

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-86(37)S
Sales Tax
September 18, 1986

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. S851028A

On October 28, 1985, a Petition for Advisory Opinion was received from Spencer Gifts, Inc., 1050 Black Horse Pike, Pleasantville, New Jersey 08323.

The issue raised is whether a New Jersey corporation, hereinafter referred to as "Mail Order", which will be created as a wholly-owned subsidiary of Petitioner, will be required to collect and remit New York State sales or compensating use taxes. In order to make this determination, two issues must be addressed: (1) whether sufficient nexus will exist between Mail Order and New York State to satisfy the Due Process and Commerce Clauses of the United States Constitution and (2) if there will be sufficient nexus, whether Mail Order will be a "vendor" for purposes of the New York State Sales and Use Tax Law and therefore required to collect New York State sales or use tax on retail mail order sales made to New York customers.

Petitioner is a Delaware corporation with its headquarters in New Jersey. It is a wholly-owned subsidiary of MCA, Inc. ("MCA"), which is also a Delaware corporation. Petitioner's business is presently divided into two divisions: (1) the mail order division which solicits sales through merchandise catalogues, promotional flyers and advertisements in newspaper supplements and national magazines and (2) the retail store division which sells merchandise through retail stores located in 46 states, including New York.

Petitioner intends to reorganize its business operations. After the reorganization, Petitioner's business operations will be divided among three corporations. One corporation, Mail Order, will engage in the business of mail order sales and will own, operate and control the assets, liabilities, employees and the business of the mail order division. The second corporation, hereinafter referred to as "Retail Stores", will engage in retail sales and will own, operate and control the assets, liabilities, employees and the business of the retail store division. The third corporation, hereinafter referred to as "Services", will be a subsidiary of MCA and will own, operate and control the remaining assets, liabilities and employees of Petitioner not transferred to Mail Order or Retail Stores. Both Mail Order and Retail Stores will be subsidiaries of Services.

Mail Order and Retail Stores will conduct their business operations as described below. Each corporation will maintain its own merchandising and marketing departments, separate warehouses and inventories and separate bank accounts. There will be no joint purchasing of merchandise from vendors. Based upon past experience, it is anticipated that less than 5% of the items sold by these companies will be of identical merchandise. If any transactions occur between Mail Order and Retail Stores relating to services or asset transfers, such transactions will be at arms length prices.

Mail Order will have no agents, salesmen, employees, inventory, warehouses, offices, sales houses, distribution centers, other facilities or property in New York. It will most likely continue to purchase some merchandise from New York vendors and visit industry trade shows held by prospective vendors in New York.

Mail Order will maintain an import support group in New Jersey and operate three offices in the Far East to facilitate the purchasing of items from overseas vendors (such group and offices hereinafter referred to as "Overseas Operations").

Mail Order will solicit sales by catalogues, promotional flyers and advertisements in newspaper supplements and national magazines. The catalogues and flyers will be mailed to prospective customers, without charge, from locations outside of New York. Customers' orders will be mailed to and accepted in New Jersey and merchandise will be shipped directly to the customer by mail or common carrier from Mail Order's distribution centers in New Jersey and Virginia. A small number of items will be shipped to New York customers on a drop-ship basis from manufacturers, none of which will be located in New York. Payments will be made by mail with the customer's order or by charging various nationwide credit cards (e.g., Visa and Mastercard). None of the bank accounts of Mail Order will be maintained with banks located in New York. Customer complaints and refunds will be handled by mail or telephone by personnel located outside New York.

Mail Order will also own and operate three discount stores, none of which will be located in New York.

Retail Stores will operate retail stores located in 46 states, including New York. Retail Stores will maintain its own merchandising and marketing departments. To the extent Retail Stores utilizes Overseas Operations for foreign purchases it will pay arms length charges to Mail Order.

None of the retail stores will act as agents for Mail Order or otherwise facilitate mail order sales. The catalogues and promotional flyers of Mail Order will not be available at the retail stores. The retail stores will not accept customer orders for mail order merchandise, nor will they handle complaints of or refunds to the customers of Mail Order.

Services will be located in New Jersey and provide data processing, corporate reporting, profit sharing and pension plans, hospitalization and administrative services for Mail Order and Retail Stores, as well as lease office space to both corporations in New Jersey. The chief operating officer of Mail Order and Retail Stores will each report to the chief executive officer of Services.

MCA will perform certain advisory, tax and financial services for Services, Mail Order and Retail Stores and will periodically review the operations of each company. Some Services, Mail Order and Retail Store employees will be covered by MCA employee stock benefit and health plans.

The executive offices of MCA are located in New York. Although not explicitly stated in the Petition, it is presumed for purposes of this Advisory Opinion that Services will not operate in New York State.

ISSUE 1 - Nexus

A state can require an out-of-state seller to collect the state's sales or use tax only when there is a sufficient nexus between the seller and the taxing state, as required by the Commerce Clause of the United States Constitution (Art. I, 8, cl. 3) and the Due Process Clause of the Fourteenth Amendment to the United States Constitution. National Geographic Society v. California Board of Equalization, 430 US 551.

The test to determine whether a particular state exaction violates the Commerce Clause by invading the exclusive authority of Congress to regulate trade between the states, and the test to determine whether a state has complied with the requirements of due process in this area, are similar. National Bellas Hess, Inc. v. Department of Revenue, 386 US 753. "[T]he 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." National Geographic Society v. California Board of Equalization, 430 US at 561.

Activities in a state that have been found to be constitutionally sufficient to establish nexus to require an out-of-state corporation to collect state taxes include the operation of retail stores of the corporation in the state, Nelson v. Sears, Roebuck and Co., 312 US 359; Nelson v. Montgomery Ward, 312 US 373; the presence of traveling salesmen in the state, General Trading Co. v. Tax Commission, 322 US 335; and the presence of independent contractors or agents of the corporation in the state, Scripto, Inc. v. Carson, 362 US 207. In the most recent United States Supreme Court opinion on the issue of nexus for use tax collection purposes, National Geographic Society v. California Board of Equalization, supra, the corporation, National Geographic, operated two offices in California. Although the activities in those offices were unrelated to the corporation's mail order activities, the Court held that it was permissible to impose the administrative burden of collecting use taxes on National Geographic. Since the two California offices, regardless of the nature of their activities, had the advantage of the same services, e.g., fire and police protection, as they would have had had their activities included assistance to the mail order operations that generated the use taxes, there was a definite link between National Geographic and the State of California.

Activities in a state that have been held insufficient to establish the necessary nexus to impose the duty to collect use taxes include mail order sales where delivery of the goods was made from out-of-state by common carrier or United States mail, National Bellas Hess, Inc. v. Illinois, supra, and over the counter sales made in a bordering state to state residents with only occasional

deliveries being made into that state, Miller Brothers Co. v. Maryland, 347 US 340. In both these cases, the Court found that the requisite relationship between the state and the out-of-state seller was lacking.

To determine whether there will be sufficient nexus for New York State to impose a requirement to collect use taxes on Mail Order, it is necessary first to determine whether there will be some relationship or minimum connection between Mail Order and New York State. Under the facts presented here, Mail Order will not operate directly in New York State, nor will it have any offices in this state. Its sales will be made by mail with delivery by common carrier or mail. Under the holdings of the National Bellas Hess and Miller Brothers cases cited above, on these facts alone Mail Order will not be required to collect tax. However, Retail Stores, which like Mail Order will be a wholly-owned subsidiary of Services, will be operating in New York State. The presence of its retail stores in New York will establish the necessary minimum connection with the state to require Retail Stores to collect New York State sales or use tax on its out-of-state sales to New York customers. The question thus becomes whether the presence in New York of a parent or an affiliated corporation, e.g., another corporation such as Retail Stores owned by a common parent, will be sufficient to establish nexus for Mail Order with New York.*

As a general rule, corporations are treated as separate legal entities, Rapid Transit Subway Const. Co. v. City of New York, 259 NY 472, and the presence of a parent corporation in one state does not require a finding of presence in that state for its wholly-owned subsidiary. However, under certain circumstances in order to prevent fraud or injustice, the corporate structure will be disregarded and the separate entity rule discarded. Astrocom Electronics, Inc. v. Lafayette Radio Electronics Corp., 63 AD2d 765; Giblin v. Murphy, 97 Ad2d 668; Berkey v. Third Ave. Railway Co., 244 NY 84. In Nelson v. Sears, Roebuck and Co., supra, the Supreme Court held that the departmentalization of the corporation's operations (i.e., the mail order and retail stores operations were separately administered) did not preclude the finding of sufficient nexus. In New York, there has been a "steady movement towards holding that in determining whether a corporation has engaged in activities in the state it is immaterial whether these are conducted through a branch or through a subsidiary corporation," Boryk v. de Haviland Aircraft Co., 341 F2d 666, 668. In certain cases, this concept should be applied to corporate reorganizations. It would be unjust to permit a corporation to use a corporate reorganization as a cloak for the evasion of its tax obligations.

*This opinion will assume that no agency relationship exists between Mail Order and Retail Stores and any of their affiliated corporations. If an agency relationship did exist, it might establish that there was a definite nexus between the state and Mail Order. Taca International Airline S.A. v. Rolls Royce of England Ltd., 15 NY2d 97; Frummer v. Hilton Hotels, Inc., 19 NY2d 533; see also, McCray, "Overturning Bellas Hess," 1985 Brigham Young Univ. L. Rev. 265, 287.

The status of the subsidiary as a separate entity should be ignored in situations where the parent so dominates and controls the affairs of the subsidiary that the subsidiary is an instrumentality of the parent. Coastal States Trading, Inc. v. Zenith Nav. SA, 446 F. Supp. 330; Fiur Co. v. Ataka & Co., 71 AD2d 370. In such situations, the subsidiary should be considered to be the alter ego of the parent. See, Van Valkenburgh, Nooger & Neville, Inc. v. Hayden Publishing Co., Inc., 30 NY2d 34.

While "New York law in this area is hardly as clear as a mountain lake in springtime," Brunswick Corp. v. Waxman, 599 F2d 34, 35, in order to invoke this alter ego doctrine, the parent corporation must dominate the finances, policy and business practices of the controlled corporation. Fisser v. International Bank, 282 F2d 231. Indicia such as common officers and directors, common offices and telephone numbers between corporate entities are relevant but are not sufficient by themselves to show that one corporation is the alter ego of another. Consideration must also be given to factors such as the degree of overlap of personnel, the amount of business discretion displayed by the corporations, whether the entities operate independently of each other, whether the parent corporation owns all or most of the stock of the subsidiary and whether the parent corporation causes the incorporation of the subsidiary. United States Barite Corp. v. M. V. Haris, 534 F. Supp. 328; Ioviero v. CIGA Hotels, Inc., 101 AD2d 852; Lincoln Center v. State Tax Commission, 113 Misc. 2d 329; Worldwide Carriers, Ltd. v. Aris Steamship Co., 301 F Supp 64. Also significant is whether the corporations trade under their own names and whether they hold themselves out to the public as separate and distinct businesses. Mangan v. Terminal Transportation System, Inc., 247 AD 853; Matter of Sbarro Holding, Inc., 111 Misc. 2d 910, aff'd 91 AD2d 613; Matter of Typhoon Industries, Inc., 6 BR 886; see, also, Plainview Realty v. Board of Managers, 86 Misc. 2d 515; Henn and Alexander, Laws of Corporations and Other Business Enterprises 3d Ed. (1983), pp. 354-356. Note that while many of the cases relating to this alter ego doctrine concern parent and subsidiary corporations, this same reasoning should be applicable to affiliated corporations, i.e., corporations owned by a common parent. CIT Fin. Services Consumer Discount Co. v. Director, Div. of Taxation, 4 N.J. Tax 349, CCH 201-026; Frummer v. Hilton Hotels, Inc., 19 NY2d 533; Matter of Bowen Transports, Inc., 551 F2d 171.

If the affairs of the subsidiary or affiliated corporation are so dominated and controlled by its parent or affiliate that the dominated and controlled corporation is the alter ego of the other, then the nexus of one with New York State for tax jurisdiction purposes will provide sufficient nexus with New York State for the other. CIT Fin. Services Consumer Discount Co. v. Director, Div. of Taxation, supra; Minnesota Tribune Co. v. Commissioner of Taxation, 37 NW2d 737; Franklin Mint Corp. v. Tully, 94 AD2d 877, aff'd, 61 NY2d 980. (Other cases supporting a finding of nexus premised on a parent/subsidiary relationship include Aldens, Inc. v. Tully, 49 NY2d 525; Reader's Digest Association, Inc. v. Mahin, 44 Ill. 2d 354, 255 NE2d 458, appeal dismissed, 399 US 919; Appeal of Dresser Industries, Inc., California State Board of Equalization, CCH 400-485. See Barber, "Piercing the Corporate Veil," 17 Willamette L. Rev. 371, 397.)

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Viewing the totality of the circumstances presented in this Petition, Mail Order will not be operating as the alter ego of its New York affiliate, Retail Stores or its New York parent. Accordingly, there will not be sufficient nexus with New York to compel Mail Order to collect New York State sales or use taxes. However, additional facts which demonstrate that Mail Order is the alter ego of its New York affiliates would warrant a conclusion that there would be sufficient nexus to compel Mail Order to collect New York tax. In that instance, it would be unjust and inequitable to allow Mail Order to avoid tax collection responsibilities.

ISSUE 2 - Status as a Vendor

In light of the conclusion reached above that Mail Order will not have sufficient nexus with New York State to require it to collect New York State sales or use taxes, it is not necessary to address the issue presented of whether Mail Order will be a "vendor" as that term is defined in the New York State Sales and Use Tax Law (Tax Law, 1101(b)(8)).

DATED: September 18, 1986

s/FRANK J. PUCCIA
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.