



When Taxes Cross State Lines

Beware the Ides of April — but as the federal tax wolf lurks, don't dismiss state revenue departments as mere foxes nipping at heels.

State tax obligations — on income, payroll, sales, use and personal property — present risks disproportionate to their initial amounts. Companies that operate in more than one state are particularly exposed.

Careful planning can counter the threat and turn up new opportunities for middle-line savings.

Got Nexus?

State taxation stands upon the concept of *nexus*, or business presence. Each state exacts tribute from companies that have “substantial nexus” within it.

A meatpacking company with two plants — a cut-and-kill in Missouri, say, and a sausage mill just across State Line Road in Kansas — does business in both states and is taxed by both. Which taxes it must pay in each state, and how much, depend upon the two tax laws and the actual allocation of the company's resources and revenues.

Your company may build appliances in just one state. If you operate a retail outlet in another state, of course, you're liable for taxes there. But some other presence there — office, inventory, employees — can expose you to taxes as well.

Even if your company has no facilities in another state, does it own undeveloped real estate there? Do you send

salespeople or service personnel there? Do your trucks haul goods there? Any of these — even a trade-name franchise, or attendance at a trade show — can establish nexus for one or another tax in some states.

With 50 states and 50 statutes, all different and all changing, state taxation issues are complicated.

Now E-commerce is adding a new element to the mix. As states clamor for the right to tax in the Internet age, new interstate commerce disputes touch upon Constitutional foundations, including taxation with representation. Congress and the courts will have to resolve these disputes, and soon.

Both the present and future of state taxation, then, present moving targets to manufacturing and distribution organizations.

It gets even better, because two other principles of the U.S. tax system are in play. One, taxpayers are responsible for identifying, calculating and paying the taxes they owe. And two, failure to file a tax return is generally not covered by statutes of limitations — meaning states can pursue claims and penalties indefinitely.

So even if you're not aware of an out-of-state levy, one may exist — out of sight, out of mind, quietly compounding. This exposure can grow serious with little notice.

Risk Is Intensifying

Meanwhile, other factors are combining to heighten the risk.

1. State treasuries are hungry, as programs strain under increased demand and reductions in federal support. Pressure to raise revenue is unrelenting — but squeezing the locals is hazardous to politicians.

Taxes on out-of-state companies, though — like those on travelers in hotels and airports — generate little opposition at the voting booth. (After several states pounced, the federal government restrained them somewhat with Law PL86-272. If a company's only connection to a state is "mere solicitation" of certain sales, the law exempts it from that state's

income tax.)

2. Instead of shotguns, today's "revenueurs" employ blazing technology. Data-mining software allows them to dig into records in their own state and beyond to generate tax claims. How far down? The depths have not yet been plumbed.
3. Related to the new technology is a trend toward greater cooperation among states. Their mutual-benefit society is growing, supported by fully legal kickbacks back and forth for tips that lead to recovery.

How Can a Company Protect Itself?

To engage state tax issues intelligently, a company must understand its current exposure and look forward. Tax considerations are only one aspect of strategy, of course, but they are rarely insignificant.

Is it worth your while to move? To expand? To do business in one place rather than another? Analysis and comparison of state tax laws can show which ones serve you well or badly, and how significantly.

Can you make some shifts to reduce or entirely eliminate your nexus in a particular state? Selling over the Internet and shipping via common carrier are standard ways to do that.

If the stakes are high enough, you might want to set up a separate entity for some sales. For example, if your Tennessee company's California plant establishes your nexus in the latter state, then your Internet sales to California will be taxed. But a separate company — one that has no nexus outside Nashville and sells to Californians only online — will be beyond Sacramento's reach.

The type of entity involved is important, too. California, for example, imposes an "LLC Fee" indexed to a company's revenues — not only revenues in California, but worldwide. A corporate form of entity, however, avoids the fee. Some entities get a break in some states, and not in others.

If you can't avoid out-of-state nexus entirely, can you limit it to tax-friendly states? No-income-tax Nevada, right next to California, is a prime example.

Finally, even if you can't avoid nexus in a state with a hostile tax environment, can you apportion more of your income and property into other states?

These are the questions that an effective multi-state tax strategy must answer.

