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Internet seller has sales and use nexus with Colorado due to in-state affiliate and its local sales and use tax collection responsibility depends on location of in-state affiliate's stores

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In Brief

An in-state affiliate established sales and use tax nexus between Colorado and an out-of-state Internet retailer. The Internet retailer was: (1) "doing business" in Colorado because the in-state affiliate acted as its in-state representative and (2) "presumed" to be doing business in the state under Colorado's controlled group nexus standard. Additionally, affiliate store locations determine what state-collected local sales and use taxes the Internet retailer must collect. [Colorado Department of Revenue, Letter Ruling PLR-12-002, (5/30/12)]

In Detail

Taxpayer is an Internet retailer with no physical presence in Colorado. The Taxpayer's affiliate operates three retail stores in the state. The Taxpayer and its in-state affiliate jointly promote a loyalty points program whereby customers receive points for purchases made either on the Taxpayer's Internet site or at the affiliate's retail stores. The in-state affiliate also accepts returns of merchandise purchased on the Taxpayer's Internet site.

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Colorado's "doing business" statute

In general, out-of-state retailers must collect sales tax for goods sold in Colorado if the retailer is "doing business" in Colorado. Colorado's "doing business" statute under Col. Revised Stat. Section 39-26-102 ("Section") provides that "doing business" is defined as:

> (3) Selling, leasing, or delivering in this state, or any activity in this state in connection with the selling, leasing, or delivering in this state, of tangible personal property by a retail sale for use, storage, distribution, or consumption within this state, including:
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> (a) The maintaining within this state, directly or indirectly or by a subsidiary, of an office, distributing house, salesroom or house, warehouse, or other place of business;
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> (b)(I) The soliciting, either by direct representatives, indirect representatives, manufacturers' agents, . . . or by any other means whatsoever, of business from persons residing in this state and by reason thereof receiving orders from, or selling or leasing tangible personal property to, such persons residing in the state for use, consumption, distribution, and storage for use or consumption in the state.
>
> (b)(II) Commencing March 1, 2010, if a retailer that does not collect Colorado sales tax is part of a controlled group of corporations, and that controlled group has a component member that is a retailer with physical presence in the state, the retailer that does not collect Colorado sales tax is presumed to be doing business in this state.

Taxpayer was "doing business" in Colorado because affiliate was acting as its representative

The Department determined that the Taxpayer satisfied Sections (3), (3)(a) and 3(b)(I) above because the Taxpayer: (1) delivers product into Colorado for sale and consumption; (2) indirectly maintains a business and sales representative in Colorado through its affiliate; and (3) has an indirect representative (the affiliate) that solicits in Colorado.

In particular, the Department noted that the affiliate is an indirect representative of the Taxpayer because it "acts on behalf of" the Taxpayer to solicit and facilitate sales and sales-related activities, including the loyalty program, and because it accepts returns on behalf of the Taxpayer. The Department concluded that the Taxpayer "indirectly maintains a place of business in Colorado through the Affiliated Company's brick-and-mortar locations."

Taxpayer also presumed to be doing business in the state under Colorado's controlled group nexus provision

As noted above, Section (3)(b)(II) provides generally that an out-of-state retailer is presumed to be doing business in Colorado if it is part of a controlled group of corporations with a component member that is a retailer with a physical location in Colorado. For more information on Colorado's controlled group nexus standard, please see our summary, available here.

The Department determined that the Taxpayer's parent company owned the Taxpayer and the affiliate and owned all the voting rights in both companies. As such, these three companies qualified as a controlled group under Colorado law. Because the affiliate group member was a Colorado retailer, the Taxpayer was presumed to be "doing business" in Colorado.

Taxpayer's local sales and use tax collection obligation is determined by the location of the affiliate stores

Generally, Colorado home-rule localities have independent sales and use tax ordinances and, accordingly, nexus requirements separate from those imposed for state-collected localities. Recognizing that the Department does not administer home-rule taxes, the PLR explicitly states that the ruling does not apply to home-rule localities. Rather, the ruling relates to state-collected local sales and use taxes.

A taxpayer typically must be doing business in a locality and the sales transaction must consummate in the locality in order for local sales or use tax to apply. The Department concluded that the Taxpayer should collect and remit local sales tax for sales shipped into state-collected local jurisdictions in which affiliated company stores are located. If the Taxpayer ships product to local jurisdictions in which affiliated companies do not have stores, then the Taxpayer will collect only state and special district use tax, as applicable, on the sale.

Actions to consider

It is curious that the Department made its "doing business" determination under both Sections (a) and (b). It could be because the Department's regulation 39-26-102.3 suggests that Section (b) satisfies only use tax nexus whereas Section (a) satisfies sales tax nexus. The Department acknowledged in a footnote that state-collected localities do not levy a use tax that applies to the Taxpayer's product. Accordingly, a sales tax nexus determination was critical for local tax to apply to the Taxpayer's transactions.

Additionally, the letter ruling makes no mention of the location of where the Taxpayer's sales were consummated, which determines the local incidence of tax. If the Taxpayer consummated the sale outside of Colorado, it arguably remains a use tax transaction subject only to state and special district use tax. In this letter ruling, the Department apparently presumes that the sales are consummated in Colorado and therefore subject to local sales tax collection.

Out-of-state taxpayers making sales into Colorado should evaluate their Colorado state and local sales tax responsibilities in light of the Department's rationale in this letter ruling. These topics are of great dispute and significant audit issues arise between out-of-state retailers and the Department as a result.

Let's talk

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