Survey Reveals That States' Tax Policies on Certain Technologies are Inconsistent

David M. Kall | Saturday, May 2, 2015

On April 25, 2015, Bloomberg BNA released its 14th annual Survey of State Departments (Survey), aimed at "clarifying each state's position on the gray areas of corporate income tax and sales and use tax administration, with an emphasis on nexus policies." For state tax purposes, the concept of nexus concerns the minimum threshold of contact between a taxpayer and a state before the state has jurisdiction to tax the taxpayer.

The Survey notes that "[s]tate tax policies continue to lag behind new business models such as cloud computing, as well as a change that began long ago: [T]he nation's shift toward a service-based economy."

A given state's nexus policy can be based on either a physical or economic presence. If the policy is based on a physical presence, nexus often results from the physical presence of employees or property, including inventory, within a state's borders. If the policy is based on an economic presence, "nexus can be triggered merely by making sales into the state; owning property or maintaining a payroll is not required."

The concept of nexus is becoming increasingly significant to taxpayers as the Internet renders geographical boundaries irrelevant. The Survey observes that nexus policies are inconsistent and unpredictable among states, which increases uncertainty. The Survey notes, "[t]he lack of uniform tax policies among states means that some transactions may be taxed by more than one jurisdiction, while other transactions may entirely escape state taxation."

The Survey also focused on clarifying each state's position on whether nexus is created under various scenarios. Here are some examples:

1. An out-of-state corporation that repairs tangible personal property located outside its borders and then delivers it by common carrier to an in-state customer: Most states agree that this would not establish a nexus.
2. An out-of-state corporation that charges fees to in-state customers for the right to access non-downloadable prewritten software that is hosted on a server in another state: All but three states said there would not be a sales tax nexus under this circumstance.
3. Multistate sales of services or intangibles in the jurisdiction in which the greatest proportion of the income-producing activity occurred: A growing minority of states now look to where the benefit is received to determine if it is a taxable transaction.

The Survey also reveals that even if a state has laws on the books, it is difficult to ascertain how and to what extent a state interprets and enforces its laws. In addition, the jurisprudence on nexus standards, both at the federal and state levels, often do not provide definitive guidance on which standards apply. As a result, there is increasing pressure on the federal government to establish uniformity.

The Marketplace Fairness Act of 2015 is one piece of pending legislation that could clarify taxation rules for certain online sales activity. According to Marketplacefairness.org, the legislation “grants states the authority to compel online and catalog retailers (remote sellers), no matter where they are located, to collect sales tax at the time of a transaction—exactly like local retailers are already required to do. However, there is a caveat: States are only granted this authority *after* they have simplified their sales tax laws.

”In addition, 24 states have voluntarily simplified their state tax laws in accordance with the Streamlined Sales and Use Tax Agreement (SSUTA). Marketplacefairnss.org notes that any state that is in compliance with the SSUTA, and has achieved full member status as a SSUTA implementing state will have collection authority on the first day of the calendar quarter that is at least 180 days following enactment of the legislation.

Besides these federal efforts, 15 states have signed on to some or all of the provisions of the Multistate Tax Compact:

- Alabama
- Alaska
- Arkansas
- Colorado
- Washington, D.C.
- Hawaii
- Idaho
- Kansas
- Michigan
- Missouri
- New Mexico
- North Dakota
- Oregon
- Texas
- Utah

Montana and Washington are also parties to the Multistate Tax Compact, but Montana did not respond to this portion of the Survey and Washington does not impose a corporate income tax.

The Multistate Tax Compact has four purposes:

- Facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes;
- Promote uniformity or compatibility in significant components of tax systems;
- Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; and
- Avoid duplicative taxation.

For now, Bloomberg BNA laments the fact that "[d]espite the shift towards a service-based economy decades ago, states are still unable to reach a consensus on sourcing rules aimed at determining how they will apply their income tax to transactions involving services or intangibles that take place in more than one jurisdiction." Bloomberg BNA is offering a webinar on May 1 to further explain the results of its survey.

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