INTRODUCTION
This practice guide was developed by the AICPA State and Local Taxation (SALT) Technical Resource Panel and related Task Forces to inform practitioners about state corporate income and franchise tax nexus issues. Practitioners should refer to the Unique Considerations for State Business Tax Returns (also available on the AICPA Tax Division Website) for common problems and unique tax issues concerning each of the states’ corporate state tax returns.

This guide is intended to be a broad reference tool concerning state nexus issues. It is not intended to answer the question of whether a specific company has certain tax obligations in a particular state. The laws and policies of each state should be researched for application to each specific taxpayer’s situation.

NEXUS
Nexus describes the amount and degree of a taxpayer’s business activity that must be present in a state before the taxpayer becomes subject to the state’s taxing jurisdiction or taxing power. For example, if a taxpayer has income tax nexus in a particular state, it will be required to file returns and pay tax on income earned in the state. Similarly, if a taxpayer has sales and use tax nexus, it will be required to collect and remit sales and use taxes on sales made to purchasers in the state.

States exercise their power to tax through tax imposition statutes. The amount of activity in or connection with a state necessary to create a tax collection or tax return filing obligation under these state imposition statutes is defined by the state statutes themselves, case law or regulation and, consequently, tends to vary from state to state. Generally, state imposition statutes are broadly written using phrases such as “doing business in” or “deriving income from” to describe the state connection (nexus) that triggers a business’ filing obligation. But, regardless of state law, there are federal limitations on a state’s power to tax which include: federal Constitutional limitations and federal statutory limitations. These federal limitations on state taxing power are interpreted by federal and state court rulings. Most of the discussion that follows assumes that the taxpayer has a filing obligation under the state imposition statute, but is questioning where a federal limitation would trump the state imposition statute.

Determining where entities with multistate presence may have nexus can be a challenge. Unless the imposition of taxation violates the U.S. Constitution or Public Law 86-272 (P.L. 86-272), these entities generally will have nexus in states in which the entity has production activities, offices, facilities, employees, and tangible property, and potentially will have nexus in states in which the entities have a significant market.
Constitutional Nexus Requirements
The U.S. Constitution’s nexus requirements are based on the Due Process and Commerce Clauses. While the language of these clauses does not directly address state taxing power, the clauses have been interpreted by the U.S. Supreme Court to protect taxpayers from the imposition of a state tax if the taxpayer lacks a sufficient connection or “nexus” with the taxing state. The Due Process Clause protects taxpayers from a state tax if the taxpayer lacks the required “minimum connection” with the taxing state. In Article I of the Constitution, Congress has the authority to regulate commerce among the states. The Court has interpreted the Commerce Clause as prohibiting states from enacting laws that unduly burden or inhibit the free flow of trade among the states. The Commerce clause protects a taxpayer from a state tax if the taxpayer lacks a “substantial nexus” with the taxing state.

Physical Presence
Historically, cases brought before the U.S. Supreme Court relating to nexus involved factual situations in which the taxpayer had a degree of physical presence in the state seeking to impose its tax. In Quill Corp. v. North Dakota, 504 U.S. 298 (1992), the U.S. Supreme Court ruled that the Commerce Clause mandated that, absent action by the U.S. Congress to the contrary, a taxpayer must have some physical presence in a state to be subject to collection responsibility for the state’s use tax (Quill at 317-318). Based on Quill and its predecessor cases, it is clear that a business must have an in-state physical presence to be subject to an obligation to collect a state’s sales/use tax. The presence of the taxpayer’s in-state customers, without more, does not create nexus and does not allow a state to impose its sales/use tax.

Congress passed Public Law 86-272 in 1959 to protect out-of-state corporations from state income taxes when the corporation’s only in-state activity was salespeople soliciting sales from customers in the state. Nexus for net income tax purposes is not established merely because sales of tangible personal property are solicited within the states. The states are prohibited under Public Law 86-272 (P.L. 86-272) from imposing a net income tax on an out-of-state entity if the entity’s only connection with the state is the solicitation of orders for tangible personal property, if those orders are accepted and shipped or delivered from outside the state.

It is important to note that P.L. 86-272 only protects certain taxpayers (those selling tangible personal property). P.L. 86-272 applies only to a “net income tax” and does not provide protection against the imposition of an obligation to collect sales tax on sales to in-state customers. Furthermore, P.L. 86-272 does not apply to gross receipts taxes, such as the

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1 The Due Process Clause States “[No] state [shall] deprive any person of life, liberty, or property, without due process of law...” U.S. Constitution, Article XIV, Section 1. The Commerce Clause states “Congress shall have power...to regulate commerce with foreign nations, and among the several states, and with the Indian Tribes...” U.S. Constitution, Article I, Section 8, Clause 3.
2 Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 US 425 (1980). The Due Process Clause also requires a rational relationship between the income taxed by the state and the taxpayer’s in-state activities.
3 Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). The Commerce Clause also requires that a state tax be fairly apportioned, not discrimination against interstate commerce, and be fairly related to the services provided by the state.
4 The designation “86-272” is a reference to the 272rd law enacted during the 86th Session of Congress.
Washington business and occupation tax or the Ohio commercial activity tax. Under P. L. 86-272, the only immunity accorded is for the solicitation of orders for the sale of tangible personal property. Thus, the solicitation for the sale of real property, intangible property, or services is not provided immunity under P. L. 86-272 and may cause a taxpayer to have nexus in a state where such solicitation occurs.

For example, the New Jersey Tax Court held that P. L. 86-272 does not protect a vendor against the state’s corporate minimum flat tax because the tax is not based on net income. For years beginning on or after 2001, taxpayers pay the highest of the minimum flat tax, tax on net income, or the Alternative Minimum Assessment (AMA), which is based on New Jersey gross receipts or New Jersey gross profits. Although of questionable constitutionality, the New Jersey law provides that P. L. 86-272 does not apply to the AMA. The AMA sunset for tax periods beginning after June 30, 2006 for corporations not claiming immunity from the New Jersey net income tax under P. L. 86-272. However, corporations protected under the public law continue to be subject to the AMA, unless they consent to the jurisdiction of New Jersey to impose the net income tax.

The term “solicitation” is not defined by P. L. 86-272. The Supreme Court has defined “solicitation of orders” as requests for purchases and any other activity that is entirely ancillary to requests for purchases. The clear line is the one between those activities that serve no independent business function apart from their connection to the solicitation of orders, and those that the company would have reason to engage in in any way, but chooses to perform through its in-state sales force.

In Wrigley, the Court affirmed the de minimis principle of P. L. 86-272 in holding that, to lose the immunity afforded by P. L. 86-272, the activity must establish a nontrivial additional connection with the taxing state. In aggregate, though minimal in comparison to Wrigley’s total solicitation activities in the state, the non-immune activities exceeded the de minimis standard. Practitioners should consider whether activities other than solicitation are more than de minimis in a particular state.

Examples of in-state activities that are generally considered protected by Public Law 86-272 include the following:

- Carrying samples and promotional materials for display or distribution without charge

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8 Wisconsin Dept. of Rev. v. William Wrigley, Jr. Co., 505 U.S. 214 (1992). In finding, Wrigley’s activities in Wisconsin exceeded the protection of P. L. 86-272; the Court held that the solicitation of orders includes “any explicit verbal request for orders and any speech or conduct that implicitly invites an order.”
• Furnishing and setting up display racks of the company’s products without charge
• Providing automobiles, computers, fax machines, and other personal property to sales personnel for use in soliciting orders
• Maintaining a display room for 14 days or less at a location within the state
• Checking of customers’ inventories without a charge therefor (for re-order, but not for other purposes such as quality control)

Examples of in-state activities that are generally not protected by Public Law 86-272 include:

• Investigating credit worthiness
• Installation or supervision of installation at or after shipment or delivery
• Making repairs or providing maintenance to property sold
• Conducting training courses, seminars, or lectures for personnel other than personnel involved only in solicitation
• Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise
• Repossessing property

Although the legislation has to date been unsuccessful, the Business Activity Tax Simplification Act (BATSA) or similar legislation has been introduced in Congress in each of the last several years as a proposed update or modernization of P. L. 86-272. The legislation seeks to, among other things, prevent the taxation of businesses that have no or minimal presence in a particular state by establishing a "bright line" physical presence standard for the imposition of state and local “business activity taxes.” Business activity taxes are defined as "any tax in the nature of a net income tax or tax measured by the amount of, or economic results of, business or related activity conducted in the State.” Many states and the Multistate Tax Commission have opposed BATSA as a costly and intrusive federal limitation on their sovereignty. They have argued that the bill would create tax planning opportunities to allow taxpayers to avoid a state’s net income tax despite a large physical presence and substantial business activity in the state.

With respect to the sales and use tax, to date, there have been several unsuccessful attempts to pass legislation that would expand a state’s jurisdiction to tax an out-of-state retailer. The Marketplace Fairness Act, most recently introduced in Congress in 2013, would grant states that meet minimum sales tax simplification requirements the authority to compel remote sellers with a sufficient amount of sales to collect sales tax at the time of a transaction – holding those retailers to the same standard as local “bricks and mortar” retailers.

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10 H.R. 2992, 113th Congress
11 S. 743, 113th Congress (2013-2014). The Marketplace Fairness Act was introduced in the Senate on 4/16/13 and an amended version passed the Senate on May 6, 2013.
Economic Nexus
In the 1992 *Quill* ruling, the U.S. Supreme Court did not address the issue of whether the physical presence test for constitutional nexus applies to nexus for income tax purposes.

Most states assert that the nexus standard for income tax purposes is a lower threshold than for sales/use tax purposes; and thus argue that physical presence is not required before an income-based tax can be imposed.

This lower, state asserted, income tax nexus standard is commonly referred to as “economic nexus” because it is based upon the business’s economic, or non-physical, connections with the taxing state’s market or customers. In recent years, a number of state courts have validated this state asserted nexus standard and held that *Quill* does not apply to income taxes.

Economic Nexus Cases in the State Courts
The highest courts in some states have ruled that an economic presence is sufficient to create income tax nexus, despite the lack of physical connection between the state and the taxpayer. Several states have enacted statutes establishing an economic nexus standard for income tax purposes. Common situations in which states have asserted the principle of economic nexus include out-of-state trademark holding companies that derive income from transactions from licensing intangibles in the state, and out-of-state credit card banks that derive income from transactions involving state residents and merchants.

Economic nexus cases originate with the landmark 1993 South Carolina Supreme Court ruling that a Delaware holding company that owned only intangible property used in South Carolina and other states was subject to that state’s income tax. The court rejected Geoffrey’s claim that it had not purposefully directed its activities toward South Carolina’s economic forum and held that by licensing intangibles for use in the state and receiving income in exchange for their use, Geoffrey had the minimum connection and substantial nexus with South Carolina required by the Due Process Clause and the Commerce Clause of the U.S. Constitution. In addition, Geoffrey’s receivables were found to have a business situs in South Carolina. The U.S. Supreme Court subsequently denied certiorari in *Geoffrey*, making the case binding only in the state of South Carolina. Many states, however, have incorporated through statute or regulation the principles of economic nexus outlined in *Geoffrey* regarding intangibles in the nature of trademarks and trade names.


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In contrast, courts have ruled that out-of-state businesses were not subject to a state nexus in several situations. For example, the Tennessee Court of Appeal considered whether Tennessee could impose its franchise and excise taxes upon J.C. Penney National Bank (“JCPNB”) based on JCPNB’s extension of credit card lending services to Tennessee residents. JCPNB had between 11,000 and 17,000 credit card accounts with Tennessee residents, but did not have employees or offices within the state. Tennessee residents could not apply for JCPNB credit cards in the local J.C. Penney stores nor could the customers make a payment on their account at the stores. The Tennessee Court of Appeal rejected the Commissioner of Revenue’s position that JCPNB’s economic presence within Tennessee by itself satisfied the Commerce Clause’s substantial nexus requirement.

Two more recent cases in West Virginia and Oklahoma found that, in certain instances, out-of-state licensors of intangible property may not have nexus in that state. In the Oklahoma case, the Oklahoma Supreme Court held that Oklahoma could not impose its corporate income tax on the out-of-state licensor as a result of its licensing of intellectual property to a related party. The licensor was organized as an insurance company under the laws of Vermont and licensed intellectual property to Wendy’s International Inc., which then sublicensed the intellectual property to Wendy’s restaurants, including restaurants located in Oklahoma. The Oklahoma court held that “due process is offended by Oklahoma’s attempt to tax an out-of-state corporation that has no contact with Oklahoma other than receiving payments from an Oklahoma taxpayer...who has a bona fide obligation to do so under a contract not made in Oklahoma.”

Economic Nexus in State Statutes and the Factor Presence Nexus Standard
Several state legislatures have taken a more aggressive stance in recent years in enacting legislation that adopts an economic nexus or factor presence nexus standard.

Factor presence nexus is dictated by the amount of property, payroll, or sales a business has within a state. The Multistate Tax Commission’s model statute entitled the Factor Presence

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16 Id.
Nexus Standard for Business Activity Taxes asserts nexus based on a certain amount of economic activity alone, or a certain amount of physical presence alone. Each factor is an indicator of a business’ contact with a state. A number of states have either adopted the MTC’s model statute or similar imposition statutes.

Ohio was the first state to incorporate factor presence into its law. Upon its adoption of the Commercial Activity Tax, Ohio incorporated the MTC’s factor presence standards into its statutory nexus requirements. Michigan was another state that incorporated factor presence principles into the nexus standards of the Michigan Business Tax (“MBT”). A taxpayer has substantial nexus in Michigan and is subject to the MBT if the taxpayer has a physical presence in Michigan for a period of more than one day during the tax year or if the taxpayer actively solicits sales in Michigan and has gross receipts of $350,000 or more.

Wisconsin enacted legislation that incorporates an economic nexus standard into its law by expending its “doing business” definition. Colorado also adopted factor presence principles in 2010 by the finalization of its regulations. Washington enacted legislation that creates a factor presence nexus standard for tax periods beginning after May 31, 2010. The factor-presence nexus standard differs from the MTC model language in that receipts of $250,000 or more, versus $500,000, creates nexus in the taxing state. The new rule also provides that if nexus is established in one year, it will also exist for the subsequent year. California ($500,000 in sales indexed for inflation) and New York ($1,000,000 in sales) are examples of states that have recently adopted factor presence nexus standards.

Practitioners with clients licensing intangibles or otherwise deriving income where the activities are not protected by P. L. 86-272 in states where the client does not otherwise have a physical presence should review any recent changes in the applicable state laws and regulations, as well as recent court decisions in this area. We expect taxpayer challenges to one or more of these factor presence statutes or regulations.

**Affiliate Nexus**
Companies may establish nexus with a state through relationships with third parties that are neither employees nor independent contractors. Often termed “representational nexus” by states and “attributional nexus” by taxpayers, nexus is “attributed” to the taxpayer through the actions of third parties that establish and maintain a market for that taxpayer.

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17 Ohio Rev. Code Ann. Section 5751.01(l)
18 Wis. Stat. Section 71.22(1r)
19 Colo. Code Reg. Section 39-22-301.1(2)(b)
21 Wash. Admin. Code 458-20-19401(9)
22 Cal. Rev. & Tax Code Section 23101(b).
23 N.Y. Tax Law Section 209.1(b).
Affiliate nexus statutes have been enacted by many states and provide that the in-state presence of an affiliated company can create nexus for a separate out-of-state entity, such as a mail order or online vendor. These statutes generally impose a filing obligation (sales/use tax) for remote sellers with an in-state bricks and mortar affiliate. The primary threshold for nexus is based on affiliated relationships between an out-of-state seller and an in-state business that maintains at least one in-state location. An entity is considered affiliated if the related entity promotes the affiliate’s business.

Older affiliate nexus statutes require a minimum common ownership between the in-state affiliate and the remote seller. However, the more recent affiliate nexus statutes have no such common ownership requirement. The leading example of this newer style of affiliate nexus statute is the New York law which requires out-of-state vendors to collect and remit sales/use tax if the seller enters into an agreement with a resident of the state under which the resident, for commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website or otherwise, to the seller. In addition, the cumulative gross receipts from such referred sales to New York customers must exceed $10,000 during the preceding four calendar quarters.

Amazon.com and Overstock.com challenged the constitutionality of New York’s law. After making its way through the trial court and initial appellate court, the New York Court of Appeals (the state’s highest court) recently held that the statute did not violate the U.S. Constitution on its face, and the U.S. Supreme Court declined to review the decision.

The Court found that it was reasonable to impose sales/use tax collection burdens on out-of-state retailers, such as Amazon.com and Overstock.com, which have effectively established an in-state sales force through affiliate programs. Since New York passed its so-called “Amazon law” in 2008, other states, including Arkansas, California, Connecticut, Georgia, Florida, Illinois, North Carolina, Rhode Island, and Vermont, have been publicly and diligently pursuing compliance through similar practices. Vermont’s statute becomes effective only when fifteen states have adopted similar legislation. Additionally, the Multistate Tax Commission is working on language for a model sales/use tax nexus statute, including a section based on New York’s “Amazon Law.”

Other states, including Colorado and Oklahoma, have enacted laws that require remote sellers to provide notice to their customers that sales/use tax may be due to the state on purchases.

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26 New York Tax Law Section 1101(b)(8)(vi)
28 In 2013, the Illinois Supreme Court held in Performance Marketing Association, Inc. v. Hamer that the state’s original click-through nexus statutes contained in P.A. 96-1544 (H.B. 3659), Laws 2011 were void and unenforceable due to the federal prohibition against discriminatory state taxes on electronic commerce contained in the Internet Tax Freedom Act. 998 N.E.2d 54 (Ill. 2013). In response, Illinois approved legislation that amended the state’s sales and use tax click-through nexus statutes. P.A. 98-1089 (S.B. 352), Laws 2014, effective Jan. 1, 2015.
they have made through the seller. Oklahoma’s law requires that remote vendors selling into the state include such a notice, but it does not require that the seller report sales to the state.29 Colorado’s law requires that all sellers that make sales over a certain threshold in the state to either collect the tax or inform the consumers of their potential tax liability and inform the state of the sale.30 The U.S. Supreme Court is currently considering whether the Tax Injunction Act bars a taxpayer from seeking a ruling on the constitutionality of Colorado’s use tax reporting requirements in federal district court.31 Whether or not the U.S. Supreme Court decides in favor of the seller, the seller is likely to appeal the notice requirements as violative of the Commerce Clause because they only apply to out-of-state retailers.

In the area of income tax, the Maryland Court of Special Appeals, that state’s highest court, determined that two out-of-state intangible holding companies had corporate income tax nexus with Maryland because they were considered to have no real economic substance as separate business entities apart from their parent corporation.32 In addition, the court upheld the Comptroller’s discretionary use of an alternative apportionment formula. With respect to the nexus issue, the court applied the “real economic substance as a separate entity” test developed in Comptroller of the Treasury v. SYL, Inc.33 and The Classics Chicago, Inc. v. Comptroller of the Treasury,34 finding that neither the out-of-state patent holding company nor the out-of-state investment management company had substantial activity apart from their Maryland parent. The court reasoned that Gore’s activity generated the subsidiaries income and that the operations of the entities were so intertwined as to make them inseparable; therefore, causing the out-of-state subsidiaries to meet the “substantial nexus” requirements of the Commerce Clause and being subject to tax in Maryland.

Multistate Tax Commission Voluntary Disclosure

Through its National Nexus Program, the MTC also assists businesses involved in multistate commerce in voluntarily resolving potential state sales/use and income/franchise tax liabilities where nexus is the central issue. The program acts as a coordinator through which companies may approach 46 states which participate in these programs (AL, AK, AZ, AR, CA (SBE only), CO, CT, DC, FL, GA, HI, ID, IN, IA, KS, KY, LA, ME, MD, MA, MI, NN, MS, MO, MT, NE, NH, NJ, NC, ND, OH, OK, OR, RI, SC, SD, TN, TX, UT, VT, VA, WA, WV, WI, WY) anonymously and seek resolution of potential liabilities arising from past activities. It is the strict policy of the MTC and its National Nexus program that they will not reveal the identity of a taxpayer to any state that does not accept the voluntary disclosure agreement. Further information on this program can be found on the MTC’s web page (http://www.mtc.gov) or by contacting the National Nexus Program at 202-695-8140 or nexus@mtc.gov. Experience has shown that, in some cases, taxpayers may be able to negotiate a more favorable arrangement directly with

29 68 Ok. Stat. Section 1401.9(B)(1).
individual states; however, the time or cost of doing so may exceed the benefit of negotiating with just one person.

**Conclusion**
The issue of nexus for income, franchise/net worth, sales/use, and other tax purposes is a complex one and there is a tremendous degree of inconsistency among the states. The large number of court cases in this area highlights the fact that the Due Process and Commerce Clause analysis is largely dependent on the specific facts and circumstances of each case. Among the state court systems, emerging issues, such as representational nexus, affiliate nexus, and economic nexus, evolve in the ever-changing market place. In addition, the changing landscape of state taxes, including the move to non-traditional, non-income based taxes adds complexity. This guide is meant as a broad reference tool to be used to highlight those areas that may warrant more in-depth study.