



DOING BUSINESS IN MORE THAN ONE STATE?

What you need to know about state and local tax nexus

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INTRO

Dear Friends,

Thank you for downloading ***Doing Business in More Than One State? What you need to know about state and local tax nexus.***

Do you have activities in multiple state and/or local jurisdictions? This Ebook will help you understand how those activities may create State and Local Taxes (SALT) filing requirements and what you can do to mitigate your exposure to related taxes, penalties, and interest. Please note that the concepts in this Ebook, while specific to state taxes, may also apply to various local taxes depending upon your jurisdiction.

SALT is a complex topic involving a vast array of tax types and related legislation. SALT is mostly comprised of income, sales and use, property, payroll, gross receipts, and franchise/net worth taxes. Beyond the complexity created by having so many potential tax types, it becomes even more complex when you consider that each taxing jurisdiction decides which taxes to impose, or not impose, and has their own laws for each tax assessed which may be vastly different from those used by other jurisdictions.

Generally, the requirement to pay a tax to a jurisdiction is dependent upon the existence of both nexus with the jurisdiction and, when applicable, exceeding a filing threshold.

If at any time you have questions or would like to meet for a no-cost, no-obligation discussion about your business and SALT filing requirements, contact me at 216.831.0733 or bneate@zinnerco.com. The Zinner team is happy to help and we are ready to start the conversation.

Sincerely,

Brett W. Neate, CPA, M.Tax

Partner

NEXUS

Nexus is a certain minimum connection that must exist in order for a taxpayer to be subject to the taxing jurisdiction of a state. Nexus may be defined differently by each state and for each type of tax being imposed. However, most states have adapted their nexus requirements utilizing methods such as Factor Presence (i.e. bright line test), Physical Presence, or Economic Presence.

- **Factor Presence**

Factor presence nexus tests are generally “bright-line” tests. This means that if you exceed a specific amount of sales, property, or payroll you are deemed to have nexus. For example, a common factor presence test is exceeding \$500,000 of sales, \$50,000 of property, or \$50,000 of payroll within a specific state. Again, not every state utilizes factor presence tests and, if they do, the thresholds can be different.

- **Physical Presence**

Physical presence is a nexus test that applies if you have an actual physical presence in a state such as property, employees, or agents acting on your behalf. Merely shipping goods via a third party shipper to a customer in another state would not create nexus in that state under a physical presence test. Physical presence has long been the standard for measuring nexus, but due to high amounts of internet sales, most states are shifting to a more modern economic presence test.

- **Economic Presence**

Under economic presence rules, nexus exists when a business directs economic activity into the state or derives income by making sales to customers, or receiving income from intangible property in the state even if the business has no property or payroll within that state. Economic presence is usually determined using a sales based threshold but may also be based on intangible income such as interest, dividends and royalties. The states are aware that this nexus test is considered controversial since it requires no physical presence. However, until Congress provides clarification through legislation, or the Supreme Court hears a case that finally determines the constitutionality of economic presence, states will continue to utilize it as a basis to assess certain taxes.

Federal Regulations Affect SALT

There are a few federal regulations that prevent states from applying certain taxes in certain situations. For example, Public Law 86-272 (“PL 86-272”) prevents a state from imposing an income-based tax on an out-of-state business if their activities in the state are limited to the mere solicitation of orders of tangible personal property and those orders are approved and fulfilled from outside the state. There are guidelines provided by the Multistate Tax Commission (“MTC”) that lists certain protected and non-protected activities when determining if the “mere solicitation of orders” threshold has been exceeded, but not every state is part of the MTC and the guidelines are not binding law.

It is worth noting that PL 86-272 was created more than 50 years ago at a time when businesses operated much differently than they do currently. As such, many states are calling for changes to be made in the law that better reflect how businesses operate in the digital age. While proposals have been considered that would change the applicability of PL 86-272, as of the date this Ebook was written, no changes have been finalized.

Filing Thresholds

Once it is determined you have nexus in a state, you must check to determine if you exceed the filing threshold, if applicable, in that state for the tax type in question. Oftentimes, states will use a filing threshold, such as a tax liability exceeding \$500 or more than \$10,000 of state sourced income, before they require a business to file a tax return. If you do not meet the threshold, then there is no filing requirement even if you technically have nexus. As usual, each state may have different filing thresholds for each of their various tax types.

How to Mitigate Your Exposure to SALT

Upon reviewing the material in this Ebook, if you are concerned you may have exposure for prior tax periods, states often allow the use of a Voluntary Disclosure Agreement (“VDA”) or Tax Amnesty Program (“TAP”) to rectify past liabilities. However, these programs may not be used if the state has already issued notices or audit letters.

Voluntary Disclosure Agreement

VDA's are programs run by each state in which a taxpayer can disclose prior period tax liabilities. The benefits of a VDA may include:

- A limited look back period (usually between 3 to 5 years, but varies by state)
- Partial or complete abatement of penalties
- Reduced interest
- The ability to negotiate the terms of the agreement with the taxing authority

Generally, a taxpayer applies for a VDA anonymously and receives an acceptance letter from the state. After receiving the acceptance letter, the taxpayer discloses their identity, provides the prior tax returns, and pays the required tax.

Tax Amnesty Program

TAPs are very similar to VDAs except they are only offered by states for a limited period of time and generally do not allow for a negotiation of the terms between the taxpayer and state. The main benefit of a TAP over a VDA is that the process is oftentimes more streamlined.

As you can see, there are many complexities to state and local taxes. For this reason, it is advisable to work with tax and business advisors, like Zinner & Co., to ensure your tax exposure is effectively mitigated.

FINAL THOUGHTS

While we strive to bring you only the most accurate and up-to-date information, be aware that changes in the law can occur at any time. Consult with your tax advisor prior to any tax filing.

Understanding state and local tax and nexus can be confusing. Becoming financially informed begins with smart advice from a trusted advisor.

Our practitioners advise countless clients regarding their business and individual taxes. Contact us at 216.831.0733 or info@zinnerco.com. We're happy to help and ready to start the conversation.

Visit zinnerco.com/financial-resources-zinner/our-publications to download any of our free Ebooks.

ABOUT THE ZINNER & CO. TAX DEPARTMENT

Lead by partner Brett W. Neate, CPA, M.Tax, the taxation department team works with individuals and businesses to create and develop meaningful strategies to yield positive financial outcomes. The team guides and counsels clients in federal, state and local taxation in addition to sub-specialty area's within taxation, such as business tax, individual tax, IRS matters, estate, gift and trust services and international tax planning.

A BIT ABOUT US

In 1938, Harry Zinner had a vision for long term success. He founded a Cleveland-based bookkeeping firm that focused on integrity, commitment and a pledge to help individuals, not-for-profit organizations and closely-held companies grow and prosper, not just for today, but for decades to follow.

Today, Zinner & Co. provides tax, accounting, audit/assurance and management advisory services to guide businesses from startup to succession planning and help individuals create a solid financial foundation.

Our Beachwood, Ohio office is home to a dedicated team of CPAs and management advisors that provide a full slate of services beyond traditional tax and accounting. Contact us to discover how we can help you achieve your greatest financial potential.

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