 when SU 11-25 was promulgated so would not have been included as an example. The Taxpayer argued that it could not be subject to sales tax as it maintained no physical presence in Rhode Island under *Quill*.

D. Whether the Taxpayer's Request for Refund is Allowed

1. Subscription Television

The Taxpayer does not dispute that it provides "subscription television." It clearly is taxable under SU 95-89. SU 95-89 provides that subscription television would not be taxable if there was an exemption specifically provided in the sales and use tax law.

An exemption from taxation is to be strictly construed. If no ambiguity in the statute is evident, the words in the statute must be applied literally. Any ambiguity in a statute is resolved in favor of the Division. *Roger Williams General Hospital v. Littler, et al.*, 566 A.2d 948 (R.I. 1989). Furthermore, a "party claiming the tax exemption has the burden of showing the language of the statute demonstrates 'a clear legislative intent to grant such exemption'" *Fleet Credit Corporation v. Frazier*, 726 A.2d 452, 454 (R.I. 1999) (internal citation omitted). See also *American Hoechst Corp. v. Norberg*, 462 A.2d 369 (R.I. 1983). In addition, pursuant to R.I. Gen. Laws § 44-19-33, the Division's regulations that are reasonably designed to carry out the intent and purpose of R.I. Gen. Laws § 44-18-1 *et seq.* and R.I. Gen. Laws § 44-19-1 *et seq.* and are *prima facie* evidence of their proper interpretation.

Rather than relying on a specific exemption, the Taxpayer argued that its service falls under the definition of digital products in SU 11-25 so its service is not taxable. However, SU 11-25 does not exempt streaming services from taxation. It provides that specified digital products such as books, movies, music, and ringtones are not taxable. Those products are specific types of products – a book, a movie, or a ringtone - and not just the provision of television programming. In other words, the Taxpayer is not providing a digital version of one (1) television show but rather provides a method to watch live television via the Internet so that the customer is receiving various "live" television shows on an ongoing basis. Live streaming is not a digital product as described

in SU 11-25. There is no statutory exemption from taxation for live streaming. Instead, as provided for specifically in SU 95-98, the Taxpayer provides television programming services to consumers for a fee via satellite transmission or any other means. Thus, its services are taxable under SU 95-98.

ii. Nexus

The time period in this matter is prior to *South Dakota v. Wayfair, Inc.*, 585 U.S. ___, 138 S. Ct 2080 (2018) which overruled the substantial nexus physical presence test set forth in *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904 (1992).

Prior to *Wayfair*, in cases involving the application of state tax statutes to out-of-state sellers, *Quill* found that a state may, consistent with the due process clause, have the authority to tax a particular taxpayer, but imposition of that tax may violate the Commerce Clause. The Court found that the due process clause requires minimal connection between a state and the taxable entity so that if a foreign corporation purposefully avails itself to the benefits of an economic market in the forum state, it may subject itself to the state's *in personam* jurisdiction, even if it has no physical presence in the state. In terms of the Commerce Clause, Article 1 section 8 clause 3 of the Constitution expressly authorizes Congress to "regulate Commerce with Foreign Nations, and among the several States." The Court found that the Commerce Clause is more than an affirmative grant of power but has a negative sweep well in that it prohibits certain state actions that interfere with interstate commerce. Thus, while due process concerns the fundamental fairness of a government action, the Commerce Clause and its nexus requirement are informed by structural concerns about the effects of state regulation on the national economy. The Court found that a corporation may have minimum contacts with the taxing state as required by the due process clause, and yet lack the substantial nexus with the state as required by the Commerce Clause. Thus,

if there is not a substantial nexus between the out-of-state entity and the state, the out-of-state entity cannot be taxed.

Quill reaffirmed *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S. Ct. 1389 (1967) which found that whether or not a state may compel a vendor to collect a sales or use tax may turn on the presence in the taxing state of a small sales force, plant, or office. (Mail does not give an entity enough contacts). Thus, the Court would look for some type of physical presence in the state. This was consistent with *Scripto, Inc. v Carson* 362 U.S. 207, 80 S.Ct. 619 (1960) which upheld a use tax when the out-of-state sellers' in-state solicitation was performed by independent contractors.

Wayfair, 138 S. Ct. at 2091 found as follows:

> These principles also animate the Court's Commerce Clause precedents addressing the validity of state taxes. The Court explained the now-accepted framework for state taxation in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). The Court held that a State "may tax exclusively interstate commerce so long as the tax does not create any effect forbidden by the Commerce Clause." *Id.,* at 285, 97 S.Ct. 1076. After all, "interstate commerce may be required to pay its fair share of state taxes." *D.H. Holmes Co. v. McNamara,* 486 U.S. 24, 31, 108 S.Ct. 1619, 100 L.Ed.2d 21 (1988). The Court will sustain a tax so long as it (1) applies to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides. See *Complete Auto, supra,* at 279, 97 S.Ct. 1076.

The Division argued that under *Complete Auto*,[4] the Taxpayer has a substantial nexus with Rhode Island. The Taxpayer relied on *Quill* to argue it was not subject to a sales tax because it lacked a physical presence with Rhode Island.

Quill did not articulate a new rule. It reaffirmed the physical presence requirement of *Bellas Hess*. *Quill* found that *Bellas Hess* was not inconsistent with *Complete Auto*. *Quill* found

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[4] Arguably, *Complete Auto* did not establish the necessity of physical presence to satisfy the substantial "nexus" requirements under the Commerce Clause as it focused on the taxpayer's activities in state. Buntrock, Shane D., *Quill Corporation v. North Dakota: Spawning the Physical Presence "Nexus" Requirement Under the Commerce Clause*, 38 S.D. L. Rev. 130 (1993).

that *Bellas Hess* concerned the first prong of the *Complete Auto* test, "and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause." *Quill*, 504 at 311, 112 S. Ct at 1912. *Quill* rejected the finding of the state supreme court below that *Complete Auto* had rendered *Bellas Hess* obsolete.

The literature on *Quill* does not agree on the applicability on *Quill*: whether it only applies to the mail order industry, all taxes, or just sales and use taxes. Kolarik II, William Joel, *Untangling Substantial Nexus*, 64 Tax Law 851 (Summer 2011). Some commentary argued that *Quill* only applied to sales and use taxes or only to the mail order industry.[5] A broader reading is that *Quill* applied to all taxes and all industries so that physical presence is required before a state may subject a taxpayer to a tax.

State cases wrestled with the application of *Quill*. *In re Appeal of Intercard, Inc.*, 14 P.3d 1111 (KS 2000) reviewed *Complete Auto*, *Quill*, and other state cases applying the same. Relying on *National Geographic v. Cal. Equalization Bd.*, 430 U.S. 551, 97 S. Ct. 1386 (1997), *Intercard* rejected some state cases that found the slightest presence was enough to find substantial nexus. Rather, relying on *Complete Auto* and *Bellas Hess*, *Intercard* held that the Commerce Clause required a taxing state to have substantial nexus with an out-of-state business to impose use tax in the form of a physical presence. As *Intercard* noted, *Quill* relied on the bright line physical presence rule and admitted to its artificiality at its edges.

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[5] See Holderness, Hayes R., *Questioning Quill*, 37 Va. Tax Rev. 313 (Winter 2018) (discussed that *Quill* is applicable to sales and use taxes). *ETC Marketing, Ltd v. Harris County Appraisal District*, 528 S.W.3d 70 (TX 2017) found that the Supreme Court only instituted the physical present test for Commerce Clause challenges in the realm of sales and use taxes and refused to do so in other cases citing to *Quill* and *Bellas Hess*. *Crutchfield Corp. v. Testa*, 88 N.E.3d 900 (OH 2016) found that the physical presence substantial nexus test in *Quill* is not the same for all taxes in that the *Bellas Hess* test was for sales and use taxes. *Crutchfield* relied on *Quill*'s finding that it did not reject the *Bellas Hess* rule in the area of sales and use taxes. *Crutchfield* upheld a business privilege tax based on $500,000 sales receipts threshold.

The Division argued that *Quill* applied not just to sales and use taxes but only to mail order or on-line sale of goods. (Division reply brief). However, that very narrow reading was not accepted by the Rhode Island Supreme Court. In *Koch Fuels, Inc. v. Clark*, 676 A.2d 330 (R.I. 1996) *cert. den.* 519 U.S. 930, 117 S.Ct. 301 (1996), the taxpayer was an out-of-state distributor of fuel that sold oil to a company in Rhode Island and the oil would be delivered by common carriers using vessels to bring oil through Narragansett Bay to Providence. In determining whether that taxpayer had a substantial nexus with Rhode Island, the Court accepted the applicability of *Quill* to sales and use taxes and did not distinguish between goods and services (and did not restrict the applicability solely to mail-order on on-line purchases).[6] *Koch* at 333–34 found as follows:

> As an initial matter we shall address whether the gross-earnings tax imposed upon Koch may be considered a "sales or use" tax. . . .
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> It is clear that although the tax at issue is defined by the Legislature as a "gross earnings" tax, its application pursuant to the statute imposes a tax upon specific sales transactions in Rhode Island. The tax mandated by the statute therefore has the practical effect of a sales or use tax. *See Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326, 331 (1977) (the United States Supreme Court noted that when confronted with commerce-clause challenges of state taxes, it considered "not the formal language of the tax statute but rather its practical effect"). We are therefore of the opinion that the District Court correctly characterized the tax at issue as a sales or use tax.
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> We shall now turn to Koch's contention that the gross-earnings tax imposed by the relevant statute violates the commerce clause. The United States Supreme Court articulated a four-part test for determining the validity of a state tax under the commerce clause in *Complete Auto.* In that case, the Court provided that a state tax will pass commerce-clause scrutiny when the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." 430 U.S. at 279, 97 S.Ct. at 1079, 51 L.Ed.2d at 331. In applying this four-pronged test to the instant case, we are not persuaded by Koch's contentions that the gross-earnings tax at issue was violative of the commerce clause.
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> In regard to the first prong of the test Koch argues that its fuel-oil sales in Rhode Island lacked the substantial nexus required in a commerce-clause analysis. Relying on *Quill Corp. v. North Dakota,* 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), Koch contends that because the gross-earnings tax at issue is a sales or use tax, the first

[6] *Koch* did not address whether *Quill* was applicable to other types of taxes. But like other state decisions (see footnote five (5)), it applied *Quill* to sales and use taxes.

prong of the test is satisfied only if the taxpayer maintained a physical presence in the taxing state. Koch argues that since it does not have a physical presence in Rhode Island, its activities lack a substantial nexus with Rhode Island. Although we do not dispute the applicability of *Quill Corp.* to the instant case, we are not persuaded by Koch's contentions that it did not maintain a physical presence in this state.

In *Quill Corp.* the Court considered the imposition of state use tax upon a mail-order vendor of office supplies under both the due process analysis and the commerce-clause analysis. In regard to the commerce-clause analysis, the Court upheld its holding in *National Bellas Hess, Inc. v. Department of Revenue of Illinois,* 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), and determined that a state cannot constitutionally impose a sales and use tax upon a seller unless the seller maintained a physical presence in the taxing state. *Quill Corp.,* 504 U.S. at 314, 112 S.Ct. at 1914, 119 L.Ed.2d at 108. In instances wherein a taxpayer did "no more than communicate with customers in the State by mail or common carrier as part of a general interstate business," the Court stressed that that taxpayer did not have a substantial nexus with the taxing state.

In the instant case we are of the opinion that Koch's activities amounted to more than mere "communication with its customers in the State by mail or common carrier." We first note that Koch shipped approximately 25.6 million gallons of oil into Rhode Island over the course of three years with a total value of approximately $18 million. It retained total control over the shipments of oil throughout delivery. Koch retained title, possession, and risk of loss over the oil up until the point it reached the flange in Providence. Koch was in continuous contact and control with both the common carrier and Narragansett and was in a position to cancel the delivery if contract performance was not met by Narragansett. Although Koch did not own the vessels that carried its fuel oil into Rhode Island, Koch's fuel oil represented the entire and exclusive cargo of the vessel. On the basis of Koch's complete control over the oil shipments, the exclusive nature of the common carrier's contract, the unique nature of the cargo, and the fact that the sales were consummated upon delivery in Rhode Island, we are of the opinion that Koch's activities created in practical effect a physical presence within this state. Given Koch's physical presence in Rhode Island, we agree with the District Court's conclusion that Koch had sufficient contact with the state to satisfy the substantial-nexus requirement of the *Complete Auto* test.

The applicability of *Quill* and *Bellas Hess* to more than just mail order or on-line sellers is found in *Wayfair* itself. *Wayfair* speaks of out-of-state sellers and remote sellers and on-line sales, but never finds that *Quill* was only applicable to mail order or on-line sellers. Indeed, it speaks of the purchase of goods and services. *Wayfair*, 138 S. Ct at 2087-2088 found as follows:

> When a consumer purchases goods or services, the consumer's State often imposes a sales tax. This case requires the Court to determine when an out-of-state seller can be required to collect and remit that tax. All concede that taxing the sales in question here is lawful. The question is whether the out-of-state seller can be held

responsible for its payment, and this turns on a proper interpretation of the Commerce Clause, U.S. Const., Art. I, § 8, cl. 3.

In two earlier cases the Court held that an out-of-state seller's liability to collect and remit the tax to the consumer's State depended on whether the seller had a physical presence in that State, but that mere shipment of goods into the consumer's State, following an order from a catalog, did not satisfy the physical presence requirement. *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967); *Quill Corp. v. North Dakota,* 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992). The Court granted certiorari here to reconsider the scope and validity of the physical presence rule mandated by those cases.

Like most States, South Dakota has a sales tax. It taxes the retail sales of goods and services in the State. S.D. Codified Laws §§ 10–45–2, 10–45–4 (2010 and Supp. 2017). Sellers are generally required to collect and remit this tax to the Department of Revenue. § 10–45–27.3. If for some reason the sales tax is not remitted by the seller, then in-state consumers are separately responsible for paying a use tax at the same rate. See §§ 10–46–2, 10–46–4, 10–46–6. Many States employ this kind of complementary sales and use tax regime.

Under this Court's decisions in *Bellas Hess* and *Quill,* South Dakota may not require a business to collect its sales tax if the business lacks a physical presence in the State. Without that physical presence, South Dakota instead must rely on its residents to pay the use tax owed on their purchases from out-of-state sellers. "[T]he impracticability of [this] collection from the multitude of individual purchasers is obvious." *National Geographic Soc. v. California Bd. of Equalization,* 430 U.S. 551, 555, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977). And consumer compliance rates are notoriously low.

The Court then went on to find as follows:

In 1992, the Court reexamined the physical presence rule in *Quill.* That case presented a challenge to North Dakota's "attempt to require an out-of-state mail-order house that has neither outlets nor sales representatives in the State to collect and pay a use tax on goods purchased for use within the State." 504 U.S., at 301, 112 S.Ct. 1904. Despite the fact that *Bellas Hess* linked due process and the Commerce Clause together, the Court in *Quill* overruled the due process holding, but not the Commerce Clause holding; and it thus reaffirmed the physical presence rule. 504 U.S., at 307–308, 317–318, 112 S.Ct. 1904.

The Court in *Quill* recognized that intervening precedents, specifically *Complete Auto,* "might not dictate the same result were the issue to arise for the first time today." 504 U.S., at 311, 112 S.Ct. 1904. But, nevertheless, the *Quill* majority concluded that the physical presence rule was necessary to prevent undue burdens on interstate commerce. *Id.,* at 313, and n. 6, 112 S.Ct. 1904. It grounded the physical presence rule in *Complete Auto*'s requirement that a tax have a "'substantial nexus'" with the activity being taxed. 504 U.S., at 311, 112 S.Ct. 1904. *Wayfair*, 138 S. Ct. at 2091–92.

The *Wayfair* Court discussed the changes in the market place and economy via online sales and technology. Finally, it concluded that it rejected its prior holdings regarding physical presence for a nexus finding in *Quill* and *Bellas Hess* and applied *Complete Auto* without such a requirement.

> For these reasons, the Court concludes that the physical presence rule of *Quill* is unsound and incorrect. The Court's decisions in *Quill Corp. v. North Dakota,* 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), and *National Bellas Hess, Inc. v. Department of Revenue of Ill.,* 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), should be, and now are, overruled.
>
> In the absence of *Quill* and *Bellas Hess,* the first prong of the *Complete Auto* test simply asks whether the tax applies to an activity with a substantial nexus with the taxing State. 430 U.S., at 279, 97 S.Ct. 1076. "[S]uch a nexus is established when the taxpayer [or collector] 'avails itself of the substantial privilege of carrying on business' in that jurisdiction." *Polar Tankers, Inc. v. City of Valdez,* 557 U.S. 1, 11, 129 S.Ct. 2277, 174 L.Ed.2d 1 (2009). *Wayfair,* 138 S. Ct. at 2099.

The Division argued that it would be "ridiculous" to impose the physical presence standard on the Taxpayer since the Taxpayer is not physically present in Rhode Island and does not sell tangible personal property. It is probably for those kinds of reasons and that these kinds of services are now sold via the Internet that *Wayfair* overruled *Quill* and *Bellas Hess*. However, at the time of the Taxpayer's refund request, the substantial nexus test for at the very least sales and use taxes for goods and services required a physical presence pursuant to *Quill* and *Bellas Hess*. *Wayfair*, 138 S.Ct. at 2092. That requirement was applied by the Rhode Island Supreme Court in *Koch.*

In a post *Wayfair* world, the outcome of this matter would most likely be different. But pre *Wayfair*, the fact that the Taxpayer had no physical presence in Rhode Island determines that the state cannot impose sales tax on the Taxpayer pursuant to *Quill*, *Bella Hess*, and *Complete Auto* (fails the first prong).

VI. FINDINGS OF FACT

1. On June 30, 2019, the Division issued a Notice in response to the Taxpayer's request for hearing filed with the Division.

2. The parties agreed to have this matter decided on an agreed statement of facts and exhibits. They timely submitted briefs by December 27, 2019.

3. The parties agreed that the Taxpayer had no physical presence in Rhode Island.

4. The facts contained in Sections IV are reincorporated by reference herein.

VII. CONCLUSIONS OF LAW

Based on the testimony and facts presented:

1. The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-1-1 *et seq.*, R.I. Gen. Laws § 44-18-1 *et seq.*, and R.I. Gen. Laws § 44-19-1 *et seq.*

2. Pursuant to *Quill*, *Bellas Hess*, and *Koch*, the Taxpayer's lack of physical presence in Rhode Island prior to *Wayfair* results in the Taxpayer not having a substantial nexus with Rhode Island under the physical presence nexus requirement.

VIII. RECOMMENDATION

Based on the above analysis, the Hearing Officer recommends as follows: Pursuant to R.I. Gen. Laws § 44-1-1 *et seq.*, R.I. Gen. Laws § 44-18-1 *et seq.*, and R.I. Gen. Laws § 44-19-1 *et seq.*, the Taxpayer's request for refund should be allowed.

Date: February 27, 2020

Catherine R. Warren
Hearing Officer

ORDER

I have read the Hearing Officer's Decision and Recommendation in this matter, and I hereby take the following action with regard to the Decision and Recommendation:

✓ ADOPT
_____ REJECT
_____ MODIFY

Date: 3.30.2020

Neena S. Savage
Tax Administrator

NOTICE OF APPELLATE RIGHTS

THIS DECISION CONSTITUTES A FINAL ORDER OF THE DIVISION. THIS ORDER MAY BE APPEALED TO THE SIXTH DIVISION DISTRICT COURT PURSUANT TO THE FOLLOWING WHICH STATES AS FOLLOWS:

R.I. Gen. Laws § 44-19-18 Appeals
Appeals from administrative orders or decisions made pursuant to any provisions of this chapter are to the sixth (6th) division district court pursuant to chapter 8 of title 8. The taxpayer's right to appeal under this chapter is expressly made conditional upon prepayment of all taxes, interest, and penalties, unless the taxpayer moves for and is granted an exemption from the prepayment requirement pursuant to § 8-8-26.

CERTIFICATION

I hereby certify that on the 1st day of ~~February~~ April, 2020 a copy of the above Decision and Notice of Appellate Rights were sent by first class mail, postage prepaid to the Taxpayer's representative's address on file with the Division of Taxation and by hand delivery to Michael Brady, Esquire, Department of Revenue, One Capitol Hill, Providence, RI 02908.

Gail Belasco