



STATE TAX DEPARTMENT POLICY TRENDS INCLUDING NEXUS POSITIONS

Analyzing BNA's 2015 Survey of State Tax Departments

Steven Roll, Bloomberg BNA, sroll@bna.com

Background Bloomberg BNA Survey of State Tax Departments

- first *Survey of State Tax Departments* published in 2001
- Questionnaires sent to tax department officials in November each year for policies as of December 31
- Survey sample is every state, the District of Columbia and New York City
- Questions formulated in consultation with state tax practitioners – new questions added every year
- Answers are reviewed and tabulated by Bloomberg BNA staff
- Results are published in April and incorporated into Bloomberg BNA state tax nexus and sourcing tools

SURVEY OF STATE TAX DEPARTMENTS CITED IN CONGRESS



State Participation in Survey

- Every state participates -- but some states don't answer every question or don't complete certain sections of the survey
- A few states consent to re-publishing responses from a prior year, which is noted on survey
- Qualifications to state responses are included in results

How Much Weight to Give Survey Responses?

- States' answers are not definitive policy statements because nexus determinations are fact specific and subject to interpretation
- Even when a state indicates that the performance of a specific activity, by itself, would trigger nexus, it's not always clear if nexus might arise if any additional activity is performed in the state
- It's a window into department's thinking. Like calling someone at the department.

Survey Coverage

- NEXUS POLICIES
- INCOME TAX NEXUS ACTIVITIES
- ADDBACKS TO INCOME
- §338(H)(10) TRANSACTIONS
- BANKRUPTCY ISSUES
- HOLDING COMPANIES (IHC)
- THROWBACK PROVISIONS
- SOURCING OF RECEIPTS
- COMBINED REPORTING
- SALES TAX POLICIES
- SALES TAX NEXUS ACTIVITIES

The Big Picture Nexus Debate

- State borders seem less relevant as digital economy continues to grow
- Business advocates argue that states are exceeding their constitutional authority by taxing these “borderless transactions”
- States counter that they need revenue to provide infrastructure upon which both businesses and customers rely.

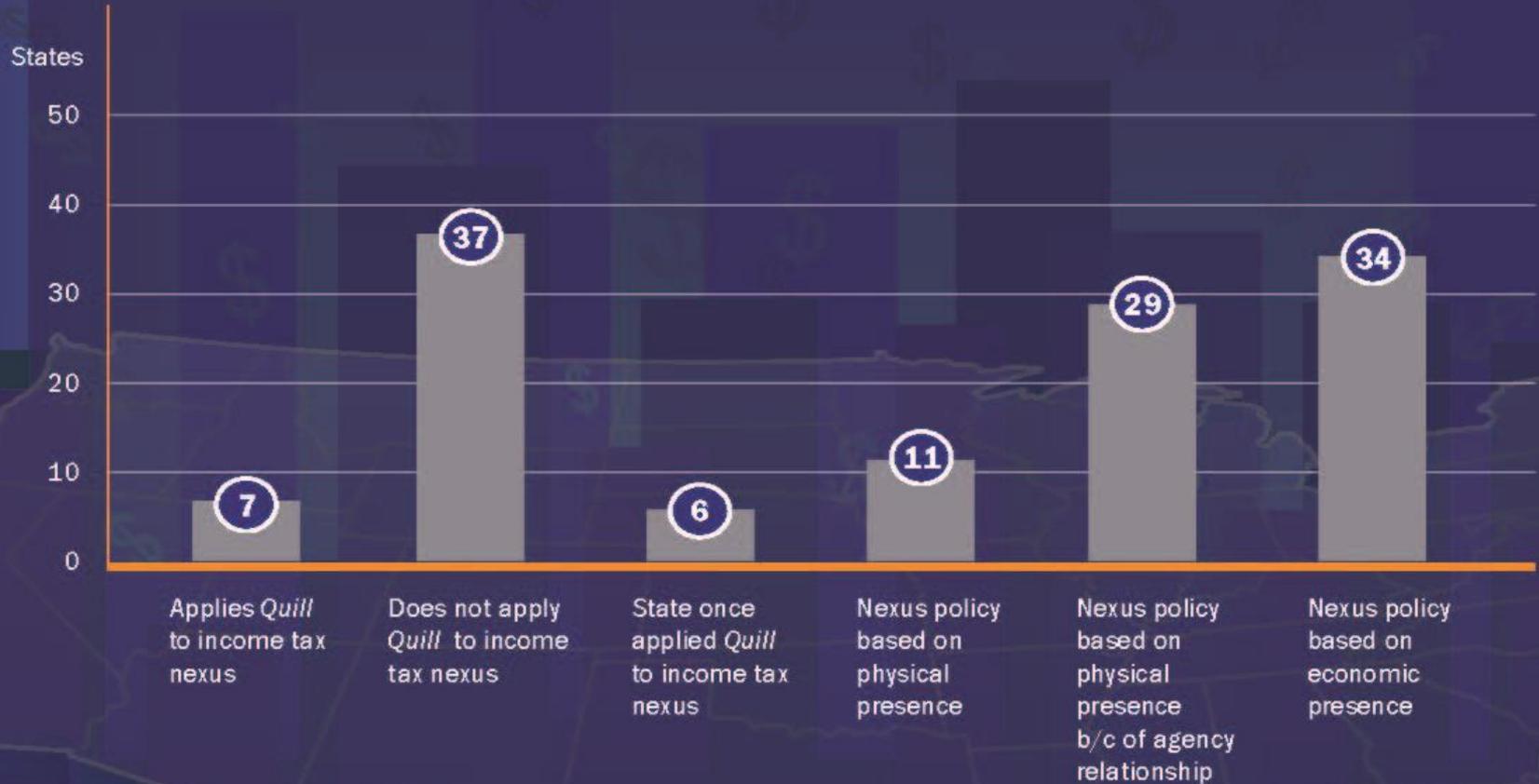
Income Tax Nexus: Physical Presence

- 37 states indicated that they do not apply Quill—up from 34 three years ago
- 7 jurisdictions said they apply Quill (DE, HI, MA, PA, TN, TX and NYC)
- 6 jurisdictions said that they once adhered to Quill (DC, IA, KY, MI, NM and OK)
- 11 jurisdictions indicated that they applied a physical presence standard (DE, HI, MI, NE, NM, NYC, OK, PA, RI, TN and TX)
- 5 states indicated that they do have a physical presence standard, but also said they do not apply the Quill decision to income tax nexus determinations

Income Tax Nexus: Economic Presence

- 34 states indicated that they apply economic presence nexus
- 6 states said they do not apply economic nexus (DE, LA, RI, TN, TX and VT)
- 29 states said physical presence can be established through an agency relationship, with only 11 states responding “no.”

Adherence to *Quill*, Physical Presence and/or Economic Presence Standards



A BNA Graphic/0415g3

Factor Presence Nexus

Factor Presence is a 21st Century bright-line standard for income tax nexus.

Joe Huddleston – Executive Director of the
Multistate Tax Commission

Factor Presence Nexus

- Known states to use some form of factor presence nexus:
 - CA: Partially conforms to the MTC's model statute (adopted for tax years after January 1, 2011.)
 - CT: Partially conforms (\$500K sales. No property or payroll min. threshold)
 - CO: Partially conforms (e.g., deleted throwback rule).
 - DC: MTC Model Statute not adopted by DC
 - KS: Partially conforms
 - MO: Partially conformed in 2013, Does not conform in 2014
 - NY: Partially conforms in 2015 - \$1 million threshold
 - OH: Conforms, but wording is modified
 - TN: Just adopted 1/1/2016 MTC Factor Nexus at \$500K
 - WA: Effective June 1, 2010 for the B&O (gross receipts) tax uses \$250K.
- Only four states (CA, CO, KS & OH) indicated they conform/partially conform

Factor Presence Nexus Litigation

- Ohio Board of Tax Appeals upheld the imposition of Ohio's Commercial Activity Tax on two out-of-state retailers, Newegg, Inc. and Crutchfield, Inc., based on the state's bright-line presence standards, even though neither company had a physical presence in Ohio. [Newegg, Inc. v. Testa, No. 2012-234 \(Ohio Bd. Tax App. Feb. 26, 2015\); Crutchfield, Inc. v. Testa, Nos. 2012-926, 2012-3068, 2013-2021 \(Ohio Bd. Tax App. Feb. 26, 2015\).](#)
- These decisions were consistent with the board's previous ruling in [L.L. Bean, Inc. v. Levin, No. 2010-2853 \(Ohio Bd. Tax App. March 6, 2014\).](#) L.L. Bean filed an [appeal to the Ohio Supreme Court, but subsequently settled.](#)
- The Ohio board took note of their arguments, but reminded the taxpayers that it had no authority to decide constitutional issues. Limited to applying the plain language of Ohio's bright-line presence statute, the board concluded that each taxpayer had substantial nexus with Ohio because their gross receipts exceeded the statutory threshold.

9 STATES SAID THEY HAVE INCOME TAX NEXUS THRESHOLDS STANDARDS (DOWN FROM 17 IN 2014)

State	Qualification/Explanation
Nebraska	Limited to for hire trucking companies
New York City	Changed from “yes” to “no” in 2015
North Carolina	Mortgage Lenders
Ohio	Indicated “yes” this year
Utah	Limited to trucking companies
Virginia	Changed from “yes” to “no” in 2015
West Virginia	Did not respond in 2015

Income Tax Nexus: Registration with State Agencies/Departments

- Does your state apply the definition of “doing transacting business” or “doing business” to determine if an out-of-state corporation must register with the secretary of state?

- ✓ 11 jurisdictions answered “yes”. (AZ, DC, HI, IL, KY, LA, MD, MA, NJ, NM and WV)

- Other results:

- ✓ 8 states said holding a business license issued by the state would create nexus
 - ✓ 10 states said registering to do business with state tax department for payroll purposes would create nexus
 - ✓ 10 states answered that registering with the state as a government vendor or contractor would create nexus

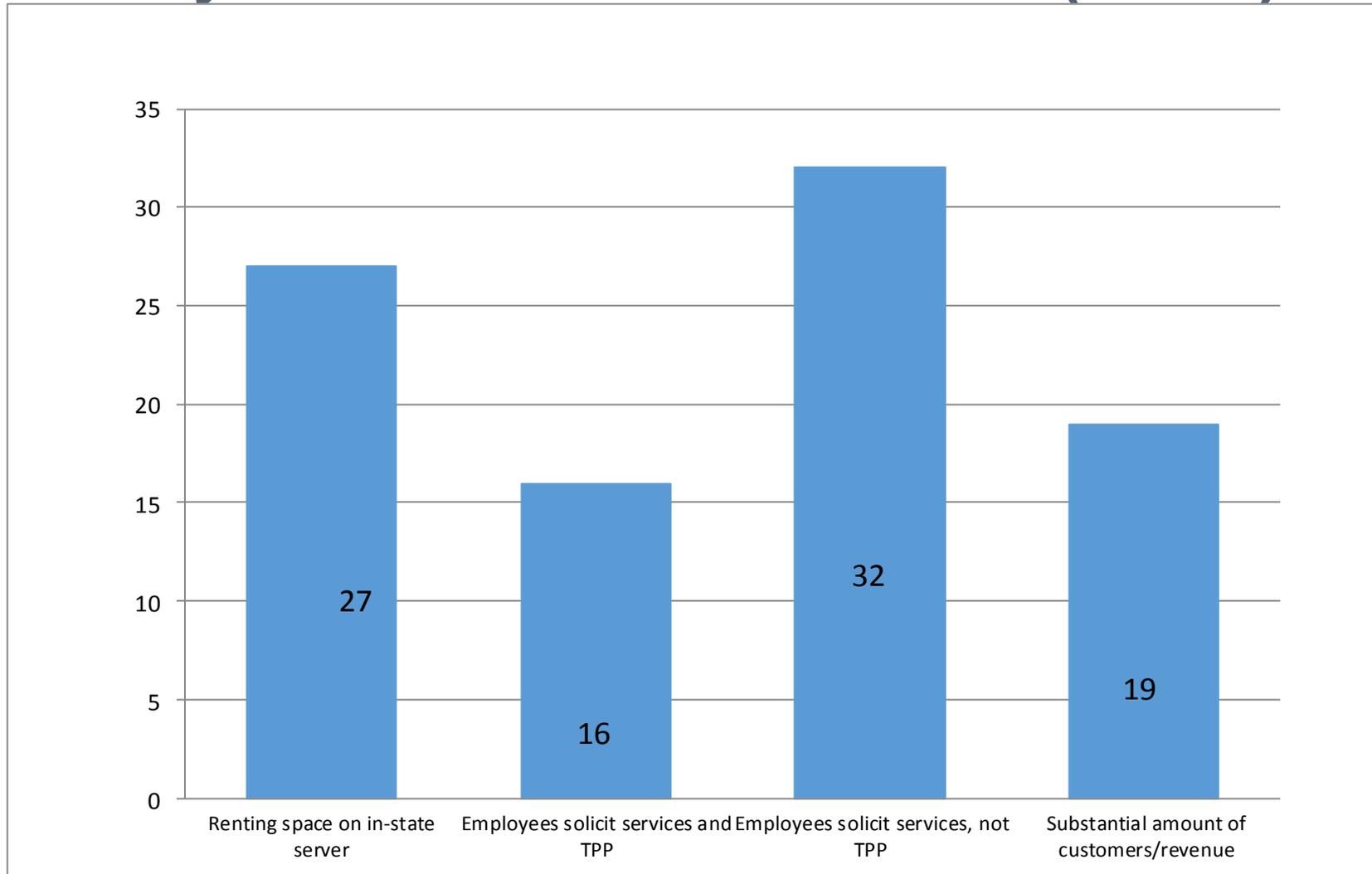
Income Tax Nexus: Telecommuting

- 38 states said they would find nexus if one employee telecommutes from a home located within their jurisdiction and performed back office administrative business functions such as payroll.
- 37 states would find nexus if employee performed product development functions
- Several states said these answers might change if corporation protected by Pub. L. No. 86-272.

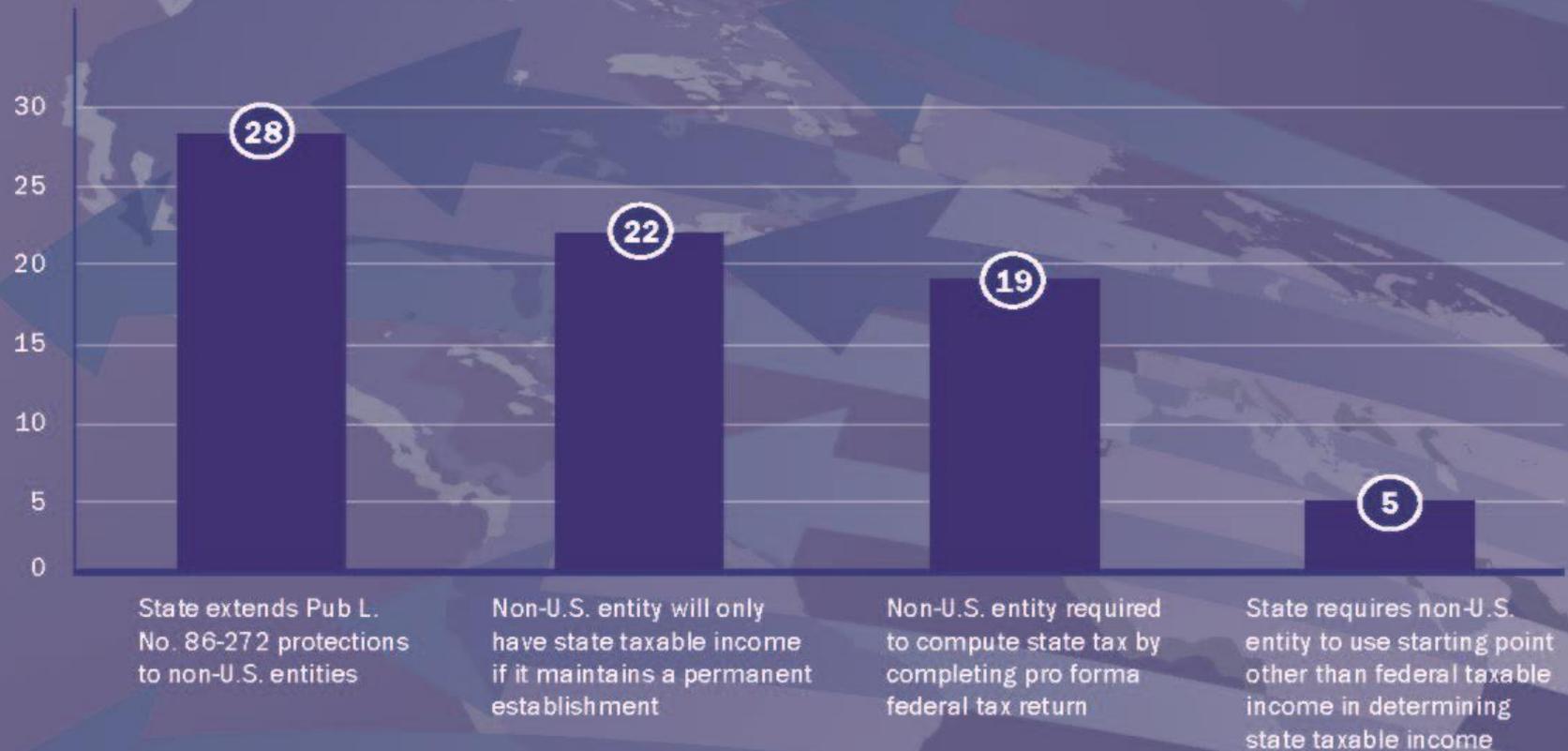
Income Tax Nexus: Internet-Based Activities

- Nexus is triggered in all states...
 - Except MS if the corporation owns internet server in the state, and owns the internet server and hires third-party technicians in the state to keep the server functioning
 - Except MS, VT, and VA if the corporation leases and has exclusive use of a server in the state (Depends in MA)
 - Except CA, MS, VT, and VA if the corporation leases space on a shared server in the state (Depends in MA and WI)
 - Except CA, IN, MS, VT, and VA if the corporation leases space on a third-party network of servers, keeps data for less than six months in the state - (Depends in MA)
 - Triggers nexus in only 15 states if a web-hosting provider in the state is paid to sell corporation's products over the internet: AK, DC, FL, HI, IA, KY, MI, MO, NH, NJ, NM, OR, RI, TN, UT

Cloudy with a Chance of Nexus? (S-124)



Nexus Treatment of Non-U.S. Entities



A BNA Graphic/0415g4

Income Tax: Federal Proposals

- Business Activity Tax Simplification Act (BATSA)
 - ✓ Define what constitutes a business' physical presence in a state for taxation purposes.
 - ✓ Expand the protection provided to interstate commerce under Pub. L. No. 86-272 to apply to sales of intangible property and services

- Mobile Workforce State Tax Simplification Act
 - ✓ Sets 30-day withholding threshold for nonresident employees

Income Tax: Sourcing Methods

- For years, nearly all of the states conformed to §17 UDITPA, in effect before its recent amendments, in determining if sales, other than sales of tangible personal property, are taxable within their jurisdiction.
- sales are sourced to the state in which the greatest proportion of the income-producing activity is performed.
- Income-producing activity is determined according to the taxpayer's costs of performance.
- jurisdictions differ in the way that this sourcing method is applied when the income-producing activity is performed in more than one state.

Income Tax Sourcing: Cost of Performance Approaches

- Plurality Method (Majority of COP states): “all or nothing” approach, where all of the receipts are sourced to a single jurisdiction based on where the costs of performance occur (plurality method).
- Proportionate Method: pro rata approach, in which receipts from income-producing activity are sourced proportionately to each state where the costs of activity occurs.

Income Tax Sourcing: Market-Based

- **Market-Based Sourcing:** based on the state where the taxpayer's market for the sale is located.

Income Tax Sourcing: Services

- 18 states said they use market-based sourcing for receipts from services.
- 24 states said they use cost of performance to sources receipts from services
 - ✓ 18 states said they use plurality method (“all or nothing approach”)
 - ✓ 6 states said they use the proportionate method
- NC, PA, TX and NYC: said they use sourcing method OTHER than COP or market-based for services.
- CA and OH said they use BOTH COP and market-based sourcing for services

Income Tax Sourcing: Intangibles

- 14 states said they use COP to source receipts from intangibles
- 18 states said they use market-based sourcing to source receipts from intangibles.
- 13 states use a method other than costs of performance or market-based sourcing.

Income Tax Sourcing: Intangibles

- Some states said they use multiple methods for sourcing receipts from intangibles:
 - ✓ IL: said it uses both COP and market-based
 - ✓ FL and UT: use both market-based and method OTHER than COP and market-based
 - ✓ HI: uses COP and a method other than COP or market-based sourcing

Income Tax Sourcing: Intangibles vs. Services

- 18 states said they use the same sourcing rules for receipts from intangibles and services

Income Tax Sourcing: Cloud Computing as Service

- Progress because most states chose only one approach to sourcing cloud computing receipts
- 12 states characterize receipts from cloud-based transactions as receipts from services—down from 19 states in 2014
- These states include: IL, IN, IA, ME, MD, MO, NE, NJ, ND, TX, WV and WI

Income Tax Sourcing: Cloud Computing as Intangible

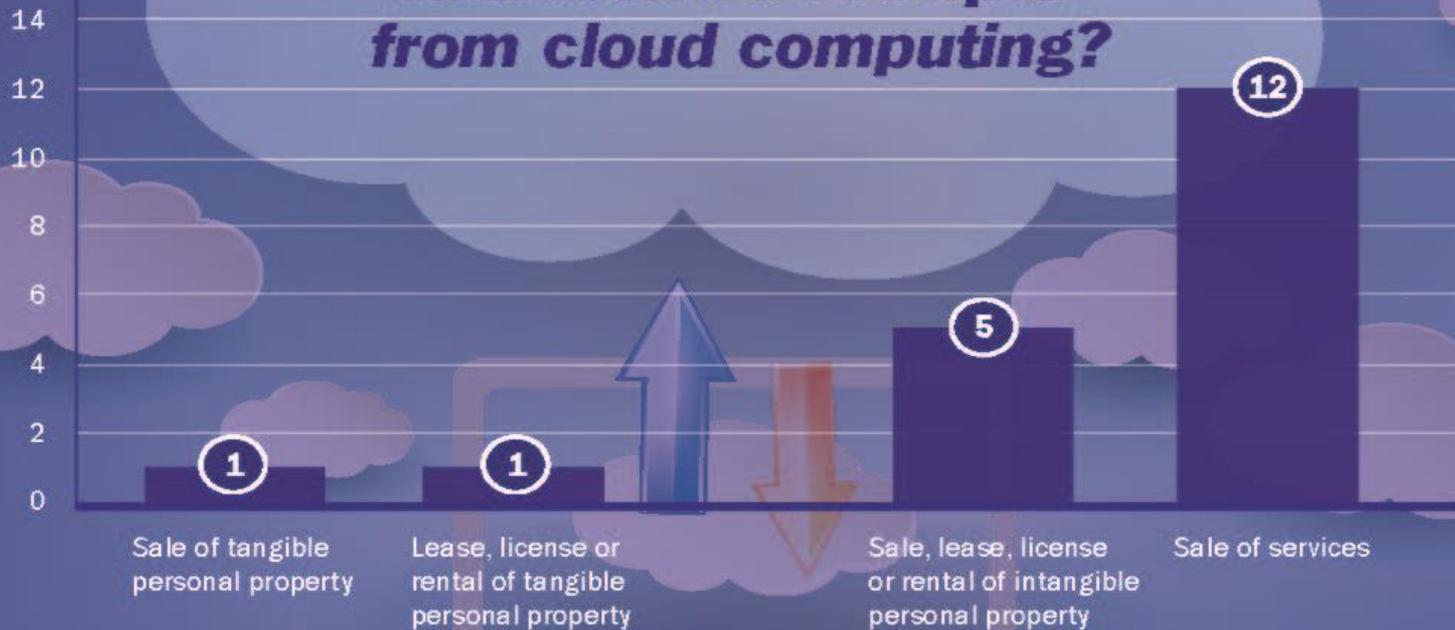
- 5 states characterize receipts from cloud-based transactions as receipts from the sale, lease, license or rental of intangible personal property
- Last year, 21 states characterized cloud computing transactions in this manner

Income Tax Sourcing: Cloud Computing as Tangible Personal Property

- Only one state, Utah, characterizes receipts from cloud computing as receipts from the sale, lease, license or rental of tangible personal property
- Last year, 11 states characterized receipts from cloud computing transactions in this manner

Sourcing Receipts From Cloud Computing

How do states characterize receipts from cloud computing?



A BNA Graphic/0415g6

Income Tax Sourcing: Cloud Computing—COP or Market?

- More states said they used the market-based method, than those that used COP or that sourced receipts based on the customer's billing address.

Sourcing Bank & Financial Institution Receipts

- Majority of the states (30) using market-based sourcing (location of customers) for sourcing bank and financial institution receipts
- AZ, CA, KS, and VA indicated that they use cost of performance to source such receipts (Kansas said “yes” to both)

Alternative Apportionment

- 29 states have some written guidance on alternative apportionment methodologies
- 12 states still said they had no written guidance available on alternative apportionment
- IN and MA issued written guidance this year

Alternative Apportionment: Burden of Proof

- 24 states indicated that the burden of proof was on the party seeking to apply an alternative apportionment method.
- 12 states indicated that the burden of proof is always on the taxpayer, without consideration to the party seeking to apply the alternative apportionment method. (DC, HI, IN, IA, LA, ME, MO, NE, OK, RI, VA, WI)

Alternative Apportionment Litigation

Litigation

IN – *Rent-A-Center* – Only state without law change that has highest decision by state court saying burden stays with taxpayer, even if DOR asserts alternative apportionment

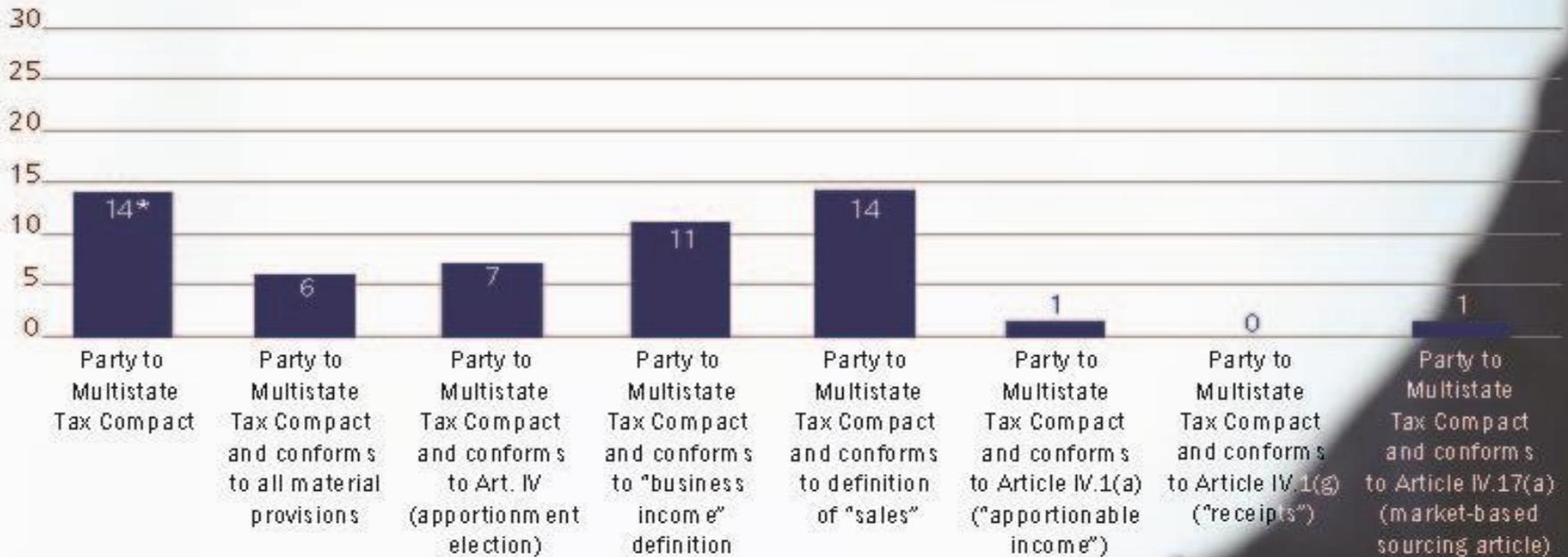
MS – *Equifax* – MS legislature fixed result by putting burden on party seeking its use and chancery court's review is not arbitrary and capricious standard

SC – *Car-Max West* – Burden of proof is on the party seeking its use and must show: 1) statutory formula not fairly represent taxpayer's activity in the state and 2) alternative method is reasonable.

Multistate Compact Conformity

- 14 jurisdictions said they are a party to the Multistate Tax Compact (AL, AK, AR, CO, DC, HI, ID, KS, MO, NM, ND, OR, TX and UT)
- MT and WA also parties to compact, but MT did not respond to this portion of the survey and WA does not impose a corporate income tax.

State Conformity to the Multistate Tax Commission's Multistate Tax Compact



*There are 16 states that are a party to the Compact. Results do not include Montana and Washington.

A BNA Graphic/O415g5

SALES TAX

Sales Tax: Trailing Nexus

- 37 states said they would find nexus for the entire taxable year (but no more) for a corporation that stops an activity during the year that once created nexus
- Exceptions: MS, NJ, NYC, TX and VT
- No states said trailing nexus would extend beyond the taxable year

Sales Tax: Drop Shipments

- Drop Shipments involve three parties:
 - Customer
 - Retailer/Manufacturer
 - Third-Party distributor that delivers to customer

- 17 would find nexus if manufacturer ships TPP by common carrier to in-state customers based on orders received from the distributor if the distributor has nexus with the state

- But no states would find nexus for the manufacturer if the distributor lacked nexus

Enacted Click-Through Nexus Laws – Part 1

State	Effective Date	Affiliate Threshold	Statute
AR (rebuttable presumption)	Oct. 24, 2011	More than \$10,000	Ark. Code Ann. § 26-52-117
CA (rebuttable presumption)	Sept. 15, 2012	More than \$10,000 (and more than \$1 million in annual in-state sales)	Cal. Rev. & Tax. § 6203(c)
CT (irrebuttable presumption)	July 1, 2011	More than \$2,000	Conn. Gen. Stat. § 12-407(a)(12)(L)
GA (rebuttable presumption)	Oct. 1, 2012	More than \$50,000	Ga. Stat. Ann. § 48-8-2(8)(K)
IL (now rebuttable)	July 1, 2011; Jan. 1, 2015	More than \$10,000	35 ILCS 105/2 and 110/2; amended by 2014 IL SB 352
KS (rebuttable presumption)	July 1, 2013	More than \$10,000	K.S.A. 79-3702(C)
LA (rebuttable presumption)	<i>Vetoed, June 19, 2015</i>	<i>More than \$50,000</i>	<i>HB 355</i>
ME (rebuttable presumption)	Oct. 9, 2013	More than \$10,000	Me. Rev. Stat. Ann. § 1754-B(1-A)(C)
MI (rebuttable presumption)	Oct. 1, 2015	More than \$10,000 (and more than \$50,000 in annual in-state sales)	Mich. Comp. Laws § 205.52b
MN (rebuttable presumption)	July 1, 2013	More than \$10,000	Minn. Stat. § 297A.66(4a)

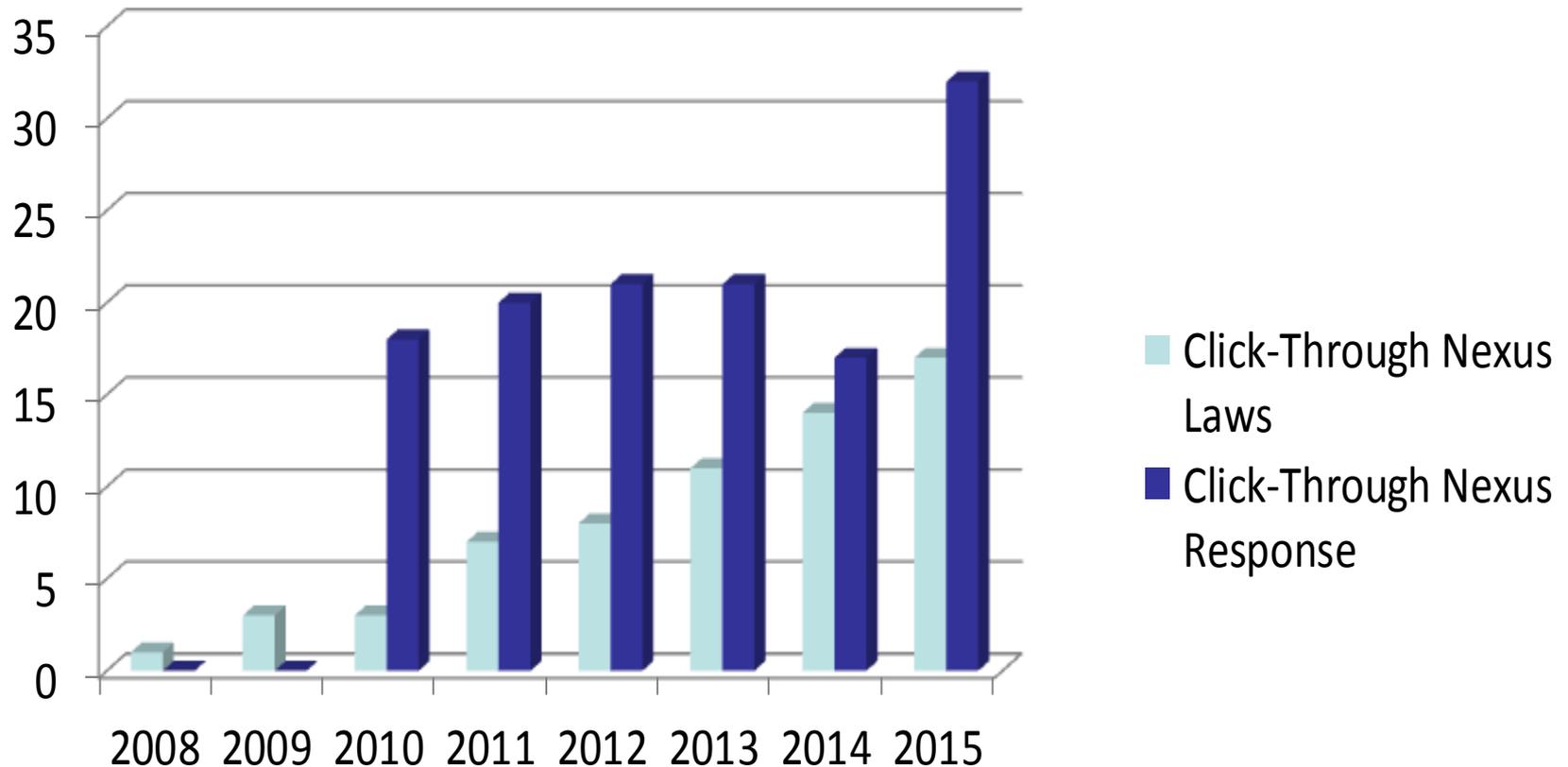
Enacted Click-Through Nexus Laws – Part 2

State	Effective Date	Affiliate Threshold	Statute
MO (rebuttable presumption)	Aug. 28, 2013	More than \$10,000	Mo. Rev. Stat. § 144.605(2)(e)
NV (rebuttable presumption)	Oct. 1, 2015	More than \$10,000	SB 380
NJ (rebuttable presumption)	July 1, 2014	More than \$10,000	N.J. Rev. Stat. § 54:32B-2
NY (rebuttable presumption)	June 1, 2008	More than \$10,000	N.Y. Tax Law § 1101(b)(8)(vi)
NC (rebuttable presumption)	Aug. 7, 2009	More than \$10,000	N.C. Gen. Stat. § 105-164.8
PA	Reg. Sept. 1, 2012	None specified	Tax Bulletin 2011-01 ; proposed legislation in 2013 (HB 1043) did not pass
RI (rebuttable presumption)	July 1, 2009	More than \$5,000	R.I. Gen. Laws § 44-18-15
TN (rebuttable presumption)	July 1, 2015	More than \$10,000	2015 HB 644
VT (rebuttable presumption)	When adopted in 15 other states.	More than \$10,000	Vt. Stat. Ann. tit. 32, § 9701(9)(I) (H.B. 436)
WA (rebuttable presumption)	Sept. 1, 2015	More than \$10,000	2015 SB 6138

ADDITIONAL CLICK-THROUGH STATES BASED ON SURVEY

ALABAMA	NEW MEXICO
ARIZONA	NORTH DAKOTA
DISTRICT OF COLUMBIA	NEW MEXICO
HAWAII	NORTH DAKOTA
IOWA	SOUTH DAKOTA
LOUISIANA – LEGISLATION PENDING	WASHINGTON – LEGISLATION PENDING
NEVADA – LEGISLATION PENDING	WEST VIRGINIA
	WYOMING

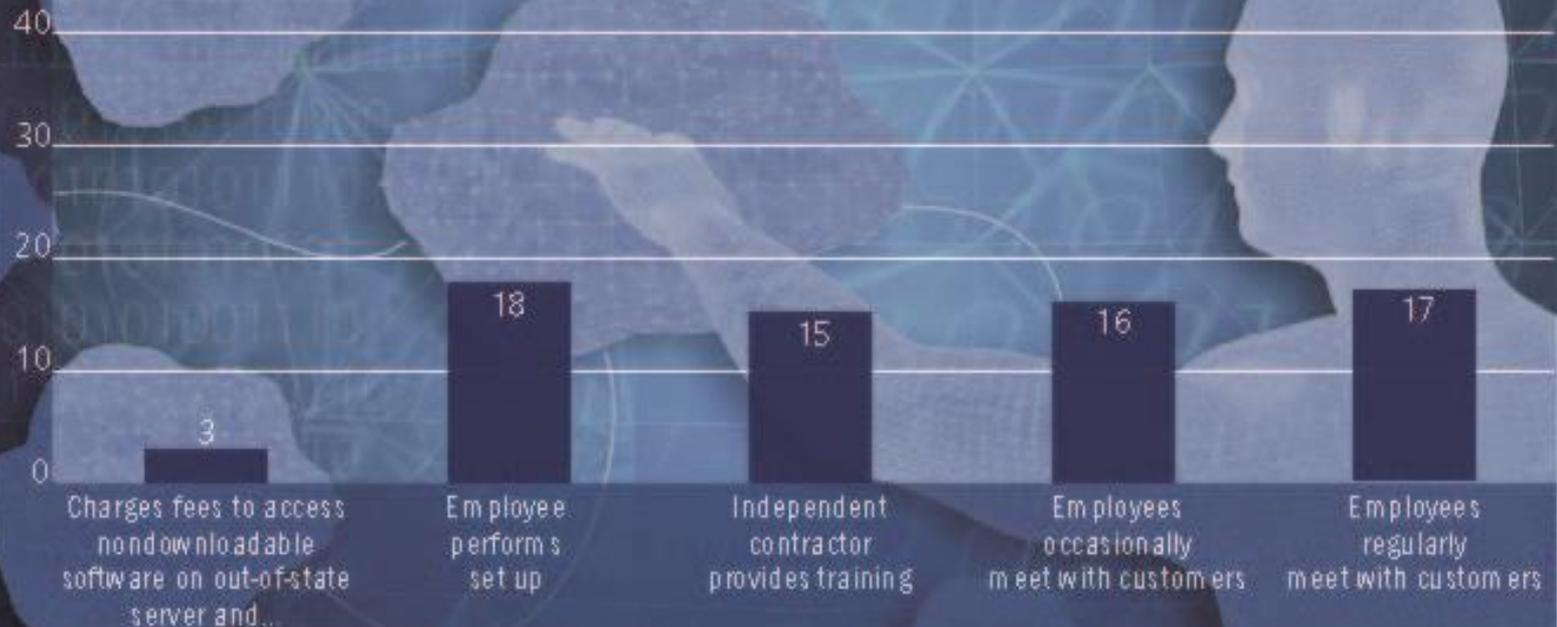
Sales Tax – “Click-through” Nexus Provision (S-342)



Recent Legislation – Nexus Presumed created by Commonly Owned “Affiliate”

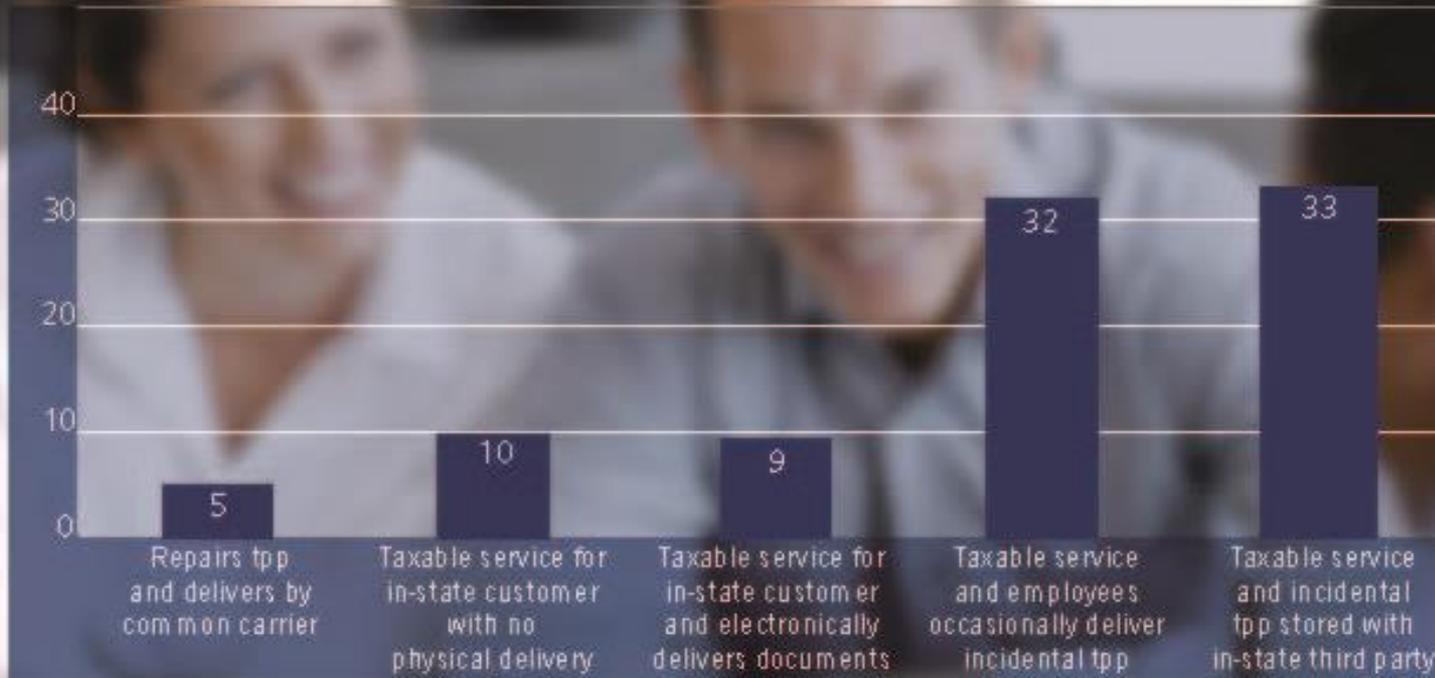
- 5% direct or indirect ownership
 - > NY (2009)
- Parent/Sub – 80% vote or value, Brother/Sister – 50% vote or value
 - > AR (2010)
 - > CO (2010)
 - > GA (2012)
 - > VA (2012)
- A “substantial ownership interest” is defined with reference to 15 U.S.C. § 78p, which is more than 10% ownership.
 - > OK (2010)
 - > SD (2010)
 - > UT (2012)
- 50% ownership in affiliate
 - > CA (2010)(50% vote)
 - > TX (2011)
- Noteworthy – Regulation
 - > Pennsylvania

Sales Tax Nexus for Cloud Computing



A BNA Graphic/0415g1

Sales Tax Nexus for Service Providers



A BNA Graphic/0415g2

Sales Tax: Federal Proposals

- Marketplace Fairness Act
 - ✓ Authorizes states adopting mandated streamlined sales tax regime to require remote retailers to collect tax
 - ✓ Safe Harbor for businesses with annual sales under \$1 million

- Online Sales Simplification Act
 - ✓ Establishes hybrid origin sourcing: retailers would source receipts based on its own location rather than where the customer is located

- Digital Goods and Services Tax Fairness Act of 2015
 - ✓ Prohibits a state or local jurisdiction from imposing multiple or discriminatory taxes on the sale or use of a digital good or service delivered or transferred electronically to a customer
 - ✓ Restricts taxation of a digital good or service to taxation by a state or local jurisdiction whose territorial limits encompass a customer tax address

Digital Copy of Survey Results?

➤ Go to:

<http://about.bna.com/2015-State-Tax-Survey-PR>

➤ Email:

sroll@bna.com