

Does *Wayfair* Affect Pennsylvania's Corporate Tax Nexus Standard?

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In this article, the authors discuss a recent bulletin from the Pennsylvania Department of Revenue regarding corporate tax nexus policy.

Historically, the Pennsylvania Department of Revenue's policy has been that "a non-Pennsylvania corporation must have some physical presence in Pennsylvania in order to make it subject to corporate net income tax."¹ This policy was consistent with Pennsylvania's corporate net income tax statute, which only imposes tax on corporations doing business in the state,² as well as decades of Pennsylvania case law interpreting that statutory language.³

In a recent bulletin, the DOR announced a change in its policy, and took the position that for tax years beginning on or after January 1, 2020, "taxpayers without physical presence in the

Commonwealth, but having nexus with Pennsylvania under the Constitution of the United States," are required to file Pennsylvania corporate tax reports.⁴ According to the bulletin, "the Department will deem there to be a rebuttable presumption that corporations without physical presence in the state, but having \$500,000 or more of direct or indirect receipts . . . sourced to Pennsylvania," have nexus. The DOR based its change in position on the U.S. Supreme Court's decision in *South Dakota v. Wayfair Inc.*, which held that the dormant commerce clause does not require a remote seller to have a physical presence in a state for the state to require the remote seller to collect sales tax.

The DOR's reliance on *Wayfair* is misplaced. If Pennsylvania statutorily imposed corporate net income tax to the full extent permitted by the U.S. Constitution, the DOR would be justified in looking to *Wayfair* for guidance. But as explained below, Pennsylvania's corporate net income tax statute does not impose tax to the full extent permitted by the U.S. Constitution.⁵ Therefore, *Wayfair* — which was purely a decision on a matter of constitutional law — does not directly affect who is required to pay corporate net income tax.

Pennsylvania imposes corporate net income tax only on corporations that:

- do business in Pennsylvania;
- carry on activities in Pennsylvania (other than solicitation protected by Public Law 86-272);

¹Letter from the DOR to CCH Tax & Accounting (July 31, 2006).

²72 Pa. Cons. Stat. section 7402(a).

³E.g., *Clairol Inc. v. Commonwealth*, 518 A.2d 1165, 1168 (Pa. 1986).

⁴Pennsylvania DOR, Corporation Tax Bulletin 2019-04 (Sept. 30, 2019).

⁵Of course, Pennsylvania's General Assembly is free to amend the corporate net income tax statute to create this type of nexus provision, as it has done for sales tax and bank shares tax. See notes 22 and 23, *infra*.

- have capital or property employed or used in Pennsylvania; or
- own property in Pennsylvania.⁶

While there are several prongs of this standard, the courts have treated them all as synonymous,⁷ and have repeatedly construed this statutory “doing-business” standard to require more of a connection with Pennsylvania than the connection required for nexus under the U.S. Constitution.

In its most recent statement on the doing-business standard, the Pennsylvania Supreme Court explained in 1986 that a corporation must have an “active presence” in the state to be subject to tax.⁸ For example, the Pennsylvania courts have held that Pennsylvania’s statutory doing-business standard does not impose tax on corporations under the following fact patterns:

- leasing tangible personal property to customers in Pennsylvania;⁹
- maintaining money on deposit at a bank located in Pennsylvania;¹⁰
- purchasing raw materials in Pennsylvania;¹¹
- holding raw materials in a company-owned warehouse in Pennsylvania while awaiting shipment to an out-of-state manufacturing facility;¹²
- owning real property in Pennsylvania that is used for investment purposes;¹³ and

- entering financing transactions, such as conditional sales contracts and bailment leases, with customers in Pennsylvania.¹⁴

While these cases predate the U.S. Supreme Court’s decision in *Northwestern States Portland Cement Co. v. Minnesota*,¹⁵ the Pennsylvania courts have established that the statutory doing-business standard does not change based on the contours of federal constitutional law.¹⁶ Thus, the case law leaves little room for the DOR to argue that the phrase “doing business” is equivalent to having constitutional nexus with the state, let alone through informal guidance such as the bulletin.¹⁷

At its core, then, the DOR’s bulletin is nothing more than a statement that the DOR intends to ask the courts to overrule a century’s worth of precedent. Persuading a court to overrule precedent is always an uphill battle, but the DOR faces several additional obstacles here that might prove insurmountable.

First, the DOR will need to overcome the heightened power of *stare decisis* in the realm of statutory interpretation (as compared with constitutional law or common law).¹⁸ Judicial gloss of a statute “become[s] part of the warp and woof of the legislation,”¹⁹ so it is the role of the

⁶ 72 Pa. Cons. Stat. section 7402(a).

⁷ See, e.g., *Commonwealth v. Reading & Southwestern Street Railway Co.*, 54 Dauph. 277 (Pa. Com. Pl. 1944) (“From the earliest interpretation of these acts down to the present, all the cases have uniformly held that ‘doing business in this Commonwealth’ and ‘having property employed or used in this Commonwealth’ are equivalent terms”). Although this case, and many others cited in this article, involved Pennsylvania’s now-defunct franchise tax rather than the corporate net income tax, the franchise tax had nearly identical imposition language to the corporate net income tax. See 72 Pa. Cons. Stat. section 7601.

⁸ *Clairol*, 518 A.2d at 1168.

⁹ *Commonwealth v. American Bell Telephone Co.*, 129 Pa. 217 (1889) (rejecting DOR’s argument that company’s right to repossess leased property constituted doing business in Pennsylvania).

¹⁰ *Commonwealth v. Tonopah Mining Co.*, 12 Dauph. 91 (Pa. Com. Pl. 1909).

¹¹ *Commonwealth v. Standard Oil Co.*, 101 Pa. 119 (1882).

¹² *Commonwealth v. Johnson & Johnson*, 23 Dauph. 270 (Pa. Com. Pl. 1920).

¹³ *Commonwealth v. Conglomerate Mining Co.*, 1 Dauph. 85 (Pa. Com. Pl. 1884).

¹⁴ See *Refrigeration Discount Corp. v. Metzger*, 10 F. Supp. 748 (M.D. Pa. 1935).

¹⁵ 358 U.S. 450 (1959) (holding that commerce clause does not prevent a state from imposing net income tax on an out-of-state corporation that solicited business in the state).

¹⁶ See *Clairol Inc. v. Commonwealth*, 489 A.2d 286, 289 (Pa. Commw. 1985), *rev’d on other grounds*, 518 A.2d 1165 (Pa. 1986) (rejecting Pennsylvania’s argument that “United States Supreme Court decisions which have approved taxation of foreign corporations engaged solely in solicitation” extend the reach of Pennsylvania’s doing-business standard).

¹⁷ If the DOR were to promulgate guidance in the form of a regulation rather than the bulletin, that would present a different question. Cf. *National Cable & Telecommunications Assn. v. Brand X Internet Services*, 545 U.S. 967 (2005) (“A court’s prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion”).

¹⁸ See William N. Eskridge Jr., “Overruling Statutory Precedents,” 76 *Georgetown L.J.* 1361, 1362 (1988).

¹⁹ *Francis v. Southern Pacific Co.*, 333 U.S. 445, 450 (1948).

legislature, not the courts, to consider whether any modifications are necessary.²⁰

Second, the DOR will need to explain why the legislature has not amended the statute to extend beyond the doing-business standard.

Pennsylvania's General Assembly has amended the sales tax statute²¹ and bank shares tax statute²² to make statutory nexus coextensive with constitutional nexus. Against this background, the legislature's silence on corporate net income tax seems intentional, rather than accidental.²³

Third, the DOR may face a challenge to the bulletin's arbitrary \$500,000 threshold for the rebuttable presumption under the Pennsylvania Constitution's uniformity clause.²⁴ That challenge would be based on case law that prevents the Commonwealth from treating taxpayers differently based on the volume of business conducted.²⁵

Fourth, even if the courts agreed to overrule the long-standing precedent on what it means to be doing business, they might decide that the overruling should take effect only prospectively from the date of the Pennsylvania Supreme Court's decision, rather than from the bulletin's arbitrary January 1, 2020, start date.²⁶ This prospective-only approach would be consistent

with the position that the Commonwealth has taken in other litigation in which it has lost on the merits.²⁷

This leaves taxpayers with the question whether they now have corporate net income tax nexus with Pennsylvania and need to file a return. Even under the DOR's own regulations, the bulletin is not binding.²⁸ According to the regulations, guidance such as the bulletin is "issued for information purposes only and should not be relied upon or used in tax appeals."²⁹ Accordingly, taxpayers can view the bulletin merely as a statement of the position that the DOR will take in issuing assessments.³⁰ As a legal matter, if a taxpayer has concluded that it was not subject to Pennsylvania corporate net income tax, the bulletin does nothing to change that conclusion. As a practical matter, it might make sense for taxpayers to consider filing zero returns to toll the statute of limitations or paying tax and filing refund claims. ■

²⁰ See *Shambach v. Bickhart*, 845 A.2d 793, 807 (Pa. 2004) (Saylor, J., concurring) ("stare decisis has special force in matters of statutory, as opposed to constitutional construction, because in the statutory arena the legislative body is free to correct any errant interpretation of its intentions, whereas, on matters of constitutional dimension, the tripartite design of government calls for the courts to have the final word") (internal quotations omitted).

²¹ Act 89 of 2002, codified as 72 Pa. Cons. Stat. section 7201(b)(3.3) (sales tax collection obligation applies to anyone who has "contact within this Commonwealth which would allow the Commonwealth to require a person to collect and remit tax under the Constitution of the United States").

²² Act 52 of 2013, codified as 72 Pa. Cons. Stat. section 7701.5(1)(vii) (bank is subject to tax if it "conducts an activity sufficient to create a nexus in this Commonwealth for tax purposes under the Constitution of the United States").

²³ See, e.g., *Fletcher v. Pennsylvania Property & Casualty Insurance Guaranty Assn.*, 985 A.2d 678, 694 (Pa. 2009) ("A fundamental principle of statutory construction is that when a section of a statute contains a given provision, the omission of that provision from a similar section is significant to show a different intention existed").

²⁴ Pa. Const. Art. VIII, section 1 ("All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws").

²⁵ E.g., *Nextel Communications of the Mid-Atlantic Inc. v. Commonwealth*, 171 A.3d 682, 696 (Pa. 2017) (observing that "classifications based solely upon the quantity or value of the property being taxed are arbitrary and unreasonable, and, hence, forbidden").

²⁶ See *Blackwell v. Commonwealth, State Ethics Commission*, 589 A.2d 1094, 1099-1100 (Pa. 1991).

²⁷ E.g., *General Motors Corp. v. Commonwealth*, 869 F.R. 2012, brief for Respondent at 16-21 (Mar. 15, 2019) (arguing that decision holding tax statute unconstitutional should only apply prospectively from the date of the decision).

²⁸ See 61 Pa. Code section 3.5.

²⁹ 61 Pa. Code section 3.4.

³⁰ Unlike many other states, Pennsylvania does not impose an understatement penalty. See 72 Pa. Cons. Stat. section 7410.