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# Nexus Considerations in the Digital Age

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# Session CPE Requirements

- You need to attend 50 minutes to receive the full 1 CPE credit.
  - There will be 4 knowledge checks throughout the presentation. You must respond to a minimum of 3 to receive the full 1 CPE credit.

**\*\*Both requirements must be met to receive CPE credit\*\***





# Learning Objectives

Recognize the impact of internet activities for state income tax nexus purposes

Identify the nexus considerations when hiring remote employees

Recognize that the *Wayfair* decision has expanded the number and types of companies that need to consider sales tax collection

Recall the issues technology companies should consider when examining their sales tax filings



# Agenda



## What is state tax nexus?

Physical Presence

Economic Nexus

P.L. 86-272 - Internet Activities



## Remote Employees



## Impact of Wayfair



## Sales Tax Issues for Technology Companies



# Nexus Overview



# Nexus Is the Starting Point

Nexus is the amount and degree of business activity that must be present before a state can tax an entity's income

- Historically, nexus standards varied by tax type
- States are testing the waters and expanding their nexus provisions to subject companies selling into their states to tax



# Nexus for Income Tax



Not as well defined as sales tax



Most nexus provisions are very broad ... based on constitutional principles



Many States have “economic nexus” language within their state statutes



When selling tangible property must take into consideration the application of Public Law 86-272 (P.L. 86-272)





# Physical Presence Nexus



# Physical Presence Nexus

*Physical presence in a state of an employee, independent contractor acting on behalf of the company, or holding any property within a state generally results in physical presence nexus.*

**Physical presence** provides the link or connection to allow the imposition of tax



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# Nexus Considerations

Employee travel

Independent  
representatives

Delivery in trucks  
owned or leased  
by the company

Trade shows

Warranty repairs

Installation and  
technical support

Consigned  
inventory

Fulfillment by  
Amazon





# Economic Nexus



# What Is Economic Nexus?

Economic Nexus generally is created by the purposeful direction at a market with **significant sales or benefits** derived by these activities



# History of Economic Nexus?

- Originated from tax planning that shifted profits to tax havens (e.g., low taxing states) and using intangible holding companies
- Does not require physical presence in the state
- Each state's definition varies
- Standards generally include broad language but to date have only been tested for very specific types of activities such as financial related activities or licensing of intangibles
- Today the majority of states do include some type of economic nexus language in their nexus or “doing business” statute



# Economic Nexus – Income/Franchise

- Some states (and localities) have “factor based” or “bright line” nexus standards
  - States/localities with factor presence threshold: States: Alabama, California, Colorado, Connecticut, Hawaii, Maine, Massachusetts, Michigan, New York, Ohio (CAT), Oregon, Pennsylvania, Tennessee, Texas, Virginia and Washington (B&O Tax). Localities: New York City, Philadelphia, Portland, and San Francisco.

## Example: **Nexus created if;**

In state sales > \$X, or in state sales > X% of total sales,

In state property > \$X, or in state property > X% of total property, and/or

In state payroll > \$X, or in state payroll > X% of total payroll





# Public Law 86-272





# Public Law 86-272

Federal Law prohibits states from imposing a net income tax on income derived from interstate commerce if the only business activity within the state is the solicitation of orders of tangible personal property, the orders are sent outside the state for acceptance/rejection, and the orders are shipped/delivered from outside the state.



# Elements of Public Law 86-272

## *State A*

### Seller's Only Business Activities

- Solicitation of orders
- By an employee or representative
- For orders of tangible personal property
- Sent outside the state for approval
- Filled by shipment or delivery from a point outside the state

**State A**

**State B**

**No Net Income Tax**



# P.L. 86-272 – Does Not Apply To:

- Domestic corporations (corporations that are incorporated under the laws of the taxing state) and resident individuals
- Foreign commerce (although some states administratively have extended the statute's provisions to foreign commerce, the practice is not uniform.)
- Sale of intangible property
- Activities connected with services
- Taxes not based on income:
  - Sales or use tax collection
  - Gross receipts tax- Texas Margins Tax, Washington B&O tax and Ohio CAT
  - Net worth tax
  - Minimum tax



# Knowledge *Check*

Has your business reviewed its state tax filing obligations recently? And, if so, do you have you process for monitoring state nexus?

- A. Yes
- B. No
- C. Yes, but we likely need to perform an update





# Multistate Tax Commission Update to Public Law 86-272



# MTC

- **Compact Members** - States that have generally enacted the Multistate Tax Compact into their state law.
  - AL, AK, AR, CO, DC, HI, ID, KS, MO, MT, NM, ND, OR, TX, UT, WA
- **Sovereignty Members** - States that support the purposes of the Multistate Tax Compact through regular participation in the general activities of the MTC. However, the states have not enacted the Multistate Tax Compact into their state laws.
  - CA, DE, KY, LA, MI, MN, NJ, RI, VT, WV
- **Associate Members** - States that participate in MTC meetings and otherwise consult and cooperate with the MTC and its member states.
  - AZ, CT, FL, GA, IL, IN, IA, ME, MD, MA, MS, NE, NH, NY, NC, OH, OK, PA, SC, SD, TN, VA, WI, WY



# Multistate Tax Commission

## *Updates to Interpretation of Public Law 86-272*

### Significant Update:

- **New Section**, “Activities Conducted via the Internet” which reflects the shift to ecommerce

### Other updates:

- Telecommuting is a nexus activity



# Activities Conducted Via the Internet



Remote internet sellers are generally protected under P.L. 86-272 if their only activity in a customer's state is solicitation of orders of tangible personal property which are fulfilled and shipped from a location outside of the state.

*New general rule:*

If a business **interacts with customers via their website**, then the business may no longer be protected under P.L. 86-272



# Activities Conducted Via the Internet



## Unprotected activity examples:

- Electronic chat or email that customers initiate by clicking on a link on the website
- “Cookies” that gather customer information to use to adjust production, inventory volumes, new product development or identifying new items to offer for sale
- Remotely fixing or upgrading previously purchased products
- Offering extended warranties through a business’ website
- Contracting with a marketplace facilitator to facilitate sales of the business’ products on the facilitator’s website where the facilitator maintains inventory and some of the business inventory in states where the business has customers



# Activities Conducted Via the Internet

## Protected activities examples:

- “Cookies” that gather customer information for ancillary purposes, such as remembering items added to a cart or storing personal information provided by the customer
- FAQ section on a business’ website
- Offering tangible personal property on a website where a customer can view products, read item descriptions and select delivery options
- Static informational websites



# States Response to MTC – to Date

- CA – TAM No. 2022-01 and Revised Publication 1050: *American Catalog Mailers Association (ACMA) v. Franchise Tax Board*, No. CGC-22-601363 (Cal. Superior Ct., San Francisco Cnty., Dec. 13, 2023) held that the FTB violated California’s Administrative Procedure Act when it issued the TAM and Revised Publication 1050.
- NJ - New Jersey's list of unprotected activities goes beyond the MTC's to address digital assets and digital advertising services.
- NYS - New York State (not New York City) recently issued final regulations that largely follow the MTC's guidance on internet-based activities. These regulations are enforceable retroactively to 2015. ACMA filed suit arguing against the merits of the internet-based nexus regulations.
- OH - Ohio examiners received audit instructions to retroactively apply the 2021 MTC model definition change. Therefore, activities such as online chat, website cookies, online job applications, and online ordering exceed P.L. 86-272 income tax protection according to Ohio. Taxpayers can challenge determinations in the Ohio Department of Taxation hearing process.
- Other – Other states are actively analyzing the MTC’s position (e.g., MN, OR).





# Remote Employees



# Remote Employees

## Generally, will be seen as nexus creating

- Most states deem employees in the state as nexus creating, even if not performing “market creating” activities. MTC, generally, takes this view.
- Many states apportion income on a sales factor only approach. If no sales sourced to state ... then most likely no tax will be apportioned to state.
- There are still employment and other tax types to consider.
  - Registrations, sales and use taxes, PPTs, local taxes
- During a COVID-Pandemic period, many states did not consider remote employees as a factor that resulted in nexus. These provisions had a short window and have all expired.



# Knowledge *Check*

Do you need a physical presence in the state in order to have state tax nexus?





# Sales/Use Tax Collection Nexus



# Sales/Use Tax Collection Nexus

- Physical Presence Nexus
  - Physical Presence Standard from *Quill Corp. v. North Dakota* since 1992
  - Employees and property (equipment)
  - Tradeshows, traveling salespeople?
    - P.L. 86-272 protection?
  - Consider third-party activity
    - *Scholastic Books, BarnesandNoble.com* and *Borders Online*
    - Amazon laws – click-through nexus





# The *Wayfair* Decision



- *South Dakota v. Wayfair, Inc.*  
138 S. Ct 2080 (2018)
- Now, six years from *Wayfair*, all states with a sales tax have an economic nexus threshold
- Sales thresholds range from \$100,000 and up
  - Wholesale/Retail?  
TPP/services?
  - Transaction test – AND/OR  
200 transactions in a state



# Wayfair Impacts



## State Sales Tax Policy Implications



## States adding more remote sellers to collection obligations

Downloaded software

SAAS (Cloud Based – Software as a Service)

Information services

Data processing services

Digital goods

# Wayfair Impacts

- New administrative issues:
  - Measurement periods may vary
    - Rolling 12 months
    - Current calendar year
    - Previous calendar year
- How is your sales data?
- When to register?



# Wayfair Impacts

How are sales measured against the threshold

- All sales?
- Retail sales only?
- Retail sales of TPP?
  - Bundled transactions
- Taxable sales?
- May need to review taxability before applying threshold



# Wayfair Impacts on Technology



States with Multiple Points of Use (MPUs)



Digital goods



Adding functionality to a product may create sales tax

Messaging

Video streaming

# What If You Don't File



- Making a business decision
- Audits
  - Websites – marketing puffery
  - Records
    - Exemption certificates
    - MPU information
    - What's in your contract language?
    - Bundling

# Knowledge *Check*

Can a state require a company to collect sales/use tax from its customers even if no one from that company has been to that state and it was not registered for sales/use tax?

- A. Yes
- B. No
- C. It depends



# Handling Nexus

- Nexus analysis
  - Examine activities in each state
  - Review sales amounts by state
  - Managing nexus
- Registering/Voluntary Disclosure Agreements (VDAs)/Amnesty Agreements
  - Limited lookback periods
  - Penalty and interest reductions





*Thank you!*

Jack Feltham, SALT Director  
[Jack.Feltham@CLAconnect.com](mailto:Jack.Feltham@CLAconnect.com)

Kathleen Thies, SALT Director  
[Kathleen.Thies@CLAconnect.com](mailto:Kathleen.Thies@CLAconnect.com)



CLAconnect.com



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