Business across state lines—
the tax implications
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When your business crosses state lines, what tax issues should you address? Will you be subject to income, franchise, business privilege or gross receipts taxes? When does your business activity become more than solicitation of sales? These are just a few of the concerns of a multi-state business.

Whether a state has the right to tax the income of a business incorporated in another state depends on the relationship between the state and the business entity. States do not impose taxes based on any standardized tax system. The amount of activity or connection to a state required to create nexus, or the right to tax an entity, varies from state to state.

Nexus

Nexus describes the amount and degree of business activity that must be present before a state can tax an entity’s income. If a taxpayer has nexus in a particular state, the taxpayer must pay and collect/remit taxes in that state. There must be at least a “definite link or minimal connection” before a state can impose an income tax on a taxpayer. For income tax standards, the mere presence of a warm body within a state may not be sufficient to establish nexus. There must be some type of distinct business activity exceeding solicitation of sales. The amount of activity or connection necessary to create nexus is usually defined by state statute or case law and/or regulation within each state.

Generally, nexus for income tax purposes is created if a legal entity:

• derives income from sources within the state,
• owns or leases property in the state,
• employs personnel in the state in activities that exceed “mere solicitation” or
• has capital or property in the state.

States also are prohibited from imposing a tax when an entity’s only connection with the state is the solicitation of orders for sales of tangible personal property, and such orders are accepted and shipped or delivered from outside the state. However, this does not offer any protection from sales tax, franchise tax, gross revenue tax, business opportunity tax, or single business tax.

Solicitation or beyond?

How do you determine if your business activities are strictly solicitation of sales or if you have stepped beyond the protected activities allowed? As “solicitation” is not defined in the law, judicial interpretations provide guidance in this area. In Wisconsin Department of Revenue vs. William Wrigley, Jr., 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.” The clear line is the one between those activities that serve no independent business function apart from their connection to the soliciting of orders and those that the company would have reason to engage in anyway but chooses to perform through its in-state sales force.

The court determined that the following activities, among others, were permitted and would not subject the taxpayer to income tax in a jurisdiction:

• provision of company cars,
• provision of stock of free samples,
• recruitment or training of sales representative,
• setting up display packs and assisting with retail display,
• use of hotels or homes for sales meetings,
• intervention with credit disputes,
• maintenance of non-reimbursed home office by in-state employee.

These activities were all considered to be connected to the process of solicitation of sales.

On the other hand, the following activities were considered to exceed the mere solicitation of sales and could subject the taxpayer to income tax within the jurisdiction:

• maintenance of office within state,
• replacing spoiled products,
• providing technical assistance,
• repairing products,
• direct sales of products.

It is important to note that business activities other than solicitation of sales may subject you to income tax in some states. These activities include attendance at trade shows, having inventory on consignment, licensing intangibles, financing activities, installations, and training. All of these activities are considered by some states to be sufficient to impose income tax.

With states becoming more aggressive in identifying business activities within their state, it might be a good idea to determine the nature and extent of your state tax filing implications sooner, rather than later. Once a state issues you a nexus questionnaire, your options become limited. A voluntary Disclosure agreement with a state can bring you into compliance for income and sales tax purposes with a limited look-back period and often eliminate penalties and sometimes interest. Being pro-active can save you money.