



## IS YOUR BUSINESS SUBJECT TO US INCOME AND SALES TAX? PART II

Hendry Warren Chronicle - Tax and Accounting Simplified

December 2018

In Part I of our two part newsletter series we highlighted possible exposures of Canadian businesses to US federal income tax. This second part identifies possible exposures to US state income and sales taxes. Canadian businesses are often surprised to learn that taxation at the state level is often more complex and requires a more involved analysis than the federal level.

### US STATE INCOME TAX

Ok, so you have read Part I of our newsletter and determined that your business is either exempt from US federal income tax by virtue of the Treaty or it is subject to US tax based upon US domestic rules. You have navigated the system and are feeling good about it.

But it is not over yet. Get a fresh coffee re-fill and read on! The next possible exposure that Canadian businesses may have is to US state income tax, which can be far more complex.

### NEXUS- 50 DIFFERENT SETS OF RULES!

American states set their own tax rules. They are not dependent upon the US federal government in this regard, nor are they a party to the Canada-US Income Tax Treaty. A Canadian business may be exempt

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*Our goal is to provide updates on topical accounting and tax issues. Information contained in this newsletter is not meant to be a comprehensive summary of the issues raised. Rather, we wish to bring what we believe to be important issues to the attention of our valued clients and readers. We would be pleased to discuss any questions that you, the reader, might have in greater detail.*

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from US federal income tax but subject to income tax at the individual state level.

The threshold for the level of business activity that must be present for a state to impose its income tax is referred to as nexus. Each of the 50 individual states have their own rules governing nexus. It is therefore necessary for a Canadian business to



consider their activities in each of the 50 states to determine their exposure to state income tax and their related filing requirement. This is seldom a simple task.

For example, the nexus standards of some states are based upon thresholds for the businesses property, payroll or sales in the state. The Canadian business would be subject to state income tax if those thresholds were exceeded. Other states base their nexus standard upon the degree to which a Canadian business owns or leases property, employs staff or otherwise establishes a physical presence in the state. This second category of nexus standard is more subjective and often results in activity thresholds below what would be found in the US federal rules to determine if there is a US Trade or Business.

If there is a nexus, fairly complex apportionment rules must be implemented to allocate income to individual states. Finally, state income tax returns must be filed.

### **NEXUS STUDY**

If your Canadian business is selling goods or services into the United States, you should consider having a Nexus Study completed. This involves a review of your activities in the US compared to the nexus standards of all 50 states. This will identify the degree to which you are exposed to US state income tax.

### **STATE SALES TAX**

The third level of US tax exposure that you should be aware of is US state sales tax. It is critically important for a Canadian business to evaluate its exposure in this regard so that it can collect the state sales tax at the point of sale. Sales tax is designed to be a tax on the customer but the burden is typically placed on the supplier to collect and



remit this sales tax, even if it is a Canadian supplier.

### **ANOTHER SET OF 50 DIFFERENT RULES**

Based upon the foregoing, it should not be a surprise that each state has its own rules to determine what products are subject to sales tax and how that tax will be applied. For example, most tangible products are subject to state sales tax. Distinctions are made between pre-written and customized software. Some consulting or on-site training fees may also be subject to sales tax.

The next step is to determine if the Canadian business has a nexus (discussed above) to the state. If it does, the Canadian business has an obligation to collect and remit the sales tax to the state. Some states have implemented an “economic nexus” for these purposes which would deem nexus if sales into that state exceed a certain threshold.

Historically, the requirement of an out-of-state business to collect and remit sales tax subject to economic nexus was significantly restricted due to a wide-ranging physical presence standard. This changed in 2018 with the US Supreme

Court ruling in South Dakota vs. Wayfair<sup>1</sup>. The Wayfair ruling effectively struck down the physical presence standard and upheld South Dakota's nexus standard<sup>2</sup>. In response to the Wayfair ruling, it is expected that all 50 states will implement an economic nexus standard for their sales tax in the near future. This will significantly increase the exposure of a Canadian business to US state sales tax.

Canadian businesses need to be aware of their obligations to collect and remit state income tax. US state sales tax can be a needless and significant cost to a Canadian business if they fail to collect from their US customers. You may wish to seek the assistance of a US sales support firm to manage the collecting and remitting of the state sales tax as well as filing the related sales tax reports.

If you are selling goods or services into the United States, we recommend that you engage a US tax professional to perform a state-by-state sales tax analysis.

### WHAT TO DO NEXT?

If your business is selling products or services to the United States, either over the internet or otherwise, you should consider your state income tax and sales tax obligations. You should consider having a state nexus study performed as well as a state-by-state sales tax analysis.

Our industrious tax team at Hendry Warren LLP can assist with this in conjunction with our external US tax advisors, Jansen Valk Thompson Reahm PC. We are always available to help. For more information, please feel free to contact our office to speak to one of our tax specialists.

1. The Wayfair decision was released on June 21, 2018

2. South Dakota's nexus standard requires out-of-state businesses with over \$100,000 of sales or 200 transactions within the prior 12 months to collect and remit their state sales tax, regardless of whether they have a physical presence in the state.



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