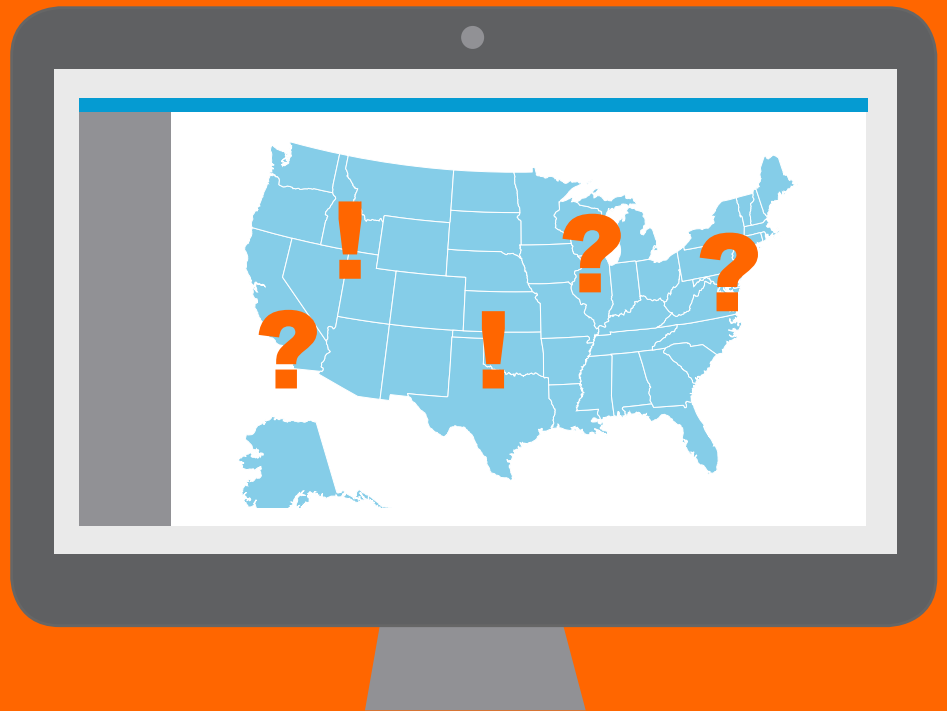
Know Your Nexus

Determining where and when you need to collect and remit sales tax



Avalara
Tax compliance done right

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INTRODUCTION

Getting sales and use tax compliance right is important. The first step to compliance often starts with understanding where your business has nexus, or where you need to collect and remit sales tax. But nexus is ever-changing and confusing for even the savviest business owner. According to a 2017 Wakefield Research report:



94 PERCENT
of businesses surveyed have misconceptions around what creates nexus.



41 PERCENT
of respondents think it's the state's responsibility to contact a company if nexus is presumed in a state (it isn't).



38 PERCENT
believe nexus triggers are the same across all states (they aren't).



31 PERCENT
don't know or can't confirm a routine process for assessing their nexus obligations, despite the fact that 61 percent are registered in multiple states.

Unfortunately, you can't just figure out where you have nexus today and forget about it – you have to closely monitor nexus moving forward. Many activities can trigger new tax collection obligations for your business, especially in the growing number of states intent on enhancing remote sales tax revenue. In other words, it's possible for you to develop new sales and use tax responsibilities in one or more states even if you do nothing new and your business doesn't change.

We know understanding nexus can be tough, which is why we've developed this handy ebook to help. In the pages that follow, we outline what nexus is, what may trigger nexus, court cases that may have an impact on nexus, and how to manage your nexus responsibilities.

If you find nexus confusing, don't worry. WITH HELP FROM AVALARA, YOU'RE NOT ALONE.

While we hope you'll find this information helpful, this guide does not offer a substitute for professional legal or tax advice.

WHAT IS NEXUS?



Sales tax nexus is the connection between a seller and a state that requires the seller to collect and remit tax on sales made in that state. If you have sales tax nexus in California and Texas, for example, you must register, collect, and remit sales tax in California and Texas. The concept of nexus is fairly easy to understand; the often-challenging part is determining what activities trigger nexus and staying on top of where your business has nexus.

REMINDER: Sales tax nexus is not the same as income tax nexus: A business can have an obligation to collect and remit sales tax in a state where it has no income tax liability. Confounding, but true.

WHAT TRIGGERS NEXUS?

So, what exactly triggers nexus? Unfortunately, there's no one thing. Nexus has long been linked to physical presence, but even physical presence can behard to define. And thanks to the explosion of ecommerce sales and a 2018 Supreme Court ruling, physical presence is no longer the defacto standard for establishing nexus.

If you find nexus confusing, you aren't alone. To help simplify the confusing nature of nexus, we've broken down some common activities that may cause your business to have nexus in the pages that follow.

QUILL AND SOUTH DAKOTA V. WAYFAIR, INC., AND THEIR IMPACT ON NEXUS

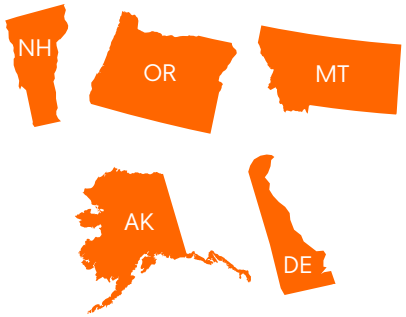
In order to understand which activities can trigger a nexus obligation for your business, it's important to understand the significance of two important Supreme Court cases: Quill Corp. v. North Dakota, and South Dakota v. Wayfair, Inc.

Quill Corp v. North Dakota (Quill): In 1992, the Supreme Court of the United States upheld an earlier decision and ruled that sales tax nexus can be established **only** when a business has a physical presence in a state. Quill was the guiding force behind state nexus laws for decades. In the District of Columbia and all 45 states with a general sales tax, businesses that have a physical presence and make taxable sales in a state are generally required to collect and remit that state's sales tax.

South Dakota v. Wayfair, Inc (Wayfair): The state of South Dakota petitioned the Supreme Court to overturn Quill's long-standing rule that a company must have "physical presence" in a state before the state can require it to collect and remit sales tax. **In June 2018, the court ruled in favor of South Dakota, authorizing the state to tax sales by remote sellers via its economic nexus rule.** Under economic nexus, a taxable connection is established when a company reaches a certain level of economic activity in the state, even if it has no physical presence in the state.

These two cases dictate the type of business activities that can trigger nexus. It's important to note that Wayfair simply expanded what can cause a business to have nexus in a state. Physical presence still triggers nexus; it's simply no longer the only nexus trigger.

DID YOU KNOW?



NOMAD STATES

New Hampshire, Oregon, Montana, Alaska, and Delaware (aka NOMAD states) do not have a general sales tax.

WHAT TRIGGERS NEXUS?

Now that you have some background on nexus, let's look at activities that remain tied to a physical presence.

As you may expect, physical presence includes brick-and-mortar locations. It can also include renting or owning property – even property located at a site owned by a third party, like tools at a construction site. Having remote employees or contractors in a state, even temporarily, can trigger nexus, as can delivering goods in your own vehicle, or storing property in a location owned by someone else (like a fulfillment center). Common physical nexus triggers include:

REMOTE EMPLOYEES/SALES REPS

Nexus can be created if you employ salespeople in different states. If your employees or contractors conduct any work at a customer's out-of-state location, or even deliver products into another state, nexus can also be triggered. Colorado, for example, has stated that nexus can be established when a remote seller has employees in the state, "even if the activities of the employee are completely unrelated to the sales transactions at issue."

EVENT ATTENDANCE

Attending tradeshows or other events in another state can also establish nexus with that state. State rules vary, and some states take a more aggressive stance than others. To trigger nexus in Arizona, for example, an employee or independent contractor generally has to be in the state to solicit sales or establish a market for more than two days per year.

Remember, nexus laws can change. Before July 1, 2016, attending just one trade show in Washington state could trigger nexus. Since then, attendance or participation at one trade convention in Washington each year doesn't automatically establish nexus – although it could if an attendee is physically present in Washington "for the purposes of establishing substantial nexus" with the state.

DID YOU KNOW?



In Texas, attendance at a single trade show may create nexus.

WHAT TRIGGERS NEXUS?

STORING INVENTORY

Storing inventory in a facility owned by another party has become more prevalent in recent years thanks to the rise of large internet marketplace providers like Amazon, eBay, and Etsy. After flying under the radar of state tax authorities for years, these types of relationships are now coming under scrutiny. Laws targeting marketplace facilitators and/or sellers are now in effect in several states, including Arizona, Pennsylvania, Rhode Island, Virginia, and Washington.

While the goal of these states is the same, the laws vary significantly and can even be contradictory. For example, while storing inventory in Virginia creates nexus for the seller, marketplace facilitators and not sellers may be liable for the tax. In Washington, the owner of the facility – the marketplace facilitator – should collect and remit tax on third-party sales; however, marketplace sellers have to collect and remit on sales made directly to consumers, and they have other reporting obligations (e.g., B&O tax) for their marketplace sales. In other words, to the frustration of business owners, even physical presence isn't always clearly defined.

DID YOU KNOW?



Marketplace providers are required to share information about third-party sellers with tax authorities in some states.

IMPORTANT NOTE: TRAILING NEXUS

Once you've established nexus in a state, it can linger longer than you might imagine. Nexus may continue even after you cease doing business or having a presence in a state, for a period that can last through the end of the calendar year or even longer. This is important to remember, especially if you trigger nexus through a temporary presence, like event attendance.

> After a remote seller ceases nexus-creating activity in California, for example, it generally is liable for sales tax for the remainder of the quarter, plus one additional quarter.

NEXUS TRIGGERS, CONTINUED

When Quill was the guiding force for nexus, states lacked the authority to tax remote sales. However, because of the rise of ecommerce and the fact that so many internet sales were going untaxed, many states expanded the definition of physical presence to include other routine business activities, such as advertising, drop shipping, or referrals from in-state businesses. Let's continue breaking down the activities that trigger nexus on the following pages.

> The fact that nexus rules vary by state – and are subject to change at any time – makes it extremely complicated to determine all the places your business needs to register and collect and remit sales tax.





DID YOU KNOW?

More than

20 states

have laws on the books that expand nexus trigger events to include online advertising in a state.

WHAT TRIGGERS NEXUS?

Nexus is confusing because it may be triggered even if you and your employees or shippers don't set foot in another state. Examples of these types of nexus triggering activities include:

ADVERTISING

It's now easier than ever for a business based in one state to advertise to potential customers in other states. But beware: Sometimes advertising across state borders can trigger a tax collection obligation.

For example, advertising in newspapers or other periodicals printed in Virginia can trigger nexus there, as can advertising on billboards or posters located in the Commonwealth. Similarly, the regular or systematic solicitation of sales through marketing channels like television, radio, magazines, mail, and more can establish sales tax nexus in Texas. However, in California, advertising via the internet, print, radio, or television generally only triggers nexus if the ads are paid for with commissions from sales of taxable goods resulting from the advertisements.

DID YOU KNOW?



Tax obligations may be established through a connection to an in-state business or individual, including online advertising.

AFFILIATE NEXUS

Affiliate nexus can be established if an out-of-state retailer is affiliated with an entity that has nexus in another state. In California, for example, out-of-state retailers must collect sales tax if they are related in any way to any entity located in the state. This includes entities that conduct business on an out-of-state seller's behalf, as well as those that use a similar trademark. The state maintains affiliate nexus exists even when the in-state business operation is completely separate from the out-of-state company's retail operations.

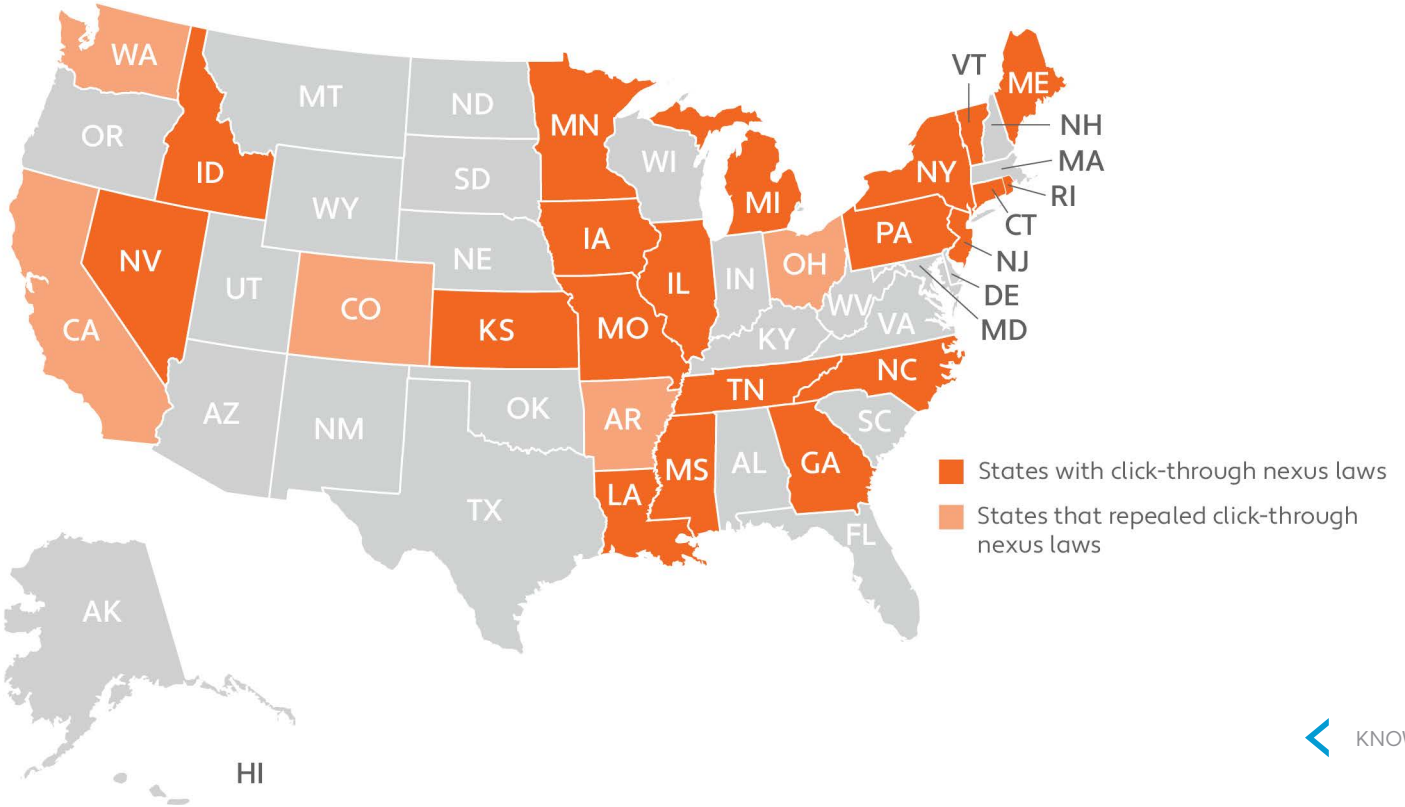
In New York, an out-of-state seller may establish affiliate nexus when a New York affiliate uses a trademark, service mark, or trade name that is the same as that used by the remote affiliate; or a New York affiliate engages in activities that help the remote seller develop or maintain a market for it's goods or services in the state.

CLICK-THROUGH NEXUS

If you contract with an individual or business in another state to directly or indirectly refer potential customers through a web link on an in-state website, for a commission or other consideration, you could develop click-through nexus. Approximately 20 states have click-through nexus laws on the books. Most have a sales threshold, meaning the referrals must generate a certain amount of sales to trigger nexus. In most states, referrals must generate more than $10,000 in the preceding 12 months or four quarters. Specific thresholds include:

- Connecticut: more than $100,000 during the four preceding quarters
- Georgia: more than $50,000 annually
- Pennsylvania: none

CLICK-THROUGH NEXUS LAWS (as of February 1, 2020):



WHAT TRIGGERS NEXUS?

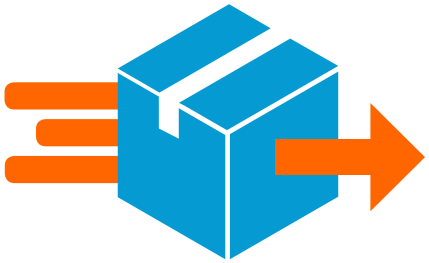
DELIVERY AND DISTRIBUTION

As long as you ship goods to customers by a common carrier such as USPS, UPS, or FedEx, you're unlikely to trigger a sales tax obligation through delivery. Delivering products to customers in your own vehicle; however, can trigger nexus. An out-of-state business that sells taxable goods to customers in New York and regularly delivers the products in its own vehicles has to register for sales tax; regular delivery means "at least 12 times a year."

In Pennsylvania and Washington, an out-of-state company can establish nexus not only by making deliveries in its own vehicles, but by hiring a third-party or representative to deliver the goods.

Drop shipping – a retail fulfillment method used when a retailer doesn't keep items in stock, but orders them from a third party and has them shipped directly to the customer – or a contract with a distributor that functions as a drop shipper, is considered a taxable, nexus-creating activity in many states. In some situations, the retailer is liable for the tax; in other situations, a state will hold the drop shipper liable.

DID YOU KNOW?



One drop-shipping transaction can trigger nexus in California, Florida, New York, and Texas.

WHAT TRIGGERS NEXUS?

ECONOMIC NEXUS

As discussed previously, economic nexus bases a tax collection obligation on economic activity alone. The Supreme Court's ruling in South Dakota v. Wayfair, Inc., authorizes South Dakota to enforce its economic nexus law in a way "not inconsistent with" the ruling. As a result of the SCOTUS ruling, 43 states and Washington, D.C. now enforce economic nexus laws.

However, the Wayfair ruling doesn't give blanket approval to all economic nexus laws. SCOTUS underscores that South Dakota's law "affords small merchants a reasonable degree of protection" because:

- It requires a merchant to collect the tax only if it does a considerable amount of business in the State
- It isn't retroactive
- South Dakota is a party to the Streamlined Sales and Use Tax Agreement, which means it's taken steps to simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance

In many states with economic nexus laws, economic activity alone triggers nexus (e.g., $100,000 in gross revenue or 200 separate sales transactions) – no physical presence is needed. Like all sales tax laws, economic nexus varies by state. Some examples of economic nexus laws and the economic thresholds that trigger nexus include:



Alabama: An out-of-state seller must make retail sales of tangible personal property into the state of more than $250,000 from the previous calendar year.



South Dakota: A remote seller must have gross revenue from tangible personal property, electronically delivered products, or services into the state of $100,000 or 200 or more transactions during the previous or current calendar year.

Because of the recent Supreme Court ruling, economic nexus laws are now enforced in 43 states, so it's important for businesses to actively monitor sales volumes in states where they're not registered. Review our state-by-state guide to economic nexus for more details on specific threshold and rules.

HOW DO YOU KEEP UP?

If you made it this far, you know that nexus is tough.

It can be hard to understand the different types of nexus, and harder still to understand what they mean for your business. But knowing where you have nexus now and where you could have it in the future is crucial for all businesses.

In short, getting nexus right takes a lot of time and dedicated effort. Unfortunately, if you don't give state nexus laws the attention they demand, the consequences of noncompliance can cost you even more time – and money.

> When it comes to staying up to date with nexus and your associated requirements, the Avalara Tax Advisory Services team is here to help.

While you may know Avalara for our software as a service (SaaS) solutions, software isn't all we do. Our Tax Advisory Services team is a group of tax experts that can:

- Help you determine where you have nexus.
- Provide ongoing monitoring services to see when new nexus is established.
- Help you register in new jurisdictions.
- Navigate the tasks related to establishing new nexus.

Although we hope you'll find the information helpful, this guide does not offer a substitute for professional legal or tax advice. If you have questions about your tax liability or concerns about compliance, please consult your qualified legal, tax, or accounting professional. This document was compiled in July 2018 and updated in February 2020. Because states constantly update and amend their sales and use tax laws, see each state's website for the most up-to-date and comprehensive information.



To learn more about how the Avalara Tax Advisory Services team can help, click here.

Avalara
Tax compliance done right

About Avalara
Avalara helps businesses of all sizes get tax compliance right. In partnership with leading ERP, accounting, ecommerce and other financial management system providers, Avalara delivers cloud-based compliance solutions for various transaction taxes, including sales and use, VAT, excise, communications, and other indirect tax types. Headquartered in Seattle, Avalara has offices across the U.S. and around the world in the U.K., Belgium, Brazil, and India. More information at avalara.com.