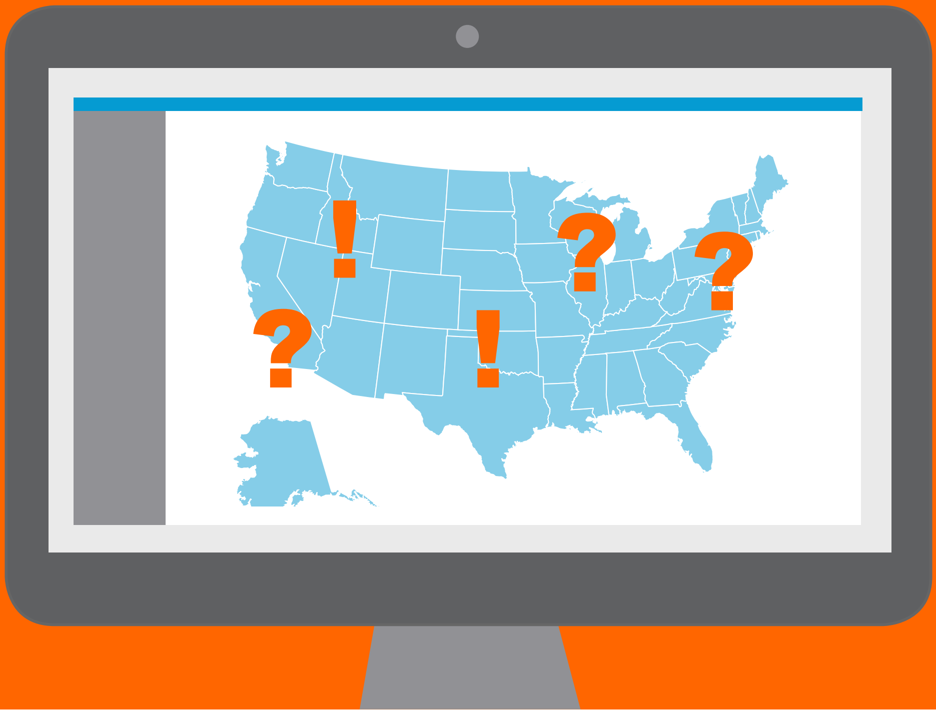
Know Your Nexus

Decoding the Confusing and Challenging Nature of Nexus Obligations



Avalara

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INTRODUCTION

As an Avalara customer, you understand the importance of sales and use tax compliance. And the first step to compliance often starts with understanding where your business has nexus, or where you need to collect and remit sales tax. But nexus is ever-changing and confusing for even the savviest business owner. According to a [2017 Wakefield Research report](#):

94 PERCENT

of businesses surveyed have misconceptions around what creates nexus.

41 PERCENT

of respondents think it's the state's responsibility to contact a company if nexus is presumed in a state (it isn't).

38 PERCENT

believe nexus triggers are the same across all states (they aren't).

31 PERCENT

don't know or can't confirm a routine process for assessing their nexus obligations, despite the fact that 61 percent are registered in multiple states.

Unfortunately, you can't just figure out where you have nexus today and forget about it – you have to closely monitor nexus moving forward. Many activities can trigger new tax collection obligations for your business, especially in the growing number of states intent on enhancing remote sales tax revenue. In other words, it's possible for you to develop new sales and use tax responsibilities in one or more states even if you do nothing new and your business doesn't change.

We know understanding nexus can be tough, which is why we've developed this handy ebook to help. In the pages that follow, we outline what nexus is, what may trigger nexus, court cases that may have an impact on nexus, and how to manage your nexus responsibilities.

If you find nexus confusing, don't worry. WITH HELP FROM AVALARA, YOU'RE NOT ALONE.

While we hope you'll find this information helpful, this guide does not offer a substitute for professional legal or tax advice.

WHAT IS NEXUS?

Sales tax nexus is the connection between a seller and a state that requires the seller to collect and remit tax on sales made in that state. If you have sales tax nexus in California and Texas, for example, you must collect and remit sales tax in California and Texas.

REMINDER: Sales tax nexus is not the same as income tax nexus: A business can have an obligation to collect and remit sales tax in a state where it has no income tax liability. Confounding, but true.

WHAT TRIGGERS NEXUS?

So, what exactly triggers nexus? Unfortunately for many businesses, there's no one thing. Nexus has long been linked to physical presence, but the explosion of ecommerce has driven many states to seek new ways to establish nexus, beyond brick and mortar.

Today states are basing nexus on a variety of criteria, from relationships to in-state affiliates to the presence of web cookies on in-state computers. And they're unlikely to stop there. Until they bring in more remote sales tax revenue, you can be sure some states will continue to push beyond the physical presence limitation.

If you find nexus confusing, you aren't alone. To help simplify the confusing nature of nexus, we've broken it down into two sections, nexus triggers tied to a physical presence and nexus triggers that go beyond standard physical presence.

NEXUS TRIGGERS TIED TO A PHYSICAL PRESENCE

In 1992, the Supreme Court upheld an earlier decision and ruled that sales tax nexus can be established only when a business has a physical presence in a state (Quill Corp. v. North Dakota, 504 U.S. 298). Since then, Quill has been the guiding force behind state nexus laws. In the District of Columbia and all 45 states with a general sales tax, businesses that have a physical presence and make taxable sales in a state are generally required to collect and remit that state's sales tax.

That makes sales tax compliance relatively simple for a business with one location in one state and no connections to other states (e.g., no interstate sales). However, if you have a physical presence in another state, you likely have nexus in that state – even if you don't realize it.

DID YOU KNOW?

NOMAD STATES

New Hampshire, Oregon, Montana, Alaska, and Delaware (aka NOMAD states) do not have a general sales tax.

WHAT TRIGGERS NEXUS?

As you may expect, physical presence includes brick and mortar locations. It can also include renting or owning property – even property located at a site owned by a third party, like tools at a construction site. Having remote employees or contractors in a state, even temporarily, can trigger nexus, as can delivering goods in your own vehicle, or storing property in a location owned by someone else (like a fulfillment center). Common physical presence nexus triggers include:

REMOTE EMPLOYEES/SALES REPS

Nexus can be created if you employ salespeople in different states. If your employees or contractors conduct any work at a customer's out-of-state location, or even deliver products into another state, nexus can also be triggered. Colorado, for example, has stated that nexus can be established when a remote seller has employees in the state, "even if the activities of the employee are completely unrelated to the sales transactions at issue."

EVENT ATTENDANCE

Attending trade shows or other events in another state can also establish nexus with that state. State rules vary, and some states take a more aggressive stance than others. To trigger nexus in Arizona, for example, an employee or independent contractor generally has to be in the state to solicit sales or establish a market for more than two days per year.

Remember, nexus laws can change. Before July 1, 2016, attending just one trade show in Washington state could trigger nexus. Since then, attendance or participation at one trade convention in Washington each year doesn't automatically establish nexus – although it could if an attendee is physically present in Washington "for the purposes of establishing substantial nexus" with the state.

DID YOU KNOW?

In Texas, attendance at a single trade show may create nexus.

WHAT TRIGGERS NEXUS?

STORING INVENTORY

Storing inventory in a facility owned by another party has become more prevalent in recent years thanks to the rise of large internet marketplace providers like Amazon, eBay, and Etsy. After flying under the radar of state tax authorities for years, these types of relationships are now coming under scrutiny. Laws targeting marketplace facilitators and/or sellers are now in effect in several states, including Arizona, Pennsylvania, Rhode Island, Virginia, and Washington.

While the goal of these states is the same, the laws vary significantly. For example, Virginia holds the owner of the inventory – the seller – liable. Washington says the owner of the facility – the marketplace facilitator – should collect and remit tax on third-party sales; however, marketplace sellers have to collect and remit on sales made directly to consumers, and they have other reporting obligations (i.e., B&O tax) for their marketplace sales. In other words, to the frustration of business owners, even physical presence isn't always clearly defined.

DID YOU KNOW?

Marketplace providers are required to share information about third-party sellers with tax authorities in some states.

TRAILING NEXUS

Once you've established nexus in a state, it can linger longer than you might imagine. Nexus may continue even after you cease doing business or having a presence in a state, for a period that can last through the end of the calendar year or even longer. This is important to remember, especially if you trigger nexus through a temporary presence, like event attendance.

> After a remote seller ceases nexus-creating activity in California, for example, it generally is liable for sales tax for the remainder of the quarter, plus one additional quarter.

NEXUS TRIGGERS BEYOND A PHYSICAL PRESENCE

Because Quill's physical presence standard prevents states from taxing remote sales, many states are pushing against it. Their efforts have intensified with the growth of ecommerce and the rise of untaxed internet sales. Dozens have already expanded their nexus rules to tax more sales by out-of-state sellers; others are looking at doing the same.

> The fact that nexus rules vary by state – and are subject to change at any time – makes it extremely complicated to determine all the places your business needs to register and collect and remit sales tax.

A growing number of states have expanded nexus to include routine business activities like advertising, drop shipping, or referrals from in-state businesses. Furthermore, some states now maintain that economic activity alone is sufficient to trigger nexus; however, at this time these laws are unenforceable until the physical presence statute of Quill is overturned.

DID YOU KNOW?

More than

30 states

have laws on the books that expand nexus beyond physical presence to capture remote sales tax revenue.

Nexus is confusing because it may be triggered even if you and your employees or shippers don't set foot in another state. Examples of nexus triggering activities beyond a physical presence include:

ADVERTISING

It's now easier than ever for a business based in one state to advertise to potential customers in other states. But beware: Sometimes advertising across state borders can trigger a tax collection obligation.

For example, advertising in newspapers or other periodicals printed in Virginia can trigger nexus there, as can advertising on billboards or posters located in the Commonwealth. Similarly, the regular or systematic solicitation of sales through marketing channels like television, radio, magazines, mail, and more can establish sales tax nexus in Texas. However, in California, advertising via the internet, print, radio, or television generally only triggers nexus if the ads are paid for with commissions from sales of taxable goods resulting from the advertisements.

DID YOU KNOW?

Tax obligations may be established through a connection to an in-state business or individual, including online advertising.

AFFILIATE NEXUS

Nexus can be established if an out-of-state retailer is affiliated with an entity that has nexus in another state. In California, for example, out-of-state retailers must collect sales tax if they are related in any way to any entity located in the state. This includes entities that conduct business on an out-of-state seller's behalf, as well as those that use a similar trademark. The state maintains affiliate nexus exists even when the in-state business operation is completely separate from the out-of-state company's retail operations.

In New York, an out-of-state seller may have affiliate nexus if it uses in-state representatives to solicit business or otherwise help it develop or maintain a market in the state. Nexus-triggering activities include distributing catalogs or coupons, accepting orders, or accepting merchandise returns on behalf of the remote seller.

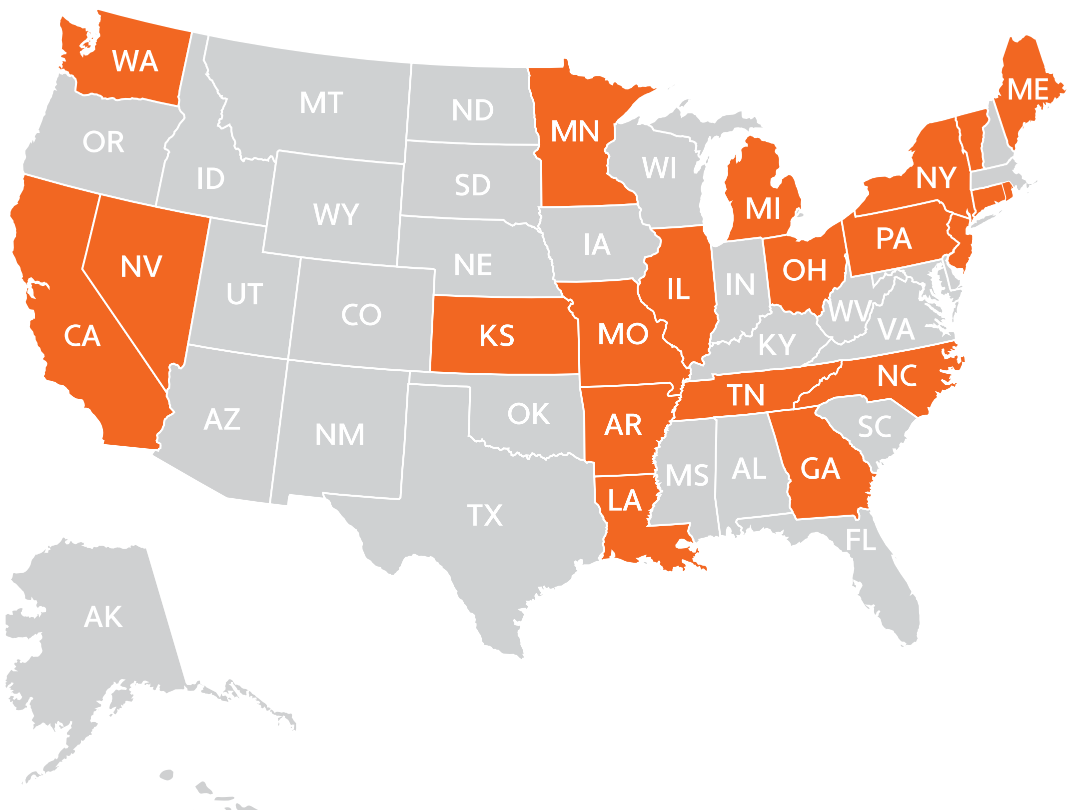
WHAT TRIGGERS NEXUS?

CLICK-THROUGH NEXUS

If you contract with an individual or business in another state to directly or indirectly refer potential customers through a web link on an in-state website, for a commission or other consideration, you could have nexus in a state with click-through nexus. More than 20 states have adopted click-through nexus laws. Most have a sales threshold, meaning the referrals must generate a certain amount of sales to trigger nexus. In most states, referrals must generate more than $10,000 in the preceding 12 months or four quarters. Other thresholds include:

- Pennsylvania: none
- Connecticut: more than $2,000 during the four preceding quarters
- Georgia: more than $50,000 annually

STATES WITH CLICK-THROUGH NEXUS LAWS (as of 3/1/2017):



WHAT TRIGGERS NEXUS?

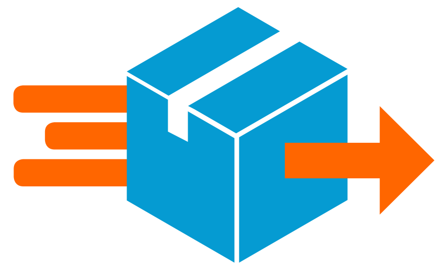
DELIVERY AND DISTRIBUTION

As long as you ship goods to customers by a common carrier such as USPS, UPS, or FedEx, you're unlikely to trigger a sales tax obligation through delivery. Delivering products to customers in your own vehicle, however, can trigger nexus. An out-of-state business that sells taxable goods to customers in New York and regularly delivers the products in its own vehicles has to register for sales tax; regular delivery means "at least 12 times a year."

In Pennsylvania and Washington, an out-of-state company can establish nexus not only by making deliveries in their own vehicles, but by hiring a third-party or representative to deliver the goods.

Drop shipping – a retail fulfillment method where a retailer doesn't keep items in stock, but orders them from a third party and has them shipped directly to the customer – or a contract with a distributor that functions as a drop shipper, is considered a taxable, nexus-creating activity in many states. In some situations, the retailer is liable for the tax; in other situations, a state will hold the drop shipper liable.

DID YOU KNOW?



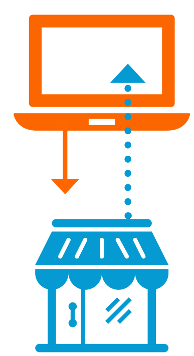
One drop-shipping transaction can trigger nexus in California, Florida, New York, and Texas.

SOFTWARE

A handful of states now assert that an out-of-state seller establishes nexus when it places software or web cookies on an in-state computer(s) to facilitate sales in the state. Massachusetts was the first state to adopt this policy, followed by Connecticut, Ohio, and Rhode Island.

Trailblazing Massachusetts argues that internet vendors differ from other vendors in key ways. Notably, they store software (apps) and ancillary data (cookies) on the computers, handheld devices, and laptops of in-state customers. This, Massachusetts claims, gives internet sellers a physical presence that other sellers don't have. It's an interesting angle.

DID YOU KNOW?



A "cookie" is a small piece of data sent from a website and stored on the user's computer while the user is browsing. Some states now assert that these cookies give remote sellers nexus.

ECONOMIC NEXUS

Economic nexus, which bases a tax collection obligation on economic activity, has become a hot issue these days in response to the rapid growth of ecommerce. Its goal is to level the playing field between non-collecting out-of-state sellers and the brick-and-mortar businesses that have to collect tax.

In many states with proposed economic nexus laws, economic activity alone triggers nexus – no physical presence is needed. In others, it's combined with certain other activities. Like all sales tax laws, economic nexus varies by state. Nexus laws are facing a big challenge and most have been unenforceable pending the outcome of South Dakota v. Wayfair – a case that could overturn the long-standing Quill precedent that defines nexus. But some states will not be deterred and have established their own economic nexus laws, for example:

Alabama: An out-of-state seller must make retail sales into the state of more than $250,000 and have sufficient contact with the state under Alabama Code Section 40-23-68.

Massachusetts: An internet vendor must make more than $500,000 in Massachusetts sales and have more than 100 separate transactions delivered into Massachusetts.

South Dakota: A remote seller must have gross revenue from taxable sales into South Dakota of more than $100,000, or have 200 or more separate taxable sales transactions delivered into South Dakota.

Additional states with economic nexus include Indiana, Maine, Tennessee, Vermont, Rhode Island, Washington, Pennsylvania, North Dakota, Ohio and Wyoming, although many of these provisions have delayed effective dates or are on hold pending litigation.

Economic nexus could be a game changer, as you'll see in the next section.

TIMES ARE CHANGING

The way consumers shop and businesses sell has moved far beyond brick and mortar stores thanks to the advent of the internet. Likewise – while some laws are pending – establishing nexus has moved far beyond mere physical presence.

States are increasingly willing to go after sales and use tax revenue from untaxed remote sales. In 2017 alone:

States introduced approximately **80** sales and use tax compliance bills.

Approximately **12 states** adopted or imposed economic nexus.

Approximately **4 states** created new reporting requirements for marketplace providers or sellers.

Now that you have a better understanding of current nexus triggers, it's important to reiterate that with all things related to nexus, laws and regulations can change quickly. In fact, there are some important pieces of legislation that are currently in review or being enacted that you should be aware of. We review three of the key developments below.

THE ROLE OF THE SUPREME COURT

To make matters even more complex, the issue has moved beyond the states. In January 2018, the Supreme Court agreed to hear South Dakota v. Wayfair, Inc., a case that gives the court an opportunity to reconsider the physical presence standard it upheld in Quill. Wayfair et al argue the state's economic nexus law violates Quill's physical presence standard; South Dakota argues the physical presence standard is now causing greater harm to the state because of internet retail.

> If the court rules in favor of South Dakota, it could overturn the physical presence limitation, at least in part. This could trigger a landslide of economic nexus legislation in other states. All eyes are now on the court, which is expected to issue a decision in late June 2018.

No matter how the Supreme Court rules, the decision will impact sales tax across the country. And if some states aren't satisfied by the outcome, there's a queue of states willing to defend nexus-broadening laws before the Supreme Court.

THE ROLE OF CONGRESS

Congress could also intervene. The Supreme Court noted in Quill that "the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve." In the intervening years, several pieces of remote sales tax legislation have made the rounds on Capitol Hill: the Marketplace Fairness Act (MFA); the Remote Transactions Parity Act (RTPA); the Online Sales Simplification Act (OSSA); and the No Regulation Without Representation Act. The MFA and RTPA would broaden state authority to tax remote sales; OSSA would do the same, to a lesser degree and quite differently; and the last would make the physical presence standard law.

To date, Congress has been unable to come up with a solution. But now that the Supreme Court has agreed to hear a challenge to Quill, there's renewed resolve on Capitol Hill to settle the matter.

USE TAX NOTICE AND REPORTING FOR NON-COLLECTING SELLERS

While Congress rallies and legal battles rage, some states are reaping the benefit of a court case fought and won.

In 2010, Colorado passed a law requiring non-collecting sellers to:

- Notify Colorado customers that sales tax wasn't charged and use tax could be owed to the state.
- Give Colorado customers annual reports of their purchase activity.
- Give the state annual reports of customer consumer activity.

THE GOAL? Encourage non-collecting vendors to collect tax on their sales, and increase use tax collections.

DID YOU KNOW?

Almost 10 states have adopted use tax notice and/or reporting requirements for non-collecting sellers.

HOW DO YOU KEEP UP?

If you made it this far, you know that nexus is tough.

It can be hard to understand the different types of nexus, and harder still to understand what they mean for your business. But knowing where you have nexus now and where you could have it in the future is crucial for all businesses.

In short, getting nexus right takes a lot of time and dedicated effort. Unfortunately, if you don't give state nexus laws the attention they demand, the consequences of noncompliance can cost you even more time – and money.

> When it comes to staying up to date with nexus and your associated requirements, the Avalara Tax Advisory Services team is here to help.

While you may know Avalara for our software as a service (SaaS) solutions, software isn't all we do. Our Tax Advisory Services team is a group of tax experts that can:

- Help you determine where you have nexus.
- Provide ongoing monitoring services to see when new nexus is established.
- Help you register in new jurisdictions.
- Navigate the tasks related to establishing new nexus.

To learn more about how the Avalara Tax Advisory Services team can help, click here.

Although we hope you'll find the information helpful, this guide does not offer a substitute for professional legal or tax advice. If you have questions about your tax liability or concerns about compliance, please consult your qualified legal, tax, or accounting professional. This document was compiled in March 2018. Because states constantly update and amend their sales and use tax laws, see each state's website for the most up-to-date and comprehensive information.

Avalara