

## State Taxation - Are We Moving Away from Physical Presence and Towards Economic Nexus'

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The continuing rise of internet sellers that do not have a physical presence in a state (such as offices and employees) is causing state taxing authorities to be more creative in asserting taxes on sales to, and revenues associated with, those sellers' customers in that state. Last week, in *Crutchfield Corporation v. Testa*, the Ohio Supreme Court ruled that an out-of-state online retailer with no Ohio office or employees was responsible for paying Ohio commercial activities tax because the retailer had sales in Ohio in excess of \$500,000.

U.S. Supreme Court precedent provides that before a state can require a company to collect and remit sales and use tax, the company must have a physical presence in that state (*i.e.*, substantial nexus). Because of the bright-line nature of the physical presence standard, companies generally only need to worry about collecting and remitting sales and use tax in states where they have an office, property, employees or agents. However, when it comes to other types of state taxes, such as gross receipts and income taxes, the U.S. Supreme Court has not expressly stated that substantial nexus requires in-state physical presence. As a result, some states are taking the position that taxpayers are subject to certain of their state taxes even if the taxpayers do not meet the traditional physical presence test.

The Ohio commercial activities tax is a gross receipts tax imposed on sellers for the privilege of doing business in Ohio rather than a true sales and use tax that is imposed on buyers. By its terms, the Ohio commercial activities tax applies to out-of-state taxpayers who meet a statutory \$500,000 sales-receipts threshold. In *Crutchfield*, the Ohio Supreme Court found that in-state physical presence was not constitutionally required because a taxpayer with more than \$500,000 in Ohio sales must clearly have a substantial nexus with Ohio by virtue of such large sales in the state. It is important to note that two justices (out of a total of five) dissented in the Ohio Supreme Court's decision stating that physical presence is still constitutionally mandated, in part, because they did not view gross receipts taxes as meaningfully different from use taxes.

It is unknown at this time whether *Crutchfield* will be appealed to the U.S. Supreme Court, but if it is, this case may serve as a catalyst for updating the nexus standard to account for today's complex and remote marketplace. Until that happens or until Congress passes legislation in this area, states will likely continue to expand what constitutes physical presence for sales and use tax purposes and to move away from a strict physical presence standard with respect to gross receipts, income and other state taxes. In the meantime, companies should remain vigilant of their activities in every state and keep up-to-date on changing nexus standards to ensure they are meeting the tax obligations in the states in which they operate.

If you have any questions regarding this new development or would like to discuss any other tax concerns, please contact one of the lawyers listed below.