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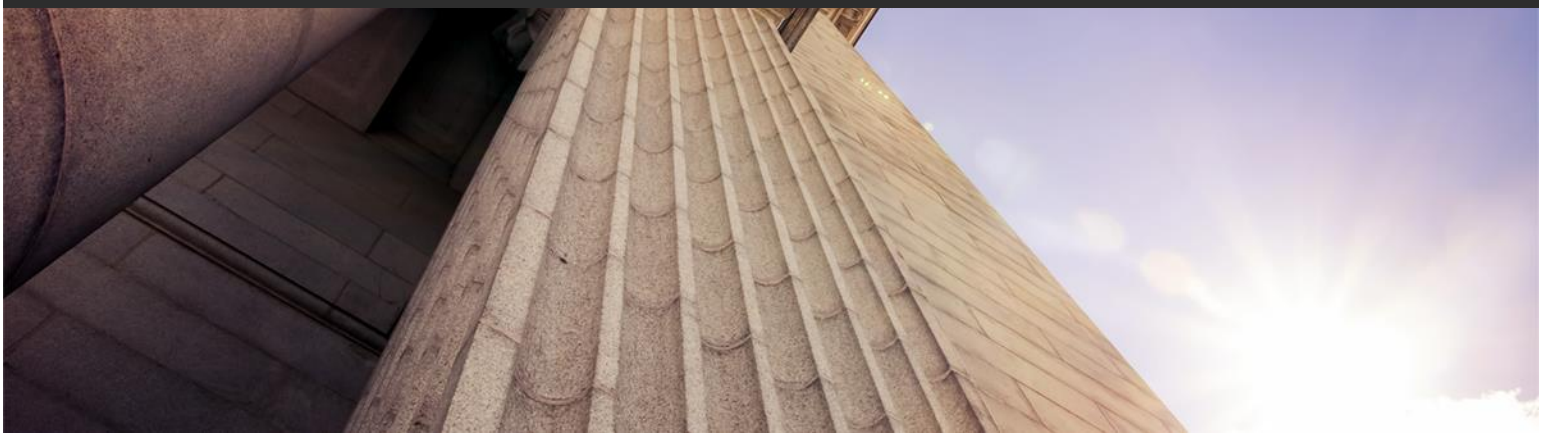

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Supreme Court Internet Sales Tax Case Will Require Many Companies to File State Corporate Income Tax Returns – Even If They Are Not Subject to Sales Tax

Although the sales tax collection obligation of online retailers was the focus of last month's momentous U.S. Supreme Court case *South Dakota v. Wayfair*, it will also impact state corporate and income tax obligations. Companies may now be exposed to state income tax as a result of the *Wayfair* case and should examine their activities in the states and may wish to consider entering into a voluntary disclosure agreement with these states.

The issue addressed by the high court in *Wayf*air was whether a remote seller needed to have a physical presence in the state before it can be required to collect sales tax. The court – reversing a 26-year old precedent - held that it did not. The same principal would apply to a state's corporate and income taxes as well – if a physical presence is not required to come under a state's sales tax jurisdiction, physical presence likewise is not required to come within a state's jurisdiction to impose income or corporate taxes. This potentially has wider ramifications to businesses around the United States because it applies to any company doing business in a state, even if the company does not sell goods or services which are subject to sales tax – as is the case with a company providing financial or other services to a customer even if it does not have an office or send employees or independent contractors into the state.

At least eight states have enacted state income tax nexus rules providing that a company must file a return in the state if it reaches a minimum sales threshold to customers in the state, even if the company does

not have a physical presence there. For example, Alabama, Colorado, Connecticut, and Tennessee will impose their corporate tax on companies that have more than $500,000 of gross receipts from sources within the state. (California's law allows for adjusting the threshold amount for inflation so that the amount for years beginning on or after Jan. 1, 2016, the threshold is $547,711.) As an alternative to the dollar threshold, Alabama, California, Colorado, and Tennessee impose their taxes if receipts sourced to the state exceed 25 percent of the total receipts of the business - with no minimum amount - so that a company with gross receipts of $40,000 that has more than $10,000 of sales in California would be subject to income tax in California.

In addition, more than 30 states have adopted an 'economic presence' test for imposing their corporate taxes including several that explicitly state that licensing an intangible that produces receipts from the state creates nexus for corporate tax purposes (Arizona; Florida; Minnesota; North Carolina; North Dakota; Nebraska; New Jersey, New Mexico; Oklahoma; South Carolina; Utah; Wisconsin). These states took the position that the physical presence requirement set forth in *Quill* only applied to sales tax collection obligations and not to corporate taxes. The holding in *Wayfair*, that physical presence is not required for imposition of state taxes, gives a green light for these states to enforce their expansive nexus laws.

In several cases these laws have been on the books for many years. It is possible that some companies who met these thresholds nevertheless did not file income tax returns on the basis that they did not have a physical presence there. Because the U.S. Supreme Court held in *Wayfair* that its prior precedents requiring a physical presence were wrongly decided and the court did not limit its holding to prospective application of the decision, some of these states might say that companies who met these sales thresholds should have filed returns going back to the date their income tax nexus laws were enacted – in some cases more than a decade ago. As a result, depending on the state, the potential exposure could be material.

Companies with state income tax exposure should consider requesting a voluntary disclosure agreement (VDA) with the respective state tax agencies in order to limit the look-back period to three or four years. Without a VDA, the state would not be limited to the seeking back taxes under the statute of limitations because the statute does not start to run until a return is filed. Generally, under a typical VDA, the company would pay the tax and interest for the look-back period, and the state would waive penalties.

A company considering a VDA with a state may wish to act quickly, because if the state tax agency contacts the company about why it has not filed a tax return before the company can make its initial VDA offer, it may be too late to negotiate an agreement.

Greenberg Traurig's State and Local Tax Practice is available if you would like to discuss a VDA.

For more on the *South Dakota v. Wayfair* case, click here.

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