

State tax audit risk

How to deal with a state nexus questionnaire

Nexus is a Latin word for a common tie or a connection, and, in today's business environment, it is also a key term in determining the tax jurisdiction that applies to state business taxes.

Because of the interconnected nature of our economy today, the discussion of state tax nexus has clear implications for many business owners. They often find themselves operating in multistate environments but may lack the expertise and the means to limit their tax liability and audit risk.

And as a result of that lack of technical expertise, business owners may find themselves stymied by a state tax nexus questionnaire, says Timothy A. Dudek, a director of tax strategies at Kreisler Miller in Horsham, Pa., and chair of the firm's State and Local Tax group.

"Nexus questionnaires are not to be taken lightly," says Dudek. "Incorrect responses on the company's part to what can be very confusing questions — questions that prompt only yes or no answers — may give rise to unsuspecting and irreversible results. This, then, leads to being subject to the multitude of taxes within each jurisdiction."

Smart Business spoke with Dudek about how to approach a nexus questionnaire and how to proceed should your business receive one.

Why would a business receive a nexus questionnaire?

In the current economic landscape, more and more states are feeling the impact of the budget crunch. In an effort to increase revenue, states are sending nexus questionnaires to out-of-state businesses that they suspect may be underreporting and underpaying taxes in their jurisdiction. Choosing to ignore these questionnaires may be dangerous for a business, as these states may take steps to impose arbitrary assessments and force companies to then defend themselves, ultimately resulting in a lot of professional fee expense for the business.

How do state and local taxing jurisdictions obtain their mailing list of companies to target?

It's not too difficult to reason how they get the names of companies that may be liable for some type of tax liability within their jurisdiction. State auditors research



Timothy A. Dudek
Director, tax strategies
Chair, State and Local Tax group
Kreisler Miller

potential business links such as customs reports, FAA logs, boating registries and realty transfer transactions.

Other revenue officials may roam trade shows and business centers, peruse telephone directories and websites and watch bridge crossings to target companies whose names are not already listed on the state database. Advanced technology allows for interdepartmental inquiries within each given state, with wage tax systems interacting with corporate tax systems.

Lastly, because of state tax compacts (information sharing agreements) signed among a number of neighboring states, the audit of one company leads to information about another company, and so on.

What types of taxes are subject to these inquiries?

While the list of taxes that are subject to these inquiries would be beyond the purview of this article, it's essentially any tax or fee that can be imposed under that state's taxing ordinance. This would encompass everything from corporate income and franchise taxes to unclaimed property reporting to sales and use taxes to wage taxes.

TIMOTHY A. DUDEK is a director of tax strategies at Kreisler Miller in Horsham, Pa., and chair of the firm's State and Local Tax group. Reach him at (215) 441-4600 or tdudek@kmc.com.

What danger do these questionnaires pose to businesses that are not familiar with them?

The answer is twofold. First, a company needs to understand the concept of nexus, which is defined differently for the different types of taxes involved. Companies may or may not be subject to state taxes based on a variety of state tax concepts, such as physical presence, constitutional nexus, economic nexus, affiliate nexus, agency nexus, or Public Law 86-272, which addresses the circumstances under which a multistate business may owe state income taxes.

Second, the questions asked on the nexus questionnaire can be quite broad in nature. A company may think that the response to a particular question should be a simple 'yes.' However, a more accurate answer may be, 'Yes, except for ...' In other words, if a company answers 'yes' to a particular question without providing further explanation of that answer, it becomes easier for the state to conclude that the company has nexus. Being able to provide a further explanation may provide a solid basis for concluding that the company does not have nexus.

Because of that it is a very good idea for companies to review their answers with their state tax professional before returning the questionnaire to the state. Once submitted to the state, it becomes extremely difficult to retract answers that were originally given in good faith but that were incorrectly submitted.

What other factors should companies be aware of regarding nexus questionnaires?

Companies should continuously assess their operations in any state or local jurisdiction where they do business. If you find that you have established state tax nexus, the law requires you to register in those jurisdictions and begin paying taxes.

However, before you register, if there is a possibility that state tax liabilities may have existed for your business in earlier years, first talk to a state tax professional about your options. There may be voluntary disclosure, amnesty or exemption programs that your business can utilize to resolve its tax requirements. <<

Insights Accounting & Consulting is brought to you by Kreisler Miller