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This Week in State Tax (TWIST)

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Arizona: Auto Parts Retailer Has Nexus Through Suppliers

An Arizona Court of Appeals recently reversed a decision in which the tax court had held that a Wisconsin-based online auto parts retailer did not have substantial nexus with Arizona for the 2013-2019 periods at issue. The taxpayer contracted with six Arizona distributors who supplied inventory, shipped orders, and processed returns for the taxpayer. The taxpayer did not maintain its own inventory; rather, the distributors sent daily inventory lists that were posted on the taxpayer's website. Customers placed orders through the taxpayer's website, and the taxpayer forwarded the orders to its distributors to fulfill. Distributors were required to adhere to the taxpayer's shipping and return policies and use the taxpayer's branded packing materials. The taxpayer chose which distributor fulfilled customers' orders and did not disclose to customers that it used distributors to fulfill orders. The taxpayer did not collect transaction privilege tax (TPT) for the periods at issue and was subsequently audited by the Town of Gilbert after a customer complained that they were not charged TPT. Eventually, the Arizona Department of Revenue assessed the taxpayer over $8 million of TPT, interest and penalties. After the tax court concluded that the taxpayer lacked a substantial nexus with Arizona, the Department appealed.

The appellate court noted that during the periods at issue, "substantial nexus" required a physical presence in the state, which could be attributed to the taxpayer by a contractor that was acting on the taxpayer's behalf and whose activities were "significantly associated with the taxpayer's ability to establish and maintain a market in th[e] state for the sales." The court noted that the distributors' activities were not the same as the solicitation related activities that occurred in cases such as Scripto and Tyler Pipe. The taxpayer highlighted the difference and argued that it had no physical presence in Arizona because its distributors did not have "in-person contact with Arizona customers for sales, product installation, and/or customer service." The court, however, determined that in person contact was not required; instead, the key was whether the activities enabled the taxpayer to maintain a market in the state. In the court's view, the distributors activities did so. First, the court noted that performing a contract was akin to maintaining a market and all the essential portions of the taxpayer's contracts with customers were performed by the distributors in Arizona. Further, the Arizona distributors sent promotional materials and branded packaging to Arizona customers. Finally, the use of the distributors likely increased the taxpayer's customers' experience as it enabled parts to be shipped more quickly. The court also noted that during the audit period, the taxpayer's employees made four trips to meet with distributors. With the taxpayer's distributors' activities in the state, the court did not need to conclude whether the trips alone were sufficient. However, the trips supported a finding that the taxpayer had a physical presence in Arizona. The court upheld the TPT assessments. Please contact Stacey Matthew with questions on *RockAuto v. ADOR.*

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