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Balance sheet

Sales Tax, Nexus and Internet Sales

By Jeffrey C. Quinlan, CPA

States with sales tax are looking for ways to have out-of-state businesses collect sales tax on their behalf. States require businesses with nexus or sufficient contact with a state to collect sales tax. Prior to a 1992 Supreme Court decision, businesses had nexus by having sales in a state which is called economic presence. The Court decided in the 1992 *Quill* case that economic presence does not create nexus and a retailer needs to establish a physical presence in the state. Generally, retailers are physically present when they:

- Maintain a place of business including offices, sales room, warehouses or storage places for the sales and delivery of goods and services within state;
- Have a representative, agent, salesman or employee sell or deliver goods within a state; or
- Maintain personal property for lease or rental within a state.

Once a retailer meets this physical presence test in the state; they are required to collect and remit sales tax. However, most businesses that sell over the internet do not meet the physical presence test. States believe a competitive advantage is being given to online retailers over the traditional brick-and-mortar stores and are not collecting enough sales tax. States addressed this concern by creating agreements with other states and passing laws to create additional nexus.

In 2005, the Streamline Sales and Use Tax Agreement (SSUTA) was created to have the same or similar sales tax administration, rules and enforcement across states. Currently, 24 states including Ohio have passed legislation to participate in SSUTA. However, states that adopt SSUTA cannot force businesses to collect and remit sales tax. To make SSUTA enforceable across every state would require an act of Congress. A bill called the “Marketplace Fairness Act” has been introduced in the Senate. Despite not being required to collect sales tax, many out-of-state online retailers are voluntary collecting sales tax as a convenience and service to their customers.

States are passing laws to require out-of-state businesses to collect and remit sales tax. The new type of laws include click-through, affiliate, economic, marketplace and reporting requirements. Many states have passed click-through and affiliate sales tax rules. The other three types of laws have been enacted in only a few states. Click-through laws establish nexus when a business sells a minimum amount in a state and pays an instate business a referral fee for generating sales through their website. Affiliate laws establish nexus when an instate affiliate of an out-of-state business meets the physical presence test in a state. Economic nexus is created having only a minimum sales amount in a state and has been ruled unconstitutional in some states. Marketplace nexus forces online marketplaces that operate in a state to collect sales tax rather than the individual vendors that use the online marketplace. Reporting requirements require businesses to notify customers they are responsible for reporting use tax on their purchases. Some states require businesses to send an annual statement to customers of all their purchases.

If you have questions about sales tax rules, including the responsibility to collect sales tax in another state, please contact our office.

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