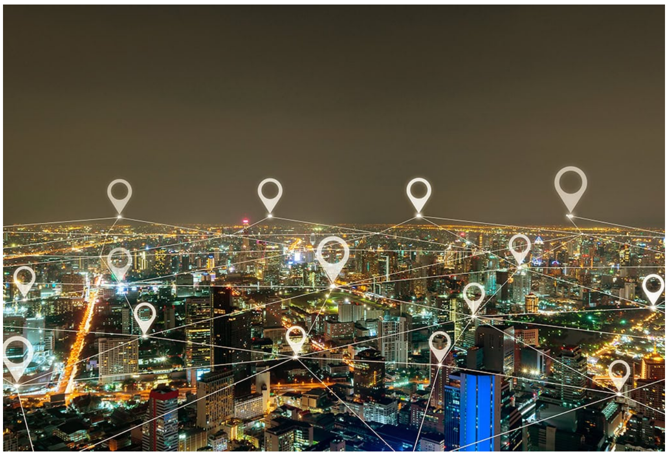
NAVIGATING STATE INCOME TAX: A GUIDE FOR MULTISTATE MANUFACTURERS



If your manufacturing business operates across state lines, understanding your state income tax obligations is crucial. While much attention has been given to sales tax obligations since the landmark 2018 Supreme Court decision in South Dakota v. Wayfair, Inc., recent developments in remote work and revised guidance from the Multistate Tax Commission (MTC) regarding Public Law 86-272 signal potential shifts in income tax liabilities.

Why Nexus Matters

States derive their authority to impose and collect business taxes from the United States Constitution, particularly the Due Process Clause and the Commerce Clause. These clauses dictate that states can only tax income earned within their borders or property located within their jurisdiction. But how do states determine the portion of income attributable to in-state activity for multistate businesses? Enter the unitary business principle, which allows states to apply an apportionment formula to approximate in-state activity.

> *"...nor shall any state deprive any person of life, liberty, or property, without due process of law."*
>
> *- Due Process clause*

Historically, nexus required a substantial physical presence. However, with the rise of e-commerce, states have increasingly adopted economic nexus standards, as endorsed by the Supreme Court in Wayfair. This means businesses may be subject to tax obligations based on economic activity that exceed certain sales thresholds in a state, regardless of physical presence.

For income taxes, Public Law (PL) 86-272 has long shielded businesses from taxation when their only in-state activity is the solicitation of sales for tangible personal property, provided orders are accepted and filled from outside the state. These activities are protected, even if they are conducted by personnel located within the state. While some states have established economic presence standards for income tax nexus, PL 86-272 protection still applies if criteria are met. However, it's important to note that PL 86-272 does not shield businesses from franchise or gross receipts taxes (see *Taking Stock* below), which may be triggered by any physical presence in a state.

Multistate Tax Commission Guidance

The MTC, an intergovernmental state tax agency, has provided invaluable guidance on PL 86-272 since 1986. Most states and taxpayers have followed their lead due to limited federal guidance. This guidance outlines protected and unprotected in-state activities, with recent revisions addressing digital and remote activities.

Historically, the MTC has listed the following:

Protected In-State Activities

- Advertising
- Soliciting orders by in-state employees
- Providing samples or promotional materials free of charge
- Providing cars for sales personnel to conduct protected activities
- Passing orders, inquiries or complaints along to the home office
- Coordinating shipment or delivery without payment
- Selling products to in-state customers via a company’s website
- Providing post-sale assistance to customers by posting a list of static FAQs

Unprotected in-State Activities

- Approving or accepting orders
- Collecting current or delinquent accounts
- Providing maintenance or repair services
- Picking up or replacing damaged or returned property
- Carrying samples for sale
- Conducting credit checks
- Maintaining an office or other place of business (other than a home office)
- Providing post-sale assistance to in-state customers via electronic chat or email
- Offering or selling extended warranty plans via the company’s website.

However, not all states have adopted the MTC's guidance. California and New York, for instance, have faced legal challenges regarding their adoption of the MTC's revised statement.

Taking Stock

Manufacturers must assess their activities across states to determine income, franchise and gross receipts tax liabilities. Franchise Tax is a tax for the privilege of doing business in a state and is generally a variation of the business's net worth. The presence of remote workers engaged in unprotected activities could trigger tax obligations. It's essential to consult with your CPA to understand the specific laws, regulations and administrative rulings in each state where you operate.

Summary

As a multistate manufacturer, navigating state income tax obligations requires a nuanced understanding of nexus, PL 86-272 protections and evolving guidance from bodies like the MTC. Contact your BMF Advisor for expert advice to ensure compliance while maximizing your business's growth and success across state lines.