



# 2023 State Tax Nexus Guide

# Contents

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2	Introduction	14	The impact of teleworking and the COVID-19 pandemic on state tax obligations
<hr/>			
3	Overview	14	Withholding
3	Definition of nexus	14	Unemployment taxes
3	Constitutional nexus requirements	15	Additional considerations
3	The physical presence standard	<hr/>	
<hr/>			
5	Sales and use taxes	16	AICPA advocacy
5	Expansion of nexus provisions	<hr/>	
5	Click-through nexus	16	Conclusion
5	Affiliate nexus		
5	Cookie nexus		
5	Notice and reporting		
6	The evolution of economic nexus and <i>Wayfair</i>		
6	State enactment of economic nexus standards		
7	Federal legislative attempts		
7	Multistate Tax Commission (MTC) voluntary disclosure		
7	MTC project on the taxation of digital products		
<hr/>			
8	Income, franchise and other state taxes		
8	P.L. 86-272 (15 U.S.C. §§ 381–384)		
10	Economic nexus for income and franchise taxes		
10	History of economic nexus cases for income and franchise taxes in the state courts		
11	Overview of factor presence nexus		
12	Factor presence nexus for income tax		
12	Affiliate nexus and income taxes		



## Introduction

The AICPA® Tax Section developed this practice guide to inform practitioners about state tax nexus issues holistically. This guide is intended to be a broad reference tool concerning state nexus history and subjects. It is not intended to answer whether a specific company has certain tax obligations in a particular state.

Users are encouraged to research the laws and policies of each state for application to each specific taxpayer's situation. Practitioners should refer to the AICPA Tax Section's [State and Local Tax \(SALT\) Roadmap and Resource Center](#) for specific state tax nexus provisions and other guidance on state tax considerations.

# 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 authority. 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 tax on sales made to purchasers in that state or remit use tax on purchases the taxpayer made but on which the seller did not charge sales tax.

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) which provides an exclusion from income tax, 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 interpreted for both income tax and sales and use tax considering the 2018 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.<sup>1</sup> 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.<sup>2</sup>

## 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 U.S. mail system, it believed the statute violated 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.

<sup>1</sup> 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*.

<sup>2</sup> *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.

<sup>3</sup> *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.



In the case *Complete Auto Transit Inc. v. Brady*<sup>3</sup> a decade later, a framework was established to identify if a taxpayer has “substantial nexus” with the 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.”<sup>4</sup> In 1992, the Supreme Court reexamined the physical presence standard with another case *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). In *Quill*, the court examined North Dakota’s law which required any business engaging in “regular or systematic” solicitation in the state to register for and collect and remit sales tax.

In its decision, 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 a collection responsibility for the state’s sales tax.<sup>5</sup> 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 substantial 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. Some states enacted factor presence nexus standards under the presumption that *Quill* applies only to sales tax.

<sup>4</sup> *South Dakota v. Wayfair Inc.*, 138 S. Ct. 2091 (2018) (citing *Complete Auto*, 430 U.S. at 279

<sup>5</sup> *Quill* at 317-318.

# Sales and use taxes

## Expansion of nexus provisions

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 before the *Wayfair* case. Presumably, these standards are less relevant given newer 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.”<sup>6</sup> The law provides that a seller who enters into an agreement with a New York resident whereby the resident refers customers to the seller’s website for a commission is soliciting business in the state and therefore has nexus if the seller exceeded an enumerated sales threshold. The threshold is cumulative gross receipts of over \$10,000 from all New York residents with such agreements. As of 2023, 20 states have enacted similar legislation or issued guidance interpreting current state laws to allow comparable treatment. Several states have repealed click-through nexus laws in favor of economic nexus.

## Affiliate nexus

In 2010, Colorado took a different approach to taxing out-of-state sellers and enacted controlled-group nexus. Under the law, out-of-state sellers were required to collect Colorado tax if they were 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.<sup>7</sup> The statute provides that the nexus presumption may be rebutted under certain conditions. Colorado repealed its affiliate nexus law effective June 1, 2019. In addition to Colorado, other states have established affiliate nexus provisions such as Alabama, Connecticut, Florida, Georgia, Ohio and South Carolina, to name a few.

## 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 a 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 withdrawn shortly after being challenged on procedural grounds. New regulations were effective Oct. 1, 2017, and provided substantially the same requirements. Massachusetts repealed this rule post *Wayfair* and now only has in effect its traditional economic nexus standard that implements a \$100,000 annual sales threshold for remote retailers and marketplace facilitators.<sup>8</sup> Ohio had a similar law imposing physical nexus standards on sellers using in-state software to sell goods and services to consumers, but it has also been repealed.

## Notice and reporting

In addition to expanding the definition of physical presence, states began enacting notice and reporting requirements for out-of-state sellers. In 2010, Colorado was the first state to enact such a law. However, an immediate challenge by the Direct

<sup>6</sup> N.Y. Tax Law § 1101(b)(8)(vi).

<sup>7</sup> Colo. Rev. Stat. § 39-26-102(3)(b).

<sup>8</sup> 830 CMR 64H.1.7.

Marketing Association (DMA) resulted in the law not being implemented until July 2017. For out-of-state retailers that do not collect Colorado sales tax and have gross receipts above \$100,000, the law requires retailers to (1) send notifications to each customer containing information about the purchases and Colorado sales and use tax and (2) report information about Colorado customers to the Colorado Department of Revenue.<sup>9</sup> Under Colorado law, non-compliant retailers are subject to penalties. Following Colorado's lead, about 17 states have enacted similar notice and reporting requirements to increase use tax compliance by individuals. For example, in Washington, as a part of a voluntary disclosure agreement (VDA), taxpayers still need to go through the marketplace waiver process to waive steep penalties associated with noncompliance with notice and reporting requirements.

Opponents 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 the DMA brought meant that these requirements were here to stay. Perhaps forebodingly at the time, 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*."<sup>10</sup>

### The evolution of economic nexus and Wayfair

Over the past few years, consumer purchases made via the internet have significantly increased and, as a result, many states have expanded their sales tax nexus rules. All but a few states now impose a sales tax collection obligation based on a new concept called "economic nexus." Broadly stated, economic nexus standards are based on a business's economic connections in the state rather than its physical presence.

South Dakota is one such 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 greater than \$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 was not applied retroactively. After enactment, three companies impacted by the law sued South Dakota: Newegg, Overstock.com and Wayfair.

After the case made its way through South Dakota's state courts, the State appealed to the U.S. Supreme Court. On June 21, 2018, in a 5–4 decision, the U.S. Supreme Court held in its historic decision that the physical presence rule of *Quill* was "unsound and incorrect." With *Quill* overturned, the Court's *Wayfair* decision gave states the ability to impose sales tax collection obligations without regard to a taxpayer's physical presence in a state. However, although the case does not directly address income tax nexus, state legislative activity for sales and use tax purposes indicates that states that have adopted *Wayfair* for sales tax have generally adopted *Wayfair* for income tax nexus purposes, even without formal legislation. States may either enact economic nexus provisions if they have not or they may begin to enforce preexisting standards more aggressively.

### State enactment of economic nexus standards

Every state with a statewide sales tax has adopted economic nexus laws since the *Wayfair* decision.

States continue to release guidance clarifying the scope of the laws (e.g., what receipts should be considered when determining whether an individual has met the economic nexus threshold, what constitutes a "transaction," etc.) and the standards vary among each of the states. Some states have revised their dollar thresholds and/or transaction thresholds for future years.

Additionally, these states have 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 (e.g., Amazon, Etsy). In addition to statewide

<sup>9</sup> See, 39 Colo. Code Regs. §21-112(3.5). —

<sup>10</sup> *Direct Marketing Ass'n v. Brohl*, 575 U.S. (2015) (Justice Kennedy, dissenting).

economic nexus standards, localities have also taken steps toward the enactment of economic nexus standards and other indirect tax types affected (e.g., accommodations, meals and telecommunications).

### Federal legislative attempts

There have been several unsuccessful attempts by Congress to legislatively expand a state's authority to tax an out-of-state retailer. The most notable attempts include the U.S. Senate's Marketplace Fairness Act (MFA)<sup>11</sup> and the U.S. House's Remote Transactions Parity Act (RTPA).<sup>12</sup>

On June 27, 2022, the AICPA submitted a [written statement](#) for the record for the [6/14/22 Senate Committee on Finance](#) hearing on "Examining the Impact of South Dakota v. Wayfair on Small Businesses and Remote Sales." The written statement focuses on what the U.S. Supreme Court determined explicitly in *Wayfair*, the states' reaction to the case, and how small businesses are affected. The AICPA also provided recommendations for Congress to assist in its consideration of whether federal legislation should address these pressing issues. The AICPA previously testified on this issue at the March 3, 2020, hearing of the House Committee on Small Business Subcommittee on Economic Growth, Tax and Capital Access on the impact of the *Wayfair* decision on small businesses.

In its written letter, the AICPA provides that a natural starting point in considering a consistent set of minimum economic threshold standards is the model factor presence nexus standard the Multistate Tax Commission (MTC) established in 2002 for business entities organized outside a state.

### 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

that 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](mailto: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.

### MTC project on the taxation of digital products

As digital products become more prevalent, they may reduce or replace the sales of other, more traditional, taxable products and services. On April 28, 2021, the Washington State Department of Revenue presented to the MTC Uniformity Committee its approach to taxing digital products. Subsequently, at the July 28, 2021, MTC Uniformity Committee meeting, the group considered a recommendation from the Standing Subcommittee to begin drafting the outline of a white paper on state sales taxation of digital products. The committee agreed that MTC staff would begin the process. At the Aug. 2, 2022, meeting of the Uniformity Committee, the committee reviewed the proposed draft outline and agreed that a project work group should be formed to provide ongoing input and review of the white paper as it is developed. In subsequent meetings of the working group since that time, a draft white paper outline has been provided. Those interested in the project can follow the process on this web page and can also contact Helen Hecht, MTC Uniformity Counsel. The current project status can be monitored on the [MTC's sales tax on digital products webpage](#).

<sup>11</sup> 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).

<sup>12</sup> Reintroduced in 2017 as H.R. 2193, 115th Congress (2017-2018)



## 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.<sup>13</sup> 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.<sup>14</sup> 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). Making a determination between those activities is based on the facts and circumstances. One factor to consider are 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.<sup>15</sup>

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.

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

<sup>14</sup> *Guardian Industries Corp. v. Dept. of Treasury*, 198 Mich. app 363 (1993).

<sup>15</sup> *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."

<sup>16</sup> 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). 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.

In *Blue Buffalo v. Comptroller*, 243 MDApp 693,221 A3d 1130, the court ruled that Blue Buffalo's employees went beyond gathering marketplace intelligence and exceeded solicitation. This case illustrates how difficult it is for a company to avoid state income taxation using PL-86-272.

Practitioners should consider whether activities other than solicitation are more than de minimis in a particular state. Also, it is important to note that other activities, such as sales of services into a state, will eliminate the protection of P.L. 86-272.

Examples of in-state activities that are generally considered protected by P.L. 86-272 include the following:<sup>16</sup>

- 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
- 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 fewer at a location within the state
- Checking of customers' inventories without a charge therefore (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

On Aug. 4, 2022 the MTC adopted a revised "statement of information" on the application of Public Law 86-272. It bars states and localities from imposing net income taxes where in-state business activities are limited to solicitation of sales of tangible personal property and ancillary activities. The revised statement takes the position that taxpayers generally engage in unprotected in-state business activities "when a business interacts with a customer via the business's website or app."

States are free to adopt the revised statement in any way they choose, regardless of their MTC membership status. The introduction to the revised statement anticipates that states may adopt all or portions of the MTC's policy "by legislation, regulation or other administrative action."

In Technical Advice Memorandum (TAM) 2022-01, the California Franchise Tax Board (FTB) considered whether remote workers and various online activities eliminate P.L. 86-272 protection. In largely reflecting the MTC guidance issued in 2021, the TAM concludes that various activities may disqualify a taxpayer from the protections provided under P.L. 86-272.

The TAM also provides that "an employee who telecommutes on a regular basis from within California" will eliminate protection unless the employee's in-state activities are entirely ancillary to solicitation of sales of tangible personal property.

<sup>17</sup> Reintroduced in 2019 as H.R. 3063, 116th Congress (2019-2020).

<sup>18</sup> See, e.g., *Geoffrey Inc. v. South Carolina Tax Comm'n*, 313 S.C. 15 (1993), cert. denied, 510 U.S. 992 (1993).

<sup>19</sup> *South Dakota v. Wayfair Inc. et. al.* No. 17-494.

<sup>20</sup> *Geoffrey Inc. v. South Carolina Tax Commission*, 313 S.C. 15, 437 s.e.2d 13 (S.C. 1993).

Note that a TAM is not binding guidance on FTB but gives a good indication of where FTBs stands on an issue.

New York is in the process of adopting the MTC's revised interpretation by promulgating the Statement into its regulations. New York has released its draft regulations, making them available for public comment. During 2022, New Jersey and Oregon both indicated that they also intend to amend their regulations to adopt the MTC's Statement, but they have yet to release the drafts for public comment.

### Economic nexus for income and franchise taxes

Because *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.<sup>18</sup> 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").<sup>19</sup> 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.<sup>20</sup> 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 intangible trademarks and trade names.

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 v. MBNA America Bank N.A.*, 220 W. Va. 163 (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, N.A. & Affiliates v. Indiana Department of State Revenue. Tax Court of Indiana*, 895 N.E.2d 140 (Ind. T.C. 2008); *Capital One Financial Corp. v. Hamer*, 2012-tX-0001/02 (Ill. Cir. Ct. 2015).

<sup>21</sup> *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W. d 831 (Tenn. Ct. app. 1999), cert. denied, 531 U.S. 927 (2000).

<sup>22</sup> *Griffith v. ConAgra Brands Inc.*, 728 s.e.2d 74 (W. VA. 2012).

<sup>23</sup> *Scioto Insurance Company v. Oklahoma Tax Commission*, 2012 OK 41, 279 p.3d 782 (2012).

<sup>24</sup> *Id.* at 784

<sup>25</sup> "Adopted Uniformity Recommendations," Multistate Tax Commission (online). August 26, 2019.

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.<sup>21</sup> 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<sup>22</sup> and Oklahoma<sup>23</sup> 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."<sup>24</sup> 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.

### Overview of 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.<sup>25</sup> Factor presence nexus is determined by the amount of property, payroll or 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.<sup>26</sup> 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

<sup>26</sup> Ohio Rev. Code Ann. Sec. 5751.01(I) (\$500,000 in sales)

<sup>27</sup> *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.

<sup>28</sup> See *id.*

<sup>29</sup> 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

<sup>30</sup> Wash. Rev. Code 82.04.066, as in effect September 1, 2015.

<sup>31</sup> Wash. Rev. Code 82.04.066.

<sup>32</sup> Economic Nexus Minimum Thresholds," Washington Department of Revenue Excise Tax Advisory, Jan. 1, 2020

<sup>33</sup> Ala. Code 40-18-31.2.

<sup>34</sup> Cal. Rev. and Tax Code Sec. 23101(b).

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

<sup>36</sup> Mich. Comp. Laws Sec. 206.621.

<sup>37</sup> N.Y. Tax Law Sec.209.1(b)

<sup>38</sup> Tenn. Code Ann. Sec 67-4-2004(49)(A).

<sup>39</sup> 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).

day by the State Board of Tax Appeals (BTA).<sup>27</sup> 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.<sup>28</sup>

Washington has enacted several iterations of nexus standards for its B&O tax. Originally, the factor presence nexus standard differed from the MTC model language in that receipts of \$250,000 (indexed annually for inflation) or more, versus \$500,000, created nexus.<sup>29</sup>

On Sept. 1, 2015, factor presence nexus extended to companies subject to the “general wholesaling” B&O tax classification (previously it only applied to companies subject to the B&O tax “services and other activities” classification).<sup>30</sup> Effective July 1, 2017, Washington extended factor presence nexus to companies subject to the “retailing” B&O tax classification.<sup>31</sup> As of Jan. 1, 2020, the property, payroll and receipts factor thresholds no longer apply. Instead, nexus is established for a business with more than \$100,000 in combined gross receipts sourced or attributed to Washington.<sup>32</sup>

### Factor presence nexus for income tax

The following states are examples of states that have enacted factor presence nexus standards for corporate income tax purposes: Alabama (\$54,000 in state property, \$54,000 of in-state payroll, \$538,000 of in-state sales or 25% of total property, payroll or sales);<sup>33</sup> California (\$500,000 of in-state sales indexed for inflation);<sup>34</sup> Connecticut (\$500,000 of in-state sales);<sup>35</sup> Michigan (\$350,000 of in-state receipts if actively soliciting in the state);<sup>36</sup> New York (\$1 million of in-state sales);<sup>37</sup> 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.)<sup>38</sup>

Applicable to tax years beginning after Dec. 31, 2022, added to the list of activities that subjects a corporation to the corporate net income tax (CNIT) is “having a substantial nexus” with Pennsylvania. A rebuttable presumption of substantial nexus exists when a corporation has \$500,000 or more Pennsylvania-sourced sales regardless of physical presence.

To see factor presence nexus standards for all states, consult the AICPA Tax Section’s [State and Local Tax \(SALT\) Roadmap and Resource Center](#).

### Affiliate nexus and income taxes

As noted above, the presence of employees in a state can establish 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.<sup>39</sup> The U.S. Supreme Court, in *Scripto v Carson*, concluded 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.<sup>40</sup> Here, the court noted that the “fine distinction” between a regular employee and an independent agent is without “constitutional significance.”<sup>41</sup> In *Tyler Pipe Indus., Inc. v. Washington Department of Revenue*, the Court applied the *Scripto* reasoning to the Washington B&O.<sup>42</sup> 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.”<sup>43</sup> 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

<sup>40</sup> *Scripto Inc. v. Carson*, 362 US 207 (1960).

<sup>41</sup> *Id.*, at 211.

<sup>42</sup> *Tyler Pipe Indus. Inc. v. Washington Department of Revenue*, 483 US 232 (1987) <sup>43</sup> *Id.*

<sup>44</sup> *Gore Enterprise Holdings Inc. v. Comptroller of the Treasury*, Md. Ct. app., No 36 (March 24, 2014).

<sup>45</sup> *Comptroller of the Treasury v. SYL Inc.*, 375 Md. 78, 825 a.2d 399 (2003), cert. denied, 540 U.S. 984 (2003).

<sup>46</sup> *The Classics Chicago Inc. v. Comptroller of the Treasury*, 189 Md. app. 695, 985 a.2d 593 (2010).



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, now renamed the Maryland Supreme 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.<sup>44</sup> 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.*<sup>45</sup>

and *Classics Chicago Inc. v. Comptroller of the Treasury*,<sup>46</sup> 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 nc. v. Comptroller of the Treasury*, No. 09-IN-00-0150 (Md. Tax Ct. 2015).



# The impact of teleworking and the COVID-19 pandemic on state tax obligations

Many employers are continuing to encourage or requiring their employees to use teleworking arrangements, whether full-time or in a hybrid capacity.

## Withholding

When an employee works in more than one state, an employer may be obligated to withhold and remit income taxes to each relevant state, and employees may also owe income taxes in any jurisdiction where they may have worked if nexus is established. In other words, if an employee is working from his or her residence in a state due to COVID-19, the fact of working in that state may establish a sufficient presence to give the state tax jurisdiction over the out-of-state employee.

Thankfully, some workarounds provide relief to taxpayers and their employers that find themselves in this category. These include reciprocity agreements and demonstrating that an employee's work is required by the employer to be performed remotely.

To bring more uniformity and consistency, over the past few years several states have enacted (or considered) a threshold model legislation supported by the AICPA, COST, and the Tax Executives Institute.

As a result of advocacy efforts, legislation has been introduced to address the state income taxation of remote and mobile workers—the Remote and Mobile Worker Relief Act of 2021 (S. 1274); the Mobile Workforce State Income Tax Simplification Act of 2021 (H.R. 429); and the Multistate Worker Tax Fairness Act (S. 1887, H.R. 4267).

For more information, see [The Cross-Border Tax Peaks and Valleys of Working From Anywhere](#).

## Unemployment taxes

Unemployment taxes also need to be considered. The unemployment tax is paid to only one state, even if an employee works in multiple states. It is possible to continue paying unemployment tax to the state an employee normally works from if the teleworking arrangement is temporary.

However, if the employee's services are localized to the telework state for the foreseeable future, unemployment tax may need to be paid to the state in which the teleworking occurs.

## Additional considerations

Because of potential state tax obligations, it is necessary that the employee and employer track all the employee's working locations. Taxpayers should take note when their workers are teleworking from states in which the employer does not otherwise have a taxable presence.

Although the economic nexus standard has dominated attention since the *Wayfair* decision in 2018, the physical presence standard remains key for many nexus determinations.

Certain tax credits are available to eliminate or minimize double taxation of the same income in two different states. Occasionally, neighboring states have reciprocity agreements that dramatically simplify income tax filing obligations for taxpayers.

While some states have issued guidance on withholding during the pandemic, that guidance has not been uniform or widely adopted. Several tax agencies for major states have yet to issue business tax nexus guidance. In others, guidance is tied to emergency orders that may soon be lifted. Consult the AICPA Tax Section's [State and Local Tax \(SALT\) Roadmap and Resource Center](#) for links to specific state revenue websites.





## AICPA advocacy

The AICPA continues to advocate for tax professionals on a vast array of state and local tax issues, including those around mobile and remote workforces, filing deadlines, sales and use taxes and state conformity.

For the latest information and documents created by the State and Local Tax Technical Resource Panel (SALT TRP) on state-level advocacy issues affecting tax professionals, visit [State and Local Tax Advocacy Resources](#).

## 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 jurisdictions. This guide is meant as a broad reference tool to highlight those areas that may warrant a more in-depth study.



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