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# State Tax Nexus & Hot Topics December 7, 2021

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# Agenda

## ✓ Introduction

## ✓ Nexus

- Defined
- Authority & limitations
- Types of nexus
- Income tax nexus – additional considerations

## ✓ Trends & Issues

- Sales & Use Taxes
- Business Income Tax

# Introduction - My Background

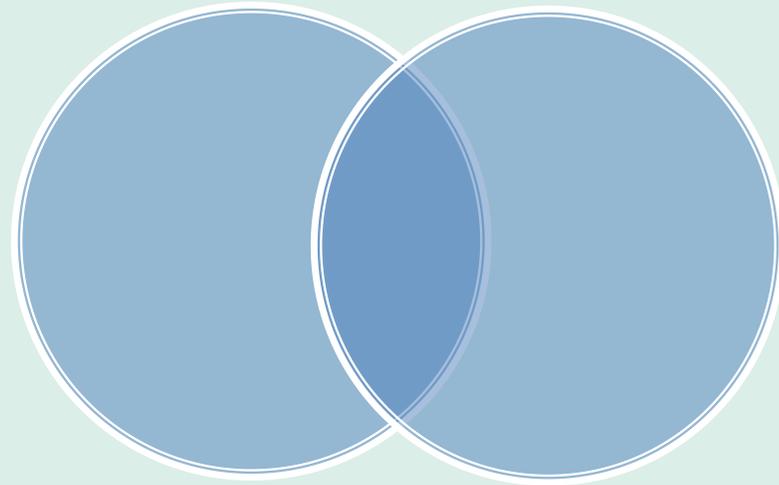
- ✓ CPA with >32 years SALT experience
- ✓ Big 4
- ✓ Fortune 500
- ✓ Consulting
- ✓ Mid-size accounting firm
- ✓ CMI's in Sales Tax & Income Tax
- ✓ Head of *Advanced Sales Tax School* for the Institute for Professionals in Taxation (“IPT”)
- ✓ Income tax CMI designation committee
- ✓ IPT Distinguished Service Award - 2021
- ✓ NCACPA –Taxation Committee, former Education Chair, Annual SALT Conference presenter
- ✓ SCACPA – Grand Strand Chapter Secretary

# Why is State & Local Tax (“SALT”) Important?

- ✓ Key risk area
  - Increasingly aggressive states
  - Recent developments increase states’ tax reach
  - Improving revenue discovery capabilities
- ✓ Financial statement impact
- ✓ M&A
  - Significant due diligence issue
  - Unlimited statute of limitations for non-filers
  - Successor liability despite transaction type



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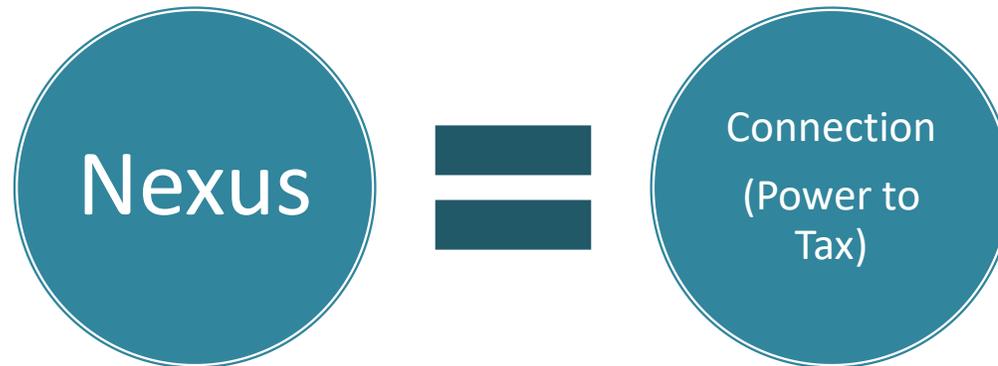
# Nexus

# What is “Nexus”?

## “Nexus”

is the minimum connection between a taxpayer and a taxing jurisdiction that allows the taxing jurisdiction to impose a tax collection and/or tax filing requirement upon the taxpayer.

The application of this definition varies by state



# Limitations on States' Reach for Taxation

- ✓ Limitations on states' authority to assert nexus come from the ***US Constitution***
- ✓ Due Process Clause – 14<sup>th</sup> Amendment
  - Concerned with “fair notice” and basic jurisdiction
  - Government cannot deprive citizens of life, liberty or property without due process of law
  - Has been interpreted as prohibiting a state's imposition of a tax without at least a “minimal connection” with the state.
  - “Purposely directing” activities toward a state has been held to meet this “minimal connection” requirement.

# Limitations on States' Reach for Taxation

## ✓ Commerce Clause

- “Congress shall have the power to regulate commerce with foreign nations and among the several states...”
- Has been interpreted as prohibiting the imposition of a state tax (or a tax collection responsibility) absent “substantial nexus” with the taxing state.
- Complete Auto Transit v. Brady - the Supreme Court articulated a four-part test to determine if a state tax violates the Commerce Clause:
  - There must be substantial nexus;
  - The tax must be fairly apportioned
  - The tax must not discriminate against interstate commerce; and
  - The tax must be fairly related to services provided to the taxpayer by the state

# Types Of Nexus

## Physical



## Economic



# Physical Presence Nexus – An In-State Facility Is NOT Required

## In-state property

Fixed assets

### Inventory

- 3PL, consigned, FBA, customer site

### Leased assets

- Office, M&E, autos
- Lessor, lessee

## Resident employees

Field sales reps

Telecommuting employees

### COVID-19 impact

- Time-based suspension of nexus rules in some states

## Visits to the state

Employees

Contractors, subcontractors, agents

Does frequency/duration matter?

# Stretching the definition of Physical Nexus

## ✓ Affiliate nexus

- A related entity doing business in the state may create nexus for its out-of-state affiliate
- Example: *Barnes & Noble* and *barnesandnoble.com*

## ✓ Agency nexus

- An unrelated party performing activities in the state on behalf of the business may create nexus
- Sales reps, local installer, warranty repair company

# Stretching the definition of Physical Nexus

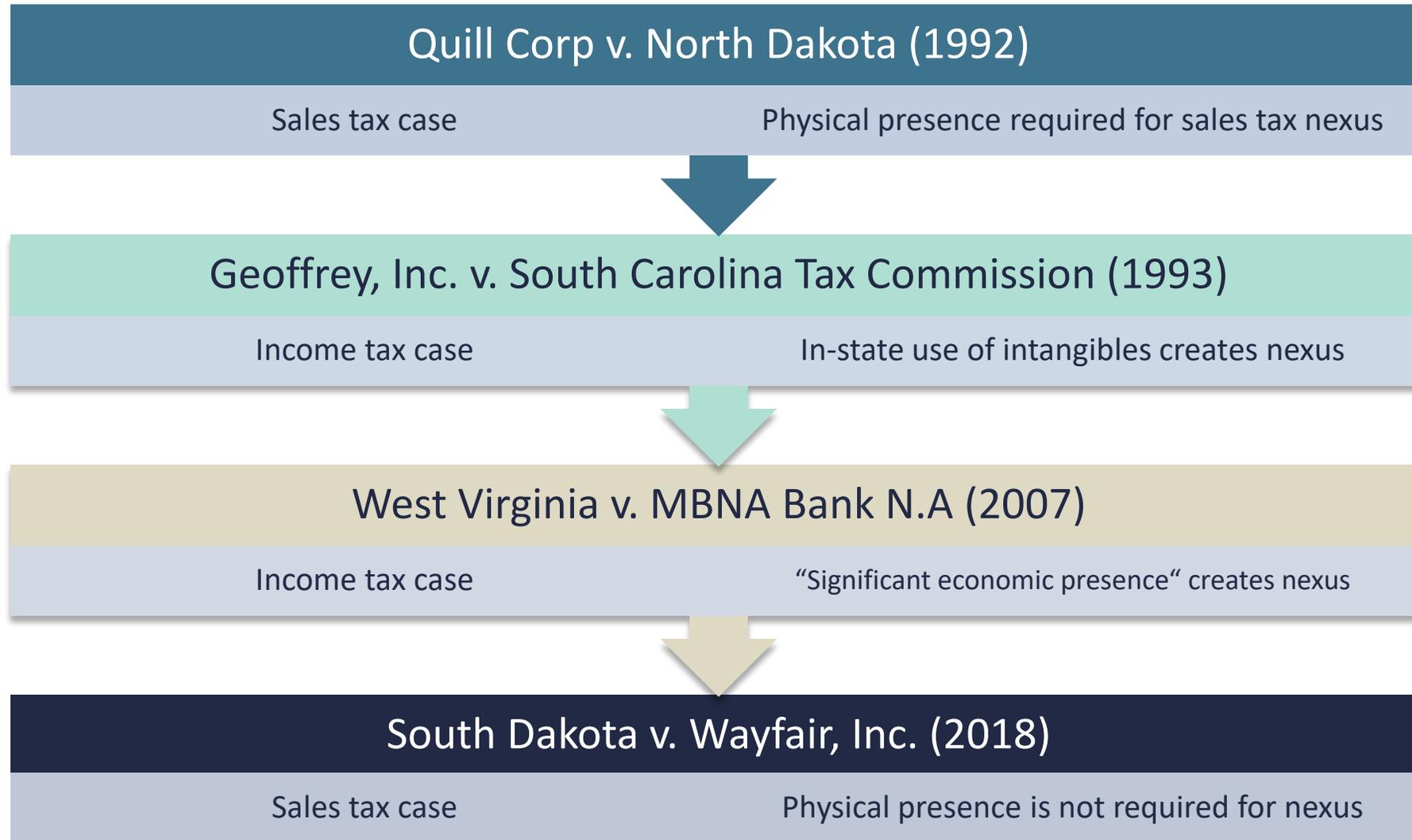
## ✓ Click-Through Nexus

- A stretch of the agency nexus concept
- The remote seller has nexus via paying an in-state person to provide a link on their website that directs online traffic to the remote seller's website

## ✓ “Cookie” Nexus

- Remote seller is treated as having physical presence with a state based on the “presence” of “cookies” on customers’ or prospective customers’ computers

# Progression from Physical to Economic Nexus



# Economic Nexus – *Sales Tax*

## ✓ *Wayfair v. South Dakota*

- US Supreme Court decision on 6/21/2018
- Overturned *Quill's* physical presence requirement
- Upheld state's economic nexus threshold of \$100,000 of sales or 200 transactions
- Sales level greater than the state's statutory threshold creates nexus

## ✓ Other states enacted economic nexus statutes

- Most used the \$100,000 or 200 transactions threshold upheld in *Wayfair*.
- *That's a really low threshold!*
- Some have higher thresholds

## ✓ Currently, *all states that impose a sales tax* have economic nexus thresholds

## ✓ **RESULT:** Nexus in states you've never even visited!

# Marketplace Facilitator Nexus – Sales Tax

- ✓ States also began enacting “Marketplace Facilitator” economic nexus statutes, to capture the large volume of small-seller transactions facilitated by companies like Amazon and eBay
- ✓ These new laws require marketplace facilitators that meet economic nexus thresholds to collect tax on behalf of all sellers on their platform who make sales into the state, and remit that tax to the state on the sellers’ behalf
- ✓ These thresholds are similar to the \$100,000/200 transactions threshold from *Wayfair*, but they apply to all sales facilitated via the marketplace provider’s platform
- ✓ All states that impose a sales tax have enacted marketplace facilitator economic nexus provisions

# Sales Tax Economic Nexus - Implementation Details Vary by State

The following impact *when* a business must register and begin collecting tax:



Effective date of the economic nexus statute



Measurement period(s) to determine when the nexus threshold is met

- e.g., prior calendar year, current calendar year, rolling 12-month average, etc.



Sales included in the threshold calculation

- e.g., total sales vs only taxable sales; related entity sales, sales made via a marketplace



Date registration is required after the nexus threshold is exceeded

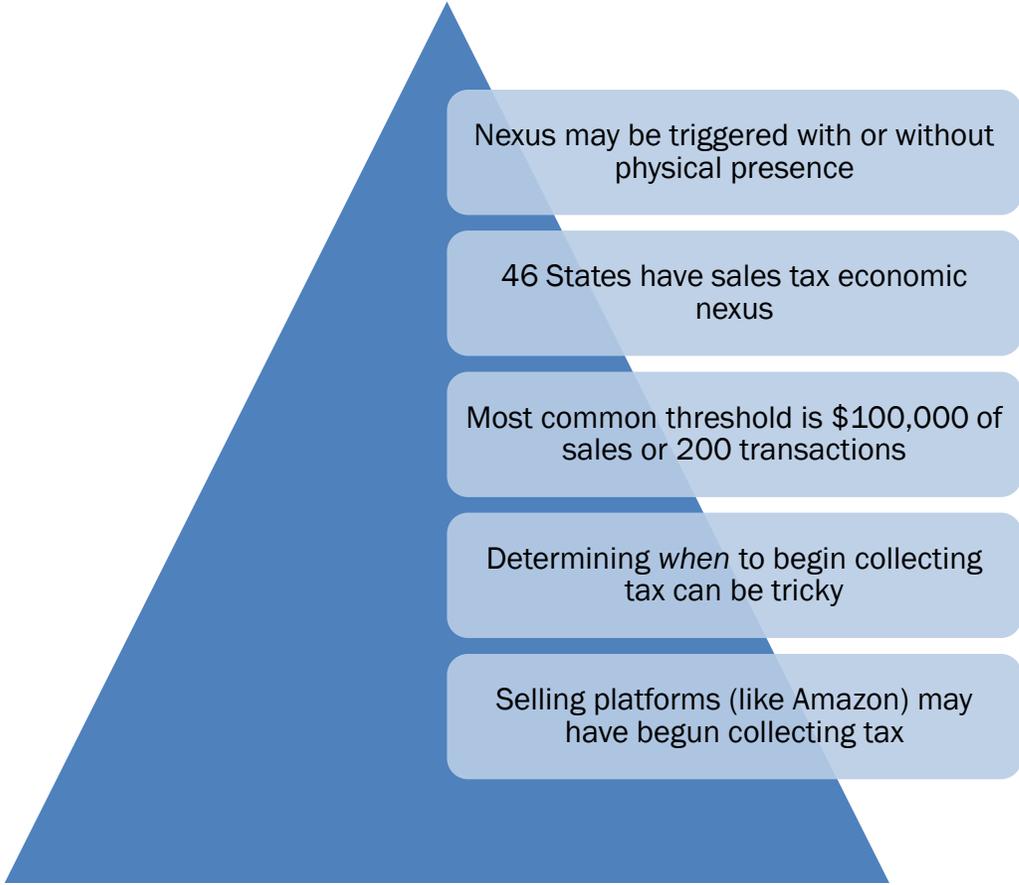
- Prospective registration & tax collection requirement
- Typically 30-60 days after date the threshold was exceeded
- Many states require registration and filing even if all sales are nontaxable



Marketplace Facilitator economic nexus

- Effective date of marketplace facilitator statute
- Portion of sales made on vs. off the platform

# Sales Tax Economic Nexus – Key Takeaways



Nexus may be triggered with or without physical presence

46 States have sales tax economic nexus

Most common threshold is \$100,000 of sales or 200 transactions

Determining *when* to begin collecting tax can be tricky

Selling platforms (like Amazon) may have begun collecting tax

# How Do I Apply These Nexus Standards to My Business?

1. Review sales by state
  - Is the data accurate, reliable, correctly sourced?
  - Am I selling via a marketplace facilitator, via my own website, or both?
2. Does the business have physical presence in these states?
3. Does the business have economic nexus in these states?
  - What is the economic nexus threshold?
  - How is it measured? (type of sales included, measurement period)

# How Do I Apply These Nexus Standards to My Business?

4. When did nexus begin?
  - When did in-state physical activities begin?
  - What is the effective date or enforcement date of the statute/rule?
  - Does the state impose “marketplace facilitator” nexus rules?
  - When did the marketplace facilitator rules become effective?
  - What portion of my taxable sales are covered by marketplace facilitator collection?

# Let's Revisit *Income Tax Nexus*

## ✓ Physical presence nexus

- The physical presence nexus concepts previously discussed apply for income tax

## ✓ Economic Nexus

- 13 states have an economic nexus sales threshold for income tax
- Sales thresholds typically are higher than the sales tax threshold
- Typically don't have the transaction volume threshold
- Can have economic nexus w/o the threshold if earning income from intangibles
  - Recall the *Geoffrey* and *MBNA* cases previously discussed



# Public Law 86-272

## *Additional Nexus Safe Harbor for Some Taxpayers*

- Enacted in 1959
- Applies *only* to sellers of tangible personal property (“TPP”)
- Applies *only* to *net income taxes*
- In-state activity limited to *mere solicitation* of orders for TPP.
- Orders sent out of state for approval (i.e., no spot-sales)
- Orders filled from a stock of goods located outside the state
- Doesn’t define “mere solicitation”. Interpretation was left to the states and the courts

# Applying Public Law 86-272

*Wisconsin Department of Revenue v. William Wrigley Jr. Co (1992)*

Seminole case attempting to define “mere solicitation”

The court looked at activities as “protected” vs “unprotected”

Only activities that are entirely ancillary to solicitation of sales are protected.

Activities independent of sales solicitation are unprotected even if conducted by sales people.

# Applying Public Law 86-272

- ✓ Multistate Tax Commission (“MTC”) Statement
  - Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272
  - Adopted in 1986 and last revised in 2001
  - Provides a list of Protected & Unprotected activities
  - Addresses other issues such as, de minimis activities and foreign commerce
  
- ✓ MTC updated this Statement on 8/24/21
  - Post-*Wayfair* re-evaluation of protected and unprotected activities
  - New section discussing “activities conducted via the Internet”
  - Updated provisions regarding independent contractors and remote employees

# MTC's Updated PL 86-272 Statement

- ✓ Interacting with customers via company website or app = unprotected activity
  - “Regularly” providing post-sale assistance through an electronic chat or email accessed via the company’s website
  - Soliciting or receiving online credit card applications
  - Inviting and or accepting applications for employment (for non-sales positions) via a web-based platform
  - Placing “cookies” on customers’ computers or other devices, designed to gather market or product research
  - Transmitting code or electronic instructions via the internet to fix or upgrade products
  - Offering or selling extended warranty services via the company’s website
  - Contracting with a marketplace facilitator to house products or inventory in the state, and
  - Contracting with in-state customers to stream videos and music to their electronic devices

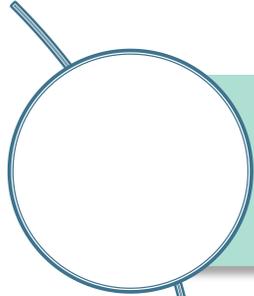
# MTC's Updated PL 86-272 Statement

✓ Static text or photos on a company's website are still protected activities.

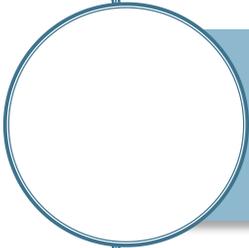
For example:

- Posting a static FAQ to assist customers
- Placing Internet 'cookies' that are used ancillary to the solicitation of orders such as to remember items in a shopping cart, and
- Offering tangible personal property for sale on a searchable website

# MTC's Updated PL 86-272 Statement



In Short: If your website does anything more than accept orders for tangible personal property, PL 86-272 protection likely is exceeded under the MTC Statement.



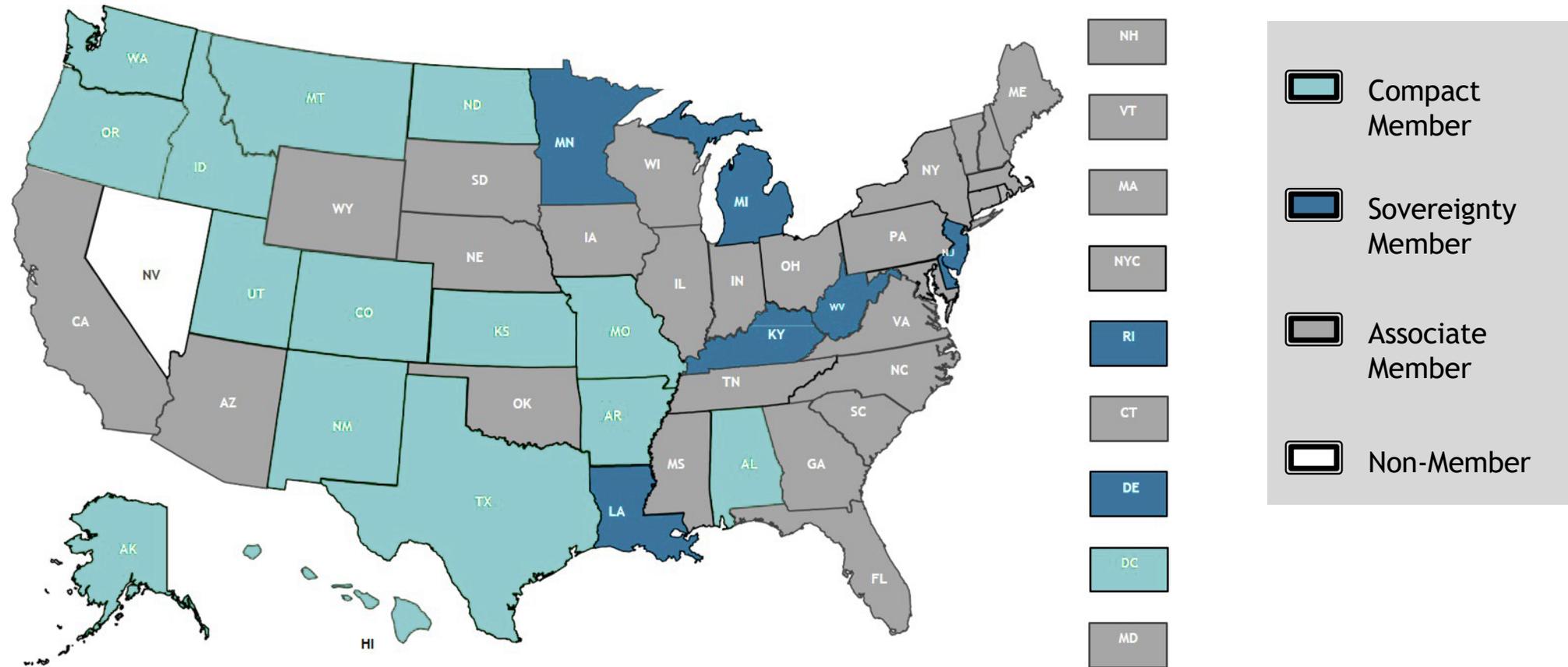
States are not required to adopt the Statement, but many intend to adopt it.



Issue for businesses – identifying and tracking when and where nexus has been triggered.

# Multistate Tax Compact (“MTC”) Membership

(AS OF 10/31/2021)



# Summing Up Nexus – For *Sales Tax* and *Income Tax*

## Physical

### Property

- PP&E
- Inventory
- Lease assets

### Resident employees

- COVID-19 impact

### Visits

- Sales solicitation, services
- Employees, contractors, agents

## Economic

### Sales Tax

- *Wayfair* sales thresholds
- Marketplace facilitators

### Income Tax

- Bright-line sales thresholds
- Using intangibles in the state
- Economic presence

## PL 86-272

Net income tax only  
TPP sellers only

### Sales solicitation only

- Protected & Unprotected Activities

### Updated MTC guidance

- Interactive website
- What type of cookies?

# Inbound Foreign Businesses

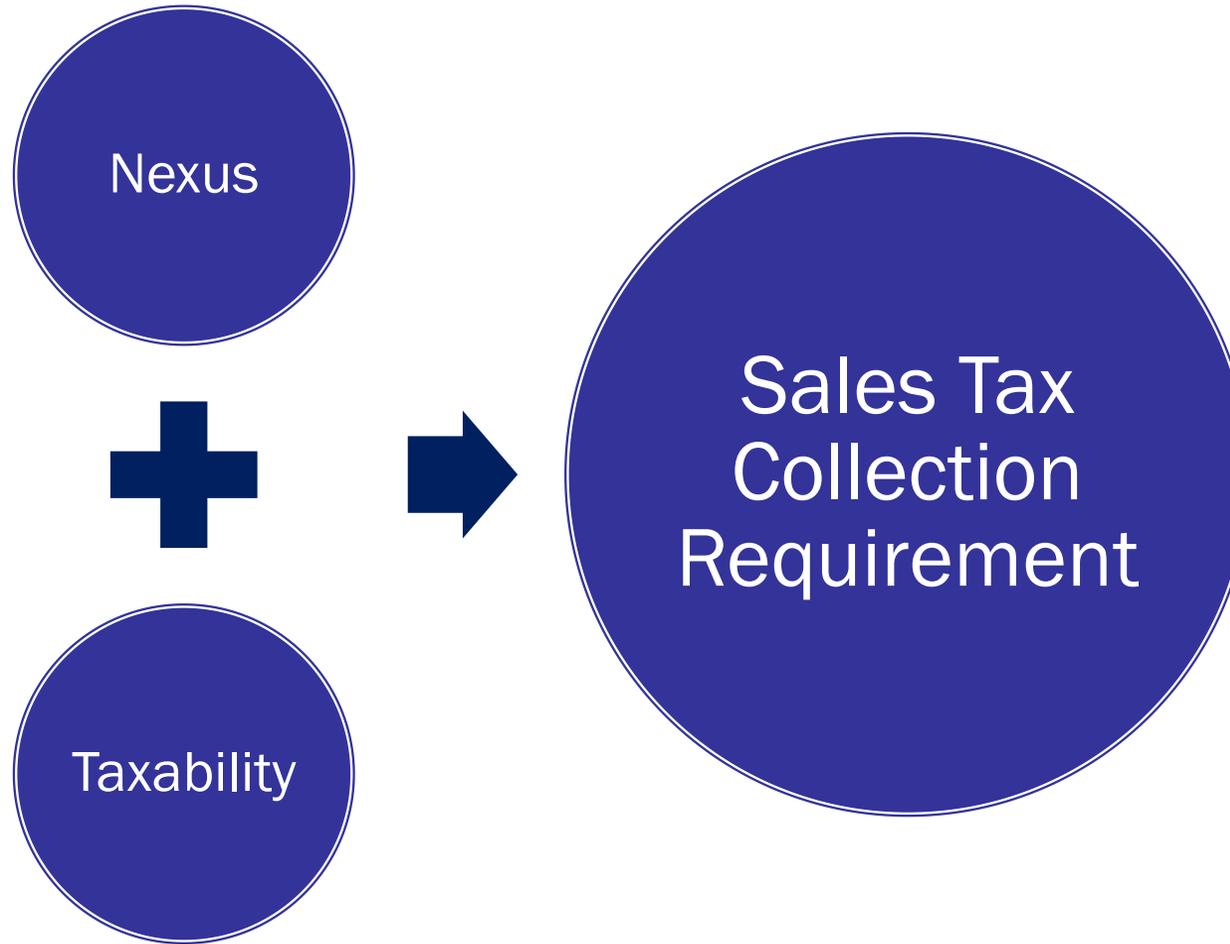
- ✓ Foreign businesses with no US PE may still be subject to income, franchise, sales/use and other state & local taxes
- ✓ U.S. tax treaties generally do not apply at the state level
- ✓ The nexus provisions previously discussed apply
- ✓ States are getting better at identifying taxpayers



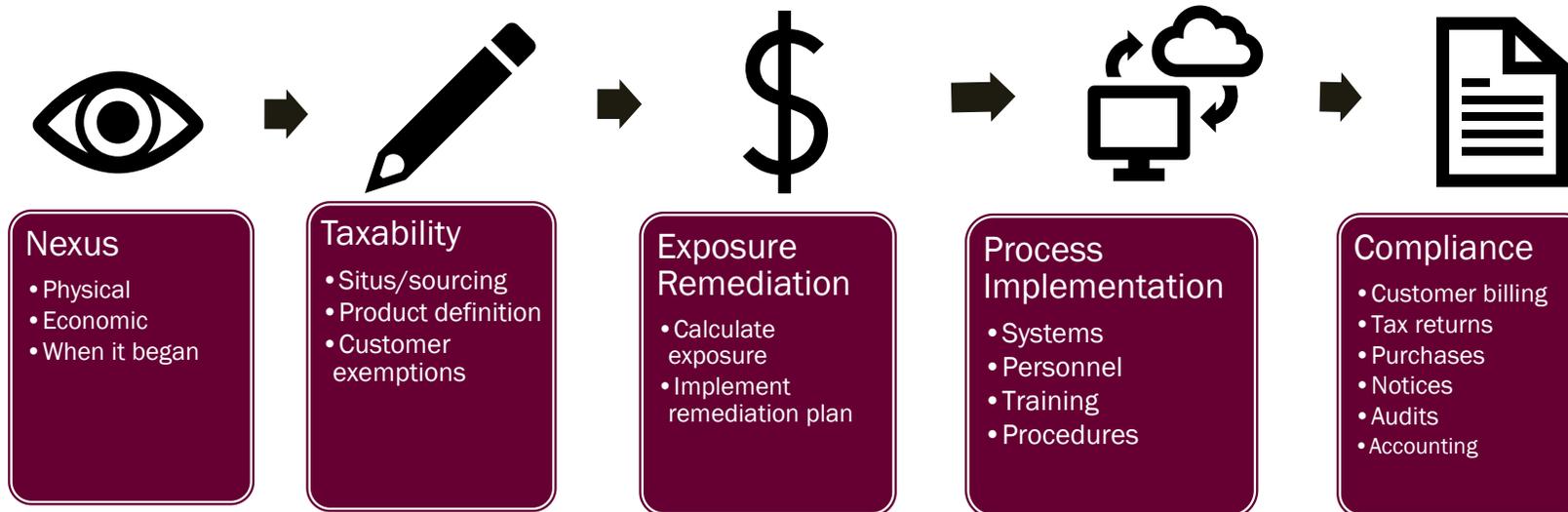
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# Key Issues - Sales Tax

# Key Take-away for Sellers



# The Path to Sales/Use Tax Compliance



# Technology Company Example

SaaS Seller

- Sales tax issues discovered in business sale due diligence

Nexus

- Economic nexus in 32 states

Taxability

- Determined taxability of products
- 12 of those states tax SaaS

Exposure

- Calculated \$1.3MM exposure

Customer Outreach

- Reduced exposure to \$200k via exemption certificates or tax paid by customer

Remediation

- Reduced ultimate liability to \$50k via Voluntary Disclosures (“VDA”)

Compliance

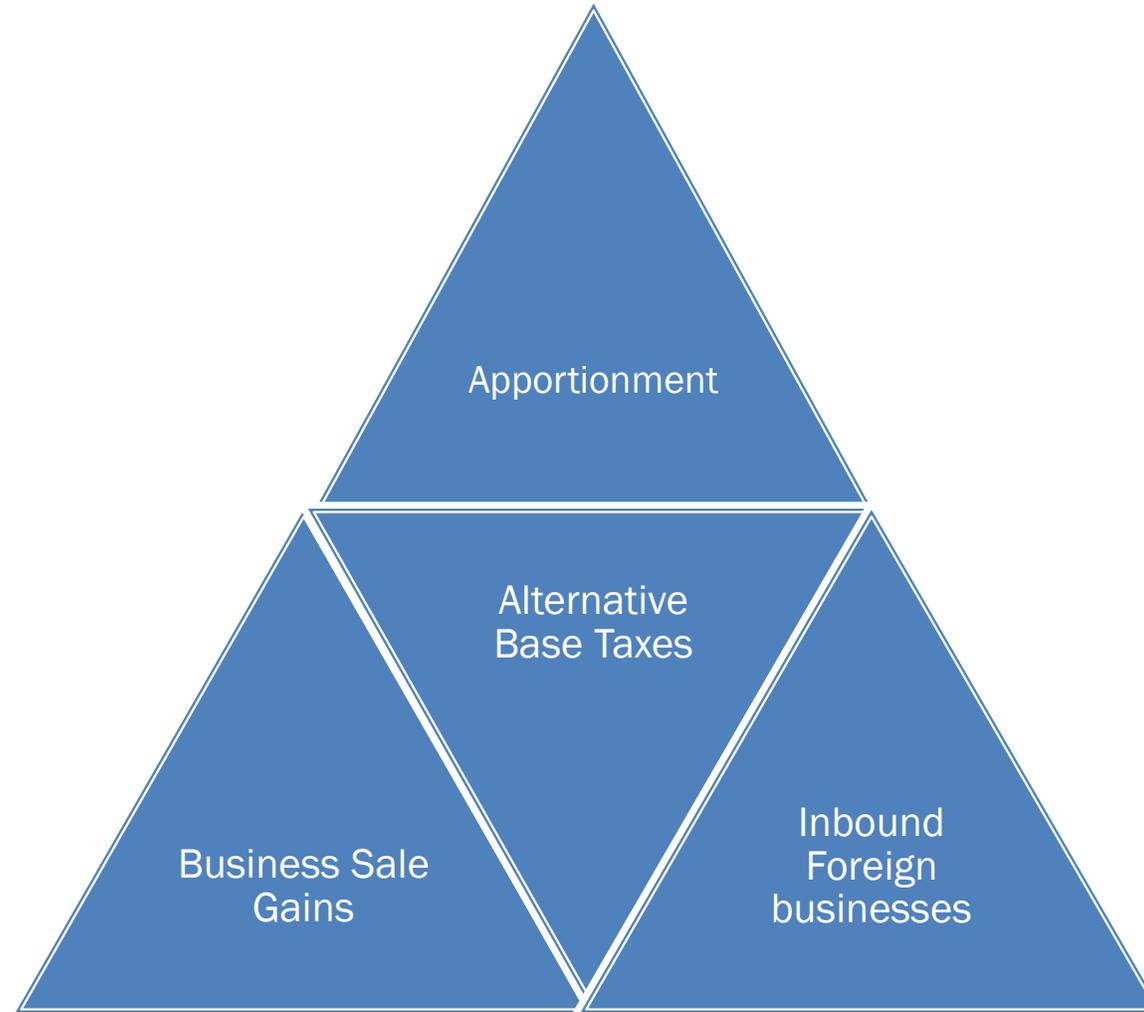
- Implemented tax automation & ongoing compliance processes



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# Key Issues - Income Tax

# Income & Franchise Taxes – Hot Issues





# Apportionment - Receipts Factor Sourcing

- ✓ Tangible personal property = destination-based sourcing
- ✓ Services
  - Cost-of-Performance (“COP”) vs. Market-Based sourcing
  - COP = location of the “income-producing activity”
  - Market = where the service was delivered or the benefit received
- ✓ Intangibles
  - Typically sourced to place of use
- ✓ Definitional issues make applying these rules challenging
- ✓ Creates risks and opportunities
  - e.g., performing services in a COP state for customer in a Market state
  - e.g., performing services in a Market state for customer in a COP state
  - Sales sourcing impacts economic nexus result



# Alternative Base Taxes

- Increasingly popular with state legislators
- Advantages for states
  - PL 86-272 doesn't apply
  - Tax revenue in a down economy – businesses pay even when not profitable
- Examples
  - California LLC Tax and Fee
  - Texas Franchise (Margin) Tax
  - Ohio CAT
  - NEW – Oregon CAT
  - Tennessee Business Tax (TNBT)
  - Washington B&O
- *All* of these have economic nexus (bright-line) thresholds

# Business sale gains – Where & How to Report

**\*\*Get it right *before* the cash is distributed\*\***

## Allocate vs. Apportion

Allocate non-business income

Apportion business income

## Sales factor inclusion

Inclusion varies by state

May exclude isolated or occasional sales, especially if significant in amount

Gross proceeds vs net gain

## Sales factor sourcing

Few states have specific provisions

Source based on type of gain

- Goodwill & intangibles
- Tangible property

# Inbound Foreign Businesses

Nexus - U.S. tax treaties generally do not apply at the state level

Foreign businesses with no US PE may still be subject to income, franchise, sales/use and other state & local taxes

Tax base for net income tax becomes a key issue

If state starts with federal taxable income, there may be no tax base

Some states use worldwide income

Some states have a tax base not tied to federal

Creating a US C-corp subsidiary can buffer the foreign entity

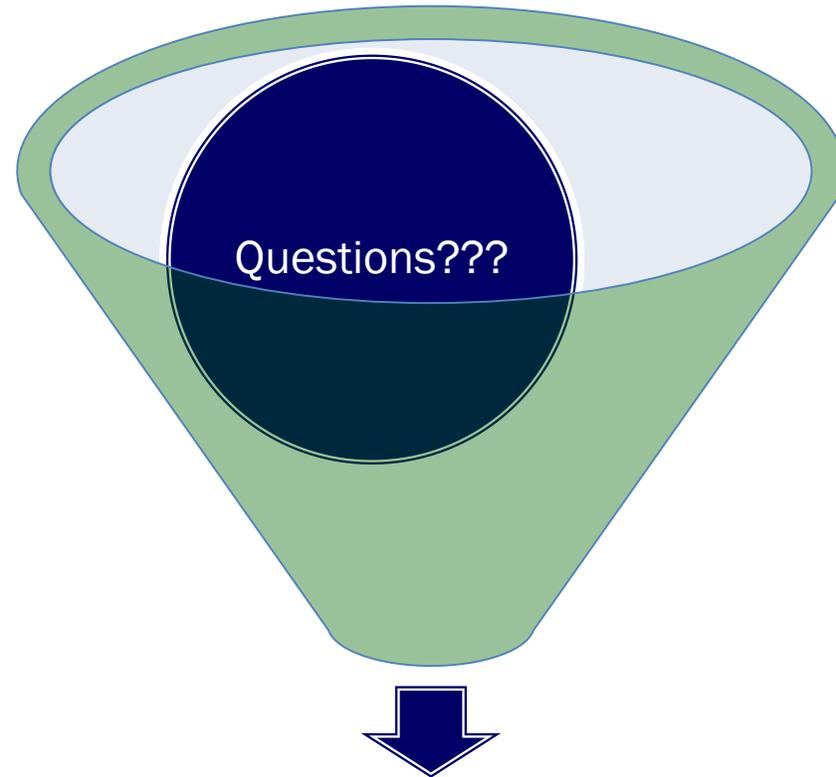
Watch out for worldwide combined reporting states and waters-edge election requirements

Watch out for US entity's use of foreign parent's employees to perform services for US customers

# Recap – Bringing it All Together

- SALT exposure can be significant, impact financial statements and M&A deals
- Expanded nexus rules increase the likelihood of exposure in new states
- Technology helps state identify taxpayers
- Different state laws create both opportunity and risk
- Proactively addressing SALT exposure allows you to minimize its impact

# Questions



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