Fundamentals of Nexus in Arizona: Sales Tax Nexus

This month's state and local tax (SALT) column introduces the U.S. Constitutional limitations on states' power to impose taxes on proceeds from interstate commerce, and some guidelines the Arizona Department of Revenue (ADOR) issued concerning nexus for transaction privilege (sales) tax.

The U.S. Constitution imposes two important limitations on states' ability to impose taxes on proceeds from interstate and foreign commerce. The "Due Process" clause, part of the Fourteenth Amendment to the U.S. Constitution, provides in relevant part, that no state shall deprive any person of property without "due process" of law. And, Article I, Section 8, Clause 3 of the U.S. Constitution, commonly known as the "Commerce Clause," grants Congress the power "to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The Due Process Clause

Compared to the hurdles that states must overcome to impose taxes on proceeds from interstate and foreign commerce without violating the Commerce Clause, the Due Process clause is more akin to a speed bump. As the U.S. Supreme Court determined in the Miller Brothers case, the Due Process clause simply requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." But, before a state may lawfully impose taxes on proceeds from interstate and foreign commerce, it must also overcome the Commerce Clause hurdles.

The Commerce Clause

In the Complete Auto case, the U.S. Supreme Court determined that states must overcome four Commerce Clause hurdles before they can impose sales tax on a remote merchant. The tax will be upheld if it is: "[1] applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the state."

While all of the Commerce Clause hurdles are important, this article focuses on the "substantial nexus" requirement. In the Quill case, the U.S. Supreme Court affirmed the bright-line test it announced in the Bellas Hess case, that physical presence by a taxpayer or the taxpayer's agent is required to establish nexus with a state for sales tax purposes (but not for other types of taxes).

Thus, for example, if a taxpayer's only connection with a state is to deliver products into the state using a common carrier or the U.S. Post Office, the state cannot require the taxpayer to remit sales tax. But, if the taxpayer delivers products into the state using vehicles it owns or leases, the state may require the taxpayer to remit sales tax, unless the activity in any given year was de minimis.

ADOR's Guidelines Regarding Nexus for Sales Tax

In Publication 623, ADOR provided the following examples of activities that may establish nexus for sales tax purposes in Arizona:

- Employee present in the state for more than two days per year.
- Ownership or lease of real or personal property in Arizona.
- Maintenance of an office or place of business in Arizona.
- Delivery of merchandise into Arizona using vehicles owned or leased by the taxpayer.
- Independent contractors or other non-employee representatives present in Arizona for more than two days per year for the purpose of establishing and maintaining a market for the taxpayer. Examples of establishing and maintaining a market include: soliciting sales; making repairs; collecting delinquent accounts; delivering property sold to customers; installing products; conducting training for employees or representatives of the company or customers; resolving customers complaints; providing consulting services; soliciting, negotiation, or entering into franchising agreements.

***Practice Tip!* –** Although it is debatable whether some of ADOR's guidelines above are too strict (in particular, Arizona state and federal courts may determine that a mere two-day presence in the state is de minimis and would not, by itself, create nexus), savvy CPAs help their clients understand the types of activities that may create nexus and recognize the additional tax collection and/or filing obligations that result from establishing nexus in additional taxing jurisdictions. **AZ CPA**

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