Does Your Company Have a Multistate Sales Tax Responsibility?

-by Ned Lenhart, President, Interstate Tax Strategies, P.C.

"Nexus"-a short and simple word with a complicated and sorted history as it relates to multistate sales tax. Understand what it means and you can greatly reduce your company's sales tax liability in states outside of your headquarters state. Ignore or misunderstand this word, and your company runs the risk of being held responsible for uncollected sales tax for many years. On audit, you will also likely be assessed interest and penalties on any of the delinquent taxes owed. Nexus has nothing to do with the taxability of the products or services your company sells; but it has everything to do with the potential responsibility your company has for complying with the laws of the states where your business has customers.

What is nexus and why is it so important? A legal entity has nexus in a state when its physical connections in that state exceed some threshold set by state law or by the U.S. Constitution. The physical contact must be "significant" which the courts have defined as anything more than "de minimis". Yes, this is confusing. What may be "significant" in one state is not be "significant" in another. For example, Michigan tax rules indicate that a single day of activity in that state by an employee or an agent of the company is sufficient to create nexus for sales tax. In New York, some courts have rules that companies having 20 days of presence in the state in a single year did not have nexus in the state. For this reason, it's vital to know the nexus rules in the states where you send employees or have independent agents working on your behalf.

Once a company has sales tax nexus in another state, the state has complete jurisdiction over that company and can require it to comply with the sales tax laws in exactly the same way that resident businesses do. This means that tax must be collected on all taxable sales, that exemption certificates must be collected and maintained on nontaxable sales, and that the state can audit your company's books and records to enforce these rules. The significant issue, however, is that states obtain jurisdiction over the company once the company establishes nexus not when a company recognizes that it has nexus in the state. As such, many companies have established nexus in states and are completely unaware of that fact and are unaware of the liability that is accruing as each month goes by. In most states, the statue of limitations does not begin running until returns are filed. If a company has nexus and is not filing returns, then the state can audit the company for as far back as it can be proved the company had nexus with the state. In many cases, this could be a 5, 10, or even15 years. In addition to the back taxes, the states will also impose interest and penalties.

Nexus can be created in a number of different ways: regularly sending employees or independent sales reps into a state to solicit new customers or see existing customers, performance of any service (setup, repair, installation, training, consulting, etc.) in the state by employees or agents, owning property in the state, having inventory stored in the state, delivering property to customers in your own trucks, and having related entities acting as agents for your company in the state. This is by no means an exhaustive list. Even wholesalers who do not have any taxable sales should be concerned about nexus in other states since the rules regarding exemption certificates can be enforced against you if your company has nexus.

Soliciting sales only through remote means (catalogs, Internet, television ads, phone solicitations) does not create nexus in the states where the property is delivered. There must be a physical connection between your company and the state where the property is delivered. Tax nexus is created at the legal entity level not the line of business level. If one company has two lines of business, the nexus created by the physical contacts of one line of business creates nexus for the other line of business also. Once a company creates nexus in the state, all the sales transactions in that state are subject to the tax rules, not just those related to the nexus creating activity.

Nexus is the lynch-pin to a company's multistate sales tax responsibility. Companies that sell property to customers located throughout the country but only have tax registrations in a few states should evaluate their nexus footprint and determine whether their filing profile is correct. If you believe your company has nexus in additional states, then a careful and thoughtful analysis should be completed to determine what type of liability exists and how best to resolve these issues. If you realize that your company has nexus in states where you are not currently registered, DO NOT just register for tax and begin filing. Without carefully analyzing the length of time that you have had nexus and the types of taxable transactions you may have had in that state, you may actually be exposing your company to a large historical liability and an audit. Contact a qualified multistate tax professional for guidance in handling these situations.

A note about the author: Prior to starting Interstate Tax Strategies, P.C., Lenhart served as Director of Multistate Tax Services for Deloitte's Atlanta office. He served as Director of the Missouri Department of Revenue's Compliance Division and led civil and criminal tax enforcement efforts; and served as Deputy Director of the Missouri Division of Taxation. He is a licensed CPA in multiple states and an active member in AICPA and GSCPA.

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