Tax Section

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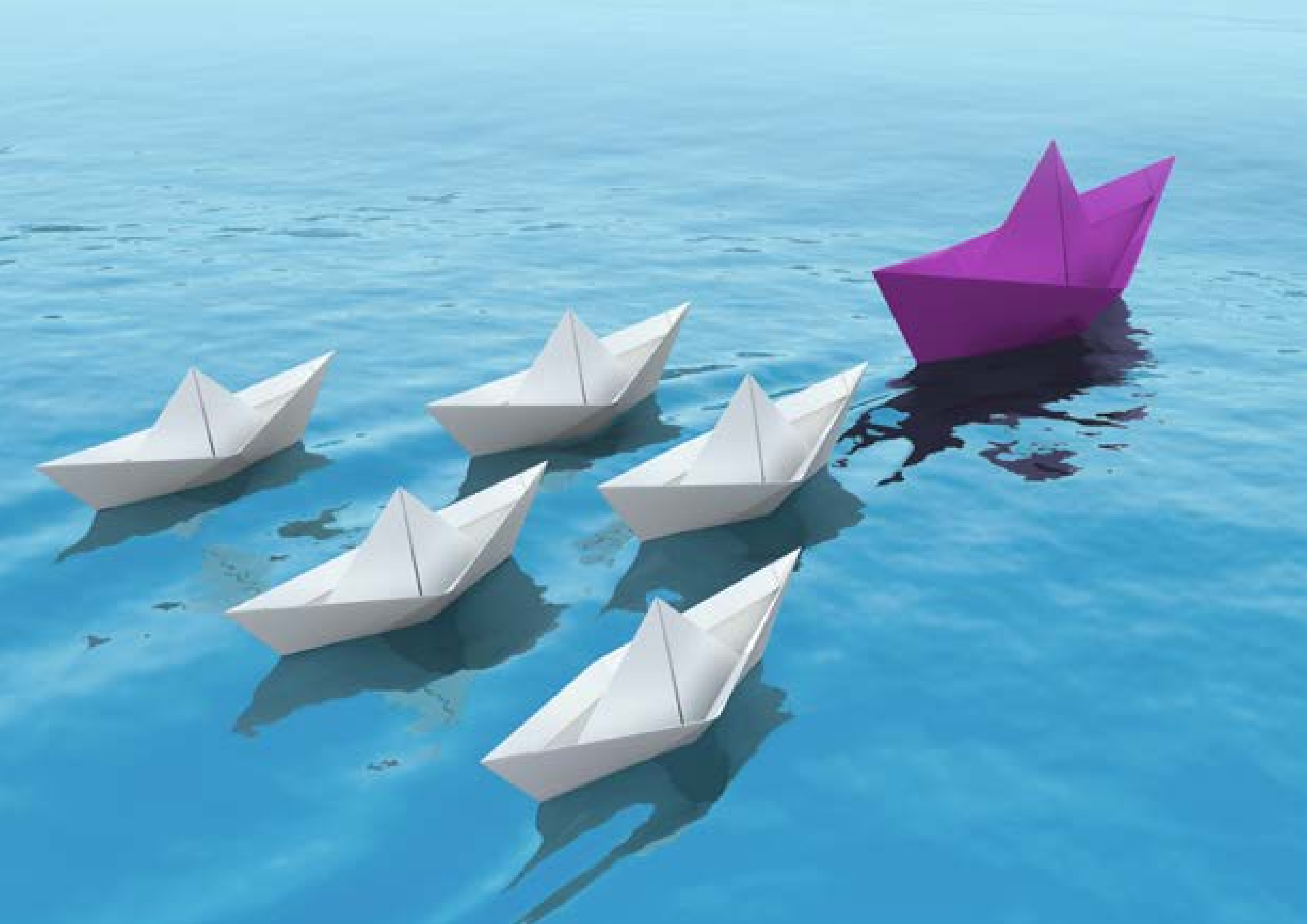
AICPA

2019 State tax nexus guide



Contents

Introduction

This practice guide was developed by the AICPA Tax Section to inform practitioners about state tax nexus issues. Practitioners should refer to the bundle of resources contained in the 2019 Annual Tax Compliance Kit for further guidance on nexus and state tax considerations.

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.

Overview

Definition of nexus

Nexus describes the amount and degree of a taxpayer's business activity that must be present in a state for the taxpayer to become subject to the state's taxing jurisdiction or taxing power. For example, if a taxpayer has income tax nexus in a state, it will be required to file returns and, subject to certain exceptions, pay tax on income earned in that 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 that 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 state statutes, case law or regulations. Consequently, nexus standards 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. In addition to state law, the U.S. Constitution and federal statutes limit a state's power to tax. Federal and state case law has interpreted these federal limitations on state taxing power.

Determining where an entity with a multistate presence may have nexus can be a challenge. Unless the imposition of taxation violates the U.S. Constitution or, for taxes based on income, Public Law 86-272 (P.L. 86-272), an entity generally will have tax nexus in states in which the entity has production activities, offices, facilities, employees or tangible property. Additionally, an entity may have nexus in states that have adopted economic nexus or factor presence nexus standards if the entity meets or exceeds the state's thresholds. These economic nexus policies have been broadly attempted for both income tax and sales and use tax considering the recent decision in *South Dakota v. Wayfair Inc.*, No. 17-494 (U.S. 6/21/18).

Constitutional nexus requirements

The U.S. Constitution's nexus requirements are based on the Due Process and Commerce Clauses.[1] 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 contacts" with the taxing state.[2]

The physical presence standard

Out-of-state sales tax collection and remittance requirements were notably addressed in *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967). In this case, National Bellas Hess Inc., a mail-order company, challenged Illinois over its statute that required out-of-state retailers to collect and remit Illinois sales tax. Because the only connection National Bellas Hess Inc. had with Illinois was through common carriers and the United States mail system, it believed the statute was in violation of the Commerce Clause. The Court ultimately determined that physical presence was needed to establish nexus for a state to require out-of-state businesses to collect and remit sales taxes.

In the case *Complete Auto Transit Inc. v. Brady*[3] a decade later, a framework was established to identify if a taxpayer has "substantial nexus" with the

[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. . ." *Constitution, Article I, Section 8, Clause 3.*

[2] *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 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 discriminate against interstate commerce, and be fairly related to the services provided by the state.

taxing state. Specifically, a tax will be enforced if it "(1) applies to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce and (4) is fairly related to services the state provides.[4] In 1992, the Supreme Court reexamined the physical presence standard with another case *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). In this case, North Dakota's law requiring any business engaging in "regular or systematic" solicitation in the state to become registered for and collect and remit sales tax was challenged.

In *Quill*, the U.S. Supreme Court reaffirmed 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 sales tax.[5] Based on *Quill*, it was clear that a business must have an in-state physical presence to be subject to an obligation to collect a state's sales tax. This standard recognizes that physical presence is needed to complete the nexus "prong" of the *Complete Auto* framework. The presence of the taxpayer's in-state customers, without more, did not create nexus and did not allow a state to impose a collection responsibility. States have taken different positions concerning whether the physical presence standard enunciated in *Quill* applies to taxes other than sales tax. The decision does not directly address this issue, but many states took the position that *Quill* only applies to sales tax.

[4] *South Dakota v. Wayfair Inc.*,138 S. Ct. 2020, 2091 (2018) (citing Complete Auto, 430 U.S. at 279
[5] *Quill* at 317-318.

Sales and use taxes

"Expanded" nexus provisions (click-through nexus, affiliate nexus, cookie nexus and notice and reporting)

While the Supreme Court may have affirmed the physical presence "bright-line rule" in *Quill*, that is not to say that the physical presence requirement has not been tested or its boundaries stretched prior to the *Wayfair* case. Presumably these standards are less relevant given the new economic nexus standards discussed below, but taxpayers should be aware of them because these "expanded" nexus provisions could result in a company having historical sales tax exposure, or prospective exposure if the company's sales do not meet a state's economic nexus threshold.

Click-through nexus

In 2008, New York enacted click-through nexus legislation that requires out-of-state internet retailers to collect and remit state sales tax on tangible personal property or taxable services sold through links on websites owned by in-state residents, referred to as "affiliates."[6] The law provided a threshold requirement of at least $10,000 in gross receipts from referred sales. Since 2008, about 22 additional states have enacted similar legislation or issued guidance interpreting current state laws to allow comparable treatment.

Affiliate nexus

In 2010, Colorado took a different approach to taxing out-of-state sellers and enacted controlled-group nexus. Under this law, out-of-state sellers must collect Colorado tax if they are part of a "controlled group," defined by reference to the Internal Revenue Code, that has a "component member" that is a retailer with a physical presence in the state.[7] The statute provides that the nexus presumption may be rebutted under certain conditions. Since Colorado enacted its law, over 20 states have enacted some form of controlled-group nexus.

Cookie nexus

Massachusetts took a different position than other states on how to require tax collection from internet sellers. The Commonwealth, through the issuance of Directive 17-1, stated that it was adopting an administrative bright-line rule for internet vendors based on a dollar and transaction threshold, so long as they had physical presence in the state. While at first blush the interpretation seems like other economic nexus standards, Directive 17-1 went on to explain that physical presence is invariably satisfied for internet vendors by the presence of in-state internet "cookies" or content delivery networks. The Directive was immediately challenged on procedural grounds and withdrawn, but new regulations were issued on Sept. 22, 2017, that provide substantially the same requirements.[8] Massachusetts has since rescinded this rule and replaced it with a traditional economic nexus standard, but the standard still exists for prior periods.

Notice and reporting

In addition to states expanding the definition of physical presence, in 2010, Colorado enacted the nation's first use tax notice and reporting requirement for out-of-state sellers. While the law was enacted in 2010, an immediate challenge by the Direct Marketing Association (DMA) resulted in the law not being implemented until July 2017. The law requires out-of-state sellers that do not collect sales tax on sales made to customers within Colorado and have gross receipts in excess of $100,000 during the previous calendar year, to report information about Colorado customers to the Colorado Department of Revenue.[9] Several states have followed Colorado's

[6] *N.Y. Tax Law § 1101(b)(8)(vi).*
[7] Colo. Rev. Stat. § 39-26-102(3)(b).
[8] 830 CMR 64H.1.7.
[9] See, 39 Colo. Code Regs. §21-112(3.5).

lead, enacting similar notice and reporting requirements to increase compliance by individuals.

Many have argued that these notice and reporting requirements are more onerous and costly than collecting the sales tax, but the ultimate failure of the challenge brought by the DMA meant that these requirements were here to stay — at least until the states had better options available. Perhaps forebodingly, Justice Anthony Kennedy noted in his concurring opinion on the DMA challenge that "it is unwise to delay any longer a reconsideration of the Court's holding in *Quill*."[10] It remains to be seen how the notice and reporting provisions will be utilized after the *Wayfair* holding.

The evolution of economic nexus

Over the years, with the widespread use of the internet and online sales, states began changing the rules and imposed the obligation to collect sales tax based on a new concept: "economic nexus." Broadly stated, economic nexus standards are standards that do not consider physical presence. Instead, they often look to a business's economic, or non-physical, connections with the taxing state's market or customers.

South Dakota was one state that enacted an economic nexus law (S.D. Codified Laws Sec. 10-64-2). The South Dakota law provides that if a seller makes $100,000 of sales into the state, or has 200 or more sales transactions into the state in a calendar year, the seller must collect sales tax. The law did not impose sales taxes retroactively. After enactment, three companies impacted by the law sued South Dakota: Newegg, Overstock.com and Wayfair.

After the case made its way through state courts, South Dakota took its arguments to the U.S. Supreme Court. On June 21, 2018, in a 5-4 ruling, the U.S. Supreme Court handed down a historic decision in *Wayfair*. The ruling concluded that the physical presence rule of *Quill* was "unsound and incorrect." With *Quill* overturned, the Court opened the possibility for states to impose sales tax collection obligations without regard to a taxpayer's physical presence in a state. Many states have responded to *Wayfair* for sales and use tax purposes; however, although the case does not directly address income tax nexus, state activity in the sales and use tax environment may indicate changes for income tax nexus.

Economic nexus

Nearly every state has released economic nexus laws since *Wayfair* was decided. As of October 2019, 43 jurisdictions have imposed economic nexus laws. While most states have enacted economic nexus laws, they continue to release guidance clarifying the nuances of these laws (e.g., what receipts should be considered when determining whether an individual has met the economic nexus threshold, what constitutes a "transaction," etc.). Some states have also revised their dollar thresholds and/or transaction thresholds for future years.

Additionally, several states have recently published guidance and/or modified their tax codes to extend economic nexus laws to marketplace sales. These rules generally provide that marketplace facilitators establish nexus and are, thus, responsible for collecting and remitting tax if the aggregate sales made on its online marketplace meet the economic nexus thresholds. An online marketplace is a platform on which individuals can sell their products (Amazon, Etsy, etc.). As of October 2019, 35 jurisdictions have adopted marketplace economic nexus rules.

For a detailed breakout of each states' economic nexus requirements, see the AICPA Tax Section's *2019 State tax guide for businesses*.

Federal legislative attempts

There have been several unsuccessful attempts to legislatively expand a state's jurisdiction to tax an out-of-state retailer, most notably through the U.S. Senate's Marketplace Fairness Act (MFA)[11] and the U.S. House's Remote Transactions Parity Act (RTPA).[12]

[10] *Direct Marketing Ass'n v. Brohl*, 575 U.S. ___ (2015) (Justice Kennedy, dissenting).

[11] *Reintroduced in 2017 as S. 976, 115th Congress (2017-2018). An amended version of the MFA passed the Senate on May 6, 2013; reintroduced in 2015 as S. 698, 114th Congress (2015-16).*

[12] *Reintroduced in 2017 as H.R. 2193, 115th Congress (2017-2018)*

Both the MFA and the RTPA have been introduced in several Congresses and, while they offered slightly different approaches, both sought to replace the physical-presence standard with an economic nexus standard. In August 2016, after both the MFA and RTPA failed to pass both the U.S. House and U.S. Senate but continued to garner more support from policymakers, opposition to the underlying policy approach promoted in MFA and RTPA increased. This led to a discussion draft of the Online Sales Simplification Act of 2016 to be circulated. This draft was a revision of a previous draft circulated in 2015. The 2016 version allowed for the collection of applicable sales and use taxes on remote sales if that state was deemed to be the state of origin for the sale. The tax would have collected from the seller by the origin state and remitted to the destination state via a clearinghouse to be established by participating states. Each member state of the clearinghouse would establish a single statewide rate for all sales destined for that state.

In July 2017, the No Regulation Without Representation Act was introduced which would have codified the physical presence requirement in *Quill*. Despite widespread support from most states and a diverse coalition of small and large retailers for MFA and RTPA, congressional efforts to address the issue remained elusive.

Multistate Tax Commission (MTC) voluntary disclosure

Through its National Nexus Program (NNP), the MTC also assists businesses involved in multistate commerce in voluntarily resolving potential state sales and use and income and franchise tax liabilities where nexus is the central issue. The program acts as a coordinator through which companies may simultaneously approach multiple states which participate in these programs anonymously to negotiate a settlement and seek resolution of potential liabilities arising from past activities using a uniform procedure coordinated through the NNP staff of the MTC. It is the strict policy of the MTC and the NNP 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 webpage or by contacting the NNP at 202.695.8140 or nexus@mtc.gov. Experience has shown that often taxpayers may be able to negotiate a better arrangement directly with individual states; however, the time or cost of doing so may exceed the benefit of negotiating with just one person via the NNP.

Income, franchise and other state taxes

P.L. 86-272 (15 U.S.C. §§ 381–384)

As discussed in detail below, the *Wayfair* decision and the evolution of factor presence or economic nexus standards applicable to business activity taxes have expanded a state's ability to impose business activity taxes on out of state entities. However, to date, P.L. 86-272 protection remains applicable to sellers of tangible personal property.

Congress passed P.L. 86-272 in 1959 to protect out-of-state corporations from state income taxes when the entity's activity in the state is limited to certain activities.[13] Specifically, P.L. 86-272 prohibits states 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 such 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 or use tax on property acquired outside of the state but used within the state.[14] Furthermore, P.L. 86- 272 does not apply to other non-income-based taxes, such as gross receipts taxes, including Washington's business and occupation (B&O) tax or the Ohio Commercial Activity Tax (CAT). 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 an income tax liability in the state where such solicitation occurs.

The term "solicitation" is not defined by P.L. 86-272. The Supreme Court defined "solicitation of orders" as requests for purchases and any other activity that is entirely ancillary to requests for purchases in *Wisconsin Dept. of Rev. v. William Wrigley Jr. Co.*, 505 U.S. 214 (1992). 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 any way but chooses to perform through its in-state sales force.[15]

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 P.L. 86-272 include the following:[16]

- Carrying samples and promotional materials for display or distribution without charge
- Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise
- Repossessing property
- 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

[13] The designation P.L. 86-272 is a reference to the 272nd law enacted during the 86th session of Congress. P.L. 86-272(b) provides for a caveat for domestic corporations of a state.

[14] *Guardian Industries Corp. v. Dept. of Treasury*, 198 Mich. app 363 (1993).

[15] *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."

[16] Excerpts from the statement of Information Concerning Practices of Multistate Tax Commission and signatory states under P.L. 86-272 (third revision adopted on July 27, 2001). We note that the MTC is considering updates to its examples of in-state activities that are protected by P.L. 86-272 and not protected by P.L. 86-272.

- Maintaining a display room for 14 days or fewer 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 P.L. 86-272 include:

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

The Business Activity Tax Simplification Act of 2019 (BATSA) and similar legislation has been introduced in each of the last several years as an update or modernization of P.L. 86-272.[17] 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 MTC 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.

Economic nexus for income and franchise taxes

Due to the fact that *National Bellas Hess* and *Quill* are both sales and use tax collection cases, some state courts have interpreted *Quill* as limiting the *National Bellas Hess* physical presence requirement to the sales and use tax domain.[18] Further, the *Wayfair* decision did not expressly differentiate between state income tax or sales and use tax when it changed the physical presence rule ("physical presence is not necessary to create substantial nexus").[19] Consequently, states without current economic or factor presence laws for income tax purposes may assert income tax nexus more broadly in the aftermath of *Wayfair*.

History of economic nexus cases for income and franchise taxes in the state courts

Economic nexus cases originated with the landmark 1993 South Carolina Supreme Court ruling in *Geoffrey Inc. v. South Carolina Tax Commission (Geoffrey)*. In *Geoffrey*, the Supreme Court of South Carolina upheld the imposition of the state corporate income tax on a taxpayer based only on its licensing agreements with a related entity located within the state.[20] The court rejected the appellant's (Geoffrey, Inc.'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, the appellant 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, the appellant'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, but allowing the decision and the imposition of nexus to stand. Many states have subsequently adopted, through statute, regulation or other guidance, the principles of economic nexus outlined in *Geoffrey* regarding intangibles in the nature of trademarks and trade names.

[17] *Reintroduced in 2019 as H.R. 3063, 116th Congress (2019-2020).*
[18] *See, e.g., Geoffrey Inc. v. South Carolina Tax Comm'n*, 313 S.C. 15 (1993), cert. denied, 510 U.S. 992 (1993).
[19] *South Dakota v. Wayfair Inc.* et. al. No. 17-494.
[20] *Geoffrey Inc. v. South Carolina Tax Commission*, 313 S.C. 15, 437 s.e.2d 13 (S.C. 1993).

Other cases that have reached similar results to *Geoffrey* include: *Kmart Corporation v. Taxation and Revenue Department*, 139 N.M. 172, 131 p.3d 22 (New Mex. 2005); *A&F Trademark Inc. v. Tolson*, 605 s.e.2d 187 (N.C. Ct. app. 2004), cert. denied, 546 U.S. 821 (2005); *Geoffrey Inc. v. Commissioner of Revenue*, 453 Mass. 17, 899 N.E. 2d 87 (Mass. 2009); *Lanco Inc. v. Director, Division of Taxation*, 379 N.J. super. 562 (2005), aff'd 908 a.2d 176 (N.J. 2006), cert. denied, 551 U.S. 1131 (2007); *Bridges v. Geoffrey Inc.*, 984 s.e.2d 115 (La. app. 2008); *KFC Corp. v. Iowa Dept. of Revenue*, 792 N.W.2d 308 (Iowa 2010), cert. denied, 132 s. Ct. 97 (2011); *Spring Licensing Group Inc. v. Dir., Div. of Taxation*, No. 010001-2010 (N.J. tax Ct. 2015). In a smaller number of cases, the courts held that the mere issuance of credit cards to customers who live in the taxing state creates nexus for income tax purposes. See *Tax Commissioner of W. VA. v. MBNA America Bank, N.A.*, 220 W. VA. 163, 640 s.e.2d 226 (W. VA. 2006), cert denied sub nom.; *FIA Card Services, N.A. v. Tax Commissioner of West Virginia*, 551 U.S. 1141 (2007); *Capital One Bank v. Commissioner of Revenue*, 453 Mass. 1, 899 Ne2d 76 (Mass. 2009), cert denied, 557 U.S. 919 (U.S. 2009); *MBNA America Bank v. Indiana Dept. of Rev.*, 895 N.e.2d 140 (Indiana Tax Ct. 2008); *Capital One Financial Corp. v. Hamer*, 2012-tX-0001/02 (Ill. Cir. Ct. 2015).

In contrast, the courts have also ruled that out-of-state businesses were not subject to a state income and franchise tax due to a lack of nexus in several situations. For example, the Tennessee Court of Appeals considered whether Tennessee could impose its franchise and excise taxes upon J.C. Penney National Bank (JCPNB) based upon JCPNB's extension of credit card lending services to Tennessee residents.[21] 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 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[22] and Oklahoma[23] found that, in certain instances, an out-of-state licensor of intangible property did not have nexus in that state. In the Oklahoma case, the Oklahoma Supreme Court held that Oklahoma could not impose corporate income tax on an out-of-state licensor as a result of its licensing of intellectual property to a related party. The taxpayer, an insurance company organized under the laws of Vermont, 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."[24] 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.

Factor presence nexus

In 2002, the MTC adopted a model for a simple bright-line nexus test for business activity tax (income tax, gross receipts tax, etc.). This test is commonly referred to as factor presence nexus. Under a factor presence nexus standard, a taxpayer establishes nexus with a taxing jurisdiction for business activity tax purposes if the taxpayer exceeds a set numerical threshold of property, payroll or, importantly, receipts during the taxing period.[25] Factor presence nexus is determined by the amount of property, payroll or

21 *J.C. Penney Nat' l Bank v. Johnson,* 19 S.W. d 831 (Tenn. Ct. app. 1999), cert. denied, 531 U.S. 927 (2000).
22 *Griffith v. ConAgra Brands Inc.*, 728 s.e.2d 74 (W. VA. 2012).
23 *Scioto Insurance Company v. Oklahoma Tax Commission*, 2012 OK 41, 279 p.3d 782 (2012).
24 *Id.* at 784
25 "Adopted Uniformity Recommendations," Multistate Tax Commission (online). August 26, 2019. http://www.mtc.gov/Uniformity/Adopted-Uniformity-Recommendations

sales a business has within a state. Each factor is an indicator of a business' contact with a state. Several states have either adopted the MTC's model statute or similar statutes.

Ohio was the first state to adopt factor presence nexus. Ohio imposes its CAT on an out-of-state business with "bright-line presence" in Ohio.[26] Ohio incorporated the MTC's factor presence standards into its statutory nexus requirements. In 2015, nexus determinations based on bright-line presence were upheld in Ohio in two decisions issued on the same day by the State Board of Tax Appeals (BTA).[27] Both taxpayers appealed these decisions to the Ohio Supreme Court. In November 2016, the Ohio Supreme Court affirmed the decisions of the BTA in both cases and the taxpayers were held liable for the tax.[28]

Washington enacted legislation establishing a factor presence nexus standard for its B&O tax for tax periods beginning after May 31, 2010. The factor presence nexus standard differs from the MTC model language in that receipts (indexed annually for inflation) of $285,000 (in 2018 or 2019) or more, versus $500,000, creates nexus in the taxing state.[29] Washington's factor presence nexus standard historically applied only to companies subject to the B&O tax "services and other activities" classification, but effective Sept. 1, 2015, factor presence nexus extends to companies subject to the "general wholesaling" B&O tax classification.[30] Effective July 1, 2017, Washington extended factor presence nexus to companies subject to the "retailing" B&O tax classification.[31] Washington's factor presence nexus rules also provide that if nexus is established in one year, it will also exist for the subsequent year.[32]

Ohio and Washington imposed factor presence nexus for purposes of gross receipts taxes; however, states also adopted factor presence nexus for income tax purposes. The following states are examples of states that have enacted factor presence nexus standards for corporate income tax purposes: Alabama ($50,000 in state property, $50,000 of in-state payroll, $500,000 of in-state sales or 25% of total property, payroll or sales);[33] California ($500,000 of in-state sales indexed for inflation);[34] Connecticut ($500,000 of in-state sales);[35] Michigan ($350,000 of in-state receipts if actively soliciting in the state);[36] New York ($1 million of in-state sales);[37] and Tennessee (if in-state receipts exceed the lesser of $500,000 or 25% of total receipts, average value of property in the state exceeds the lesser of $50,000 or 25% of the average value of total property, or in-state payroll exceeds the lesser of $50,000 or 25% of total payroll.)[38] See the AICPA's *2019 State tax guide for businesses* for the latest factor presence standards.

Affiliate nexus and income taxes

As noted above, the presence of employees in a state establishes nexus for an out-of-state entity for income tax purposes. Moreover, the courts have confirmed that the activities of non-employee agents or independent contractors may create agency or affiliate nexus for an entity even where the entity itself does not maintain a place of business.[39] The U.S. Supreme Court, in *Scripto v Carson*, concluded

26 Ohio Rev. Code Ann. Sec. 5751.01(I) ($500,000 in sales)

27 Crutchfield Corp. v. Testa, Ohio S. Ct., Dkt. No. 2015-0386, 11/17/2016, 151 Ohio St 3d 278,88 NE3d 900,(2016) aff'g Case Nos. 2012-926, 2012-3068 and 2013-2021, 02/26/2015; Newegg Inc. v. Testa, Ohio S. Ct., Dkt. No. 2015-0483, 11/17/2016,149 Ohio St 3d 289,74 NE3d 433, (2016) aff'g Case No. 2012-234, 02/26/2015.

28 See id.

29 Wash. Admin. Code 458-20-19401(3)(a)(iii). See also "Economic Nexus Minimum Thresholds," Washington Department of Revenue Excise Tax Advisory, December 20, 2018. Washington nexus thresholds are indexed annually for inflation

30 Wash. Rev. Code 82.04.066, as in effect September 1, 2015.

31 Wash. Rev. Code 82.04.066.

32 Wash. Admin. Code 458-20-19401(9)

33 Ala. Code 40-18-31.2.

34 Cal. Rev. and Tax Code Sec. 23101(b).

35 Conn. Gen. Stat. Sec. 12-216a(a); Informational Publication 2010 (29.1) (Dec. 28, 2010)

36 Mich. Comp. Laws Sec. 206.621.

37 N.Y. Tax Law Sec.209.1(b)

38 Tenn. Code Ann. Sec 67-4-2004(49)(A).

39 See *Scripto Inc. v. Carson*, 362 US 207 (1960); *Howell v. Rosecliff Realty Co.*, 52 NJ 313, 245 A2d 318 (1968); *Tyler Pipe Indus. Inc. v. Washington Department of Revenue*, 483 US 232 (1987).

that an out-of-state retailer had sufficient nexus with Florida to warrant the imposition of a use tax through the activities of the retailer's agents, who were not considered regular employees.[40] Here, the *Scripto* court noted that the "fine distinction" between a regular employee and an independent agent is without "constitutional significance."[41] In *Tyler Pipe Indus., Inc. v. Washington Department of Revenue* the Court applied the *Scripto* reasoning to the Washington B&O.[42] However, the *Tyler Pipe* court noted that not all the activities of a contractor would create nexus for an entity; "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales."[43] Overall, the Court's decisions in *Scripto* and *Tyler Pipe* stand, in part, for the collective proposition that an out-of-state company may have nexus by virtue of the in-state activities of independent contractors establishing and maintaining a market for the out-of-state company's products or services.

Along similar lines, the Maryland Court of 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 Maryland parent corporation.[44] 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.*[45] and *The Classics Chicago Inc. v. Comptroller of the Treasury*,[46] 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 the taxpayer'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 subject them to tax in Maryland. In 2015, the Maryland Tax Court upheld nexus over an intangible holding company for similar reasons in *ConAgra Brands Inc. v. Comptroller of the Treas.* No. 09-IN-00-0150 (Md. Tax Ct. 2015).

40 *Scripto Inc. v. Carson*, 362 US 207 (1960).
41 *Id.*, at 211.
42 *Tyler Pipe Indus. Inc. v. Washington Department of Revenue*, 483 US 232 (1987)
43 *Id.*
44 *Gore Enterprise Holdings Inc. v. Comptroller of the Treasury*, Md. Ct. app., No 36 (March 24, 2014).
45 *Comptroller of the Treasury v. SYL Inc.*, 375 Md. 78, 825 a.2d 399 (2003), cert. denied, 540 U.S. 984 (2003).
46 *The Classics Chicago Inc. v. Comptroller of the Treasury*, 189 Md. app. 695, 985 a.2d 593 (2010).

Conclusion

The issue of nexus for income, franchise/net worth, sales and 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 highlight 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 marketplace. In 2018, the landscape of nexus was significantly altered in the *Wayfair* decision, and states are reacting to the decision within their own jurisdictions. This guide is meant as a broad reference tool to highlight those areas that may warrant a more in-depth study.