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Individual and Organizational Liabilities Created by Business Travel Across State Lines

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A GROWING MARKET FOR STATE TAXATION

In 2016, Americans took 458.9 million domestic business trips.[1] Businesses excited about fruitful growth opportunities and the prospect of taking advantage of different markets are sending employees throughout the country. In today's vastly interconnected world, it is easy to see why so many companies are expanding their geographical footprint. However, many businesses do not realize or fully appreciate the extent that chasing an exciting growth opportunity across state lines, even for short periods of time, may create multistate tax compliance issues. As states become more aggressive in their pursuit of new ways to increase tax revenues, out-of-state companies with slight connections to their state become easy targets.

As the number of traveling employees continues to grow, a figure that is estimated to reach 478.2 million domestic trips by 2020,[2] the aggressive nature of states will only grow. Consequently, businesses need to be aware of the range of state tax obligations — not just sales taxes, but income taxes and employment taxes — for which they may be responsible. This is not a simple or straightforward task. The first step is figuring out each state's rules, including which states might have filing obligations based on the company's business activities there. As discussed in more detail below, the central concept in the analysis is *nexus*. In other words, where does the company have enough of a connection to permit a state to tax it under the U.S. Constitution?

This article will discuss the variations in state taxing rules, when companies may become responsible for state taxes, and the multitude of issues a company must consider when sending employees across state lines on domestic business trips.

NEXUS — CONSTITUTIONAL REQUIREMENTS

The first step and central concept when identifying a company's potential multistate tax responsibilities begins with an analysis of that company's nexus. Obviously, not every company that conducts business activities within the United States is subject to every state's tax laws and jurisdiction. A state's ability to impose its tax obligations on an out-of-state corporation — whether they be sales, corporate, franchise, employee withholding, or otherwise — is limited by the Constitution and, possibly, by additional federal and state laws. The nature and frequency of contacts an out-of-state company must establish in a state before being subject to that state's tax laws and jurisdiction is generally referred to as ''nexus.'' The term ''nexus'' is a fancy word for ''connection'' and, for state tax purposes, the term is used to indicate when the connection between an out-of-state company and the taxing state is sufficient to allow the state to impose tax collection or payment responsibilities on that company.

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[1] Statista, Number of domestic business and leisure trips in the United States from 2008 to 2020 (in millions)*, https://www.statista.com/statistics/207103/forecasted-number-of-domestic-trips-in-the-us/.

[2] *Id.*

The principal provisions that limit states' jurisdictional powers to impose tax responsibilities on an out-of-state company are the Constitution's 14th Amendment Due Process Clause and the Commerce Clause.[3]

To be constitutional, a state may only tax a company that has such minimum contacts to the taxing state so that imposing the tax would not burden interstate commerce. To that end, in *Complete Auto Transit v. Brady*, the Supreme Court enunciated the modern four-prong commerce clause test that is used to determine whether a state tax is constitutional.[4] The first prong of this test requires that a state tax must be applied to an activity that has a "substantial nexus" with the taxing state.[5]

Thus, the questions become: when does an out-of-state company create enough in-state connections to trigger nexus and become subject to a state's tax laws and jurisdiction? How substantial is "substantial nexus?" Is it "substantial" and a nexus trigger if only one employee is sent into a state for a limited period of time? What if the employee travels for a tradeshow or other similar event to solicit business, but does not make any sales? What if they do make sales?

This list of potential questions could go on and on and, unfortunately, the answer to these questions, and others like them, is not always straightforward. However, one thing is straightforward — only a small level of connection is needed to allow a state to impose tax responsibilities. States vary in their interpretation concerning the types of connections and actions that constitute nexus and often apply different nexus rules depending on the specific type of tax. Nevertheless, the fundamental consideration under the Due Process Clause, the Commerce Clause, and the *Complete Auto* test is that "some definite link, some minimum connection between a state and the person, property, or transaction it seeks to tax" must exist.[6]

Despite the framework provided by the Constitution and the Supreme Court, the type of state tax imposed certainly matters when considering nexus and potential company tax exposure and liabilities. States may establish different state nexus thresholds for specific state taxes, and certain connections may create nexus for one type of tax and not another. Thus, it is important to consider potential liabilities on a tax-by-tax basis.

PHYSICAL PRESENCE: SALES TAX AND THE SUPREME COURT STANDARD

Like all other forms of state-level taxes, liability to collect sales and use taxes is premised on an out-of-state company's nexus to the taxing jurisdiction. However, unlike other forms of taxes, the Supreme Court has established a specific framework for nexus as it relates to sales and use tax. First in *National Bellas Hess, Inc. v. Dept. of Rev.*[7] and again in *Quill Corp. v. North Dakota*,[8] the Supreme Court established a seemingly bright-line test that the Commerce Clause prohibits a state from imposing sales and use tax responsibilities on an out-of-state company if that company has no physical presence within the taxing state.[9] The Supreme Court indicated that the type of physical presence necessary to create sales and use tax nexus must be more than de minimis, but may be as slight as temporary presence in the taxing jurisdiction by the company's property or employees.[10]

The de minimis physical presence standard established by the Supreme Court has led states to be aggressive in asserting the existence of nexus. For example, the New York Court of Appeals has indicated that while physical presence is required, it need not be more than the "slightest presence." The takeaway — sending an employee into another state for business purposes will generally create sales and use tax nexus for the employer concerning all sales to that particular state. This creates liability on the employer for collecting and remitting sales taxes on all sales within the state.[11]

Trade Shows

Some states have, in the midst of becoming exceedingly more aggressive in their interpretation of physical presence nexus and their targeting of out-of-state companies, created exemptions or carve-outs in their nexus rules for specific events. One such common area concerns out-of-state companies sending employees to attend trade shows and other similar events.

The rules vary considerably on a state-by-state basis. For example, an out-of-state company whose only

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[3] *See Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954). Courts have interpreted the Due Process Clause to mean that there must be minimum contacts, or connections, between the state and the business, person, property, or transaction it seeks to tax. However, even the most minimal of connections have been held to satisfy this requirement (*Scripto Inc. v. Carson*, 362 U.S. 207 (1960)).

[4] 430 U.S. 274 (1977).

[5] *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977).

[6] *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 777 (1992).

[7] 386 U.S. 753 (1967).

[8] 514 U.S. 298 (1992).

[9] *See id.*; *see also National Bellas Hess.*

[10] *Id.*

[11] *Nat'l Geographic Soc'y v. California Bd. Of Equalization*, 430 U.S. 551 (1977).

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connection to California is engaging in a convention or trade show for less than 15 days and whose gross income from that activity is less than $100,000 is not considered to have nexus for sales and use tax purposes.[12] In Michigan, an out-of-state company may participate in a trade show for up to nine days in a single calendar year without creating nexus, as long as the company does not make sales or take orders at the show.[13] However, not all states are generous when considering out-of-state attendees. For instance, sending employees from out of state to attend trade shows in Texas creates nexus and is sufficient to require the out-of-state company to collect tax on all sales to Texas customers for the following 12 months.[14]

EXPANSION OF SALES AND USE TAX RESPONSIBILITIES BEYOND PHYSICAL PRESENCE

States, in their never-ending quest to increase tax revenues, have shown themselves to not be satisfied simply taxing out-of-state companies based on their physical presence. Across the country states have been devising new schemes and are seeking to expand what types of connections may constitute sales and use tax nexus. As the economy has moved from brick-and-mortar stores and ''mom and pop'' retailers to e-commerce giants dominating the landscape, states are starting to push the limits beyond what has been traditionally viewed as physical presence.

Affiliate Nexus Rules

One such expansion has been the adoption, by many states, of ''affiliate nexus'' rules. Affiliate nexus rules provide that nexus may be established if an out-of-state seller's parent or affiliate has a physical presence or operates within the state.[15] It is important for such out-of-state employers to be aware not only of the physical location of its employees or assets, but also the location of the company's affiliates' employees or assets. Generally, states that have enacted affiliate nexus provisions have drafted the rules to provide a presumption of nexus. In these states, an out-of-state seller is presumed to have sufficient activity within a state, resulting in nexus, if any commonly controlled person or entity has sufficient nexus with the taxing jurisdiction.[16]

Click-Through Nexus Rules

Another expansion of the physical presence doctrine has been the adoption of ''Amazon'' or ''click-through'' nexus rules. Under these taxing regimes, out-of-state companies are deemed to have sales and use tax nexus when an out-of-state seller contracts with an independent in-state website to promote its sales by placing links on its website directing customers to the out-of-state seller's site in return for a commission based on the sales generated from customers accessing the out-of-state company's website through the in-state link.[17] It has become a common position for states to argue that such arrangements create nexus through agency principles. For example, in New York, an out-of-state retailer with no physical presence in New York may be deemed a vendor for New York sales and use tax purposes if it has an agreement with a New York resident to refer customers to the online retailer by way of a link on the resident's website and the arrangement generates over $10,000 in annual sales.[18] The out-of-state seller does not have employees in New York or other traditional forms of physical presence, but is deemed to be physically present through the existence of an in-state contracted third party.

States are not only expanding physical presence to third parties, but attempting to do away with the standard all together. The Supreme Court recently agreed to hear the states' arguments in *South Dakota v. Wayfair, Inc.*, a case concerning a South Dakota law passed in 2016, which attempted to impute a 4.5% sales tax collection obligation on all goods sold by companies that have more than $100,000 in sales within the state annually or engage in more than 200 total transactions, regardless of physical presence.[19]

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[12] Cal. Rev. & Tax Cd. §6203(d).

[13] Mich. Dep't of Treas. RAB 1999-1 (May 12, 1999).

[14] In Re: ***, Texas Comptroller Decision Hearing No. 46,628 (Tex. Cmptr. Pub. Acct. Aug. 28, 2006).

[15] *See* Cal. Rev. & Tax Cd. §6203; Conn. Gen. Stat. §12-407(a)(15)(A); Fla. Stat. §212.0596(2); Ga. Code Ann. §48-8-2(8)(J); ILCS Chapter 32 §105/2; Mass. Gen. L. Chapter 64H §1; Md. Code Ann. Tax-Gen §11-701(b); N.J. Rev. Stat. §54:32B-2(i)(2); N.Y. Tax Law §1101(b)(8)(I); Pa. Stat. Ann. 72 §7201(b)(1); Tex. Tax Code Ann. §151.107(a); Va. Code Ann. §58.1-612(D).

[16] *See* Conn. Gen. Stat. §12-407(a)(15)(A); Fla. Stat. §212.0596(2); Ga. Code Ann. §48-8-2(8)(J); ILCS Chapter 32 §105/2; Mass. Gen. L. Chapter 64H §1; Md. Code Ann. Tax-Gen §11-701(b); N.J. Rev. Stat. §54:32B-2(i)(2); N.Y. Tax Law §1101(b)(8)(I); Pa. Stat. Ann. 72 §7201(b)(1); Tex. Tax Code Ann. §151.107(a); Va. Code Ann. §58.1-612(D).

[17] *See* Ark. Code Ann. §26-52-110(d); Cal. Rev. & Tax Cd. §6203(c)(5)(A); Conn. Gen. Stat. §12-407(a)(12)(L), §12-407(a)(15)(A)(x); Ga. Code Ann. §48-8-2(8)(M); ILCS Chapter 35 105/2; Kan. Stat. Ann. §79-3702(h)(2); La. Rev. Stat. Ann. §47:302(V); Me. Rev. Stat. Ann. 36 §1754-B(1-A)(C); N.J. Rev. Stat §54:32B-2(i)(1)(C); N.Y. Law §1101(b)(8)(vi); Pa. Stat. Ann. 72 §7201(b); Wash. Rev. Code §82.08.952.

[18] N.Y. Law §1101(b)(8)(vi).

[19] *South Dakota v. Wayfair, Inc.*, *cert. granted*, 138 S. Ct. 735 (U.S. Jan. 12, 2018) (No. 17-494).

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CORPORATE INCOME TAX NEXUS — MORE THAN THE TRAVELING EMPLOYEE

Similar to sales tax, historically, out-of-state companies had corporate income tax nexus in a state when the company had some type of physical presence and revenue derived within the state. Traditionally, this has meant the company maintained an office, owned or leased property, or employed staff. However, corporate income tax nexus could also be triggered by the physical presence of traveling employees. As straightforward as the rules may have been, states have enacted new laws and rules to try and increase the amount of revenue available to them from out-of-state companies.

In addition to states requiring out-of-state companies to file income taxes based on physical connections to the taxing state — such as offices, property, or employees within the state — a clear majority of states have developed ''factor presence'' or ''economic nexus'' standards either through legislation or judicial decisions. This widespread trend, involving laws that are generally similar to South Dakota's pending sales and use tax law discussed earlier, has created rules that create nexus and filing requirements for out-of-state companies with no physical presence in the state. However, because the Supreme Court has not specifically developed a physical presence test concerning income taxes, but only sales and use taxes, these rules have largely been upheld by courts.

Economic nexus legislation typically creates some bright-line threshold called ''factor presence.'' California is a typical example: businesses with more than $50,000 in property, $50,000 of payroll, or $500,000 of sales in the state are required to file income tax returns.[20] In New York, an out-of-state company is considered to be doing business, and therefore required to file returns, if it has $1 million or more receipts from within the state assuming Pub. L. No. 86-272, which is discussed in more detail below, does not apply. State courts that have held companies liable for income taxes even with no physical presence typically rely on a standard of ''purposeful activity in the state'' reflected in the volume of in-state receipts.[21]

As mentioned above, one limitation to the imposition of thresholds for a state to impose income tax, whether due to physical presence or economic nexus, is Pub. L. No. 86-272.[22] The law was passed by Congress in 1959 to prevent a state from imposing income tax obligations on an out-of-state company if its only activities within the state were soliciting sales of tangible property. This rule trumps state law; however, it is important to be aware of the very limited application of this law. It only applies to sales of tangible property, not sales of services or digital property, and only applies to net income taxes and not gross receipts taxes, such as the Ohio Commercial Activity Tax[23] or the Texas Margin Tax.[24] In addition, it only protects activities that are narrowly defined as solicitation of sales or ancillary to solicitation; anything viewed as beyond the scope of solicitation — repairs, collection activities, management of customer complaints — is not protected. Moreover, states can still subject a business to a filing obligation and payment of minimum taxes under an alternative tax base (e.g., Georgia's ''net-worth'' tax or Massachusetts excise base tax).[25]

WITHHOLDING RULES REGARDING THE TRAVELING EMPLOYEE

Companies that send employees into other states have another set of state tax burdens. Each state has unique withholding responsibilities and requirements aimed at raising tax revenue from the wages or income earned by out-of-state employees while doing business away from home.

Currently, 41 states impose a personal income tax. Two states — New Hampshire and Tennessee — tax income from intangibles only,[26] and seven states — Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming — do not impose an income tax at all. Therefore, prior to sending traveling employees, out-of-state companies should be familiar with the rules in each of the 41 states that impose income tax. There is considerable variation regarding the withholding rules in each of those states.

Many states require an out-of-state company to begin withholding personal income taxes on employee wages on the first day of employee business travel into that state. In these states, such as Colorado, Massachusetts, North Carolina, Ohio, and Virginia,[27] a company is responsible for withholding no matter how short an employee's stay or how little the amount of income.

Other states require out-of-state businesses to withhold nonresident employee income after the employee spends a minimum amount of days within the taxing state. In Arizona, for example, an employer is not re-

[20] Cal. Rev. & Tax. Cd. §23101(b); Doing Business in California, CA FTB (Dec. 1, 2016).

[21] *See Geoffrey, Inc. v. South Carolina*, 437 S.E.2d 13 (1993).

[22] Pub. L. No. 86-272.

[23] Ohio Rev. Code Ann. §5751.

[24] Tex. Tax Code §171.002.

[25] *See* Ga. Code Ann. §50-8-260.

[26] N.H. Rev. Stat. Ann. §77:3; Tenn. Code Ann. §67-2-103, §67-2-124.

[27] *See, e.g.,* Ohio Rev. Code Ann. §5747.06(A)(3).

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sponsible for withholding Arizona personal income tax until the nonresident employee is physically present in the state for 60 days.[28] In Connecticut, the requirement is 15 days.[29]

In some states, de minimis thresholds exist that require out-of-state companies to withhold employee personal income tax only when a certain amount of wages have been earned. In California, a nonresident employee must earn income exceeding the state's ''Low Income Exemption Table'' before its employer must withhold.[30] Elsewhere, states have different thresholds: in Idaho an employee must earn $1,000 or more in a calendar year;[31] Oklahoma requires an employee to earn $300 or more in a calendar quarter;[32] and Oregon's rules require withholding only after in-state income is equal to or exceeding the employee's standard deduction.[33] Making compliance potentially even more difficult, some states combine day-based and income-based withholding requirements, creating rules based on both the amount of time spent in the state and the amount and character of income earned.[34]

However, when considering personal income tax withholding requirements, companies need to also consider the possibility that a reciprocal agreement may exist between the resident and nonresident states. Reciprocal agreements are agreements between two states that allow the residents of each state to claim an exemption from withholding tax in the other state. There are 15 states that have engaged in such reciprocity agreements.[35] For example, if an employee is a resident of Wisconsin but works in Illinois, due to the agreement between the states, the employee is only subject to Wisconsin's withholding rules. Likewise, an employee who lives in Illinois but works in Wisconsin would only be subject to Illinois's rules. In each situation, the employer would be responsible to withhold wages for purposes of the employee's resident state only.

WITHHOLDING FOR THE NON-TRAVELING OUT-OF-STATE EMPLOYEE

In addition, a company may have to be aware of withholding rules beyond those associated with traveling employees. Many web-based businesses permit their employees to work from home, which can create a number of different tax obligations for the business. First, the business will likely have to withhold taxes in the employee's state of residence and work. While this may not be particularly burdensome, it can translate into nexus for other state tax obligations. Some states — such as New Jersey, Illinois, and Ohio — have determined that the presence of a telecommuter is a sufficient connection to require the business to file income tax returns.[36] Permitting telecommuting as a cost-saving measure may therefore have much wider financial implications. Second, a handful of states — New York, Pennsylvania, Delaware, New Jersey, and Nebraska — have a so-called ''convenience rule.'' This means that if the business is located in New York, for example, and the employee is based out of or reports to that office, the state treats the employee as if he or she is physically working in that office for withholding tax (and personal income tax) purposes, even if he or she is actually working from a home office in Connecticut. Thus, New York would require the business to withhold New York taxes from that employee. Connecticut could also treat those same wages as subject to Connecticut withholding and taxation. After all, that is the state where the employee works.

CONCLUSION

As companies increase the amount of employees traveling across the country on domestic business trips, state revenue authorities are getting more sophisticated and aggressive every day in their never-ending quest to increase state tax revenues. It is important that companies are aware, recognize, and address the multistate tax compliance issues — including sales taxes, income taxes, and employment taxes, that such business travel may create.

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[28] Ariz. Rev. Stat. Ann. §43-401, §43-434.

[29] Conn. Gen. Stat. §12-701(a)(2).

[30] *See* Cal. Code Regs. tit. 18, §18662-2.

[31] Guide to Idaho Tax Withholding, EPB00006 (July 3, 2017).

[32] Okla. Stat. 68 O.S. §2385.1(e)(4).

[33] Or. Admin. R. §150-316-0257.

[34] *See* Ga. Code Ann. §48-7-1(11)(A); *see also* NY Dep't of Taxation and Fin. TSB-M-12(5)I (July 5, 2012).

[35] *See* Ill. Form IL-W-5-NR; Ind. Form WH-47; Iowa Form 44-016; Ky. Form 42A809; Md. Form MW 507; Mich. Form MI-W4; Minn. Form MWR; Mt. Form NR-2; NJ Form NJ-165; ND Form NDW-R; Ohio Form IT-4NR; Pa. Form REV-420; Va. Form VA-4; W.V. Form WV/IT-104; Wisc. Form W-220.

[36] *See Telebright Corp. v. Dir.*, 424 N.J. Super. 384 (Super. Ct. App. Div. 2012); Ill. Dep't of Rev. General Information Letter No. IT-99-0058-GIL (May 24, 1999).

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