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Tennessee Joins Bright-line Factor Nexus States

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Overview

As of May 20, 2015, the list of states imposing factor nexus laws grew once again as Tennessee Governor Bill Haslam signed the Revenue Modernization Act (the Act). The Act expands the definition of nexus, changes sourcing rules for franchise and excise tax in addition to placing greater weight on the sales factor.

Nexus Changes

For tax years beginning on or after January 1, 2016, the Act provides that taxpayers are subject to the franchise and excise tax if they are doing business in Tennessee and have substantial nexus with Tennessee. Substantial nexus is created if: (1) the taxpayer is organized or commercially domiciled in Tennessee; (2) the taxpayer owns or uses capital in Tennessee; (3) the taxpayer has systematic and continuous business activity in Tennessee that has produced gross receipts attributable to customers in Tennessee (often referred to as economic nexus); (4) the taxpayer licenses intangible property for use by another party in Tennessee and derives income from the use of that intangible property; or (4) the taxpayer has "bright-line presence" in Tennessee. The taxpayer has bright-line presence in Tennessee if any of the following applies: (1) the taxpayer's receipts in Tennessee exceed either $500,000 or 25% of the taxpayer's total receipts everywhere; (2) the average value of the taxpayer's real and tangible property owned or rented and used in Tennessee during the tax period exceeds $50,000 or 25% of the taxpayer's total real and tangible property; or (3) the taxpayer paid compensation in Tennessee that exceeded more than $50,000 or 25% of the total compensation paid by that taxpayer.

With these changes, Tennessee joins a growing list of states that have modified their economic nexus laws with set dollar values or *factors* that must be applied in determining whether nexus exists. Connecticut was the first state with income tax to modify its economic nexus laws and assert that any taxpayer meeting a *bright-line* test of $500,000 in sales from Connecticut-sourced business activities had income tax nexus in their state. California, Colorado and Michigan soon followed suit. New York joined the club as of January 1, 2015 with a $1,000,000 sales threshold. Remember, economic nexus is not always limited to income tax. Taxpayers need to be aware that Ohio, Oklahoma and Washington have instituted similar factors for determining non-income-based taxes such as the Ohio Commercial Activity Tax (CAT).

Apportionment Changes (Especially for service based businesses)

In addition to increasing the weight of the sales factor so that it makes up 60% of the apportionment factor rather than 50% of the apportionment factor, Tennessee will also follow another trend, which involves moving towards a market-based sourcing method. As of January 1, 2016, sales are in Tennessee if the taxpayer's market for the sale is in Tennessee. In the case of the sale, rental, lease, or license of real or tangible property, the market for the sale is in Tennessee to the extent that the property is located in Tennessee. For the sale of a service, the sale will be sourced to Tennessee to the extent that the service is delivered to a location in Tennessee. In the case of intangible property that is rented, leased, or licensed, the sale will be sourced to Tennessee to the extent that the intangible property is used in Tennessee.

Boulay Can Help

Remember that Boulay offers both nexus and sourcing consulting services to help identify and quantify nexus exposure and sourcing requirements. Ask your trusted Boulay advisor for details at 952-893-9320 or learnmore@BoulayGroup.com.