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Does Your Business Have “NEXUS” Issues?

A business that sells to customers in many states may be exposed to a variety of multistate tax issues. “Nexus” is a concept that is increasingly becoming a hot-button issue for companies with a multistate presence.

As many states grapple with budget deficits, nexus is gaining momentum as a means by which a state or other jurisdiction may claim that a particular activity of a company is subject to tax. Activities of a company in a given state where the business has a presence may be considered sufficient — from the taxing state’s perspective — to cause a strong enough connection to impose any one or more of a number of taxes.

Businesses operating in a variety of states should consult with their tax professional as to whether taxes or other levies may be triggered in each state in which it operates. Not every state has each of the following taxes. For instance, many states do not impose an income tax and a franchise tax.

Sales and Use Tax. Generally, under federal law, a state must have “substantial nexus” to a seller in order to require the collection of sales and use taxes imposed on buyers upon the sale of goods or merchandise in its state. Over the years, “substantial nexus” has been defined generally as a company’s having a physical presence in the state, as determined by one or more of a number of factors, including the presence of a salesperson or a contractor or a location within the state.

You should determine whether any of your business’ activities creates substantial nexus with each state in which it does business. In your analysis:

- Consider the activities that you are engaged in that may rise to the level of nexus;
- Determine which states consider the activities a sufficient connection; and
- Prepare for the possible exposure to uncollected tax by conducting an analysis regarding those states where substantial nexus exists.

An added complication to the nexus concept is that, even if your out-of-state business activities do not result in exposure to one type of tax, it does not necessarily mean that those activities aren’t sufficient for the state to impose other taxes.

Income Tax. Generally, a higher level of business activity than what constitutes nexus for sales tax must be present in a given state for it to also impose an income tax. As a general rule, if an out-of-state business engages in any of the following activities, it is generally considered to have sufficient state income-tax nexus:

- Derives income from sources within the state;
- Owns or leases property in the state; or
- Employs personnel who engage in activities that go beyond those protected under federal interstate commerce laws.

Merely selling into a state should not be enough to cause nexus for income-tax purposes. Under federal law, a state may not impose a tax on out-of-state taxpayers based on or measured by net income where the only activity connecting it to the state is the solicitation of orders for sales of tangible personal property — as long as such orders are approved and shipped from outside the state trying to impose the tax. Generally, tangible personal property is an asset that can be touch or moved. Examples include furniture, jewelry, clothing, artwork, or household goods.

As a result, businesses must be vigilant against the potential exposure to income tax as it relates to a business’ solicitation for the sale of intangible property (such as goodwill, trade secrets, patents, trademarks, or copyrights), real estate, or services.

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Franchise Tax. A business' protection under federal law against the imposition of a given state's income tax does not necessarily insulate it from franchise tax. Franchise tax is typically imposed based on non-income factors, such as net worth or apportioned capital. Generally, franchise tax is exacted on a business entity for the privilege of doing business in the state. If a business has substantial nexus for sales- and use-tax purposes, it may well have exposure to a state's franchise tax.

Gross Receipts or Other Business Taxes. The concept of basing tax on non-income factors is a growing trend. Many states have passed laws that base the imposition of such a tax on measuring gross receipts generated from the seller from:

- The sale of products or services within the state;
- The value of a business' transactions within the state; or
- Some other modified base.

Such so-called gross-receipts taxes imposed on sellers are separate from sales and use tax imposed on buyers — even though the same sales receipts give rise to both tax liabilities.

A Review Is Needed

Many states have expanded their tax reach by imposing a variety of taxes based both on income and non-income factors. Business taxpayers should carefully consider their potential exposure to any one or more of the taxes discussed in this article in each state in which it does business. Need assistance determining your multistate tax obligations? Doeren Mayhew can help.

