



Multistate Taxation

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Multistate Taxation Overview –Part 1

- Introduction to State and Local Taxation
- Nexus
 - Constitutional limitations
 - Public Law 86-272
- Current Developments

Multistate Taxation

- Significance of state and local taxation
 - Current economic conditions and state budget shortfalls have changed the landscape of state taxation
 - Increase in types and levels of taxes has added complexity and increased costs to business operations
 - Taxing jurisdictions have more actively sought to collect tax revenues – issuance of taxpayer unfavorable interpretations of tax statutes, more closely scrutinized compliance and increased information sharing between states

Examples of State and Local Taxes

- Sales Tax
- Use Tax
- Income Tax
- Franchise Tax
- Payroll Tax
- Real Property Tax
- Personal Property Tax

Nexus

What is Nexus?

- The connection or link that must be established with a taxing jurisdiction (state or locality) before the taxing jurisdiction can constitutionally impose a tax or subject an entity to the responsibility of collecting the jurisdiction's tax
- State Nexus Statutes
 - A very low nexus threshold is the general rule
 - Typical state statutes will assert nexus to the limits of the U.S. Constitution

Constitutional Restrictions

- US Constitution prohibits a state from taxing a person unless both the Due Process Clause and Commerce Clause requirements are met
 - Due Process Clause: Requires “minimal connection” between taxpayers’ interstate activities and the taxing state
 - Commerce Clause: Requires that taxpayers’ activities have a “substantial nexus” with the taxing state

U.S. Constitution: Due Process Clause

- No state shall “deprive any person of life, liberty, or property without due process of law”
 - Generally interpreted by the courts as requiring a minimal connection between the taxpayer and the state or jurisdiction that seeks to impose the tax
- Due Process Standards:
 1. A minimum connection between the state and the taxpayers interstate activities
 2. A rational relationship between the measure of the tax and the intrastate values of the enterprise

U.S. Constitution: Commerce Clause

- Gives Congress alone the power to “regulate commerce with foreign nations, and among the several states”
 - Drafters were concerned with the effects of state regulation on the national economy
 - Prohibits states from enacting laws that discriminate against or imposing greater burdens on interstate commerce in favor of intrastate commerce

Nexus Standards: Quill

- *Quill Corp. v. North Dakota* 504 U.S. 298 (1992)
 - Quill was a mail-order vendor of office supplies
 - Quill did not maintain an office or have any employees in the state and delivered all of its merchandise via US mail or common carrier
 - ND asserted that Quill's systematic solicitation in the state through catalogs and advertising flyers created nexus and therefore Quill was required to collect use tax on sales to ND residents
 - The US Supreme Court held that although Quill's economic presence in ND satisfied the Due Process Clause "minimum connection" test, the Commerce Clause "substantial nexus" test was not satisfied because Quill did not have a physical presence in ND

Nexus Thresholds: Complete Auto

- *Complete Auto Transit* established a 4-pronged test to determine whether the Commerce Clause would permit a state to impose tax on an interstate transaction
 1. Substantial Nexus
 2. Fairly Apportioned
 3. Non-discriminatory
 4. Fairly related to state services of which a taxpayer may avail itself

History of Public Law 86-272

- In *Northwestern States Portland Cement v. Minnesota* 358 U.S. 450 (1959), the Supreme Court ruled that mere solicitation through a sales force within the state was sufficient to create constitutional nexus
- The business community lobbied and convinced Congress that such a low threshold for nexus would impede interstate commerce
- As a result, Public Law 86-272 was enacted in 1959 to restrict a state from imposing a net income tax, but only if a taxpayer's activities in state were limited

Public Law 86-272

- Applies to:
 - Net income based taxes
 - Activities limited to solicitation of orders
 - Sales of tangible personal property
- Does not apply to:
 - Sales/use taxes, net worth taxes, or other taxes not based on net income
 - Activities that exceed the solicitation of orders
 - Sales of services, real property, and intangible property

Public Law 86-272: Wrigley

- *William Wrigley Jr. Co. v. Wisconsin Department of Revenue* 504 U.S. 298 (1992)
 - An Illinois-based manufacturer that sold chewing gum nationwide
 - Wrigley did not own or lease any real property in Wisconsin. All orders were sent to Illinois for approval and were filled by shipment through common carrier from outside Wisconsin. Credit, collection, and advertising activities were also managed from Illinois.
 - Wrigley's Wisconsin activities consisted of a regional manager and sales representatives who were provided with company cars
 - Wrigley representatives' in Wisconsin replaced stale gum, restocked retailers' display racks, and Wrigley reimbursed one sales representative for storage of gum

Public Law 86-272: Wrigley (cont.)

- Supreme Court’s definition of “solicitation of orders”
 - “Making requests for purchases” and
 - “Activities that are entirely ancillary to requests for purchases – those that serve no independent business function apart from their connection to the soliciting of orders”
- Court noted that a de minimis level of non-solicitation activities does not forfeit protection of P.L. 86-272
- Supreme Court ruled that the replacement of stale gum, restocking of retailers' display racks, and storage of gum each served an independent business function separate from requesting orders and, thus, exceeded solicitation.

Public Law 86-272: Nexus Thresholds

- Examples of *protected* activities:
 - Providing a car or free samples for salesperson
 - Renting space for temporary display (two weeks or less)
 - Assisting with product display in retail shops
 - Maintaining informal home offices

Public Law 86-272: Nexus Thresholds

- Examples of *unprotected* activities:
 - Providing technical assistance
 - Maintaining a company office
 - Repairing or servicing product
 - Approving sales
 - Account collections
 - Replacing spoiled product
 - Engaging in “agency stock checks”
 - Storing product not related to solicitation

Advanced Nexus Concepts

- Agency Nexus
- Affiliate Nexus
- Economic Nexus
- “Click-Through” Nexus
- Factor-based Nexus, “Bright line” Tests

Questions?

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