

Nexus Considerations in the Digital Age

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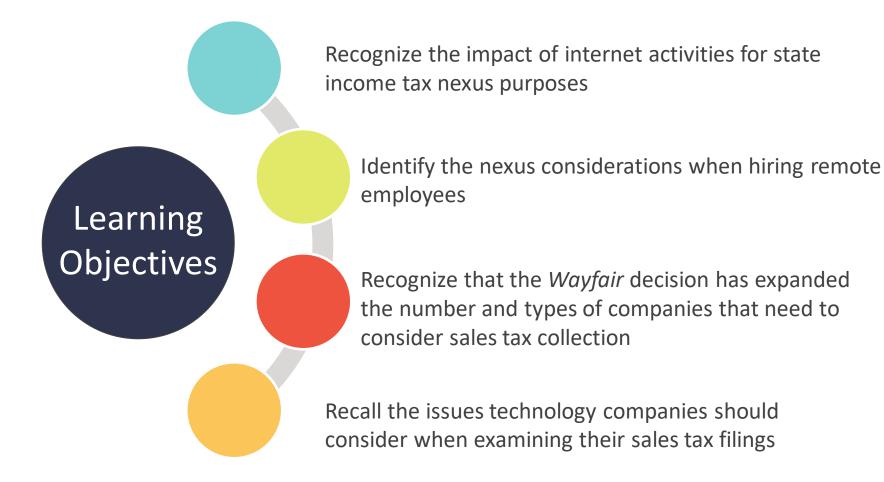
Session CPE Requirements

• 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

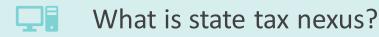






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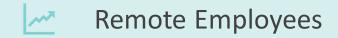


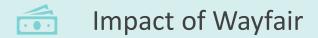


Physical Presence

Economic Nexus

P.L. 86-272 - Internet Activities







Sales Tax Issues for Technology Companies







Nexus Overview



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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





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



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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





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Economic Nexus



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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: <u>States</u>: Alabama, California, Colorado, Connecticut, Hawaii, Maine, Massachusetts, Michigan, New York, Ohio (CAT), Oregon, Pennsylvania, Tennessee, Texas, Virginia and Washington (B&O Tax). <u>Localities</u>: 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, <u>and/or</u> In state payroll > \$X, or in state payroll > X% of total payroll





Public Law 86-272



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Public Law 86-272

Federal Law prohibits states from imposing a net <u>income tax</u> 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

State A

- Sent outside the state for approval
- Filled by shipment or delivery from a point outside the state

No Net Income Tax





State B

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



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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

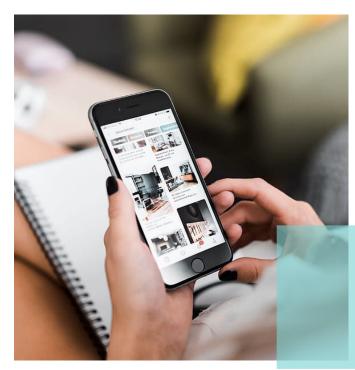
Other updates:

• 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



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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?





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Sales/Use Tax Collection Nexus



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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



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Wayfair Impacts



State Sales Tax Policy Implications



States adding more remote sellers to collection obligations

Downloaded software SAAS (Could 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)







Adding functionality to aMessagingproduct may create sales taxVideo streaming





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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

Kathleen Thies, SALT Director <u>Kathleen.Thies@CLAconnect.com</u>



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