

New Year's Resolution ? State Tax Compliance

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PRACTICES Tax

As small and medium-sized businesses grow and expand, it is common for them to do business outside their home state; sometimes through the internet and other times by having “boots on the ground.” For example, having employees travel to other states to promote sales, providing assistance to customers, attending trade shows, and engaging in other business activities. It is also common for businesses to engage local representatives in other states, many of which represent such businesses on a non-exclusive basis.

As the New Year begins, companies conducting interstate businesses should make it a priority to review where they are doing business, ensure they are in compliance with the state tax requirements in those locations, and make plans for states that they will first venture into this year. All companies should review their state tax compliance as non-compliance will result in the accrual and eventual payment of taxes, penalties, and interest. This is particularly important for businesses that may be sold in the next few years because due diligence will uncover any non-compliance, and non-compliance, in many cases, can cause a transaction to go off the rails.

The level of business activity that must occur in a state before a state is able to require compliance with its tax laws is a federal constitutional law question. While each state has its own statutes and regulations regarding the level of contacts necessary to give rise to “nexus,” every state takes the position that minimal activity within its state lines is sufficient. As a result, companies should review whether their activity in a given state meets that state’s particular threshold. It is important to note that it doesn’t take much activity to be subject to a state’s income tax, sales tax, employee withholding tax, and other taxes.

Most states consider any of the following activities sufficient for them to impose tax obligations on an out-of-state taxpayer:

- Having offices or facilities in a state (including a leased storage facility);
- Owning any personal property or other assets in a state;
- Having employees in a state (including part-time and temporary employees);
- Having salespeople, independent representatives, or other agents in a state (even for one day here and there); and
- Providing in-state support services (directly or through an independent third-party) for products shipped into a state.

For companies already in compliance or resolving to be in 2017, now is also a great time to consider what activities planned in 2017 might trigger new state tax obligations. For instance, are there plans to open new facilities? Are any employees traveling out-of-state to attend trade shows or conferences? As stated above, even relatively minimal activity could result in a business being subject to a state’s tax regime. Advanced planning before conducting business in a state can sometimes allow you to reduce state taxes while still achieving your company’s goals. For example, leasing space on a server may be taxable in one state, but not in another state, so choosing the more tax efficient state may provide a better result for your company.

If you have any questions regarding your state tax obligations, please contact one of the lawyers listed below.