Got Nexus?

By Richard A. Vallari CPA, CMI

Last month, I discussed the Streamlined Sales Tax Project and its goal: to create sales tax simplification in an effort to entice federal legislation that would require remote sellers to collect use tax. In this installment of my series discussing the Streamlined Sales Tax Project, I will offer a general overview of how the United States Supreme Court has viewed nexus regarding sales and use tax, and why a general comprehension of sales and use tax nexus is crucial to understanding the magnitude of the Streamlined Sales Tax Project.

In order for a state to impose a tax on out-of-state business, that business must meet or exceed a minimum threshold of activity in the state. This concept is known as nexus. The standard of nexus for income tax is different than the standard for sales and use tax. In connection with income tax, Congress implemented a temporary stopgap measure in 1959 known as Public Law 86-272 to address circumstances in which multi-state companies may owe state income taxes.

For sales and use tax, the United States Supreme Court has always defined nexus in terms of physical presence. As a sales tax practitioner, there are two cases I often cite when discussing direct nexus standards for sales and use tax with clients: National Bellas Hess Inc. v. Illinois Department of Revenue, 386 U.S. 753 (1967), and Quill Corp. v. North Dakota, 504 U.S 298 (1992). In addition, practitioners should be aware of cases that address third party nexus. Third party nexus is that attributed through an agent, solicitor, or other party acting on behalf of a seller in the taxing state. Such cases include, but are not limited to, Scripto, Inc. v. Carson, 362 U.S. 207 (1960), and Tyler Piper Industries Inc. v. Washington Department of Revenue, 483 U.S. 232 (1987). For purposes of this article, I will focus on two cases involving direct nexus issues.

In National Bellas Hess, it was held that the Due Process Clause and the Commerce Clause of the Constitution prohibits a State from imposing the duty of use tax collection and payment upon a seller whose only connection with customers in the state is by common carrier or by mail. The Court noted that the administrative burden of mail order houses to collect use taxes from a multitude of jurisdictions created an impediment to interstate commerce.

In Quill, the facts were practically identical to National Bellas Hess. In Quill, the Supreme Court ruled that a taxpayer whose sole contact with a taxing jurisdiction is by common carrier or U.S. mail is still protected by the Commerce Clause from use tax collection responsibility under National Bellas Hess. While the Court agreed with the North Dakota Supreme Court that the minimum contacts requirements of the Due Process Clause was met, the Commerce Clause requires a higher level of contacts. In other words, substantial nexus with a state is required.

In Quill, the Court acknowledged that Congress retains the ultimate authority to decide which taxes hinder interstate commerce. The creation of the Streamlined Sales Tax Project by its advocates may ultimately affect the view of Congress and require remote sellers to finally collect use tax in jurisdictions they currently do not have an obligation to do so. Simplicity of our sales and use tax systems by the Streamlined Sales Tax Project would definitely address concerns the Supreme Court had in National Bellas Hess, and certainly make Congress address the issue of remote sellers collecting use tax.
Next month I will discuss the evolution of the Streamlined Sales Tax Project, and specifics on the simplicity of Sales and Use tax collection that the project promotes.

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