

# **Multistate Taxation: Nexus Can Be a Good Thing!**

## **By Mary F. Bernard, CPA**

Once upon a time, most businesses operated only in their state of residence. Now, it is uncommon for a business to have customers in only one state, especially in areas like New England, where state lines can be crossed in one hour!! This exposes businesses to a myriad of tax issues, not only on an income tax level, but also involving sales and use taxes as well as payroll taxes. With the current financial situation, states will be looking closer at interstate activities in hopes of raising revenues from outside their own state. Most states are gearing up for increased audit activity.

Nexus, or an economic presence, can be established by minimal activities within a state, unknowingly exposing a company to additional state taxes. Each state has its own requirements for nexus, differing with each type of tax. For many states, sales and use tax responsibilities occur with very minimal contact. Franchise or business privilege tax obligations often creep up on the unsuspecting business owner. Some states have no *de minimus* rules for wage withholding, requiring state tax withholding on the first dollar earned within the state!! Good record keeping of state activities has now become more critical than ever before.

Sometimes establishing nexus in another state can actually help lower total state tax liability. If a corporation has no economic presence outside of its home state, it will be taxed on 100% of its income in the state of domicile. By establishing nexus in at least one other state, the corporation is now allowed to apportion its income among the states involved. Understanding how corporate state tax apportionment works can help with state tax planning.

Most states use some variation of a three-factor apportionment formula, giving different weights to sales, property, and payroll located within the state. The variations among the states allow for some interesting tax consequences. Depending on the distribution of these factors and the state income tax rates, favorable tax treatment is possible to achieve.

**EXAMPLE:** Assume XYZ Corp. ships its sales to two states, 75% to the non-resident state, and has nexus in both states, although 100% of the company's property and payroll are located only in the home state. If both states use the same apportionment formula and have the same tax rate, the tax liability remains the same if the corporation operates only in the home state or in both states. Once the formula and/or the tax rates differ, tax savings opportunities arise.

	<b>Home State</b>	<b>State A</b>	<b>Total</b>
Taxable Income to apportion	\$100,000	\$100,000	\$100,000
Property factor	1.00	0	
Payroll factor	1.00	0	
Sales factor	.25	.75	
Double weighted sales	.25	0	
Average factor	.625	.25	
Apportioned income	\$62,500	\$25,000	\$87,500
Tax rate	8%	5%	
State tax liability	\$5,000	\$830	\$5,830
<b>Effective total rate</b>			<b>5.83%</b>

**RESULT:** By having the ability to apportion income outside of the home state, XYZ Corp. was only taxed on 87.5% of its income on a state level, with over 12% of its income attributable to “nowhere sales.” (Note: This phenomenon cannot occur in a home state that is a “throwback” state, like Massachusetts.) In addition, the state tax effective rate was lowered from 8%, if all income was taxed in the home state, to 5.83%.

However, what helps you could also hurt you. With a slightly different scenario, it would be just as possible to raise the effective tax rate, depending on the apportionment formulas and tax rates. Careful analysis of the states involved is required to maximize potential tax savings. Having the ability to apportion income outside the state of domicile is not necessarily a bad thing.