State’s Failed Attempt to Tax a Nonresident Limited Partner: Lanzi v. Alabama Department of Revenue

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Department of Revenue

I. Introduction

Analysis of a state’s taxing jurisdiction must begin with Quill Corporation v. North Dakota. In Quill, the Supreme Court for the first time established parameters for the interplay between the Due Process and Commerce Clauses of the United States Constitution. This interplay has become increasingly important as state revenue authorities attempt to maintain state revenues through assertions of “long-arm” taxing jurisdiction over “nonresidents.” The issues are particularly exacerbated when pass-through entities are involved.

In Lanzi v. Alabama Department of Revenue, the Alabama Court of Civil Appeals held that Alabama lacked due process nexus to tax a Georgia resident on his pro rata share of income from an Alabama limited partnership. The position taken in this article is that the Lanzi

2 U.S. Const. art. I, §8, cl. 3; U.S. Const. amend. XIV, §1; Quill: Id., 504 U.S. at 305 (stating: “As in a number of other cases involving the application of state taxing statutes to out-of-state sellers, our holding in Bellas Hess relied on both the Due Process Clause and the Commerce Clause. Although the “two claims are closely related,”” Bellas Hess, 386 U.S., at 756, 87 S.Ct., at 1391, the Clauses pose distinct limits on the taxing powers of the States. Accordingly, while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause. See, e.g., Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987).”
5 Id.
decision correctly analyzed and applied Quill’s Constitutional principles to an area of tax law greatly in need of clarification. 6

In dealing with jurisdiction over pass-through entities and/or their owners, Constitutional “nexus”7 issues dealing with legal persons have become improperly confused with tax law fictions.8 Entity law, not tax laws, should control these Constitutional issues. "Conflict exists in the area of nonresident partner taxation because of the manner in which partnership law is interpreted and applied to state income tax laws. A question that was raised in Lanzi (and has similarly been raised in various other state and federal tax cases) is whether a partnership is treated as an entity separate from its owners, or is simply an aggregation of the partners with no separate identity.”9

Quill and its precedent are the initial focal point of this article. The article then summarizes due process and commerce clause principles and issues proscribing state taxation of nonresidents. Thereafter, having briefly stated the simple and undisputed facts of the Lanzi case, this article discusses conflicting state and federal due process tax opinions issued in recent years following Quill. The impact of Lanzi’s holding on outstanding issues is thereafter projected.

Lanzi held that Alabama lacked jurisdiction to tax a Georgia resident solely on the basis of his limited partnership interest in an Alabama limited partnership. The Lanzi ruling10 supported the more traditional view of due process proscriptions found in federal decisions,11 and

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6 The key issue in Lanzi was the due process nexus necessary to allow a state to tax an out of state limited partner on income of a limited partnership which was present within the state. [Clearly, Lanzi held that mere ownership of a limited partnership interest was not enough.] Similar troublesome issues include other tax flow-through entities such as trusts, S corporations, LLC’s, etc., and whether the entity’s nexus with a forum state flows through to its owners and/or vice versa. See e.g. infra Note Error! Bookmark not defined. and accompanying text. Tax fictions should not control Constitutional rights and processes.

7 Quill, infra, Notes 2725 and 3643, Due Process “minimum nexus” and Commerce Clause “substantial nexus.”

8 Gotlinger and Mahon, supra, Note 3.

9 Lanzi, 2006 WL 1793221 at *1-5.

10 Lanzi, 2006 WL 1793221 at *1-5.

11 See infra notes 11-15.
abandoned the more expansive trend found in certain recent state court decisions. In doing so, Lanzi based its Constitutional analysis on state entity law, not on federal income tax fictions. It is the conclusion of this article that Lanzi was correctly decided, particularly in the Alabama Administrative Law Judges’ opinion, did carefully and properly analyze the due process and commerce clause nexus issues were soundly based on state entity law establishing “legal persons” rather than on ever-changing income tax fictions, e.g. entity vs. aggregate partnership theories.

II. Taxing Jurisdiction and the Constitution: A Brief Overview.

AA. Applicable Due Process Precedent


12 See infra, e.g., note 83.
14 Blumberg, THE CORPORATE ENTITY IN AN ERA OF MULTINATIONAL CORPORATIONS, Delaware Journal of Corporate Law 1990. “The commentaries assume the existence of the corporation as a separate juridical unit, recognized by the law with those fundamental attributes identified centuries ago by Coke, [FN2] Kyd, [FN3] and Blackstone [FN4]: the capacity to sue and be sued, to hold and to transfer property, to have a term of existence, typically perpetual [FN5] all separate from the individuals or others who might own its shares from time to time.”
15 “The legal power and authority of a court to hale a person into its adjudicative process, to declare the rights of that person, and to grant relief.” BLACK’S LAW DICTIONARY 840 (8th ed. 2004).
16 Pennoyer v. Neff, 95 U.S. 714, at 720 (1877) (holding that a state could not assert personal jurisdiction beyond its territorial limits).
17 Int’l Shoe Co. v. Washington, 326 U.S. 310, at 316 (holding that personal jurisdiction requires “certain minimum contacts with [the forum state] such that the maintenance of the suit does not offend ‘traditional notions of fair play and substantial justice’”) (emphasis added).
18 Hanson v. Denckla, 357 U.S. 235, at 253 (1958) (holding that for personal jurisdiction to be proper, “the defendant [must] purposefully avail[s] itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws”) (emphasis added).

**Quill.** Quill has been dissected in many scholarly articles. Part of Quill’s importance lies in the Supreme Court’s reaffirmation of precedents established in earlier decisions such as Shaffer v. Heitner and Hanson v. Denckla. Quill’s importance also lies in its limitation of the applicability of certain precedent, particularly the “presence” requirement of National Bellas Hess, Inc. v. Department of Revenue of Ill.

Quill Corporation conducted a national mail order business. Quill was not organized in North Dakota and had no physical presence in the state, but did, however, send its catalogues and make sales of its products into North Dakota.

Addressing North Dakota’s ability to tax Quill’s North Dakota activities the Court reaffirmed applicability of International Shoe, stating “we have framed the relevant inquiry as

19 Shaffer v. Heitner, 433 U.S. 186, at 207-12 (1977) (holding that in rem jurisdiction must meet the same “minimum contacts” test of International Shoe to justify jurisdiction over interest of persons in a thing; the presence of property in a jurisdiction does not alone provide personal jurisdiction over its owner).
20 World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, at 298 & 292 (1980) (holding that “personal jurisdiction over a corporation that delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum state” is appropriate if it would be fair to assert jurisdiction according to the following factors: “the burden on the defendant . . . the plaintiff’s interest in obtaining convenient and effective relief . . . the interstate judicial system’s interest in obtaining the most efficient resolution of the controversies . . . and the shared interest of the several States in furthering fundamental substantive social policies”) (citations omitted).
21 Burger King v. Rudzewicz, 471 U.S. 462, at 475 (1985) (“This ‘purposeful availment’ requirement ensures that a defendant will not be haled into a jurisdiction solely as a result of ‘random,’ ‘fortuitous,’ or ‘attenuated’ contacts, or of the ‘unilateral activity of another party or a third person’”) (emphasis added) (citations omitted).
26 Id.
whether a defendant had minimum contacts with the jurisdiction ‘such that the maintenance of
the suit does not offend traditional notions of fair play and substantial justice.’” 27 “Minimum
contacts” and “fair play” clearly reflect the notice requirements inherent in Due Process.

In *Shaffer* the Supreme Court further held that for Due Process, the Defendant’s
minimum contacts with the forum state must necessarily be related to the subject matter at
issue. 28 Thus “minimum contacts” and their “necessary relationship” became a two part test for
Due Process.

**Quill and “physical presence”**. The Supreme Court held in Quill that due process could
be satisfied even if a taxpayer had no physical presence within the taxing state. 29 The Court held
that presence was not required to justify “the imposition of the collection duty on a mail-order
house that is engaged in continuous and widespread solicitation of business within a State. Such
a corporation clearly has ‘fair warning that [its] activity may subject [it] to the jurisdiction of a
foreign sovereign.’” 30 Thus, North Dakota’s sales/use tax levy was held to satisfy the Court’s due
process standard of “fair play and substantial justice” as applied to a nonresident with no
physical presence within the taxing state. Citing *Burger King Corp. v. Rudzewicz*, 31 the Quill
Court stated, “So long as a *commercial actor’s* 32 efforts are ‘purposefully directed’ toward
residents of another State, we have consistently rejected the notion that an absence of physical
contacts can defeat personal jurisdiction there.” 33

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27 *Quill*, 504 U.S. at 307 (quoting *Int’l Shoe Co. v. Wash.*, 326 U.S. at 316-317 (1945)).
28 See infra, Note 48 and accompanying text.
31 *Burger King Corp. v. Rudzewicz*, 471 U.S. 462.
32 *(emphasis added).*
33 *Quill*, 504 U.S. at 308. *Id.* at 476, 105 S.Ct. at 2184 (emphasis in original). Clearly, “physical presence” was not a determinative factor in satisfying requirements of due process.
**Quill and the Commerce Clause.** The Court then analyzed possible negative impact on interstate commerce from North Dakota’s taxation of a nonresident corporation with no physical presence in North Dakota.\(^{34}\) Ultimately, the Court held that it would apply the four-part test which it first established in Complete Auto Transit, Inc. v. Brady\(^ {35}\) in analyzing the negative sweep of the Commerce Clause.\(^ {36}\) The Court stated: “Under Complete Auto's four-part test, we will sustain a tax against a Commerce Clause challenge so long as the ‘tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.’”\(^ {37}\)

Substantial Nexus. Just as with the Due Process Clause, the Commerce Clause requires a nexus between the taxpayer—"commercial actor"—and the taxing state.\(^ {38}\) The Supreme Court has ruled that to satisfy the Commerce Clause, there must be “substantial nexus”,\(^ {39}\) not mere “minimal nexus.”\(^ {40}\) This test requires analysis to determine what person’s, i.e. commercial actor’s, contacts must be assessed for Constitutional purposes. For example, substantial nexus in the Lanzi administrative law judge’s opinion was clearly established by Quad-L limited

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\(^{34}\) Again, this analysis was being applied to the allocable, i.e. North Dakota source, sales of a nonresident.


\(^{36}\) Quill, 504 U.S. at 310. (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)). See infra, Note 153 et seq and accompanying text.

\(^{37}\) Id. at 311. (citation omitted).

\(^{38}\) Id.

\(^{39}\) Quill, 504 U.S., at 312. “Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. **The two standards are animated by different Constitutional concerns and policies.**” (emphasis added). Also, see infra Note 4740.

\(^{40}\) Id.
partnership, the commercial actor, but not No nexus, however, was established by the limited partner, Lanzi, a separate person who only participated in the formation of Quad-L.

Fair Apportionment. Fair apportionment of the tax and/or taxable income among all states involved in the taxed activity’s production of income is also required under the Commerce Clause.

Discrimination Against Interstate Commerce. Discrimination has many faces. In Shaffer, the Supreme Court pointed specifically to the “risk” of multiple taxations. In Quill, the Supreme Court focused on the compliance burden which would be imposed on interstate commerce as a result of the innumerable, nonconforming sales and use tax obligations imposed by cities, counties, and states throughout the country.

To determine discriminatory “risk” of multiple taxations one must examine “the practical effect of the challenged tax.” “[T]he Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.”

41 Quad-L was formed under the laws of the State of Alabama. Quad-L, under Alabama law, is a separate legal entity which owns its intangible investment property and its related taxable income is thereby deemed to be located and sourced in Alabama. Also, Quad-L’s general partner-agent/managers were domiciled in Alabama.

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43 See e.g., City of Winchester v. American Woodmark Corp., 252 Va. 98, 471 S.E.2d 495 (1996) (assessment on 100% of multi-state corporation’s gross receipts was struck down because not fairly apportioned). See also Oklahoma Tax Commn. v. Jefferson Lines, 574 U.S. 175 (1995) and Blackburn, supra, Note 1, at__.

44 Shaffer v. Heitner, 433 U.S. 186, 218 (1977) (citations omitted). The Supreme Court noted in Shaffer that it had “adopted a ‘multiple-taxation doctrine’ that focused . . . on whether a tax subjected interstate commerce to a risk of multiple taxation.” (emphasis added)

45 Quill, 504 US at 313 n. 6.

46 Id., at 303-304.

47 Id., at 312 (emphasis added). See Note 3943.
Taxpayer-Commercial actors contacts must be related to services provided by the state. Again, in Shaffer, it was clear that general benefits provided through application of a state’s laws to an issue, did not give the state jurisdiction over the parties associated with such issue. 48

Shaffer held there must be a “necessary relationship” between the subject of the litigation and the Defendants' due process contact with the forum state. 49 As restated in Quill, “... the income attributed to the State for tax purposes must be rationally related to values connected with the taxing state.” 50

This Due Process “necessary relationship” between the minimum contacts and the matter at issue also became the fourth element of in the Commerce Clause requirement.

Some state court decisions have mistakenly treated state provided values’ “rational connection” with a taxpayer’s-commercial actor’s activities as establishing due process nexus standing alone. Such an approach fails to consider the essential due process requirement that a taxpayer-commercial actor must initially direct its activities at a state thereby “purposefully availing” itself of the related benefits and protections of the state’s laws. 51 For example, the Appellee’s discredited argument in Shaffer was much the same as Connecticut's in Gavin:

48 Shaffer, infra Note 14, at 215 (“[W]e have rejected the argument that if a State's law can properly be applied to a dispute, its courts necessarily have jurisdiction over the parties to that dispute.”).
49 Id.
51 Id. at 308.
“[Appellee] notes that Delaware law provides substantial benefits to corporate officers and directors, and that [it is] only fair and just to require appellants, in return for these benefits, to respond in the State of Delaware.” [FN235]

But the Court absolutely rejected this general “legal benefits” argument and stated:

“this line of reasoning does not demonstrate that appellants have ‘purposefully availed themselves of the privilege of conducting activities within the forum state.’ Hanson v. Denckla, 357 U.S. 235, at 253 (1958).” [FN236]

Again, the Commerce Clause and Due Process are animated by totally different purposes and concerns.52 Due process is animated by the need to provide fair notice to persons over whom a state attempts to exercise personal jurisdiction.53 The Commerce Clause’s purpose, particularly in its negative sweep,54 is to avoid states’ imposition of undue burdens on interstate commerce.55 Each must be interpreted in the context of these fundamentally different purposes.

“At least in the context of sales/use taxes and the mail order business, the Court did reaffirm the continued applicability of its bright line presence test set forth in National Bellas Hess, Inc. v. Department of Revenue of Ill. as applied to factor [1] of Complete Auto's four-part Commerce Clause test.”56 The Court was also emphatic that the Commerce Clause “substantial

52 Supra, Note 115.
53 Supra, Note 33.
54 Quill, 504 U.S. at 312.
55 Id.
56 Blackburn, supra note 1, at 26. See Quill, 504 U.S. at 317 (stating “[T]he continuing value of a bright-line rule in this area and the doctrine and principles of stare decisis indicate that the Bellas Hess rule remains good law.”). The Bellas Hess test remains good, at least as applied to state sales and use taxes and the mail order business, but the Supreme Court also stated that “the bright-line rule of Bellas Hess furthers the ends of the dormant Commerce Clause.” Quill, 504 U.S. at 314.
nexus” test required more than the due process “minimum contacts” test, stating, “[a] tax may be consistent with due process and yet unduly burden interstate commerce.”

In addition to upholding the principle of *stare decisis*, the *Quill* opinion’s continued application of the “presence” test in the context of state sales and use taxes has a very practical underpinning. As stated in Footnote 6 of the *Quill* opinion:

North Dakota’s use tax illustrates well how a state tax might unduly burden interstate commerce. On its face, North Dakota law imposes a collection duty on every vendor who advertises in the State three times in a single year. Thus, absent the *Bellas Hess* rule, a publisher who included a subscription card in three issues of its magazine, a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation’s 6,000-plus taxing jurisdictions. See *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 759–760, 87 S.Ct. 1389, 1393, 18 L.Ed.2d 505 (1967) (*National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 759–760, 87 S.Ct. 1389, 1393, 18 L.Ed.2d 505 (1967) (noting that the “many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations”) (footnotes omitted); See also Shaviro, An Economic and Political Look at Federalism in Taxation, 90 Mich. L. Rev. 895, 925–926 (1992).

In the context of sales and use taxes, innumerable city, county and state taxing jurisdictions throughout the United States have resulted in an absolute morass of inconsistent tax rates, exemptions from taxation, filing, reporting and payment requirements. Requiring a nonresident with only minimum contacts with a state to comply with such a tax conundrum is indeed an unreasonable encumbrance on interstate commerce.

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57 *Quill*, 504 U.S. at 313, n. 7.
58 The rule of law previously established in *Bellas Hess* requiring “presence.” Id. at 311.
59 Id. at 313, n. 6.
The Court noted that it had “adopted a ‘multiple-taxation doctrine’ that focused . . . on whether . . . a tax subjected interstate commerce to ‘a risk of multiple taxation.’” Both the burden of multiple tax compliance requirements and the added burden of costs of multiple taxes imposed on interstate commerce violate factor [3] of Complete Auto. Since sales and use taxes subject mail order businesses to multiple taxations even within a single state, the Bellas Hess “presence” requirement was retained for the mail order businesses.

Proposed State Remedy - The Streamlined Sales and Use Tax. The principle outstanding issue as to continued Commerce Clause “presence” following Quill is whether the “presence” requirement is limited solely to sales and use taxes applicable to the mail order business. In Lanzi, the administrative law judge’s opinion specifically held that the presence requirement was limited to sales and use taxation in the context of the mail order business.

In a post-Quill attempt to eliminate this Achilles’ heel of sales and use taxes, state revenue departments developed the unifying Streamlined Sales and Use Tax Project. The uniform Streamlined Sales and Use Tax Act was developed and thereafter enacted in many states throughout the United States. The Streamlined Act provided for a single, unified rate of tax,

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60 Quill, 504 U.S. at 309.
61 Supra, Note 37.
62 Id. at 311.
64 Bellas Hess initially developed the presence requirement in the context of the mail order business. Quill restricted it to Commerce Clause analysis. Quill was decided in the context of problems specifically dealing with sales and use tax in the mail order business.
65 See infra, Note 141 and accompanying text.
conformed operative definitions, eliminated exemptions, and unified reporting and filing requirements for each state solely at the state level.

It was the goal of signatories to the Streamlined Sales and Use Tax Act to eliminate burdens on interstate commerce arising from compliance with numerous, diverse filing requirements previously imposed by the 6,000 different taxing jurisdictions. Adoption of the Streamlined Sales and Use Tax among the states has been impressive, though far from uniform. The Supreme Court in Quill clearly pronounced that Congress had both the power and blessings of the Court to enact legislation permitting state sales and use taxes to apply to the interstate mail-order business under whatever conditions Congress thereafter imposed. Since Congress has not acted legislatively to resolve the issue, it seems doubtful that the Supreme Court would change its “presence” requirement for “substantial nexus” as applied to sales and use taxation of the interstate mail-order business.

II. The Lanzi Case.

Facts. Lanzi was an individual resident of Georgia. Lanzi was a limited partner in an Alabama Limited Partnership, Quad-L Limited Partnership. Other than his limited partnership interest in Quad-L, Lanzi “owned no property, conducted no business,” and had no economic

68 Burdensome municipal and county filings were eliminated.
69 Supra, Note 5942.
70 See Note 60 (22 states are now members of the USSUTA).
71 Quill, 504 U.S. at 318.
72 Hereinafter referenced as “Quad-L.”
73 In its Motion for Reconsideration filed with the Alabama Court of Civil Appeals, the ADOR did assert that the taxpayer had, through Quad-L, conducted business in Alabama.
ties to Alabama™ for the years in question, i.e., 1998 and 2000. As a limited partner, Lanzi took no part in management of the partnership.™

Quad-L was initially formed under Alabama’s Uniform Partnership Act in 1995. In 1997, Alabama adopted the Alabama Limited Partnership Act of 1997,™ and these revised statutes applied to Quad-L for the tax years in question, 1998 and 2000.™ Quad-L was a rather typical family limited partnership, the purpose of which was to manage and preserve family assets. Quad-L was managed by the parents, Alabama residents, as general partners. Limited partners included a daughter who resided in Alabama and a son (“Lanzi”) who resided in Georgia.™

The Lanzi Issue. As stated in the Administrative Law Judge’s Opinion, “The issue in this case . . . is whether Alabama has jurisdiction to tax a nonresident whose only connection with Alabama is his limited partnership interest in an Alabama limited partnership.”™

Every state has jurisdiction to tax a nonresident on income derived from property owned or business transacted by the nonresident in the state.™ The Department asserted™ that the Taxpayer™, Lanzi, the taxpayer,™ had nexus with Alabama because the limited partnership, Quad-L, had nexus, i.e. owned property and transacted business in Alabama. In other words, the

75 Id. at *2.
76 See also Ala. Code § 10-9B-101 et. seq. (1975).
77 Lanzi, 2003 WL 22535609 at *2.
78 Id. at *1.
79 Id. at *4.
80 See Shaffer, 433 U.S. at 132-33.
81 “The [Constitutional] test is whether or not the entity earning the income has 'minimum contacts' with Alabama rather than the nonresident partner that is allocated the tax burden of the entity.” (emphasis in original.) Department’s Brief at 16.
Department attributed the Alabama presence and activities of Quad-L, the commercial actor, to Lanzi, the Taxpayer-taxpayer under partnership flow-through tax principles, as the owner of a limited partnership interest.

**Minimum Contacts Attributed from Authorized Agent.** Some states in one context or another have asserted that minimum due process nexus can be applied to a person by proxy, i.e. through mere attribution of minimum contacts to such person from a third party. For example, there is no question that the presence and actions of an authorized agent representing a legal entity inside a state can be attributed to such legal entity as the principal. Likewise, there is no question that a legal entity’s own contacts by its sales staff or independent manufacturers’ representatives, or even its regular catalogue mailings into a state constitute deliberate contacts by such an entity directed at the forum state as required under Quill. Such deliberate contacts constitute “purposeful availment” and clearly satisfy due process “notice” and “fairness” requirements as to such entity.

However, a limited partner of a partnership is not its agent and is prevented from involvement in the partnership’s operations. Furthermore, a partnership is clearly not an agent acting for and on behalf of either its general or limited partners.

82See Gavin infra, Note 95.
83 Individual persons, shareholders and corporations, trustees, partnerships formed under RUPA, limited liability companies, LLC members, REITs, etc., i.e. individuals and entities treated as “legal persons” which can own property.
84 See, however, Burger King Corp., supra, Note 16.
86 Quill, 504 U.S. at 313 n. 6.
87 Infra, Note 100 and accompanying text.
88 Infra, Note 104.
As stated in International Shoe Co., “Since the corporate personality is a fiction . . . it is clear that unlike an individual its ‘presence’ without, as well as within, the state of its origin can be manifested only by activities carried on in its behalf by those who are authorized to act for it. . . . the terms ‘present’ or ‘presence’ are used merely to symbolize those activities of the corporation’s agent within the state which courts will deem to be sufficient to satisfy the demands of due process.”

General partners can act for and on behalf of and bind a general partnership which exists under state law as a separate legal entity. If, however, under applicable state law a partnership is not a “legal person”, then the actions of general partners are actions by and on behalf of themselves and other partners individually.  

**Nexus by Attribution of Commercial Actions of an Unauthorized Third Party Proxy?**

Clearly, legal entities’ actions “purposefully directed” at a forum state can be taken by authorized employees and independent contractors. Such “purposefully directed” commercial actions give rise to “fair notice,” the essential element of due process. However, unauthorized commercial actions of third parties who are not under the direction and control of a separate and distinct legal entity cannot have been “purposefully directed” actions of the entity nor give rise to “fair notice” to such entity.

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89 International Shoe Co., 310 U.S. at 316-17.
90 Walter Hellerstein, State Taxation, 3rd edition, ¶ 20.08[2] (“The theory underlying the state’s power to tax nonresident partners is that a partnership is an aggregation of individual partners rather than an entity separate and distinct from their owners as in the case of corporations.”)
91 Quill, 504 U.S. at 306.
92 See Scripto, Inc. v. Carson, 362 U.S. 207, 211 (U.S. 1960) (finding the title of independent contractor is without constitutional distinction and their activities warrant imputation of minimum contacts)
93 Quill, 504 U.S. at 312.
94 Burger King Corp., 471 U.S. at 475 (stating that “purposeful availment” excludes “the ‘unilateral activity of another party or a third person’”)
Nevertheless, certain state courts have asserted that unauthorized contacts of a third party commercial actor not under the direction and control of an entity or person can be attributed to the separate and distinct legal entity or such other person to establish “nexus” from such an unauthorized third party for purposes of establishing due process minimum contacts.

_Gavin._ Perhaps the most misguided of these cases is _Chase Manhattan Bank v. Gavin._

In _Gavin_, the Connecticut Supreme Court held that Connecticut had due process minimum contacts with a New York trustee, even though the trust relationship was formed under New York law, was administered in New York, no property subject to the trust relationship was located in Connecticut, and the trustee had not directed any other contacts at the State of Connecticut. The sole basis for Connecticut’s assertion and finding of due process minimum contacts of an _inter vivos_ trust relationship was that a beneficiary was domiciled in Connecticut. Benefits of Connecticut law that had accrued to the Connecticut beneficiary, serving here as the commercial actor, were attributed to the New York trustee in a wholly unprecedented ruling.

Clearly, a beneficiary is not an authorized agent of nor under the direction or control of a wholly independent New York bank serving as trustee under a trust relationship established and

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95 Chase Manhattan Bank v. Gavin, 733 A.2d 782 (Conn. 1999).
96 Id.
97 Id., at 786-88.
98 Id., at 801-03. Testamentary trustees were found to have due process nexus based on the decedent settlor’s residence in Connecticut at the time of his death. See Blackburn, supra Note 1, at 2.
99 See Blackburn, supra note 1, at 50 (analysis on the unprecedented nature of the Connecticut Supreme Court ruling).
administered under New York law. Nevertheless, general benefits of Connecticut law provided to the beneficiary were attributed by the Connecticut Supreme Court to the wholly independent New York trustee. Such a holding completely fails to consider whether any of the Trustee’s commercial actions were purposefully directed at the state of Connecticut or whether there was “fair notice” of such nexus based solely on the activities and choices of the wholly separate and distinct beneficiary.

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Shaffer v. Heitner.

Hanson v. Denckla. Domicile or presence of a beneficiary in a state does not mean an independent trustee has knowingly and intentionally directed its commercial activities at the forum state. In Hanson, in which the beneficiary was domiciled in Florida and the trustee in Delaware, the Supreme Court held,

“[w]e fail to find such [minimum] contacts in the circumstances of this case. The defendant trust company has no office in Florida, and transacts no business there. None of the trust assets has ever been held or administered in Florida, and the record discloses no solicitation of business in that State [by the trustee] either in person or by mail. The first relationship Florida had to the agreement was years later when the settlor became domiciled there, and the trustee remitted the trust income to her in that State. From Florida Mrs. Donner carried on several bits of trust administration . . . But the record discloses no instance in which the trustee performed any acts in Florida . . . this suit cannot be said to be one to enforce an obligation that arose from a privilege the defendant exercised in Florida.”

100 Id., at 801-03. A beneficiary is not a necessary party to any actions of the Trustee and trust property can be held solely in the name of the trustee with no reference to the trust relationship or the beneficiary. There is no principal/agent relationship between the trustee and the beneficiary; nor can a trustee even have certain knowledge as to the beneficiary’s state of residence.

101 Gavin, 733 A.2d at 801-03.

102 Shaffer, Note 19, at 216 and accompanying discussion of Shaffer.

103 Supra, Note 18.

104 Hanson, 357 U.S. 217-219.

As stated by the Supreme Court, "'purposeful availment' excludes random, fortuitous, or attenuated contacts or the unilateral activity of another or third party." The beneficiary’s actions and presence were not the commercial actions of the trustee as determined by the Supreme Court in Hanson. Furthermore, a beneficiary’s domicile, residence, or presence in a state can change easily and quickly. For minimum contacts sufficient to provide “fair notice”, “… it is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus knowingly invoking the benefits and protections of its laws.”

**Compare and Contraest Lanzi and Gavin, Shaffer v. Heitner.** Comparing Lanzi to Gavin, in each case the taxing jurisdiction’s, i.e. the forum state’s, revenue authorities attempted attribution of unauthorized contacts through a non-agency relationship. Lanzi involved asserted attribution of contacts from an Alabama domiciled legal entity, Quad-L, to a nonresident limited partner, Mr. Lanzi. Conversely, Gavin involved attribution of contacts from a Connecticut resident individual, i.e. the beneficiary, to a nonresident legal entity, CitiBank, as Trustee.

Flow of attribution in the cases were polar opposites, i.e. Lanzi was attempted attribution from a resident legal entity to a nonresident individual, and Gavin was asserted attribution from a resident individual to a nonresident legal entity.

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106 Burger King, supra, Note 16.
107 In Hanson, the Pennsylvania beneficiary/settlor moved to Florida after the trust relationship was established. For a Gavin-like analysis, is the Trustee required to determine legally and factually whether there has been an actual change in the beneficiary’s domicile or is actual domicile irrelevant so long the beneficiary has some presence in and derives some general benefit from Florida’s laws?
109 Shaffer v. Heitner, 133 U.S. 146, at 207-12 (1977) holding that in rem jurisdiction must meet the same “minimum contacts” test of International Shoe to justify jurisdiction over interest of persons in a thing; the presence of property in a jurisdiction does not alone provide personal jurisdiction over its owners.
110 Lanzi, 2006 WL 1793221 at *1.
111 Gavin, 733 A.2d at 786-87.
Query. Under the holding of the Connecticut Supreme Court, must Connecticut now accept the reverse attribution as asserted in Lanzi, i.e. could New York now tax any Connecticut resident beneficiary\(^{112}\) merely because of such beneficiary’s trust relationship with a New York trustee which itself benefited from New York laws and whose courts were available to the nonresident, Connecticut beneficiary for resolution of issues affecting the trust relationship?

The answer would have to be “Yes,” given the over-broad holding in the \textit{Gavin} case. Likewise, if you applied the \textit{Gavin} attribution ruling to the \textit{Lanzi} facts, Alabama could have taxed the Georgia nonresident individual, and Georgia in turn would be able to tax Quad-L through attribution of contacts its limited partner, Lanzi, had with Georgia. The foregoing responses, like the holding in \textit{Gavin}, do not reflect minimum contacts arising from deliberate \textbf{commercial} actions of the defendant directed at the forum state and knowingly invoking the benefits of the forum state’s laws.

Just as noted in \textit{Quill}, such attribution, reattribution, and re-reattribution would eventually subject every person engaged in interstate commerce to multiple taxation by every taxing jurisdiction in the United States.\(^{113}\) In \textit{Quill}, the Supreme Court did find that this ever-expanding sales and use tax web did create an unreasonable encumbrance on interstate \textbf{commerce}. The consistent requirement established by the United States Supreme Court and reiterated in \textit{Quill} has been that a \textbf{taxpayer}/\textbf{commercial actor},\(^{114}\) or its authorized legal agent, must

\[^{112}\text{Under New York tax law, distributions by a trustee of its income to the beneficiary, are taxed to the beneficiary. }\textit{Compare N.Y. Tax }\S\ 612\text{(McKinney 2008)}\text{ (providing taxable income in New York is defined by the laws of the United States); and I.R.C }\S\ 651\text{ (2008)}\text{ (providing that beneficiaries are taxed on the distribution of income).}\]

\[^{113}\text{Supra, }\textit{Quill}, 504 U.S. at 313, n. 6 (Note }\text{, “What is more significant, similar obligations might be imposed by the Nation’s 6,000-plus taxing jurisdictions. See }\textit{National Bellas Hess, Inc. v. Department of Revenue of Ill.}, 386 U.S. 753, 759-760, 87 S.Ct. 1389, 1393, 18 L.Ed.2d 505 (1967)\text{ (noting that in the context of sales and use taxes the ”many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [any taxpayer] in a virtual welter of complicated obligations”).”}\]

\[^{114}\text{Acting through its authorized officers, employees or independent contractors. See supra Note, 84.}\]
have deliberately initiated its contacts with the taxing state.\textsuperscript{115} It is error for states to assert minimum contacts, and thereby fair notice, solely by way of attribution of the random, fortuitous, or attenuated contacts of a third party \textit{proxy/commercial actor}\textsuperscript{116} to the nonresident taxpayer who has not initiated any contacts with the taxing state.\textsuperscript{117}

Due process nexus is concerned with adequacy of notice\textsuperscript{118} and with fairness,\textsuperscript{119} neither of which is furthered by way of the asserted satisfaction of due process by attribution of contacts from an unauthorized third-party proxy. \textit{Further, such an ever-widening tax jurisdiction through attribution can also lead to unreasonable restraints on interstate commerce in violation of the negative sweep of the Commerce Clause.}

\textbf{Position of the Alabama Department of Revenue.} The Alabama Department of Revenue (ADOR) in Lanzi relied most heavily on \textit{Borden Chemicals}\textsuperscript{120} in its briefing and oral arguments. However, on careful review, \textit{Borden} was properly found to be inapplicable\textsuperscript{121} to the facts and law at issue in \textit{Lanzi}. \textit{Again, the analysis was based on whose commercial activities were purposefully directed at the taxing state.}

In \textit{Borden}, Plaintiff nonresident limited partner (“Nonresident”) was a Delaware limited partnership which owned a 98.99\%\textsuperscript{122} interest in a limited partnership which was present in, owned operating assets in, and was actively operating its business in Illinois (“Operating

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\textsuperscript{115} Hanson, 357 U.S. at 253.
\textsuperscript{116} Supra, Note 75.
\textsuperscript{117} Hanson, 357 U.S. at 253; Quill, 504 U.S. at 307-308
\textsuperscript{118} Quill, 504 U.S. at 312.
\textsuperscript{119} International Shoe Co., 326 U.S. at 319.
\textsuperscript{121} Lanzi, 2006 WL 1793221 at *6.
\textsuperscript{122} Borden Chemicals & Plastics, L.P., 726 N.E.2d at 77 (The 1.01\% general partnership interest was owned by Borden Chemicals & Plastics Management, Inc., a typical structure for operating limited partnerships utilizing a corporation as its general partner.)
\end{flushleft}
Partnership”). The Illinois appellate court had to determine whether the Nonresident could constitutionally be taxed on its pro rata share of the Illinois Operating Partnership’s income from Illinois operations.

In determining satisfaction of Due Process requirements, the Illinois court did not address which legal person’s, i.e., which entities’, commercial activities and rights to Due Process were being evaluated. The appellate court merely discussed fictions of income taxation, e.g., a partnership was treated as a separate taxpayer [person] for some tax purposes but was treated as an aggregation [nonperson] of its individual partners for other tax purposes.

Due Process rights are bestowed by the Constitution to prevent state action from depriving “any person of . . . property, without due process of law.” Under the Constitution, if a partnership is a legal person which can be a commercial actor and own property, then the partnership cannot be deprived of that property without due process of law. Conversely, if a partnership is not a legal entity and cannot therefore be a commercial actor and own property, the due process clause is clearly inapplicable to such a nonentity, nonperson. Federal income tax rules and fictions do not control the parameters of Constitutional due process.

123 Id.
124 Id. at 79-80 (applying both Due Process and Commerce Clause analysis as dictated by Quill).
125 Id. at 75 & 77 (The issue was actually whether the Nonresident could benefit from an available tax credit passed through to it from the Operating Partnership. In order to answer this question, the court was first required to determine whether Illinois’ initial income tax levy on the Nonresident was itself Constitutional).
126 Id. at 81-82 (“The partnership is regarded as an independent recognizable entity apart from the aggregate of its partners. Once its income is ascertained and reported, its existence may be disregarded since each partner must pay a tax on a portion of the total income as if the partnership were merely an agent or conduit through which the income passed.”).
127 U.S. Const. Amend. XIV, § 1
128 Id.; see also
A “trust”, for example, is not a person, but is merely an abstract concept describing the relationship between the trustee, the settlor, and the beneficiaries of the relationship. All legal and equitable property and property rights subject to the trust relationship are owned by the trustee or the beneficiary. Due process protections of such property rights are bestowed on the trustee and the beneficiary as their respective property interests may appear, but there are no due process rights extended to the abstract “trust” which is not a “person” and cannot own property.

The nature of legal entities as “persons” is determined by the laws under which they are created. State laws under which an entity is organized determine the bundle of rights, which define such an entity. This bundle of rights can, of course, evolve over time, thereby fundamentally altering the nature of such a creature of law. The evolution of partnerships under the law of Illinois is a clear example.

At the turn of the twentieth century, Illinois law applicable to partnerships conformed to legal concepts of the day. Under statutory and common law, partnerships, like trusts today, described relationships among “partners” and governed the rights of such persons between and among themselves. This partnership relationship allowed individual parties to aggregate their capital and collectively manage an enterprise. At such time, a partnership was not a legal “person,” and could not itself engage in commercial activities. A partnership was an aggregation of its individual partners who themselves acted cooperatively to achieve their mutual

129 Blackburn, supra note 1, at (summarizing that, a trust is not a “legal person” and cannot own property, etc. The due process clause is therefore inapplicable to the trust relationship which is merely an abstract concept, not a separate legal entity.)
130 Beneficial rights in the hands of the beneficiaries also constitute property rights protected in the hands of the beneficiaries. See
131 Id. Some state laws have redefined trusts to include [confirm whether Business Trusts, REITs, etc. can own property and sue or be sued in their own name rather than in the name of the trustee] under any state laws are persons and can own property in their own names.
132 Illinois being the jurisdiction under which Borden Chemicals was decided, though not the jurisdiction under which the partnership was formed.
undertaking. As a nonentity, nonperson, the “partnership” could not act in its own name, i.e.,
could not contract, sue, or be sued in its own name.\textsuperscript{134} Likewise, as a nonentity, a partnership
could not own property in its own name. The property interests of the mutual endeavor were
held in the individual names of its partners.\textsuperscript{135} A partnership was therefore a nonentity under
Illinois law\textsuperscript{136} and did not possess Constitutional Due Process property rights.\textsuperscript{137}

During the twentieth century, statutory partnership law evolved. Under the Revised
Uniform Partnership Act (“RUPA”), partnerships gained rights making them legal entities, e.g.,
partnerships could own property in their own name\textsuperscript{138} and could act \textit{commercially} in their own
name.\textsuperscript{139} With their new bundle of rights and powers, partnerships became legal persons and
possessed the same due process rights, including property ownership, as other legal persons, e.g.,
corporations. RUPA was adopted in Illinois in 2002 and became effective on and after January 1,
2003.

version of the Uniform Partnership Act (1997) (“RUPA”). Illinois now joins
over 30 states that have adopted RUPA. The Act represents the first
significant revision of Illinois partnership law in over 80 years. . . . A review of
these changes reveals several themes in the new statute. First, whenever
possible, \textit{the Act clearly moves from treating the partnership as the aggregate
of its partners to treating the partnership as an entity separate from its
partners.}\textsuperscript{140

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{134} J. William Callison \& Maureen A Sullivan, Partnership Law \& Practice § 3:5 (2007).
\item \textsuperscript{135} Id. at § 3:1.
\item \textsuperscript{136} Illinois Uniform Partnership Act,
\item \textsuperscript{137} Id. at
\item \textsuperscript{138} As contrasted with earlier law under which such property was held in the individual names of its partners. See Revised Uniform Partnership
\textsuperscript{139} Act.
\item \textsuperscript{139} Partnership can contract in its own name and own property in its own name. See Revised Uniform Partnership Act,
\item \textsuperscript{140} Steven G. Frost, Illinois’ Revised Uniform Partnership Act, 90 Ill. B.J. 644, 644 (2002) (\textit{emphasis added}). See also id. at 645 (stating “This
section makes explicit a significant policy change made to existing partnership law by the Act – the partnership is now more clearly an entity
distinct from its partners. This change in policy has numerous consequences in other provisions of RUPA, which are discussed below.”).
\end{enumerate}
\end{footnotesize}
Again, Judge Thompson\textsuperscript{141} noted that “the Department asserts that for nexus purposes the presence and activities of Quad-L in Alabama must be passed through or attributed to the Taxpayer [i.e., the limited partner, Mr. Lanzi].”\textsuperscript{142} Judge Thompson emphatically disagreed, citing clear federal precedent where federal courts have held that the physical presence and commercial activities of a limited partnership, which was a separate and distinct legal entity under Alabama law, in a state cannot be attributed to an out-of-state limited partner for jurisdictional purposes.\textsuperscript{143}

In \textit{Borden}, however, Illinois state courts had improperly focused on partnership flow-through taxation principles, i.e. a partnership is treated as an entity for some tax purposes and as an aggregate of its individual partners for others. Ultimately the partners themselves are the taxpayers who include income derived from partnership activities on the partners separate tax returns. Based on this tax fiction that income was taxed to the partner, the court attributed the commercial activities which produced such income as also being the partners’. This was the correct result at the time, but it was reached for the wrong reasons.

When \textit{Borden} was decided, the Operating Partnership in Illinois was not a separate and distinct person under Illinois law and was not itself engaged in commercial activities in Illinois. Rather, the Nonresident, Delaware partners were themselves directly engaged in commercial

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\textsuperscript{141} \textit{In re}, Note \textsuperscript{132}.
\textsuperscript{142} Id., at 8-9

\textsuperscript{143} Marriott PLP Corp. v. Tuschman, 904 F.Supp. 461 (D.C. Md. 1995), (4th Cir. 1996) (“Shareholders in a corporation do not subject themselves to personal jurisdiction in the forum in which the corporation was formed (cite omitted) ... The same rationale applies to limited partners who, like shareholders, are passive investors with limited liability (cite omitted) ...” Marriott PLP, 904 F.Supp. at 466); Construction Aggregates, Inc. v. Senior Commodity Company, 86 F.Supp. 1176 (E.D. Tex. 1994) (“And it strains reason to infer that anyone buying a limited partnership interest as a passive investment in a Texas limited partnership impliedly consents to or expects to be hauled into court ... in Texas.” Construction Aggregates, 860 F.Supp. at 1180); see also, Sher v. Johnson, 911 F.2d 1357 (9th Cir. 1990).
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actions which they had purposefully directed at Illinois. However, Illinois law has now changed and conforms with Alabama law of limited partnerships applied in Lanzi. Thus, due to the Lanzi analysis, the result of Borden should be different if decided today in Illinois.

Summary of Lanzi Due Process and Commerce Clause Analysis as Applied to Partnerships v. Partners. For nexus, the essential initial question is whose activities must be analyzed as being purposefully directed at a taxing jurisdiction. Following Quill, Lanzi has established that due process nexus for taxpayers must be based on contacts initiated by the taxpayer commercial actor, i.e. entity or person, with the taxing jurisdiction, e.g., contacts of corporations and partnerships as legal entities separate and distinct from the contacts of their shareholders and taxpayer partners. Prior to RUPA, due process nexus analysis in Illinois applied to the individual partners, i.e., did individual partners have “minimum contacts” and/or substantial contacts with Illinois? Following RUPA, due process nexus analysis in Illinois now applies to the partnership itself, i.e., did the partnership’s Illinois commercial activities constitute minimum contacts by the partnership with Illinois?

As discussed above, Borden Chemicals was decided pre-RUPA. Thus the opinion did ignore the nonentity “partnership” and instead analyzed Borden Chemical’s Illinois operations as contacts with the Illinois taxing jurisdiction initiated directly by the nonresident partners taxpayers themselves.

144 Id.
146 Borden Chemicals, 726 N.E.2d at 44.
Conversely, the *Lanzi* opinion applied to post-RUPA tax years in Alabama. Instead of treating Alabama investment activity undertaken by Quad-L as the direct activities of its nonresident partner, the *Lanzi* opinion under RUPA treated Quad-L as a legal person which was itself engaged in Alabama investment activity. Applying due process Constitutional nexus analysis, Quad-L had been formed under Alabama law, and its investment activities in Alabama were its own and were not the activities of its individual, nonresident partner, Mr. Lanzi.

*Lanzi’s analysis properly focused on the crucial nexus question of whose commercial contacts must be analyzed. Stated alternatively, the question is: “Who has purposefully directed their own commercial activities at the taxing state?” The answers to these questions are found in state entity law and not in income tax fictions. Thus, Quad-L clearly met both due process minimum nexus and commerce clause substantial nexus requirements. Lanzi himself failed even the minimum due process nexus requirement.*

*Lanzi and the Commerce Clause.* In *Lanzi*, the Alabama administrative law judge’s holding as well as the holding of the Alabama Court of Civil Appeals were based on absence of minimum due process nexus, i.e. lack of jurisdiction. Other than a discussion of “substantial nexus” by the administrative law judge, neither opinion found it necessary to discuss the four

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147 Alabama adopted RUPA in 1997.

148 See Gavin for a failed Commerce Clause analysis, e.g. the principle focus of the Gavin opinion's Commerce Clause analysis was whether or not a Connecticut “settlor would choose a Connecticut bank, over an out-of-state bank, as trustee solely because of the potential for future multiple taxation of some portion of the trust's future income.” As noted, supra, the Gavin opinion stated, “Although we agree that there are such incentives and risks, we conclude that they are too remote and speculative to constitute a dormant commerce clause violation.” [FN222] The opinion found the speculative nature in the selection of a trustee from its belief that multiple and diverse factors would be considered by a Connecticut settlor before selecting a trustee. The Connecticut court found that its tax imposed on a foreign trustee would indeed subject the trust income to the risk of multiple taxation, a risk not shared by the domestic trustees. Thus, even if a state tax created an undue burden on interstate commerce, the Gavin opinion would not find a Commerce Clause violation unless it could determine the precise role, i.e. the sole role, such tax played in commercial decisions of consumers of interstate products and services.

149 Supra, Note 43.

150 Supra, Note 139.
elements which must be present in order for state taxation to overcome a Commerce Clause challenge.

As stated in Quill, a state tax will be sustained against a Commerce Clause challenge only so long as the four factors developed in Complete Auto are present, i.e., a “tax (1) is applied to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to services provided by the State.”

In analyzing “substantial nexus” for tax purposes the essential initial question is still—“Whose commercial activities must be analyzed?”

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151 Supra, Note 35.
152 Supra, Note 1.
154 Supra, Note 35 and accompanying text.