ECONOMIC NEXUS: THE NEW NORMAL?


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States are continuously looking for additional revenue streams in order to mitigate budget shortfalls in today's challenging economic environment. One method that has continued to gain traction is for states to introduce sales and use tax economic nexus bills that will allow them to collect sales or use taxes from as many sellers as possible, including remote sellers. In fact, these economic nexus tax issues are expected to be some of the biggest—if not the biggest—tax issues facing state legislatures in 2017.

What Is Economic Nexus?

Economic nexus bills trace their genesis to a U.S. Supreme Court decision 25 years ago, Quill vs. North Dakota, which held that a state could not impose tax collection requirements on an out-of-state seller unless the seller had a substantial physical presence in the state in which the purchase was made or shipped.

In subsequent years, the concept of "physical presence" has been expanded to include the concept of "economic nexus," meaning, a seller may not have a physical presence in a state but may still have a substantial economic presence for sales and use tax purposes. One of the first states to enact such a law, as applied to sales and use tax, was Alabama, in October 2015. That law defined substantial economic presence as sales exceeding $250,000 per year based on the previous calendar-year sales.

Other states are following the Alabama model, enacting nexus provisions that defy the Quill physical presence standard, and seek to impose sales and use tax registration, collection and remittance obligations on out-of-state sellers. While many of these state laws set dollar limits for tax collection purposes, there are no standardized sales figures among the states.

The focus on sales tax economic nexus results from at least three simultaneous occurrences:

1. Inaction at the congressional level;
2. The increase in the purchases of goods online rather than in brick-and-mortar stores. (In a related matter, this shopping pattern is well-documented, and has contributed to the reduction in the size and number of locations for many of the nation's largest retailers); and
3. The desire by states to grow their revenue—without incurring voter backlash—by imposing across-the-board income tax or sales tax increases.

A Glimpse at the Sales Tax Economic Nexus Picture in 2017

As of January 27, 2017, a total of 35 bills have been introduced in 17 states to promote the broader collection of sales tax. Success in generating new revenue in Alabama and South Dakota—the first two states to implement these economic nexus type bills—has spurred similar activity in states across the country. For example, Tennessee recently adopted similar legislation. Effective January 1, 2017, Tennessee deems out-of-state dealers to have substantial nexus for sales and use tax purposes if they engage in regular or systematic solicitation of consumers through any means in that state and when their sales into Tennessee exceed $500,000 during the previous 12-month period.

Additional states have generally implemented economic nexus in one of three forms:

1. **Economic nexus bills.** These bills establish a sales threshold, in dollars, numbers of transactions, or both. Sellers exceeding the threshold are required to collect and pay sales or use taxes. These laws set aside the previous concept of "physical nexus" as the standard for tax collection and payment.
2. **Expanded nexus bills.** These bills expand the definition of physical presence to include the activities of agents, affiliates, or others, who act on behalf of an Internet seller. These initiatives are sometimes referred to as "affiliate nexus" or "click-through" nexus. To date, there are 15 active expanded nexus bills in state legislatures.
3. **Non-nexus reporting bills.** These bills indicate that out-of-state sellers must inform their in-state buyers about the responsibility of paying sales or use tax on their purchases. Typically, out-of-state sellers accomplish this notification with an annual mailer. For example, Colorado requires out-of-state retailers to notify Colorado customers of Colorado's use tax requirement and to report tax-related information to those customers and the Colorado Department of Revenue.

In the Tristate area, New York and Connecticut have expanded sales tax nexus bills that have been introduced to their respective state legislatures. To date, New Jersey does not have a similar bill on the floor of its legislature, but we anticipate this will change as more states adopt similar legislation.

Other states considering nexus bills in 2017 include Arkansas, Georgia, Hawaii, Indiana, Massachusetts, Minnesota, Mississippi, Nebraska, New Mexico, North Dakota, Rhode Island, South Carolina, Utah, Virginia, Washington and Wyoming.

As companies continue to expand their operations, it is important for them to have an understanding of current and pending economic nexus legislation. As with all tax issues, proper planning is the key to tax savings and successful business growth.

Questions? Contact your Berdon advisor or **Terence Avella, J.D., LL.M.** at tavella@berdonllp.com.

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