

And So It Begins.....

Economic Nexus Starts To Apply To More Than Just Sales Tax

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Ohio and Hawaii - two states that would seem to have very little in common. One is known as a vacation destination, the other for hosting the Rock and Roll Hall of Fame. But now they have something in common. Both are requiring out-of-state companies to pay a state-level tax (think income tax or the equivalent substitute) based on the companies having Economic Nexus above a certain threshold.

For more on the concept of Economic Nexus, visit our blogs here:

<https://www.dopkins.com/blog/should-you-be-collecting-sales-tax-probably-remote-seller-sales-tax-hits-more-than-just-e-commerce/>

NEWSFLASH: We are talking about a tax levied on the business *itself*, not its customers like a sales tax.

As remote sales have become so common, it has long been considered only a matter of time before the States challenged the limitations imposed by the Courts, through the interpretation of public laws, on their ability to assess taxes on those doing business within their borders. With the change created by the landmark case of Wayfair v South Dakota and the creation of the concept of Economic Nexus, the door has been cracked open.

While both of these states are pushing forward on imposing their taxes on the out-of-state sellers, they are going about it in entirely different ways.

Ohio imposes what is called a Commercial Activity Tax (CAT). It is essentially a tax on the gross receipts generated by a business from sales to customers located in Ohio. Ohio's Economic Nexus threshold is quite high at \$500,000. Recently though, the Court of Appeals of Ohio held that an out-of-state company with only economic nexus was subject to the CAT tax and that this did not violate the Public Law which has restrained States in the past. Even though the products were shipped from outside of Ohio, using a common carrier arranged for by the buyer, title passed to the buyer outside of Ohio, and there was no physical presence by the company inside Ohio's borders, the Court sided with Ohio that the sales were subject to the CAT tax based on Ohio being the destination of the products sold.

Now unlike, Ohio's "non-income" tax, Hawaii imposes the more traditional net income tax. Also, Hawaii has a more common Economic Nexus standard of \$100,000 or 200 transactions. In a direct challenge to the current Courts interpretations of the Due Process and Commerce Clauses of the U.S. Constitution (Public Law 86-272), Hawaii signed into law Act Number 221 on July 2nd 2019 which requires any "persons lacking physical presence in the State" to be determined to have nexus for state income tax

purposes if they meet the State's current economic nexus standard threshold. The law goes into effect for tax years beginning in 2020.

While it is uncertain if Ohio's ruling will be challenged, Hawaii's most certainly will be, as it is a direct challenge to a previous Supreme Court ruling (*Wrigley*).

One thing to keep in mind though is that we are beginning to see more and more use of the Economic Nexus concept being applied by States to all kinds of taxes which have not been determined by the Courts yet as being covered by the Public Law's restrictions. The States, in an aggressive attempt to balance their budgets without directly increasing taxes on their constituents, are highly likely to continue to apply their Economic Nexus standards to more and more of these taxes.

Unfortunately, Congress has yet to weigh in on this issue, and given the increasing partisan conflicts going on right now, they are unlikely to do so any time soon. This leaves businesses at the mercy of the State legislatures, which are quick to add taxes, and the Courts, which are slow to react.

Whether or not the Supreme Court decides to weigh in again on the subject is anyone's guess. And given that they only take a few cases each year, it could be a long time before this issue is settled. In the meantime, businesses need to be aware of their state compliance filings obligations and decide if it is worth the extra compliance costs to continue selling into a particular state.

Dopkins can assist you in determining your state filing requirements. For more information, please contact your Client Service Coordinator or Victoria S. Carlin at vcarlin@dopkins.com.



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Victoria has over 27 years of experience in providing tax consulting, compliance and tax audit representation to closely held businesses, delivering a full range of tax services in federal, multi-state, and cross-border tax laws and regulations for partnerships, S and C corporations, and individuals.