

Abstract: The term “nexus” refers to a business presence in a given state that’s substantial enough to trigger the state’s tax rules and obligations. This article explores common criteria for nexus and suggests strategic moves to consider. A sidebar looks at a newer approach called “market-based sourcing” that many states are using to tax out-of-state service companies.

Got nexus? Find out before operating in multiple states

For many years, business owners had to ask themselves one question when it came to facing taxation in another state: Do we have “nexus”? This term indicates a business presence in a given state that’s substantial enough to trigger the state’s tax rules and obligations.

Well, the question still stands. And if you’re considering operating your business in multiple states, or are already doing so, it’s worth reviewing the concept of nexus and its tax impact on your company.

Common criteria

Precisely what activates nexus in a given state depends on that state’s chosen criteria. Triggers can vary but common criteria include:

- Employing workers in the state,
- Owning (or, in some cases, even leasing) property there,
- Marketing your products or services in the state,
- Maintaining a substantial amount of inventory there, and
- Using a local telephone number.

Then again, one generally can’t say that nexus has a “hair trigger.” A minimal amount of business activity in a given state probably won’t create tax liability there.

For example, an HVAC company that makes a few tech calls a year across state lines probably wouldn’t be taxed in that state. Or let’s say you ask a salesperson to travel to another state to establish relationships or gauge interest. As long as he or she doesn’t close any sales, and you have no other activity in the state, you likely won’t have nexus.

Strategic moves

As with many tax issues, the totality of facts and circumstances will determine whether you have nexus in a state. So it’s important to make assumptions either way. The tax impact could be significant, and its specifics will vary widely depending on just how the state in question approaches taxation.

For starters, strongly consider conducting a nexus study. This is a systematic approach to identifying the out-of-state taxes to which your business activities may expose you. The results of a nexus study may not necessarily be negative. You may find that your

company's overall tax liability is lower in a neighboring state. In such cases, it may be advantageous to create nexus in that state by, say, setting up a small office there. If all goes well, you may be able to allocate some income to that state and lower your tax bill.

Taxation and profitability

“The grass is always greener on the other side of the fence,” so the saying goes. If profitability beckons in another state, please contact our firm for help projecting how setting up shop there might affect your tax liability.

Sidebar: Service companies, beware of market-based sourcing

Nexus has been and remains the primary focus of companies considering whether and how they'd be taxed across state lines. (See main article.) But, recently, many states have established “market-based sourcing” for determining the tax liability of *service* companies that operate within their borders.

Under this approach, if the benefits of a service occur and will be used in another state, that state will tax the revenue gained from said service. “Service revenue” generally is defined as revenue from *intangible* assets — not the sales of tangible personal property.

Thus, in market-based sourcing states, the destination state of a service is the relevant taxation factor rather than the state in which the income-producing activity is performed (also known as the “cost of performance” method).

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