



MULTISTATE INDIRECT TAX

Oregon Tax Court decides nexus challenge to Tobacco Products Tax Tax Alert

Overview

In an appeal regarding issues for summary judgment, the Regular Division of the Oregon Tax Court heard constitutional and statutory challenges regarding Oregon's Tobacco Products Tax ("TPT") on products other than cigarettes.¹ The Oregon Tax Court granted partial motions for summary judgment filed by the Oregon Department of Revenue ("Department") and Global Hookah Distributors, Inc. ("Taxpayer").

This Tax Alert summarizes the Oregon Tax Court's decision.²

Oregon Tax Court reviews assessments of Oregon's Tobacco Products Tax on products other than cigarettes

Background facts

Taxpayer, a North Carolina corporation, buys and sells shisha and non-tobacco products. Taxpayer conducts all of its business operations in North Carolina and ships its products via common carrier or U.S. mail from North Carolina to customers worldwide. Taxpayer holds an Oregon distributor license and is registered as a foreign corporation with the Oregon Secretary of State. During calendar years 2008 and 2009, Taxpayer had approximately \$10,000 in gross sales and fewer than 20 invoiced transactions in Oregon; Taxpayer's Oregon sales volume increased in later years.

Procedural history

The tax periods at issue are the 16 quarters ending December 31, 2008, and June 30, 2009, through December 31, 2012. In these cross-motions for summary judgment, the Oregon Tax Court analyzed multiple issues but this Alert focuses on the constitutional question: Does the Commerce Clause of the United States Constitution prevent the Department from subjecting Taxpayer to the TPT for some, if not all, of the periods at issue?

Does the Commerce Clause prohibit Oregon from imposing the TPT on the Taxpayer?

Taxpayer argued that its activities lacked a substantial nexus with Oregon due to a lack of physical presence, the TPT is not fairly related to the services Oregon provides to Taxpayer, and the TPT unduly burdens interstate commerce in contravention of the Commerce Clause. The Oregon Tax Court began by looking at the substantial nexus issue, turning to *South Dakota v. Wayfair, Inc.* (“*Wayfair*”). Because the dispute at issue involves tax years prior to the *Wayfair* decision, the Oregon Tax Court considered whether *Wayfair* applied retroactively. The Oregon Tax Court determined that *Wayfair* applied retroactively to Taxpayer’s facts because the United States Supreme Court (“Supreme Court”) declared “a general rule that the Court’s holdings apply with retroactive effect in other cases.”

The Oregon Tax Court then considered whether the physical presence requirement under *Quill* and *Bellas Hess* applied for TPT purposes. The Oregon Tax Court noted that both *Quill* and *Bellas Hess* were use tax cases, and the Supreme Court has not extended the physical presence requirement to other tax types. Therefore, the Oregon Tax Court analyzed whether the TPT imposed undue burdens and whether an assessment would upend settled expectations.

The Oregon Tax Court found that, unlike a sales and use tax law, the TPT does not require distributors to collect the tax from customers, hold the tax in trust, and remit the collected tax in a short period of time. Furthermore, the TPT Act does not subject taxpayers to multiple local regimes with varying compliance obligations within the state. Additionally, the Oregon Tax Court found that Taxpayer provided no evidence that Taxpayer or other distributors expected the TPT to apply only if they established a physical presence in the state. The evidence demonstrated that, despite a lack of physical presence in Oregon, Taxpayer had complied with the TPT Act since its first sale to Oregon customers and had successfully grown its sales in Oregon. As a result, the Oregon Tax Court determined that “pre-*Wayfair* law did not require a taxpayer to have a physical presence in Oregon as a prerequisite to imposition of the TPT.”

Substantial nexus

The Oregon Tax Court started its substantial nexus analysis with a discussion of the three levels of connection presented in *Wayfair*: (1) sufficient nexus; (2) minimum connection under the Due Process Clause; and (3) substantial nexus. The sufficient nexus standard states that “an activity must have a ‘sufficient’ nexus with the state to allow that state to treat the activity in the same manner as if the seller were an in-state taxpayer.” Examples of sufficient nexus include the sales of services and goods delivered within the state. The Oregon Tax Court found that Taxpayer had sufficient nexus with Oregon because of its activities in the state.

In analyzing whether Taxpayer had substantial nexus with Oregon, the Oregon Tax Court looked at *Wayfair*’s holding that South Dakota’s economic nexus threshold represented a “‘considerable’ amount of business in the state, and that none of the taxpayers could have achieved that quantity of business without ‘avail[ing] itself of the substantial privilege of carrying on business’ in the state.” Applying the *Wayfair* substantial nexus standard, the Oregon Tax Court noted that “[a] taxpayer’s ‘avail[ing] itself’ of the substantial privilege of ‘carrying on’ business in a state implies intentionality and continuity.” The Oregon Tax Court found that Taxpayer satisfied both elements. Taxpayer knew that it was selling shisha to customers in Oregon. After Taxpayer began selling its products into Oregon, it did so on a regular basis during all of the tax periods at issue. The Oregon Tax Court held that “Taxpayer availed itself of the substantial privilege of carrying on business in Oregon in all of the periods at issue.”

The Oregon Tax Court also applied a Due Process Clause analysis as a means of testing for a different result “that might indicate a flaw in the Commerce Clause reasoning.” In applying the Due Process principles, the Oregon Tax Court found that Taxpayer’s activities satisfied purposeful availment and minimum contacts. Taxpayer regularly sold and shipped its shisha to Oregon customers. Over time, Taxpayer gained more Oregon customers and had greater dollar amounts of sales in Oregon. The Oregon Tax Court rejected the Department’s waiver argument that when Taxpayer registered as a distributor of tobacco products in Oregon, Taxpayer waived any defense based on a lack of nexus with Oregon.

Fairly related to services Taxpayer received from Oregon

Taxpayer also argued that the TPT was not fairly related to the services it received from the state because the burden on distributors with a small amount of business in the state would be disproportionately high compared to the benefits the distributors would gain from Oregon services. The Department argued that the TPT was fairly related because the TPT is measured as a percentage of the wholesale sales price only for the tobacco products that enter the state. The Oregon Tax Court agreed with the Department.

The Oregon Tax Court also conducted a *Pike* balancing analysis, finding that the burdens imposed by the TPT were no heavier than those in the South Dakota tax issue in *Wayfair*. Furthermore, “[t]he benefits to Oregon from the TPT are manifest and are qualitatively at least as significant as the benefits to South Dakota from its tax.” Notably, the TPT raises more than \$30 million annually and around half of the revenue is dedicated to health improvement programs in Oregon. Also, while there is no software available related to the TPT and there exists a lack of published guidance for determining the price paid for untaxed tobacco products, the Oregon Tax Court found that the burdens on out-of-state distributors were not clearly excessive in relation to the state benefits.

Thus, the Oregon Tax Court granted the Department’s motion for summary judgment on the constitutional issue that Taxpayer has substantial nexus with the state and denied Taxpayer’s motion for summary judgment.

Considerations

It remains to be seen whether the constitutional/nexus analysis in the Oregon Tax Court’s decision will be applied to other Oregon taxes besides the TPT. The Oregon Tax Court found that nexus with Oregon was established in tax years where the Taxpayer’s annual activity in Oregon was lower in terms of annual sales and total transactions than the Supreme Court considered in *Wayfair*. The Oregon Corporate Activity Tax (“CAT”), however, applies tests measured by annual gross receipts that are far in excess of the annual sales at issue in this decision (e.g., CAT registration threshold is \$750,000 of Oregon-sourced commercial activity; taxpayers with less than \$1 million of Oregon-sourced commercial activity do not need to file CAT return, etc.), and this nexus decision does not appear to have any impact on the CAT thresholds that have been established by Oregon statute – a taxpayer may have nexus with Oregon under this decision of the Oregon Tax Court but still not have a registration or tax return filing requirement under the Oregon CAT.³

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Footnotes

¹*Global Hookah Distributors, Inc. v. Dep't of Revenue*, T.C. 5272, Or. T.C. (2021), <https://cdm17027.contentdm.oclc.org/digital/collection/p17027coll6/id/8390/rec/1>.

² The statutory challenge regarding whether the wholesale sales price of the tobacco products sold to Oregon customers includes certain charges is outside of the scope of this Alert.

³ Or. Rev. Stat. §§ 317A.131, 317A.137.

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