Do I Need to File a Tax Return in This State?

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What can create a filing requirement for a business?

Nexus

- A situation in which a business has tax presence in a particular state

- A connection between the taxing authority and an entity that must collect or pay the tax

Types of Nexus

- Physical
- Economic
- Factor presence
- Agent
- Affiliate
- Click-through

How is Nexus created?

- Physical Presence Nexus
  - Facilities, employees, inventory, or other property permanently located in the state
  - Employees or property temporarily located in the state (solicitation, installation, services, delivery trucks)
  - Agents permanently or temporarily in the state (independent sales representatives, service providers, subcontractors)

- Public Law 86-272 exemption for solicitation of sales only

How is Nexus created?

Common Examples of Physical Nexus

- Having a physical location or brick and mortar business
- Owning or leasing a business office in another state
- Owning or leasing a warehouse in another state
- Sending employees or agents to another state (for example, traveling sales reps)
- Temporarily doing physical business in a state for a limited amount of time, such as at a trade show or craft fair

How is Nexus created?

- Factor Presence Nexus
  - An out-of-state company has nexus if it has property, payroll, or sales that exceed certain thresholds during the tax period
  - Generally, the thresholds are: $500,000 of sales, $50,000 of payroll, $50,000 worth of property, or 25% of total property, total payroll, or total sales

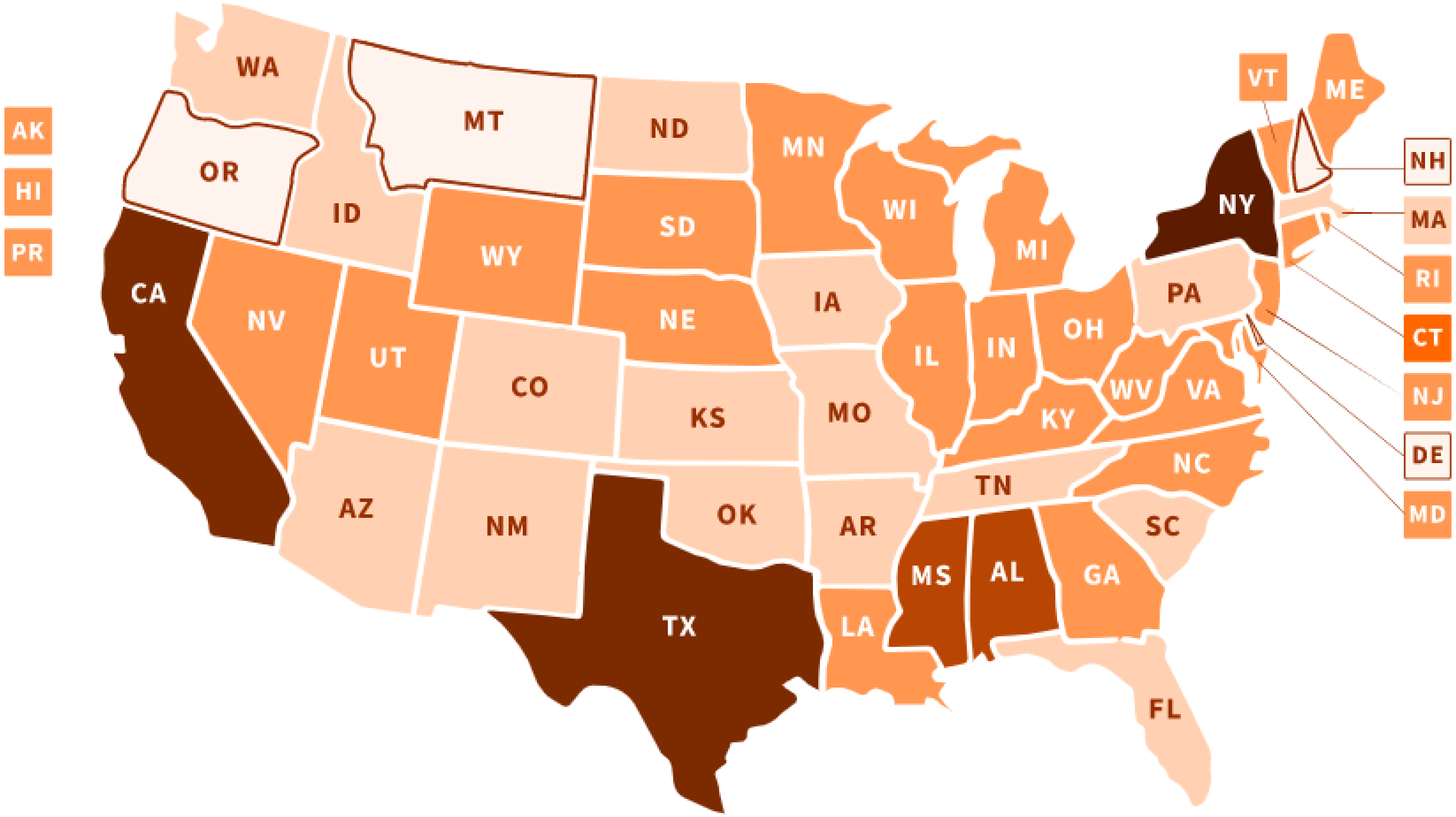
How is Nexus created?

- Economic Nexus
  - In-state presence consisting of annual sales revenue or sales transaction volume exceeding state’s threshold
  - Economic nexus is triggered by passing a certain number of total transactions in a state or exceeding a certain amount of revenue from transactions in the state. Some states require both for it to trigger; other states require only one. This means you must watch out for “and/or” language in state legislation.

Economic nexus thresholds

Thresholds legend

- No economic nexus
- $100,000
- $100,000 **or** 200 transactions
- $100,000 **and** 200 transactions
- $250,000
- $500,000
- $500,000 **and** 100 transactions



What is a Nexus Study, and when should it be considered?

- A nexus study documents your business activities in a state or states, and whether (and why) they do or do not create nexus.
- If you are considering to register in a new state – a nexus study should be performed
- The study should address all tax types:
  - Sales Tax, Income Tax, Franchise Tax, and Gross Receipts Tax
- Physical presence will usually override economic nexus rules

Nexus Study Approach

- Nexus studies can be overwhelming

- Use a phased Approach
  - Start with largest states first

Example of Nexus study questions

- In which state was the business organized or incorporated?
- In which states did you file income/franchise tax returns last year?
- In which states are you registered to do business?
- In which states do you have a business location?
- In which states do you have employees:
  - Working on a permanent basis?
  - Working on a temporary basis?
  - Visiting on occasion for business?
  - Attending trade shows?
  - Living but not working?
- Please describe the activities of employees in states without a business location.
- In which states do you have:
  - Fixed assets?
  - Inventory (including consignment)?
  - Raw materials?
- Please provide a list of your sales by state based on the location of the customer.
- In which states are you currently collecting and remitting sales tax?
- In which states do you have independent contractors performing services for customers on your behalf?
- What types of products/services do you sell?
- In which states do you advertise? In what media?
- In which states do the owners of the business live?
- In which states does the business receive mail (PO Box or street address)?
- In what states is the company listed in the telephone directories?
- Which states are listed in the contact information on the company website?

What to do once additional states are identified?

- Calculate risk of not filing in prior periods for Sales Tax and Income Tax

- Voluntary Disclosure vs Prospective Filing

Pros and Cons - VDAs

- PROS
  - Limited exposure, tax liabilities, and penalties
  - VDA negotiation is often anonymous
  - Opportunity to "come clean" and get right with the state when you realize a mistake
- CONS
  - Any missing details can void the VDA or result in ineligibility
  - States have varying requirements for VDAs
  - Additional tax liabilities may be uncovered

Nexus Studies are not a one and done deal

- Recommendation: perform a nexus study every year, at a minimum
  - Identifies any new states that you need to register and start filing in
  - Also identifies states where you may decide to withdraw from

Composite Returns vs Non-Resident Withholding

- Composite Return: a return filed by the pass-through entity that reports the nonresident owner's share of state income and calculates tax that is paid by the passthrough entity on behalf of the nonresident owner. The owner does not need to file an individual return in the state.
- Non-Resident Withholding: a mandatory prepayment of tax of individuals or entities that are not resident in the state.

To file or not to file a composite return…

- Factors to consider when faced with the decision to file a composite return:
  - Does the individual owner qualify to participate in a composite return?
  - Can the individual still file a return even if they have participated in a composite return?
  - Do the owners have any other source of income from that state?

Composite Returns Continued…

- Advantages:
  - Convenient
  - State tax credit for taxes paid to other states
    - Exceptions: AZ, CA, OR, DC
  - Eliminate the need to file non-resident tax returns
  - Avoid the cost and complexity of complying with multiple state income tax rules
  - Shift the burden of dealing with notices or audits to the entity.
- Disadvantages:
  - May subject nonresident income to the highest marginal tax rate
  - Forfeit state tax benefits of exemptions and deductions

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