



Arizona's New State and Local Sales Tax Nexus Guidelines

This month's state and local tax (SALT) column addresses a new ruling that outlines the Arizona Department of Revenue's (Department's) position concerning the factors that determine whether an out-of-state company has nexus for purposes of Arizona's sales and use taxes, and concerning the state's position regarding nexus for municipal sales taxes.

With Arizona Transaction Privilege Tax Ruling TPR 16-1, the Department rescinded and replaced the guidance it issued eight years ago concerning the factors it considers to determine whether an out-of-state business has nexus for purposes of Arizona's sales and use taxes. In the ruling, for the first time, the Department stated that businesses that have nexus for state sales tax purposes also have nexus for municipal sales tax purposes.

Why the Ruling is Controversial

Of the 45 states that collect sales taxes, Arizona is one of just four that permit municipalities to impose sales taxes under their own municipal tax codes. The other 41 states impose municipal sales taxes under their state tax codes, collect the taxes centrally, and distribute a portion of the taxes they collect to their municipalities. Because the municipal sales taxes in most states are imposed by the states, when those states have sufficient nexus to collect sales taxes from transactions in interstate commerce, the municipalities in those states receive a portion of the taxes collected.

However, in Arizona — at least before the Department issued this new ruling — out-of-state retailers frequently contended that municipalities are not automatically entitled to sales taxes on proceeds from interstate commerce just because the state is entitled to sales taxes. The retailers believed that establishing nexus with Arizona and one or more municipalities in the state did not automatically establish nexus with all municipalities in the state.

An Example

Assume that an out-of-state retailer establishes nexus with Arizona solely by sending employees or engaging an unrelated third party to install products it sold to customers in Tucson over the course of several days.

By sending employees or agents to Tucson to install products for customers over the course of several days, the out-of-state retailer established nexus with the State of Arizona and the City of Tucson. So, the state could require the retailer to file sales tax returns and pay state and county sales taxes on those transactions and any subsequent transactions with customers in Arizona during the same calendar year, even if the subsequent transactions are online transactions and do not involve installations or any other physical presence in Arizona by the retailer or its agents. Likewise, the City of Tucson could require the retailer to do the same thing — but only for transactions with customers located in Tucson.



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However, in this scenario, the retailer could argue that it only established nexus with the state and with the City of Tucson and that other municipalities in Arizona could not require it to pay sales taxes on proceeds from transactions with customers located within their municipal limits.

While Arizona municipalities value the autonomy that comes with imposing sales taxes under their own tax codes, if this theory is correct, that autonomy comes at a price.

An Important Position Not Disclosed in the Ruling

Although the Department did not disclose this, its position is that when out-of-state software companies retain ownership of the software that they license to their customers, they establish nexus with the state regardless of how the software is delivered and whether or not the out-of-state software company has any other connections with the state.

Practice Tip

In days past, when deciding whether to collect and remit sales taxes, businesses almost always were best advised to simply follow any written guidance issued by taxing authorities — even though it seems tax authorities often lean toward the taxable end of the spectrum on gray issues. But, in today's litigious environment in which businesses also have to contend with class action lawsuits when they accidentally collect too much tax from their customers, they should consult with their tax advisors on gray issues even when the taxing authority has weighed in on the issue, and especially when the taxing authority's position on the issue is suspect. ■