



TAXING DELIVERY IN THE SKY:

DRONE DELIVERY AND SALES AND USE TAXATION IN NEVADA

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The word “drone” previously invoked an image of a mechanical bird of war. Now, the world of Unmanned Aircraft Systems (UAS) is stretching into the commercial realm at an increasing pace. With drones leeching into commercial airspace, companies will need to assess the business ramifications for use of UAS, including the tax implications. Depending on how used, UAS operation may create a tax liability for retail transactions that previously avoided taxation.

Commercial Drone Activity and Its Possibilities

Currently, the Commercial UAS Modernization Act fosters innovation in the commercial UAS arena and sets clear guidelines for the Federal Aviation Administration (FAA). It is evident that UAS will soon be active in corporate functions, including the sales and delivery of goods. Online retailer Amazon is proposing to make deliveries in 30 minutes or less using its Amazon Prime Air Service, while a more lighthearted attempt at such delivery includes the “TacoCopter,” which promises to get a taco safely into your hand through drone delivery. Amazon has already begun testing the potential use of UAS for package delivery, and has suggested the creation of drone highways: regulated airspace used only for commercial drone activity.¹

Potential Taxability of Drone Activities

In predicting a future where companies use UAS to deliver packages from a central distribution hub, it is conceivable that UAS could deliver packages in multiple states or taxing jurisdictions that differ from the state of launch. In such scenarios, issues arise as to the appropriate taxation of UAS activity when the UAS cross state lines.

Nexus Generally

Generally, a retailer is liable for the collection of sales or use tax. It has been routinely held for almost 70 years of due process jurisprudence that “[t]o make the distributor the tax collector for the state is a familiar and sanctioned

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device.”² In order to assess sales or use tax for cross-border sales, the Supreme Court has indicated that there must be sufficient minimum contacts to satisfy due process and substantial nexus between the retailer and the taxing jurisdiction.³ The relevant inquiry is whether or not the activities in a state are sufficient to establish and maintain a market for such sales within the state.

Due process analysis under the Commerce Clause requires a minimum connection between a state and a person, property or transaction that the state seeks to tax.⁴ This is an expansive standard, requiring purposeful availment of the state’s protections “such that the maintenance of the suit does not offend ‘traditional notions of fair play and substantial justice.’”⁵

Within the UAS context, it appears that utilization of airspace and landing strips within the taxing jurisdiction may be sufficient to establish purposeful availment of the protections of the state, since that movement is specific and targeted. However, under Commerce Clause evaluation, whether UAS create a substantial nexus within the state is another issue. Under the Commerce Clause, the issue of jurisdiction to tax also turns on whether the theory of “substantial nexus” is present. Nevada has adopted the four-pronged test from *Complete Auto Transit, Inc. v. Brady*, upon which the substantial nexus requirement is derived.⁶ Under *Complete Auto Transit*, a tax will be sustained against a “Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state.”⁷

The idea of substantial nexus “is not, like due process’ ‘minimum contacts’ requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce.”⁸ This, however, does not mean that the purpose of this heightened level of nexus is to prevent

the state from levying its taxing authority, but rather to ensure that there has been significant involvement to ensure that the Commerce Clause restrictions are met. Therefore, physical presence becomes a bright line rule for a determination of substantial nexus.

In the UAS context, what constitutes physical presence? Likely, delivery by UAS, whether touch-down is made or not, will be sufficient to assert physical presence and therefore substantial nexus. However, this issue has not been resolved and may have wide reaching implications.

Drone Delivery

Nevada imposes a sales tax upon retailers for selling tangible personal property in the state.⁹ Use tax is imposed on tangible personal property used in one state but acquired from another state retailer, and it applies generally when no sales tax has been imposed.¹⁰

In a UAS delivery situation, where there is no actual contact with the ground in the delivery state, there is a question as to whether or not there are sufficient contacts with the taxing jurisdiction to levy either sales or use taxation. However, in this context, ownership of the UAS is ultimately determinative as to the taxability of the transaction. Where UAS are owned by a common carrier, the excise is levied when the goods are tendered to the deliverer. Where the delivery UAS are owned by the remote seller, transfer of title occurs at actual delivery to the purchaser. The analysis, at that point, is whether or not there are sufficient substantial nexus factors for levy of use tax.

Does Drone Action Create a Taxable Nexus?

The use of UAS for the transaction of sales of tangible personal property will raise issues relating to the interpretation of current sales and use tax statutes. As provided, when UAS operated by a seller touch down in the taxing jurisdiction of the purchaser, the seller is likely subject to that state’s taxing authority. Where there is no touchdown of the UAS, but delivery is still made in a jurisdiction other than the jurisdiction of the seller, there is likely substantial nexus to permit the recipient’s jurisdiction to assert taxing authority. The answer to the question of whether or not a robotic instrument can create a physical presence in a neighboring taxing jurisdiction could have significant implications for other sales and use tax transactions in which delivery is made by robotic or digital means. While the physicality of UAS seems to clarify the issues in some tangible way, ultimately, the UAS are simply a physical form of the code and circuits driving technical computing and digital delivery. It is an interesting time in the sales and use tax world, and the use of UAS is only going to further blur the lines in an environment where states and taxpayers are working harder and harder to make such lines more distinct. **NL**

1. See British Broadcasting Corporation, *Amazon suggests a separate airspace for delivery drones*, July 29, 2015 (available at <http://www.bbc.com/news/business-33698812>); Kia Kokalitcheva, *Amazon wants a special air zone for its fancy delivery drones*, *Fortune*, July 28, 2015 (available at <http://fortune.com/2015/07/28/amazon-air-zone-delivery-drones/>).

2. *General Trading Co. v. State Tax Comm'n*, 322 U.S. 335, 338 (1944).
3. *Quill Corp. v. North Dakota*, 504 U.S. 298, 315 (1992).
4. *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 346 (1954).
5. *Quill*, 504 U.S. 298, 307 (1992) (quoting *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945) (quoting *Milliken v. Meyer*, 311 U.S. 457, 463, 61 S.Ct. 339, 343, 85 L.Ed. 278 (1940)).] Thus, "if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum state, it may subject itself to the state's in personam jurisdiction even if it has no physical presence in the state." *Quill*, 504 U.S. 298, 307 (1992); see also *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985).
6. *Great Am. Airways v. Nevada State Tax Comm'n*, 101 Nev. 422, 425, 705 P.2d 654, 656 (1985) (adopting *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977)). See also *Arizona Dep't of Revenue v. Care Computer Sys., Inc.*, 4 P.3d 469, 470 (Ariz. Ct. App. 2000); *Gen. Motors Corp. v. City & County of Denver*, 990 P.2d 59, 67 (Colo. 1999); *Tamagni v. Tax Appeals Tribunal of State*, 695 N.E.2d 1125, 1130 (N.Y. 1998); *Star-Kist Foods, Inc. v. County of Los Angeles*, 719 P.2d 987, 996 (Cal. 1986).
7. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).
8. *Quill*, 504 U.S. 313.
9. NRS 372.105.
10. See e.g., NRS 372.185(1) & (2); *Nevada Tax Comm'n v. Nevada Cement Co.*, 116 Nev. 877, 8 P. 3d 147 (2000). See also *Sparks Nugget, Inc. v. State of Nevada ex rel. Department of Tax'n*, 124 Nev. 159, 179 P.3d 570 (2008) ("any non-exempt retail sales of personal property that have escaped sales tax are nonetheless taxed when the property is utilized in the state"); *State, Dep't Taxation v. Kelly-Ryan, Inc.*, 110 Nev. 276, 280, 871 P.2d 331, 334 (1994); see also NRS 372.345.

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