REVENUE DISCOVERY SYSTEMS – ADMINISTRATIVE LAW DIVISION

ISAGENIX INTERNATIONAL, LLC Petitioners, V. CITY OFALICEVILLE, ALABAMA, TOWN OF ARLEY, ALABAMA, *et al.*, Respondents.	)))))))))	**FINAL ORDER**

The taxpayer, Isagenix International, Inc., an Arizona corporation headquartered in Chandler, Arizona, is an international provider of health and wellness products which are sold to intrastate, interstate, and international customers and organizational associates throughout the United States and abroad. They conduct their business by recruiting independent sales associates who become responsible for selling the products, recruiting other associates, and operating through a personalized, Isagenix replicated website provided by the taxpayer where they can sell direct retail purchases with the taxpayer collecting funds, shipping the product, and directly depositing the associates' profits into an account. The company maintains a very similarly structured, although not identical, marketing and enrollment program to other mail-order retail sellers in which they set up intricate sales forces throughout markets in interstate commerce. Once enrolled, the associates become eligible for "reward points" and commissions based upon their volume of sales which are then converted into actual monetary compensation or other forms of income paid out on a weekly basis. The associates become eligible to build sales organizations and receive direct bonus points from those sales which they generate personally as well as indirect bonus points from sales generated through their pyramidal sales organization. The associates, who elect to do so, order their product supply from the taxpayers and resell their product to customers within their own market area. The associates' customers pay them directly for the products they purchase in whatever payment form they choose to accept.

The taxpayer has developed a rather large sales force consisting of pyramidal sales organizations within the State of Alabama, and regularly supplies those associates with product for distribution throughout the state. All orders are received in Arizona and shipped via common carrier or U.S. mail to the associates in Alabama, or directly to other customers. The taxpayers

do not own property in Alabama, real or personal, and they have no physical presence in Alabama except for the organizational associates located within the State.

The taxpayer was audited by Revenue Discovery Systems on behalf of self-administered county and municipal taxing authorities throughout the State of Alabama. The audit revealed that the taxpayer was collecting and remitting State and local seller's use taxes on all sales made within the State of Alabama. However, the taxpayer is not registered with the Secretary of State in Alabama to conduct business, and they do not obtain local jurisdictional business licenses in counties and municipalities throughout the State. The examiner assessed the taxpayer for business license taxes on their gross sales receipts in all jurisdictions in which it was determined that the taxpayer had organizational associates purchasing products and soliciting business. However, the auditor determined that the taxpayer did not have sufficient nexus for a business license on direct sales in those jurisdictions in which they had no organizational associates, and their only contact was through common carrier or U.S. mail.

The taxpayer timely appealed the final assessments in accordance with ALA. CODE § 40-2A-7(b)(5)a (2011 Repl.), and a hearing was conducted on July 20, 2012.

ANALYSIS

The primary issue for analysis is whether the taxpayer's activities within Alabama taxing jurisdictions are sufficient to constitute "doing business" within those jurisdictions to warrant the imposition of municipal business license taxes under Alabama and federal law.

On final assessment appeal, the taxpayer contends that it is irrelevant whether their activities and physical presence in Alabama represent a substantial nexus for sales and use tax purposes under the Commerce Clause because such activities would still fail to attain the heightened standard of whether the taxpayer is in fact "doing business" within the municipalities under Alabama law. *See* Taxpayer's Supplement to Notice of Appeal, July 19, 2012, p. 2. The examiner determined that the taxpayer established nexus in Alabama under the Supreme Court of United States' decision in *Scripto v. Carson*, 362 U.S. 207 (1960), concluding that the independent organizational associates operating within the State were representative of a sales force presence within Alabama jurisdictions sufficient to establish a substantial, physical-presence, nexus supporting the imposition of local business license taxes.

It is first necessary to distinguish between the concepts of "nexus" and "doing business." "Nexus" is a constitutional-based concept that serves as a prerequisite as to whether a state has the authority to tax a foreign entity. The application of taxing statutes to foreign entities relies upon two fundamentally different standards under the Due Process and Commerce Clauses which reflect different constitutional concerns. Due Process centrally concerns the fundamental fairness of government activity and the elements of "notice" and "fair warning" of a State's ability to exercise power over a foreign entity. *Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992). In contrast, the Commerce Clause and its nexus requirements are centered not so much by concerns about fairness for the individual as by structural concerns about the effects of State regulation on the national economy. *Id.* The Due Process Clause "requires some definite link,

some minimal connection, between the state and the person, property or transaction it seeks to tax," *Miller Brothers v. Maryland*, 347 U.S. 340, 344 (1954), and that the "income attributed to the State for tax purposes must be rationally related to the values connected with the taxing State" *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978). The Commerce Clause requires a "substantial nexus," fair apportionment, non-discrimination, and a relationship between the tax and State-provided services, *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), to limit the reach of State taxing authority so as to ensure that State taxation does not unduly burden interstate commerce. Thus, the "substantial nexus" requirement is not, like due process "minimum contacts" requirement, a proxy for notice, but rather a means for limiting State burdens on interstate commerce." *Quill*, 504 U.S. at 313. Accordingly, a foreign taxpayer may have the "minimum contacts" with a taxing State as required by the Due Process Clause, and yet lack the "substantial nexus" with that State as required by the Commerce Clause.

On the other hand, "doing business" in Alabama is a practical question of whether an entity is exercising or engaging in any of the functions, powers, or primary business activities for which it was created within the State's boundaries. *State v. Anniston Rolling Mills*, 27 So. 921 (Ala. 1900). The amount of the business done is immaterial to the concept, *Rhode Island Hospital Trust Co. v. Rhodes*, 91 A. 50 (R.I. 1914), however, an entity engaging in an activity which is "merely incidental" to its primary functions is not doing business for tax purposes in Alabama. *State v. City Store Co.*, 171 So.2d 121, 123 (Ala. 1965). Consequently, a substantial nexus is not required to constitute "doing business" within a taxing jurisdiction, but is necessarily required to subject a foreign entity's interstate activities to local taxation. However, the Supreme Court in *Quill* did not attempt to equate the substantial nexus requirement with a universal "bright-line, physical-presence requirement" for State taxation under the Commerce Clause. 504 U.S. at 316. A careful reading of *Quill* reflects the express limitation for sales and use taxes as a matter of *stare decisis* in light of *National Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 504 U.S. 753 (U.S. 1967), even though the *Bellas Hess* rule appears artificial at its edges. *Quill*, 504 U.S. at 315.[1]

All municipal business licenses in Alabama are governed by the Municipal Business License Reform Act of 2006 ("MBLRA"). Act. No. 2006-586, Ala. Acts 2006; ALA. CODE § 11-51-90 *et seq.* The MBLRA grants all municipalities the authority "[t]o license any exhibition, trade, business, vocation, occupation, or profession not prohibited by the Constitution or laws of the state which may be in engaged in or carried on *in the municipality*." ALA. CODE § 11-51-90(a)(1) (emphasis added). The term "business" is defined by the MBLRA as "[a]ny commercial or industrial activity or any enterprise, trade, profession, occupation, or livelihood, including the lease or rental of residential or nonresidential real estate, whether or not carried on for gain or profit, and whether or not engaged in as a principal or as an independent contractor, which is *engaged in, or caused to be engaged in, within a municipality*." ALA. CODE § 11-51-90.1(1) (emphasis added). The broad language of the MBLRA manifests a clear intent to reach foreign corporations engaged in business activities within the municipalities to the full extent that is

[1] "[W]e have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes." *Quill*, 504 U.S. at 314. "Although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes." *Quill*, 504 U.S. at 317.

constitutionally permissible. Clearly, the taxpayer's direct sales activities in Alabama constitute a primary function for which the entity was created, and in fact, represent the primary activity for which it exists, and therefore, amount to "doing business" in Alabama taxing jurisdictions. This leaves only the question of whether the taxpayer has substantial nexus within such jurisdictions to subject it to their taxing authority.

The taxpayer relies upon several historic Alabama cases to support the contention that they lack the substantial nexus in Alabama for license tax purposes. The taxpayer cites *Family Discount Stamp Co. of Georgia v. State*, 148 So.2d 218 (Ala. 1963) for the proposition that "solicitation of orders and subsequent delivery of the products ordered are not sufficient nexus with Alabama to subject the company" to a license tax. The taxpayer in *Family Discount* was a foreign corporation with no office, warehouse, redemption center or establishment of any kind in Alabama which took orders for stamps through servicemen who transmitted the same to the home office in Georgia whereupon approval they were picked up and delivered by said servicemen into Alabama. *Id.* at 219. Admittedly, the result in that case does represent that position, however, the Alabama Supreme Court premised its decision upon the then valid precedent of *Robbins v. Shelby County Taxing District*, 120 U.S. 489 (1887) and *Breard v. City of Alexandria*, 341 U.S. 622 (1951), which held that fixed sum license taxes upon solicitors in interstate commercial transactions amounted to an unconstitutional and undue burden on interstate commerce. *Family Discount*, 148 So.2d at 220. The Commerce Clause construction in that line of cases later fell out of favor, see *Western Livestock v. Bureau of Revenue*, 303 U.S. 250 (1938) ("It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business."), and were expressly overturned in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. at 288-289. (holding that a state tax on the "privilege of doing business" is not unconstitutional when applied to interstate commerce). Therefore, the Alabama Supreme Court decision holds little weight today in light of the disavowed precedent on which it was premised. On the contrary, current Commerce Clause analysis requires only minimum connections, without physical-presence, to constitute substantial nexus with the forum and subject a foreign taxpayer to local taxes other than sales and use. See, e.g., *Prince v. State Dep't of Revenue*, 55 So.3d 273, 284-285 (Ala. Civ. App. 2010), cert. denied, *Ex Parte Prince*, 55 So.3d 287 (Ala. 2010) ; *Joe E. Lanzi, III v. State Dep't of Revenue*, Admin. Law Div., Dkt. No. INC. 02-721 (Sept. 26, 2003).[2]

Another compelling Alabama Supreme Court decision cited by the taxpayer is *State v. West Point Wholesale Grocery Co.*, 223 So.2d 269 (Ala. 1969), which also holds that the presence of soliciting agents and subsequent delivery via common carrier or corporate vehicles is insufficient to establish substantial nexus. However, the *West Point Wholesale* decision carries with it the same disavowed line of precedent as *Family Discount*, which was cited as the controlling case on which the Court's decision was grounded. 223 So.2d at 271-272. Moreover, both decisions were made well before the Alabama legislature's enactment of the MBLRA in 2006, which indirectly overturns the premise relied upon in both cases that solicitation of orders and subsequent delivery of merchandise by employees or agents, absent any other physical-presence within the jurisdiction, does not form a sufficient nexus to subject them to municipal

[2] See also *Geoffrey, Inc. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993), cert. denied, 510 U.S. 992 (1993); *KFC Corp. v. Iowa Dep't of Revenue*, 792 N.W.2d 308 (Iowa 2010), cert. denied, 132 S.Ct. 97 (2011); *Lanco, Inc. v. Dir., Div. of Taxation*, 908 A.2d 176 (N.J. 2006), cert. denied, 551 U.S. 1131 (2007).

exaction under the Commerce Clause. The MBLRA authorizes municipalities in Alabama to impose a license tax for the "limited privilege of delivering and requisite set-up and installation, by the taxpayer's employees or agents, of the taxpayer's own merchandise in that municipality, by means of delivery vehicles owned, leased, or contracted by the taxpayer" upon "any business that has no other physical presence within the municipality or its police jurisdiction." ALA. CODE § 11-51-194(a) & (b). Through the enactment and subsequent codification of the MBLRA, the Alabama legislature essentially overturned the precedent relied upon by the taxpayer in the previously cited cases that such activities do not establish substantial nexus under the Commerce Clause, and every judicial presumption is in favor of the constitutionality of an act of the legislature. *Rogers v. City of Mobile*, 169 So.2d 282 (Ala. 1964); *Miller v. Marshall County Bd. of Educ.*, 652 So.2d 759 (Ala. 1995).

Indeed, the Commerce Clause substantial nexus standards set forth in *Family Discount* & *West Point Wholesale* also contradict current Alabama precedent regarding sales and use taxes, which require the heightened "bright-line, physical presence requirement" for substantial nexus established in *Quill* & *Bellas Hess*. Under current Alabama law, the presence of soliciting agents and subsequent delivery of merchandise, even via common carrier, forms a substantial nexus with the State of Alabama, and any political subdivision within, imposing upon the seller a duty to collect and remit seller's use taxes on such sales. *Yelverton's Inc. v. Jefferson County*, 742 So.2d 1216 (Ala. Civ. App. 1997), aff'd, *Ex parte Jefferson County*, 742 So.2d 1224 (Ala. 1999); ALA. ADMIN. CODE r. 810-6-3-.51(2) (2012). Accordingly, the presence of soliciting agents coupled with the delivery of merchandise within an Alabama municipality would certainly establish sufficient nexus with a foreign taxpayer for purposes of a license tax for the privilege of "doing business" therein.

The taxpayer also argues under the purview of *State v. McFadden- Bartell Corp.*, 194 So.2d 543 (Ala. 1967) that the taxpayer's representatives in question cannot form the requisite nexus with Alabama because they are operating as independent businesses rather than under any legal relationship with the taxpayer. Notwithstanding that *McFadden-Bartell* dealt with use tax, that case is clearly distinguishable by the taxpayer's own acknowledgement that their associates receive compensation in the form of commissions. *See* Taxpayer's Supplement to Notice of Appeal, July 19, 2012, p. 5. In the absence of any form of commission or remuneration in *McFadden-Bartell*, 194 So.2d at 547, the Court distinguished the situation from that in *Scripto* and determined that the business was making purchases at wholesale, reselling the merchandise and, in effect, operating its own business. *Id.* at 548. The Alabama Supreme Court later illuminated this distinguishing element in *Ex Parte Newbern*, in which they held that nexus of a foreign corporation was constitutionally sufficient to support liability of such corporation to collect use tax on sales in Alabama where orders were received by salesmen receiving commissions and operating within Alabama, regardless whether the salesmen were designated as independent, self-employed, or without "legal relationship" to the taxpayer. 239 So.2d 792, 796 (Ala. 1970).

The organizational associates of the taxpayer's sales network represent the taxpayer daily and act in its interest which is necessary for the maintenance of a market in Alabama for sales. They develop long-established and valuable relationships with their customers which results in maintaining and improving the name recognition, market share, goodwill, and relations within

the forum in Alabama. The fact that the associates are independent and do not have actual contracts or territories under their sales membership is an irrelevant distinction that bears no constitutional significance. *Scripto*, 362 U.S. at 211. The associates regularly receive compensation from the taxpayer in the form of commissions based upon the relative volume of their sales. The showing of a sufficient nexus also cannot be defeated by the argument that the taxpayers' associates are properly characterized as independents rather than agents, because the tagging of the salespersons neither results in changing their local function of solicitation nor bears upon their effectiveness of securing a substantial flow of goods into the foreign State. *Id.* Rather, it is the nature and extent of the business related activities conducted by the soliciting agents representing the foreign taxpayer that is determinative for nexus. *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232, 250-251 (1987). Therefore, as a practical matter, it is irrelevant that the taxpayers in the instant case do not have actual "employees" within the state, because their commissioned sales force acting as agents on their behalf and securing and maintaining a systematic flow of interests into the market is sufficient to establish a substantial nexus in Alabama for Commerce Clause purposes. *Ex Parte Newbern*, 239 So.2d at 796.

Nonetheless, in this instance, whether the taxpayer's organizational associates form the requisite nexus under the Commerce Clause to support the exaction of municipal business licenses is overshadowed by the lack of evidentiary support to the auditor's determination that such associates were in fact conducting business *within* the relative municipalities as is required under the statute. ALA. CODE § 11-51-90(a)(1). The taxpayer's counsel properly asserts that the auditor was never provided with any information pertaining to the precise locations in which sales associates were operating. The independent nature of the sales associates, their ability to establish and make sales through a company replicated website, and the mobile nature of the sales industry in general would make it nearly impossible for the taxpayer to consistently track when and where the sales associates are physically operating.

Statutes must be read in context, and should be given a sensible and practical construction, and when a strict, literal reading would defeat the purpose of the statute, or lead to absurd consequences, that interpretation should not be adopted if any other reasonable construction can be given to it. *Sizemore* v. *Franco Dist. Co., Inc.*, 594 So.2d 143, 147 (Ala. Civ. App. 1991). Further, when construing statutes of this character, one must resort to the well-established rule that taxing statutes should be read with favor indulged to the taxpayer, and against the taxing authority, and that license statutes must be confined to the strict letter of their language and their application cannot be enlarged by implication or inference. *State v. Dr. Pepper Bottling Co.*, 155 So. 92, 93 (Ala. Civ. App. 1934).

In this instance, the auditor inferred that the taxpayer had organizational associates physically present in the jurisdictions in which the taxpayer had historically reported sales taxes. No further evidence existed to support the fact that the associates were in fact operating within the municipalities in a manner which would represent the taxpayer and increase its business activities. To broaden the MBLRA to a degree that would require a foreign taxpayer, whose only other contacts with the State consist of shipments of merchandise via common carrier, to monitor the physical presence of independent sales representatives to determine whether their activities are reaching municipalities within a State so as to amount to a sufficient nexus subjecting them

to a license tax for conducting business within each municipality would be a harsh, unduly burdensome, and impractical result which would not likely represent the intent of the legislature. *State Dep't of Revenue v. A-1 Bonding Co. of Montgomery, Inc.*, Admin. Law Div., Dkt. No. L. 85-167, *5 (Aug. 28, 1986). Indeed, the MBLRA expressly prohibits taxing jurisdictions from assessing business license taxes against taxpayers who merely deliver merchandise via common carrier. ALA. CODE § 11-51-194(b). Accordingly, the final assessments entered against the taxpayer are due to be dismissed.

Entered this 31st day of August, 2012

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Jonathan V. Gerth
Administrative Law Judge, RDS

cc. Bruce P. Ely, Esq.
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