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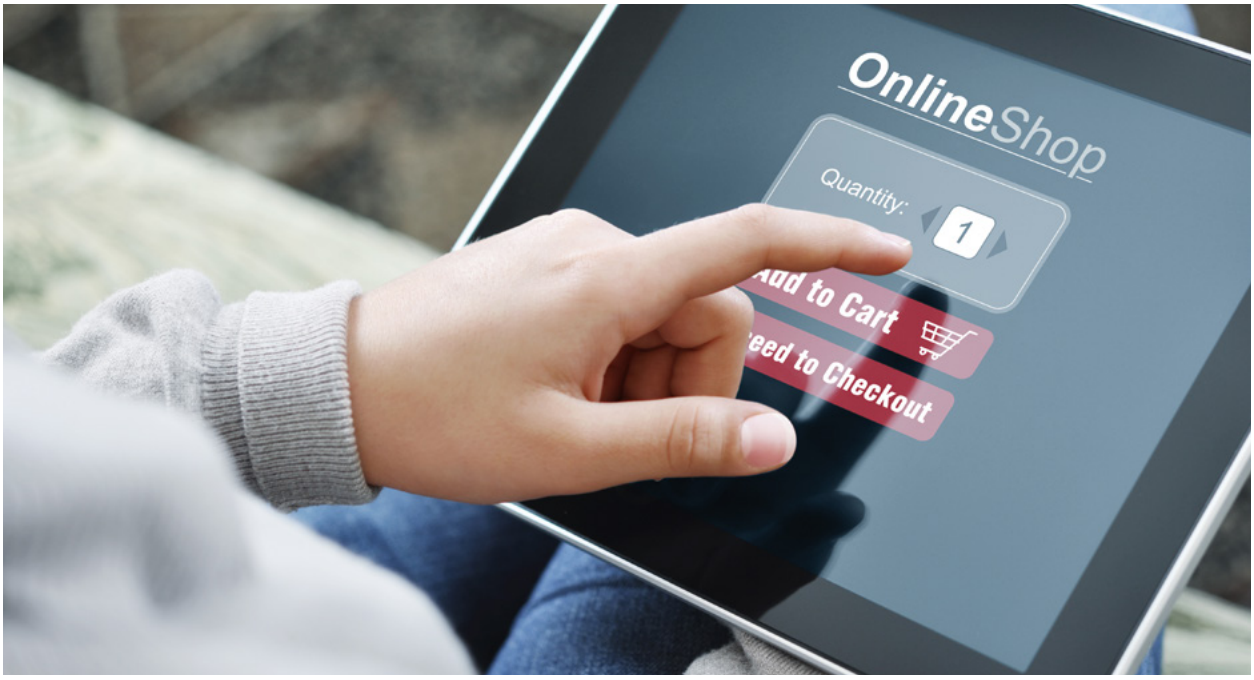
State Corporate Income Tax: E-Commerce Study 2018

Rebecca Newton-Clarke and Emily Porter



SPECIAL REPORT

THOMSON REUTERS®

State Corporate Income Tax E-Commerce Study

by Rebecca Newton-Clarke and Emily Porter

Purely electronic transactions, such as cloud computing, entertainment downloads, and online services, are a rapidly growing part of our economy with uncertain state corporate income tax consequences. These transactions continue to diversify, even as state tax revenues and jurisdictional standards are in flux. The interplay between pure e-commerce and state corporate income taxes is an increasing concern for multistate companies that sell these kinds of products and services to customers all over the country and have a physical footprint limited to one or two states.

Sales and use tax e-commerce considerations receive the bulk of attention from state lawmakers, perhaps because they are less difficult to conceptualize. The corporate income tax concerns raised by these transactions are just as pressing, if not more so, given the potential liabilities at stake.

There are two primary issues. First, does selling purely electronic products and services to customers in a state establish nexus (a sufficient connection to warrant imposition of tax) for an out-of-state company lacking any other contacts with the state? Second, if an out-of-state company does have nexus with the state, which pure e-commerce receipts are sourced to the state? In other words, how are these sales apportioned for purposes of computing the total income that the state can tax? These questions have many permutations and answers are often elusive.

To assist businesses in navigating this uncertain landscape, Checkpoint Catalyst has issued its second annual state corporate income tax e-commerce survey. We sought direct guidance from state taxing agencies and received answers from seventeen states: Arkansas, California, Connecticut, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Minnesota, Nebraska, New Jersey, North Dakota, Tennessee, Texas, and Wisconsin. Minnesota was a new participant. Three state taxing agencies that participated last year did not answer the survey this time. Of these, West Virginia was still working on it at press time, but (perhaps in a sign of how tricky these questions can be even for taxing agencies) Alaska declined to respond and Florida did not participate.

Below we provide an overview of the issues and states' responses. Following our summary, each state's detailed response to the survey is included in the packet.

Overview

E-commerce has precipitated enormous changes in the ways companies do business – changes that states' corporate income tax laws did not anticipate and lawmakers did not foresee.[1] Increasingly, companies engage in transactions with customers in a state while lacking any of the contacts traditionally associated with sales of goods or performance of services. Sales of products can involve downloads and streaming of items that cannot be touched or held; services can be performed remotely, rather than in proximity to the customer.

These "pure e-commerce transactions" raise many corporate income tax issues that states are only beginning to consider, much less address.[2] They include, just for example, sales of: music, video, and software downloads, remote access to software and apps, streaming games and entertainment, electronically provided information services, cloud computing services, digital storage, online education, and online research. New kinds of transactions are continually emerging, outpacing states' ability to catch up.

1 Hellerstein & Hellerstein: State Taxation, ¶9.18[3][f]; Hellerstein & Hellerstein: State Taxation, ¶13.06A; State Taxation of Cloud Computing: A Framework for Analysis, Walter Hellerstein and Jon Sedon, Journal of Multistate Taxation, Vol. 22, No. 07, Oct. 2012.

2 Hellerstein & Hellerstein: State Taxation, ¶9.18[3][f]; Hellerstein & Hellerstein: State Taxation, ¶13.06A; State Taxation of Cloud Computing: A Framework for Analysis, Walter Hellerstein and Jon Sedon, Journal of Multistate Taxation, Vol. 22, No. 07, Oct. 2012.

The first question to consider is nexus, or whether a state can and does assert jurisdiction to impose tax on a pure e-commerce seller, and, if so, whether federal law affords the seller any additional protections. States have significant latitude in designing and implementing their tax systems, but federal constitutional and statutory provisions do place constraints on state taxation. (These constraints, and the context into which pure e-commerce transactions have emerged, are discussed in detail in Checkpoint Catalyst™, Topic #1010: E-Commerce.)

Few states have considered the nexus implications of pure e-commerce transactions specifically. Some states have "economic nexus" or "factor-presence" laws asserting jurisdiction to tax based on the amount of sales, property, or payroll in the state, and these laws, being based purely on dollar amounts, would sweep in transactions such as sales of pure e-commerce goods and services to customers in the state. The constitutionality of economic nexus is uncertain, but the U.S. Supreme Court has consistently declined to hear challenges to the concept in the income tax arena.

If the seller does have nexus with a state, the next question is how the seller apportions receipts from its pure e-commerce sales under the state's law. This inquiry involves two main issues: how a state classifies a particular transaction (as a sale of tangible personal property, a service, or intangible property) and how to source a transaction for purposes of the sales factor. A handful of states provide detailed rules, but many states offer little to no guidance concerning apportionment of pure e-commerce transactions.

In the past several years, states have begun to import the economic nexus concept into the sales and use tax environment. Many states concede that these laws are facially unconstitutional under Quill v. North Dakota, in which the U.S. Supreme Court ruled that a business must have some physical presence in a state before sales and use tax nexus can arise.[3] The goal of this economic-nexus push was to force the Court to revisit its ruling in Quill, and now, in South Dakota v. Wayfair, the Court is doing so.[4] Most state courts have determined that the physical presence rule does not apply in the corporate income tax context, but a handful have ruled otherwise. If Quill is overturned, the reverberations will almost certainly be felt across the corporate income tax landscape, particularly insofar as pure e-commerce transactions are concerned.

In the second year of our survey, the responses from state taxing agencies once again confirmed that, in many states, the absence of legislative guidance in this important area creates nearly as much uncertainty for those tasked with administering corporate income tax laws as for those responsible for ensuring compliance with those laws. The full results of the study are discussed below, with summaries of each responding state's approach following the general overview.

3 Quill Corp. v. North Dakota, U.S. S. Ct., 504 U.S. 298 (1992).
4 South Dakota v. Wayfair, Inc. et al., S.D. S. Ct., 2017 S.D. 56 (2017), cert. granted, U.S. S. Ct., Dkt. No. 17-494, 01/12/2018.

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State Corporate Income Tax E-Commerce Survey

Multistate companies increasingly sell purely electronic products and services to customers all over the country but have a physical footprint limited to one or two states. In fall 2017, Thomson Reuters sent a survey to state taxing agencies asking how these "pure e-commerce transactions" affect nexus and apportionment for state corporate income tax purposes.

48 JURISDICTIONS SURVEYED

17 — **PARTICIPATED**
AR, CA, CT, GA, HI, ID, IN, IA, KS, KY, MN, NE, NJ, ND, TN, TX, WI

21 — **DID NOT REPLY**
AL, AZ, DE, DC, FL, LA, ME, MA, MI, MS, MO, NH, NM, NC, OR, PA, RI, UT, VT, VA, WA

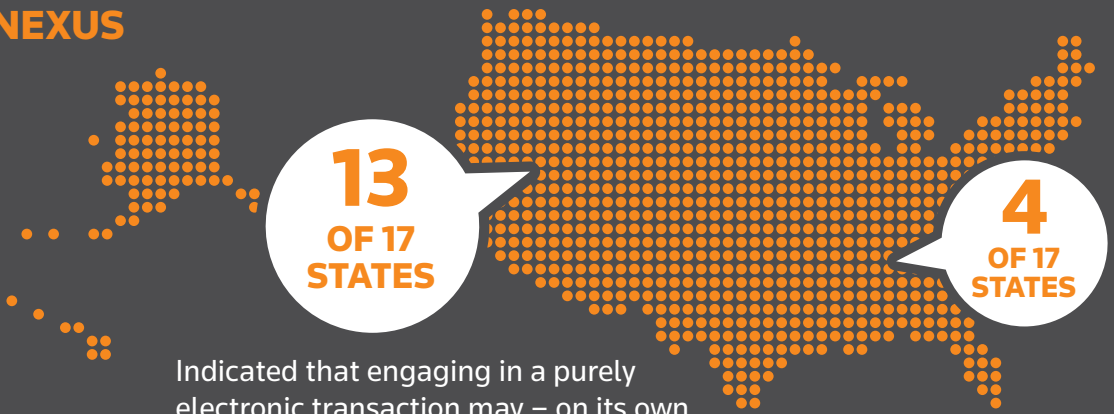
7 — **DECLINED TO PARTICIPATE**
AK, CO, IL, MT, NY, OH, SC

3 — **DID NOT RESPOND IN TIME**
MD, OK, WV

APPORTIONMENT

The states above have comprehensive rules addressing classification and sourcing of digital goods and services. Most states have little to no formal guidance, relying instead on the **facts and circumstances** of each sale.

NEXUS



Indicated that engaging in a purely electronic transaction may – on its own – create corporate income tax nexus.

Indicated that engaging in a purely electronic transaction will not – on its own – create corporate income tax nexus.

Checkpoint Catalyst's E-Commerce Survey

In an effort to assist lawyers, accountants, and businesses in navigating these uncertainties, we sought guidance from state taxing agencies in the form of a detailed survey. The participating states were Arkansas, California, Connecticut, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Minnesota, Nebraska, New Jersey, North Dakota, Tennessee, Texas, and Wisconsin.

On the nexus front, the questions were designed to determine whether a state will assert jurisdiction to tax an out-of-state company merely because it makes pure e-commerce sales of electronic products or services to customers in the state.

We identified a large cross-section of pure e-commerce transactions and encouraged states to indicate the nexus consequences of engaging in each of them. (The transactions were: selling software for download; selling apps for download; providing cloud computing; providing digital storage; selling downloads of songs, ebooks, videos, or games; providing subscriptions for or paid access to streaming video, music, events, or other entertainment offerings; providing subscriptions for or paid access to games; providing subscriptions to research sites; providing professional services (legal, medical, accounting, research, analytical, engineering, or consulting services); providing information services; providing online educational services; hosting advertising on the seller's website; providing customer service or product support; providing remote maintenance or warranty services; facilitating hotel arrangements in the state as an online travel company; facilitating home-sharing in the state through online listings; facilitating crowd-funding of projects in the state through online listings; or engaging in any other purely electronic transactions.)

See appendix for map showing Corporate Income Tax Nexus

We also asked if the nexus consequences for any of these transactions change if the seller provides or distributes the products or services using a server located in the state that is owned by a related or unrelated third party with whom the seller contracts to provide ISP services, digital storage, remote access to software, or other remote products or services.

Our last nexus question was inspired by a Washington law under which the state presumes that a remote seller presumed to have sales and use tax nexus under the state's click-through nexus law also has nexus for purposes of the state's business and occupation tax. We asked whether (assuming the state has a click-through nexus law for sales and use tax purposes) the state takes the position that a seller having click-through sales and use tax nexus with the state is also presumed to have corporate income tax nexus.

Agencies for many states, such as California, Connecticut, and Georgia, all of which have a large tax base and are home to significant multistate players, made a good faith effort to complete the survey but repeatedly emphasized the importance of "facts and circumstances" in making a nexus determination. The Tennessee Department of Revenue's replies incorporated and deferred to the language of the state's laws and the agency's regulations. Many other state taxing agencies took a similar approach.

The Minnesota Department of Revenue, a new participant, indicated that it will assert nexus aggressively against companies engaging in pure e-commerce transactions with customers in the state. The Arkansas Department of Finance and Administration implicitly emphasized the importance of facts and circumstances, noting that it was not comfortable answering some of our questions, but generally replied that nexus can and does arise for out-of-state sellers whose only contact with the state is engaging in pure e-commerce transactions, regardless of the dollar amount of those sales.

See appendix for map showing Corporate Income Tax Nexus: Electronic Transactions

The Indiana Department of Revenue took the position that none of the pure e-commerce sales we identified would, in themselves, create nexus for an out-of-state corporation. The Office of the Texas Comptroller indicated that an out-of-state corporation would not have nexus with the state if it lacked Texas contacts other than engaging in purely electronic transactions with Texas customers. The Comptroller also said that the nexus consequences for that seller would not change merely because it provides or distributes the e-commerce services or products using a server located in the state that is owned by an unrelated third party with whom it contracts to provide ISP services, digital storage, remote access to software, or other remote products or services.

The New Jersey Division of Taxation, citing Quark, Inc. v. Director, also said that an out-of-state seller would not have nexus with New Jersey merely because it engaged in pure e-commerce transactions with New Jersey customers.[5] The Nebraska Department of Revenue likewise replied straightforwardly, taking the position that nexus does not arise from any of the pure e-commerce transactions we identified.

With respect to apportionment, we first asked how the state would classify and source each of the identified pure e-commerce transactions for purposes of the state's sales factor. While many states have issued guidance on classifying software for sales and use tax purposes, treatment of software, online services, and licensing agreements is still largely unsettled in the context of corporate income taxes. For states that have adopted a throwback rule, we asked how the state would determine the origin point of a purely electronic sale.

See appendix for map showing Apportionment: Sourcing Sales of Services

We also asked how the state sources products or services delivered electronically through or on behalf of a customer. Regulations in Massachusetts, Montana, Oregon, Rhode Island, and Tennessee specifically address these scenarios; most states lack guidance.

For sales of cloud storage services, we asked whether the location where the relevant data is stored is a factor in sourcing. While data storage location may be a factor in some states that look at the totality of a transaction's facts and circumstances, a few agencies specified that they do not take it into account.

See appendix for map showing Apportionment: Sourcing Sales of Digital Products and Services

We asked about the treatment of bundled transactions – an issue also addressed in more depth in the sales and use tax arena than in the corporate income tax sphere. Again, many agencies replied that the treatment depends on the facts and circumstances, in some cases providing that whether charges are separately stated is relevant to the inquiry.

Finally, for states that use a property factor, we asked how, if at all, taxpayers should account for software and data storage agreements in the factor. Ten states that responded to our survey use a single (sales) factor apportionment formula. Of the seven responsive states that use a property factor, most provided some clarifying guidance on the issue.

Seventeen state taxing agencies completed the survey. Alaska, which offered fairly aggressive answers in our first survey, declined to participate this time around. Florida has not provided answers as of press time. West Virginia, busy with the legislative season, is still working on the survey, as is Maryland, which would be a new participant. Agencies from a number of states, including Colorado, Illinois, New York, Ohio, and South Carolina, chose not to participate. Many state taxing agencies simply did not reply.

5 Quark, Inc. v. Director, N.J. Tax Court, Dkt. No. 004692-2002 (Aug. 13, 2009).

Conclusion

Taxpayers engaged in pure e-commerce transactions must navigate an uncertain state income tax landscape. Most states lack guidance on the complex nexus and apportionment issues that arise in the context of these transactions. Even in states that have addressed digital products and remote sales (e.g., Massachusetts and New York), substantial questions remain. These questions will likely be the subject of litigation in the coming years, particularly as additional states adopt market-based sourcing and economic nexus provisions.

Taxpayers should be aware that most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction should seek guidance from the state taxing agency or a tax professional. Our hope is that states will become more proactive on these issues. Pure e-commerce continues to be a large-growth segment of our economy and the questions and complexities surrounding these transactions continue to mount.

Participating States

ALASKA

The Alaska Department of Revenue declined to participate in our 2018 survey but did participate in 2017.[6]

ARKANSAS

In the reply accompanying its 2018 survey responses, the Arkansas Department of Finance and Administration reiterated its 2017 position that there were many questions the Department did not feel comfortable answering. Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Arkansas should seek guidance from the Department or a tax professional.

In its 2018 survey answers, the Department continued to assert jurisdiction to tax broadly, taking the position that corporate income tax nexus arises when an out-of-state seller sells any of the purely electronic products or services we identified to customers in the state and lacks any other contact with the state. The answer did not change because the seller uses a related or unrelated third party with whom the out-of-state seller contracts to provide ISP services, digital storage, remote access to software, or other remote products or services. The Department said it does not take the position that a company having "click-through nexus" for sales and use tax purposes would also have nexus for corporate income tax purposes.

As supporting authority, the Department pointed to Ark. Corp. Inc. Tax Regs 8.26-51-702, which asserts that "a taxpayer has nexus with Arkansas if its business activity in Arkansas goes beyond the mere solicitation of orders for the sale of tangible personal property as set forth in Public Law 86-272."

Taxpayers apportion income to Arkansas using a three-factor apportionment formula with a double-weighted sales factor.[7] Sales other than sales of tangible personal property are sourced using a proportional cost of performance method.[8] The Department provided responses to the survey's apportionment queries regarding sales factor classification as well as the property factor, but did not respond to questions about sourcing or determining the location of the income-producing activity. The property factor includes owned canned or custom software at cost "if on media," and leased or licensed custom software at eight times the annual lease/licensing rate; software held only in electronic form is excluded from the factor. Owned server space is also excluded. Further, other electronic products or services are excluded from the factor, even if the state considers the item to be real or tangible personal property. For sales factor classification, the Department provided the following information:

6 Newton-Clarke, Rebecca and Oaks, Melissa, Special Report: Checkpoint Catalyst State Corporate Income Tax E-Commerce Survey 2017. https://tax.thomsonreuters.com/checkpoint/catalyst-ecommerce-state-survey-results/

7 Ark. Code Ann. § 26-51-709.

8 Ark. Code Ann. § 26-51-717.

TRANSACTION	CLASSIFICATION
Sale of prewritten software for download	Service
Sale of custom software for download	Service
Sale of apps for cell phones, tablets, computers, and other devices	Service
Providing cloud computing (including SaaS, PaaS, and IaaS)	Service
Providing digital storage	Service
Providing professional services	Service
Providing information services	Service
Providing online educational services	Service
Hosting advertising on its website	Service
Providing customer service or product support	Service
Providing remote maintenance and warranty services	Service
Facilitating hotel arrangements in the state as an online travel company	Service
Facilitating home-sharing in the state through online listings	Service
Selling downloads of songs, ebooks, video, or games	Intangible property
Providing subscriptions for or paid access to streaming video, music, and events, or other entertainment offerings	Intangible property
Providing subscriptions for or paid access to games	Intangible property
Providing subscriptions to research sites	Intangible property

CALIFORNIA

In its 2018 survey responses, the Franchise Tax Board continued to emphasize the importance of facts and circumstances in determining the nexus consequences of the transactions we identified. Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in California should seek guidance from the Franchise Tax Board or a tax professional.

In each of its survey answers, the FTB indicated that whether jurisdiction to tax arises in pure e-commerce transactions "depends on facts and circumstances." This is the case when an out-of-state seller sells any of the purely electronic products or services we identified to customers in the state and lacks any other contact with the state. A facts-and-circumstances analysis is also necessary when an out-of-state seller uses a related or unrelated third party with whom the out-of-state seller contracts to provide ISP services, digital storage, remote access to software, or other remote products or services, according to the FTB.

As supporting authority, the FTB provided the following analysis: "Whether any of these activities give rise to nexus is a facts and circumstances analysis. Purely economic transactions from out-of-state will give rise to nexus if those sales exceed the California Revenue & Taxation Code (RTC) section 23101(b) thresholds (adjusted for inflation as per RTC 23101(c)). However, taxability may depend on whether the activity is the sale of a good or a service, which requires a facts and circumstances analysis and may fall within the Public Law 86-272 safe harbor. Please see California Code of Regulations, title 18, Section 25136-2, and Microsoft Corp. v. Franchise Tax Board (2012) 212 Cal.App.4th 78, for more guidance in performing the analysis."

Taxpayers apportion income to California using a single (sales) factor apportionment formula.[9] Sales other than sales of tangible personal property are sourced using a market-based method; services are sourced to California to the extent that the purchaser received the benefit of the service in California.[10] The FTB responded to survey questions regarding classification and sourcing of common digital products and services by stating, in each case, that the answers depend on the facts and circumstances. Specifically: "Whether California considers the following types of activities as sales of services, tangible personal property, or intangible property does not necessarily depend on the activity, but on the totality of what is being sold and what is being provided." The FTB provided that further guidance on classification can be found in Microsoft Corp. v. Franchise Tax Board (2012) 212 Cal.App.4th 78. With respect to bundled transactions, the FTB stated only that the treatment of these transactions depends on whether the charges are separately stated.

9 Cal. Rev. & Tax. Cd. § 25128.7.
10 Cal. Rev. & Tax. Cd. § 25136(a)(1); Cal. Code Regs. Title 18 § 25136-2(b)(10).

CONNECTICUT

In its 2018 survey responses, the Connecticut Department of Revenue Services emphasized the totality of a seller's economic contacts with the state, and also pointed to facts and circumstances. Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Connecticut should seek guidance from the Department or a tax professional.

The Department indicated that whether jurisdiction to tax would arise in pure e-commerce transactions depends on the facts and circumstances. "Seller may have nexus depending upon the frequency, quantity and systematic nature of its economic contacts with the state," the Department said. A facts-and-circumstances analysis would also be necessary when an out-of-state seller used a related or unrelated third party with whom the out-of-state seller contracted to provide ISP services, digital storage, remote access to software, or other remote products or services, according to the Department. The Department noted that it has not taken a position on whether a company having "click-through nexus" for sales and use tax purposes will also have nexus for corporation business tax purposes, but again stated that "sellers may have nexus depending upon the frequency, quantity and systematic nature of [their] economic contacts with the state."

As supporting authority, the Department pointed to Conn. Gen. Stat. 12-216a, which establishes that Connecticut imposes the tax on "all corporations or associations carrying on or doing business" in the state that aren't organized under the laws of the state. The Department also pointed to Connecticut Informational Publication No. 2010(29.1), the Department's interpretation of the economic nexus legislation that imposes tax on companies that derive income from Connecticut or have a substantial economic presence in the state. The following example, not explicitly highlighted by the Department, appears in the publication: "Company X is an out-of-state corporation with no office or employees in Connecticut and is not otherwise subject to Connecticut income taxation. Company X engages in active solicitation of Connecticut residents. Moreover, Company X performed online financial services for Connecticut customers from which it generated significant receipts. Company X has economic nexus with Connecticut."

Connecticut taxpayers apportion business income using a single (sales) factor formula.[11] Sales other than sales of tangible personal property are sourced using a market-based method.[12] The Department responded to the survey's apportionment questions regarding classification and sourcing by stating the following: "Beginning with income year 2016, Connecticut has adopted market-based sourcing. Under these sourcing rules, sales of services and intangible property will be sourced to the location where they are used by the customer."[13] Since last year's survey, the Department released Special Notice 2017(1), providing guidance on the state's market-based sourcing provisions; the notice does not specifically address the common e-commerce transactions identified in our survey.[14]

11 Conn. Gen. Stat. § 12-218(b); Special Notice 2017(1), 04/17/2017.
12 Conn. Gen. Stat. § 12-218(b); Special Notice 2017(1), 04/17/2017.
13 Conn. Gen. Stat. § 12-218(b).
14 Connecticut Special Notice 2017(1), 04/17/2017.

FLORIDA

Florida did not respond to the 2018 survey but did participate in 2017.[15]

GEORGIA

In its 2018 survey responses, the Georgia Department of Revenue continued to emphasize the importance of facts and circumstances to nexus determinations. Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Georgia should seek guidance from the Department or a tax professional.

In its answers to the nexus portion of the survey, the Department indicated that "Georgia considers all the facts and circumstances before making a nexus determination." No supporting authority was provided. The Department also emphasized facts and circumstances in response to our inquiry about interplay between Georgia's click-through nexus law and determinations of corporate income tax nexus.

Taxpayers apportion net business income to Georgia using a single (gross receipts) factor apportionment formula.[16] Gross receipts from sales other than sales of tangible personal property are sourced using a market-based method.[17] Georgia has adopted specific rules for classifying and sourcing sales of software.[18] In response to the survey's classification and sourcing questions, the Department stated that "sourcing is very fact based" and cited the applicable law and regulation.[19] With respect to bundled services, the Department replied, "No response."

15 Newton-Clarke, Rebecca and Oaks, Melissa, Special Report: Checkpoint Catalyst State Corporate Income Tax E-Commerce Survey 2017. https://tax.thomsonreuters.com/checkpoint/catalyst-ecommerce-state-survey-results/
16 Ga. Code Ann. § 48-7-31(d).
17 Ga. Code Ann. § 48-7-31(d)(2)(A)(i).
18 Ga. Comp. R. & Regs. § 560-7-7-.03(5)(c)(6)(i).
19 Ga. Code Ann. § 48-7-31; Ga. Comp. R. & Regs. § 560-7-7-.03.

HAWAII

Several state taxing agencies returned the survey with disclaimers, but the Department of Taxation did not include this kind of cautionary language. Nonetheless, most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Hawaii should seek guidance from the Department or a tax professional.

In its survey answers, the Department indicated that "Nexus is determined by facts and circumstances. Hawaii follows Public Law 86-272 and adopted the Multistate Tax Commission Bulletin #95-1. There is no dollar threshold for determining nexus with Hawaii."

As supporting authority, the Department pointed to two of its publications, Tax Information Release (TIR) #95-3, discussing its adoption of the MTC's Phase Two approach to immunity from net income tax under Public Law 86-272, and TIR 96-1, which established the Department's position that a computer company's provision of in-state repair services creates nexus.

The Department indicated that the nexus consequences of the pure e-commerce transactions we identify did not change if the seller provided or distributed the services or products using a server in the state that was owned by an unrelated third party with whom the seller contracted to provide ISP services, digital storage, remote access to software, or other remote products or services. "Joyce rule applies," the Department noted, citing Tax Information Release (TIR) #95-3. The answer was the same if the seller contracted with a related third party, "unless the related third party acts in a representative capacity on behalf of the company." Again, the Department noted that the Joyce rule applies and cited Tax Information Release (TIR) #95-3.

Taxpayers apportion income to Hawaii using an evenly weighted, three-factor apportionment formula.[20] Sales other than sales of tangible personal property are sourced using the cost-of-performance method.[21] The Department indicated in its response that, in classifying e-commerce transactions, sales of canned software are considered tangible personal property while sales of custom software are considered sales of services. The Department did not provide any supporting authority for these classifications, nor were we able to find any official guidance supporting them. The treatment of bundled transactions depends on the facts and circumstances, per the Department's response.

20 Haw. Rev. Stat. § 235-29.
21 Haw. Rev. Stat. § 235-37(2); Haw. Admin. Rules § 18-235-37-01(d)(3).

In response to our throwback/throwout rule question, the Department cited its administrative rules for its position that "Sales of TPP to destinations where the taxpayer is not taxable are attributable to Hawaii. Sales of services are attributed to where the income-producing activity occurs. If more than half of the activity is attributed to Hawaii, the income is attributed to Hawaii."[22]

The Department responded to our examples regarding sales delivered electronically on behalf of or through a customer as follows:

• Example:	An in-state seller contracts with a retailer in State X, which will electronically deliver the seller's product or service directly to the retailer's customers — one or more third parties in State Y.
• Response:	"For sales of [tangible personal property], if the taxpayer is taxable in State Y, then the sales are attributed to State Y. If the taxpayer is not taxable in State Y, but is taxable in State X, then the sales are attributed to State X. For the sale of services, gross receipts are attributed to Hawaii if services are performed entirely or mostly in Hawaii."
• Example:	An in-state seller contracts with a State X retailer, which will market and sell the seller's digital products or services to end users in various states. The end user purchases the product or service from the retailer, which then compensates the seller for the transaction.
• Response:	"For sales of TPP, sales are attributed to State X if the taxpayer is subject to tax in State X. Otherwise, the sales are attributed to Hawaii if all or most of the income-generating activity occurs in Hawaii."

With respect to the property factor, the Department provided that whether owned or leased software is included in the factor depends on the facts and circumstances.

22 Haw. Admin. Rules §§ 18-235-36-01, 18-235-37-01.

IDAHO

In the reply accompanying its survey responses, the Idaho Tax Commission emphasized the importance of facts and circumstances. Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Idaho should seek guidance from the Commission or a tax professional.

In its survey answers, the Commission noted that it has not explicitly ruled on the nexus consequences of any of the pure e-commerce transactions identified in the survey, and added that "Cost of performance applies to sales 'other than the sale of tangible personal property,'" citing the case of Cable One v. State Tax Commission, 337 P.3d 595. The Commission also cited Idaho Code 63-3027(p), (q), and (r), which deal with sourcing and computation of the sales factor, and Idaho Administrative Rules 35.01.01.525 - 35.01.01.550, also dealing with the sales factor. Whether nexus arises in a given pure e-commerce transaction depends on the facts and circumstances, according to the Commission.

Regarding cloud computing transactions, the Commission observed that it has not ruled on cloud computing issues and that each case depends on the facts and circumstances. "Most software is treated as tangible personal property for state income tax purposes which could fall under the protection of 86-272. However, leasing the right to use software or music for a limited period of time may be considered an intangible right which is not protected and would be subject to a cost of performance analysis," the Commission said. The Commission also noted that sales of services "are not protected by 86-272 so these are sourced to Idaho," and discusses the possibility that "storage of [electronic] products within the state would be treated as having inventory in the state. That is beyond the protection of 86-272." Because Idaho follows the Joyce approach to computing the sales factor, "nexus for each separate corporation is determined separately." The Tax Commission observed that Idaho did not have a click-through nexus law for sales and use tax purposes; in the interim, however, the state has enacted click-through nexus effective July 1, 2018.[23] Whether click-through nexus in the sales and use tax context would affect nexus for corporate income tax purposes is uncertain.

23 L. 2018, H578, effective 07/01/2018.

Idaho stated in its response that the Commission has not issued a ruling on the classification of common e-commerce products and services for apportionment purposes. The state responded similarly to the question regarding application of the state's throwback rule to purely electronic transactions stating further that "[i]t is possible that they could be thrownback, but that would depend on the facts and circumstances."[24] When sourcing depends on the location of the income-producing activity, "Idaho requires a cost of performance analysis and considers the direct costs related to each sale only." Concerning the sourcing implications of bundled transactions involving the pure e-commerce products and services we listed, the Commission indicated that the answer "Depends on the facts. It is possible that the storage of products within the state would be treated as having inventory in state. That is beyond the protection of [P.L.] 86-272." The same answer was given in response to our question about how corporations should account for owned, leased, or licensed software or server space in calculating the property factor.

INDIANA

In its 2018 survey responses, the Indiana Department of Revenue continued to take the straightforward position that corporate income tax nexus does not arise through the pure e-commerce transactions we identified. Several state taxing agencies returned the survey with disclaimers, but the Department did not include this kind of cautionary language. Nonetheless, most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Indiana should seek guidance from the Department or a tax professional.

The Department took the position that electronic delivery of products would not create nexus for a company having no physical presence in the state, and that "services would have to be performed in person in Indiana in order to create nexus." Noting that the state does not assert affiliate nexus, the Department indicated that nexus does not arise if the seller provides or distributes the products using a server located in the state that is owned by a third party, whether that party is related or unrelated to the seller.

The Department took the position that electronic delivery of products would not create nexus for a company having no physical presence in the state, and that "services would have to be performed in person in Indiana in order to create nexus."

As supporting authority, the Department pointed to: Ind. Code 6-3-2-2(e) & (f), which establish the receipts that must be included in the sales factor; Indiana Admin. Code 3.1-1-38, which provides the Department's interpretation of the "doing business" nexus standard; and Income Tax Information Bulletin #12, which discusses corporate income tax reporting and more. Indiana does not assert click-through nexus in the sales and use tax context, so the Department noted that the question about the relevance of click-through nexus in the corporate income tax context was inapplicable.

Taxpayers apportion business income to Indiana using a single (sales) factor apportionment formula.[25] Sales other than sales of tangible personal property are sourced using the cost-of-performance method.[26] The Department indicated that it considers a sale of computer software to be a sale of tangible personal property and takes the position that it is "sourced to Indiana since it is delivered in Indiana." In response to our question about cloud computing, the Department indicated that sourcing of cloud computing depends on whether it is classified as tangible personal property or a service. The Department provided the following specific transaction classifications:

24 Idaho Income Tax Administrative Rule 35.01.01.540.05.
25 Ind. Code § 6-3-2-2(b)(5).
26 Ind. Code § 6-3-2-2(f); Ind. Admin. Code Title 45 § 3.1-1-55.

TRANSACTION	CLASSIFICATION
Sale of prewritten software for download	Tangible personal property
Sale of custom software for download	Tangible personal property
Sale of apps for cell phones, tablets, computers, and other devices	Tangible personal property (if considered "computer software")
Providing cloud computing (including SaaS, PaaS, and IaaS)	Tangible personal property (if considered "computer software") OR service
Providing digital storage	Service
Selling downloads of songs, ebooks, video, or games	Tangible personal property (if considered "digital media")
Providing subscriptions for or paid access to streaming video, music, and events, or other entertainment offerings	Service
Providing subscriptions for or paid access to games	Service
Providing subscriptions to research sites	Service
Providing professional services	Service
Providing information services	Service
Providing online educational services	Service
Hosting advertising on its website	Service
Providing customer service or product support	Service
Providing remote maintenance and warranty services	Service
Facilitating hotel arrangements in the state as an online travel company	Service
Facilitating home-sharing in the state through online listings	Service
Facilitating crowd-funding of projects in the state through online listings, in exchange for a fee	Service

The Department previously interpreted the state's cost-of-performance provision in a manner approximating a market-based method, and its 2017 survey response echoed this treatment (while noting the issue was the subject of litigation).[27] The Department's position was rejected in University of Phoenix, Inc. v. Dept. of State Revenue, in which the Indiana Tax Court held that the Department's sourcing method was "contrary to the explicit direction in Indiana's sourcing statute."[28] In its 2018 survey response, the Department stated that the sourcing of transactions classified as services is based on the cost of performance and, in contrast to 2017, no longer asserted that the sourcing of certain services is based on the location of performance.

For transactions in which products or services are delivered electronically through or on behalf of an in-state seller, the Department stated that the sale is "sourced to the in-state seller's destination state" (i.e., the location of the taxpayer's customer rather than the ultimate end-users).[29] The Department indicated it takes the same approach to products or services delivered electronically through a customer.

For bundled transactions, the Department stated that when the charges are not separately stated, the treatment of the transaction is "undetermined," while separately stated charges are sourced on an itemized basis under the relevant rules.[30]

27 See Indiana Letter of Finding No. 02-20130359, 11/01/2014; Indiana Letter of Finding No. 02-20130402, 02/01/2015; Newton-Clarke, Rebecca and Oaks, Melissa, Special Report: Checkpoint Catalyst State Corporate Income Tax E-Commerce Survey 2017. https://tax.thomsonreuters.com/checkpoint/catalyst-ecommerce-state-survey-results/

28 University of Phoenix, Inc. v. Department of State Revenue, (02/06/2017, Ind. Tax Ct.) Dkt. No. 49T10-1411-TA-00065 (published on 11/30/2017).

29 Ind. Code § 6-3-2-2(e) & (f); 45 Ind. Admin. Code 3.1-1-38 & 3.1-1-50; Income Tax Information Bulletin #12.

30 Ind. Code § 6-3-2-2(e) & (f); 45 Ind. Admin. Code 3.1-1-38 & 3.1-1-50; Income Tax Information Bulletin #12.

IOWA

The Iowa Department of Revenue continued to emphasize facts and circumstances in its 2018 responses. Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Iowa should seek guidance from the Department or a tax professional.

In its survey answers, the Department noted that a nexus determination "depends on the facts and circumstances surrounding the sales" to Iowa customers. As supporting authority, the Department cited Iowa Code section 422.33, the law imposing the tax on every corporation doing business in Iowa, or deriving income from property in Iowa, along with Iowa Admin. Code r. 701—52.1, providing the Department's rules on who must file returns. In its 2017 responses, the Department also pointed to KFC Corp. v. Iowa Dept. of Revenue, which established that Iowa does not accept physical presence as the governing standard for corporate income tax nexus purposes.[31]

Taxpayers apportion income to Iowa using a single (sales) factor business activity ratio.[32] Sales other than sales of tangible personal property are sourced using a market-based method, with sales of services sourced to the location where the benefit of the service is received.[33] The Department did not provide substantive answers to the survey's apportionment inquiries. Instead, the Department indicated that classification of the pure e-commerce transactions we identified "depends on the facts and circumstances, including the actual use and function of the item sold." Sourcing of sales depends, in turn, on the facts and circumstances surrounding the sale or a product or service, and on the classification of the product or service, according to the Department.[34]

31 Newton-Clarke, Rebecca and Oaks, Melissa, Special Report: Checkpoint Catalyst State Corporate Income Tax E-Commerce Survey 2017. https://tax.thomsonreuters.com/checkpoint/catalyst-ecommerce-state-survey-results/; KFC Corp. v. Iowa Dept. of Revenue, 792 N.W.2d 308 (Iowa 2010).

32 Iowa Code § 422.33(2)(a)(2).

33 Iowa Admin. Code § 701--54.6.

34 The Department advised taxpayers to "See generally, Iowa Admin. Code 701--Chapter 54, 'Allocation and Apportionment.'"

KANSAS

In its 2018 survey responses, the Kansas Department of Revenue departed from its 2017 replies, emphasizing facts and circumstances and implicitly suggesting the possibility that nexus could arise in the pure e-commerce context. Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Kansas should seek guidance from the Department or a tax professional.

The Department observed that "Nexus is determined by facts and circumstances. If the income is derived from the sale of tangible personal property, then Public Law 86-272 would need to be considered. If the income is derived from sales other than tangible personal property, nexus is achieved when the service is performed in Kansas. There is no minimum sales requirement."

(Conversely, in its 2017 survey answers, the Department was straightforward, taking the position that pure e-commerce transactions involving electronic sales and delivery of products and services had "no nexus consequences at any $ amount."[35] There was one exception in 2017. The Department took the position that sales of prewritten software for download established nexus "at any dollar amount" if the seller provided or distributed the products or services using a server located in the state that was owned by a related third party with whom it contracted to provide ISP services, digital storage, remote access to software, or other remote products or services.)

In its 2018 responses, the Department continued to take the position that nexus does not arise in the corporate income tax context merely because of click-through nexus in the sales and use tax context.

In its 2018 responses, the Department continued to take the position that nexus does not arise in the corporate income tax context merely because of click-through nexus in the sales and use tax context. The Department once again observed, however, that the state follows the Finnigan rule, and that "a business with no nexus in Kansas is required to apportion sales of tangible property in Kansas if an affiliated company of a unitary group has established nexus in Kansas."

Taxpayers apportion business income to Kansas using an evenly weighted, three-factor apportionment formula (some taxpayers can elect to use an alternative two-factor or single-factor formula).[36] Sales other than sales of tangible personal property are sourced using the cost-of-performance method.[37] In its response, the Department stated that sales of prewritten software for download are classified as sales of tangible personal property for apportionment purposes. As supporting authority for that position, the Department cited Kan. Stat. Ann. § 79-3286, which deals with the sourcing of tangible personal property generally, and does not specifically address the treatment of software. While existing Department guidance establishes this software classification for sales and use tax purposes, we were unable to locate any official guidance on the treatment of software for income tax purposes. The Department declined to classify the remaining transactions, stating that "[r]egardless of whether 'cloud computing' is considered a service or intangible property" the statute and regulations require the taxpayer to use the cost-of-performance sourcing method.

In our 2017 survey, the Department provided that owned, leased, or licensed canned software was includable in the property factor, while owned, leased, or licensed custom software was not. The Department took a more nuanced position in its 2018 answers, responding that classification of software depends on the facts and circumstances, and that if any of the canned or custom software items "are real and/or tangible personal property, they are included in the property factor."

The Department also retreated from its 2017 responses to questions about services delivered electronically on behalf of or through a customer, noting in its 2018 responses that sourcing "is determined by facts and circumstances." In 2017, the Department responded that these sales would be "sourced to [the] seller's origination of electronic delivery." For bundled transactions, the Department's response provides that when charges are separately stated receipts are sourced based on the classification of the separate items.[38]

35 Newton-Clarke, Rebecca and Oaks, Melissa, Special Report: Checkpoint Catalyst State Corporate Income Tax E-Commerce Survey 2017. https://tax.thomsonreuters.com/checkpoint/catalyst-ecommerce-state-survey-results/

36 Kan. Stat. Ann. § 79-3279(b)(2).

37 Kan. Admin. Regs. § 92-12-100(a).

38 Kan. Stat. Ann. § 79-3280; Kan. Admin. Regs. § 92-12-84

KENTUCKY

In its 2018 responses, the Kentucky Department of Revenue continued to emphasize facts and circumstances. Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Kentucky should seek guidance from the Department or a tax professional.

For each of our nexus questions, the Department indicated that the answer "depends on facts and circumstances." As supporting authority, the Department cited: Ky. Rev. Stat. Ann. § 141.010(25),[39] which defines "doing business" to include "deriving income from or attributable to" Kentucky sources and "directing activities at Kentucky customers for the purpose of selling them goods or services;" Ky. Rev. Stat. Ann. § 141.0401, discussing the tax on limited liability entities; and Ky. Admin. Regs. Title 103 § 16:240, providing the Department's rules interpreting and implementing the state's nexus standards for corporations and general partnerships and recognizing the limitations of Public Law 86-272. For corporations having click-through nexus for sales and use tax purposes, the Department also emphasized facts and circumstances for determining whether the business has corporate income tax nexus.

Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Kentucky should seek guidance from the Department or a tax professional.

For tax years beginning on or before December 31, 2017, taxpayers apportioned business income to Kentucky using a three-factor apportionment formula with a double-weighted sales factor and followed the cost-of-performance method for sourcing sales of services and intangibles.[40] Since receiving the Department's survey response, the state adopted a single (sales) factor apportionment formula and market-based sourcing, applicable to tax years beginning on or after January 1, 2018.[41] Thus, the Department's apportionment responses should be interpreted as applying only to tax years beginning before 2018. In its survey response, the Department stated that receipts from each of the listed pure e-commerce transactions we identified were sourced using the cost-of-performance method – including sales of prewritten software for download – and cited Ky. Rev. Stat. Ann. § 141.120(8)(c)(3) and Ky. Admin. Regs. Title 103 § 16:270 as supporting authority, although these provisions do not specifically address classification. The Department also stated that both canned and custom software as well as server space (whether owned, leased, or licensed) were excluded from the property factor as the factor included only real and tangible personal property. The Department's responses to our apportionment questions consistently treated prewritten/canned software as property not classified as tangible personal property. Note that Kentucky treats downloaded prewritten software as tangible personal property for sales and use tax purposes; we were unable to locate any official guidance on the treatment of software for income tax purposes.[42]

For products or services delivered electronically through a customer, treatment depends on the facts and circumstances. In contrast, the Department stated that products or services delivered electronically on behalf of a customer were sourced using the cost-of-performance method.

39 Effective for tax years beginning on or after 01/01/2018, Ky. Rev. Stat. Ann § 141.010(25) is renumbered as Ky. Rev. Stat. Ann § 141.010(7).
40 Ky. Rev. Stat. Ann. § 141.120 (eff. through 12/31/2017).
41 Ky. Rev. Stat. Ann. § 141.120 (eff. 01/01/2018).
42 Ky. Rev. Stat. Ann. § 139.010(33).

MINNESOTA

The Minnesota Department of Revenue participated for the first time this year and indicated that it would assert nexus aggressively against companies engaged in the pure e-commerce transactions we identified. Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Minnesota should seek guidance from the Department or a tax professional.

For all but one of our nexus questions, the Department indicated that the pure e-commerce transaction would create nexus for an out-of-state seller. Concerning our question about an out-of-state seller hosting advertising on its website, however, the Department stated, "National advertising of tangible personal property may be protected under P.L. 86-272. Advertising published or located within Minnesota creates nexus." As authority for its position, the Department cited Minn. Stat. § 290.015, which provides what the legislature considers to be the minimum contacts required for jurisdiction to impose corporate income and franchise taxes on a trade or business.

The Department noted that the nexus consequences of pure e-commerce transactions are unaffected by the fact that the seller provides or distributes the products using a server located in the state that is owned by a third party, whether that party is related or unrelated to the seller. The Department indicated that it does not take the position that click-through nexus in the sales and use tax context creates corporate income tax nexus.

Taxpayers apportion income to Minnesota using a single (sales) factor apportionment formula.[43] Sales other than sales of tangible personal property are sourced using a market-based method.[44] In its survey response, Minnesota provided the following classifications for the common e-commerce transactions we identified:

TRANSACTION	CLASSIFICATION
Sale of prewritten software for download	Intangible property
Sale of custom software for download	Intangible property
Sale of apps for cell phones, tablets, computers, and other devices	Intangible property
Providing cloud computing (including SaaS, PaaS, and IaaS)	Sale of service
Providing digital storage	Sale of service
Selling downloads of songs, ebooks, video, or games	Intangible property
Providing subscriptions for or paid access to streaming video, music, and events, or other entertainment offerings	Sale of service
Providing subscriptions for or paid access to games	Sale of service
Providing subscriptions to research sites	Sale of service
Providing professional services	Sale of service
Providing information services	Sale of service
Providing online educational services	Sale of service
Hosting advertising on its website	Sale of service
Providing customer service or product support	Sale of service
Providing remote maintenance and warranty services	Sale of service
Facilitating hotel arrangements in the state as an online travel company	Sale of service
Facilitating home-sharing in the state through online listings	Sale of service
Facilitating crowd-funding of projects in the state through online listings, in exchange for a fee	Sale of service
Engaging in other purely electronic transactions	Intangible property

When delivery occurs electronically through or on behalf of the customer, the Department indicated that the type of delivery, relation between the parties, and any alterations made by the customer do not affect the sourcing determination.

43 Minn. Stat. § 290.191, Subd. 2(b).
44 Minn. Stat. § 290.191, Subd. 5(i); Minn. Stat. § 290.191, Subd. 5(j).

NEBRASKA

In its 2018 survey responses, the Nebraska Department of Revenue continued to be straightforward in taking the position that nexus does not arise through any of the pure e-commerce transactions we identified. Several state taxing agencies returned the survey with disclaimers, but the Department did not include this kind of cautionary language. Nonetheless, most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Nebraska should seek guidance from the Department or a tax professional.

As supporting authority for its position that pure e-commerce transactions do not create nexus, the Department cited Neb. Rev. Stat. §§ 77-2734.04 (9) and (12), defining "corporate taxpayer" and "doing business," and 77-2734.02, imposing tax on every corporate taxpayer doing business in the state. The Department noted that Nebraska does not assert click-through nexus in the sales and use tax context.

Taxpayers apportion income to Nebraska using a single (sales) factor apportionment formula.[45] Sales other than sales of tangible personal property are sourced using a market-based method.[46] Unlike many other states, Nebraska has adopted an "application services" classification that encompasses a number of common digital services; receipts from sales of application services are sourced based on the location of use.[47] Except as to cloud computing services qualifying as "application services," the Department declined to answer any of the survey's apportionment questions, stating "There is not enough information provided to determine sourcing. Please see Neb. Rev. Stat. 77-2734.14."

45 Neb. Rev. Stat. § 77-2734.05(1); Neb. Admin. R. & Regs. § 24-023.01.
46 Neb. Rev. Stat. 77-2734.14.
47 Neb. Rev. Stat. § 77-2734.14(3)(b).

NEW JERSEY

In its 2018 responses, the New Jersey Division of Taxation continued to take the straightforward position that the pure e-commerce transactions we identified do not create corporate income tax nexus. Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in New Jersey should seek guidance from the Division or a tax professional.

The Division of Taxation urged taxpayers to consult the following sources:

- Quark/AccuZIP, Inc. v. Director, Div. of Taxation, 25 N.J. Tax 158 (Tax Ct. 2009)
- N.J.A.C. 18:7-8.10(c):

§ 18:7-8.10 Receipts; compensation for services; allocation for certain special industries

(c) Certain service fees from transactions having contact with this State are allocable to New Jersey based upon the following:

1. Twenty-five percent of such fees are allocated to the state of origination.
2. Fifty percent of such fees are allocated to the state in which the service is performed.
3. Twenty-five percent of such fees are allocable to the state in which the transaction terminates.

Example 1: A taxpayer issues credit cards to its customers allowing funds to be obtained through the use of authorized machines located within New Jersey. A customer originates a transaction at a New Jersey location, and the taxpayer's computer, located outside this State, performs a credit check. Funds (or a bank draft) are received by the customer at the point of origin in New Jersey, where the transaction terminates. Taxpayer must allocate 50 percent of the service fee income earned from this transaction to New Jersey based upon the points of origination and termination. For purposes of this example the issuer of credit cards has nexus with New Jersey through physical presence in New Jersey.

Example 2: Taxpayer earns income by providing on-line internet access to customers located within New Jersey and outside New Jersey. Taxpayer's physical equipment allowing such access is located outside New Jersey. Taxpayer must allocate 50 percent of its revenue from internet access charges to New Jersey based upon the origination and termination of such access from points within New Jersey. Absent specific identification of points of origination and termination, the customer's billing address will serve to locate these activities. For purposes of this example, the internet service provider has physical presence through a home office located in New Jersey.

In its 2018 responses, the New Jersey Division of Taxation continued to take the straightforward position that the pure e-commerce transactions we identified do not create corporate income tax nexus.

4. Certain lump sum payments for services performed within and without New Jersey must be apportioned in the following manner in order to result in a fair and reasonable receipts fraction.

i. Transportation revenues of an airline are from services performed in New Jersey based on the ratio of departures from New Jersey to total departures. Departures may be weighted as to cost and value of aircraft by type where weighting would give a more fair and reasonable business allocation factor.

ii. Trucking companies deriving revenues from transporting freight will calculate their receipts fraction using mileage as follows: The taxpayer's receipts are multiplied by a fraction, the numerator of which is the number of miles in New Jersey and the denominator of which is the mileage in all jurisdictions. For convenience, taxpayers required to maintain mileage records in compliance with the International Fuel Tax Agreement pursuant to N.J.S.A. 54:39A-24 and to N.J.A.C. 13:18-3.12 shall make calculations using such records.

(1) In addition, with regard to the property fraction, movable property, such as tractors and trailers, shall be allocated to this State using the same mileage fraction set forth in (c)4ii above. Such allocated movable property shall be added to the fraction formed by non-movable property in New Jersey over non-movable property everywhere to arrive at the property fraction.

(2) With regard to the payroll fraction, wages of mobile employees such as drivers shall be allocated to New Jersey based upon mileage as set forth in (c)4iii above. Such allocated payroll shall be added to the fraction formed by non-mobile employee wages in New Jersey over non-mobile wages everywhere to arrive at the payroll fraction."

Taxpayers apportion income to New Jersey using a single (sales) factor formula. Sales of services are sourced to New Jersey if performed in the state; services performed within and without New Jersey are sourced based on the cost of performance, the amount of time spent in the performance of the service, or by some other reasonable method.[48] See the Division's statement above regarding the "25/50/25" sourcing for certain service fees. In its response, the Division classified common digital products and services as follows, citing Quark, Inc. v. Director as supporting authority:

TRANSACTION	CLASSIFICATION
Sale of prewritten software for download	Tangible personal property
Sale of custom software for download	Tangible personal property
Sale of apps for cell phones, tablets, computers, and other devices	Tangible personal property
Selling downloads of songs, ebooks, video, or games	Tangible personal property
Engaging in other purely electronic transactions	Tangible personal property
Providing cloud computing (including SaaS, PaaS, and IaaS)	Service
Providing digital storage	Service
Providing subscriptions for or paid access to streaming video, music, and events, or other entertainment offerings	Service
Providing subscriptions for or paid access to games	Service
Providing subscriptions to research sites	Service
Providing professional services	Service
Providing information services	Service
Providing online educational services	Service
Hosting advertising on its website	Service
Providing remote maintenance and warranty services	Service
Facilitating hotel arrangements in the state as an online travel company	Service
Facilitating home-sharing in the state through online listings	Service
Facilitating crowd-funding of projects in the state through online listings, in exchange for a fee	Service

48 N.J. Rev. Stat. § 54:10A-6(B)(4); N.J. Admin. Code § 18:7-8.8(a)(2); N.J. Admin. Code § 18:7-8.10(a).

NORTH DAKOTA

In the reply accompanying its survey responses, the North Dakota Office of State Tax Commissioner said, "because some of these questions and issues may be affected by the specific facts and circumstances of a transaction or an arrangement among taxpayers, responding to questions may become counter-productive to providing correct guidance. Therefore, going forward we may re-evaluate whether we are able to provide responses to certain questions or surveys." Most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in North Dakota should seek guidance from the Commissioner or a tax professional.

In the survey responses, the Commissioner generally answered the nexus questions in a straightforward fashion, noting that selling prewritten software for download, custom software for download, or apps for cell phones, tablets, computers, and other devices, and selling downloads of songs, ebooks, videos, or games, would be "treated as a sale of tangible personal property," and "would create nexus unless preempted by P.L. 86-272." The dollar amount, according to the Commissioner, is not relevant. No supporting authority was provided.

In the reply accompanying its survey responses, the North Dakota Office of State Tax Commissioner said, "because some of these questions and issues may be affected by the specific facts and circumstances of a transaction or an arrangement among taxpayers, responding to questions may become counter-productive to providing correct guidance.

According to the Commissioner, the remainder of the transactions (cloud computing, digital storage, subscriptions or paid access to games, subscriptions to legal research sites, professional services, information services, online educational services, website advertising hosting, customer service and product support, remote maintenance and warranty services, online travel company hotel arrangements, home-sharing arrangements through online listings sites, and facilitating crowd-funding through online listings in exchange for a fee) are "generally treated as a sale of a non-tangible and sourced based on location of the income-producing activity." The dollar amount, again, is not relevant. As supporting authority, the Tax Commissioner cited N.D. Cent. Code 57-38.1-17, which provides sourcing rules for sales other than sales of tangible personal property, and N.D. Admin. Code 81-03-09-31, which establishes the Tax Commissioner's apportionment rules. The Commissioner notes that click-through nexus is not applicable in North Dakota.

Taxpayers apportion income to North Dakota using an evenly weighted, three-factor apportionment formula (certain taxpayers can elect to use an enhanced sales factor formula).[49] Sales other than sales of tangible personal property are sourced based on the location of the income-producing activity.[50] When products or services are delivered electronically on behalf of the taxpayer's customer, the Commissioner stated that sourcing depends on the classification of the sale. For tangible personal property, and "assuming the contract [between the taxpayer and its customer] is for delivery service only," the sale is sourced to the delivery destination (i.e., the taxpayer's customer's customer), unless the throwback rule applies. When the transaction is not considered a sale of tangible personal property, the sale is sourced based on the location of the income-producing activity and the throwback rule does not apply to the transaction. As supporting authority, the Commissioner cited N.D. Cent. Code 57-38.1-16 and N.D. Admin. Code 81-03-09-29 for tangible personal property and N.D. Cent. Code 57-38.1-17 and N.D. Admin. Code 81-03-09-31 for non-tangible property (see above for discussion of classification).

49 N.D. Cent. Code § 57-38.1-09.
50 N.D. Cent. Code § 57-38.1-17.

The Commissioner's replies indicated similar treatment for sales of products or services delivered electronically through the taxpayer's customer to one or more end users. When the product sold is classified as tangible personal property, the sale is sourced to the destination of the property and depends on the contract and the arrangement between the taxpayer and its customer. When the product sold is classified as non-tangible, the sale is sourced based on the location of the income-producing activity. The Commissioner also stated that, in both cases, the sourcing "should not depend on the method of delivery" (i.e., whether the transfer occurs over the customer's own server, a server or portal maintained by the taxpayer, or over a third-party application), "does not depend on whether the retailer [taxpayer's customer] and end users are related," and "does not change if the retailer [taxpayer's customer] alters" the product or service between initial transfer from the taxpayer and the ultimate delivery to the end users. The Commissioner did not cite any supporting authority for these sourcing rules and we were unable to identify any official guidance on treatment of these transactions or on the treatment of dock sales generally.

The location where a customer's data is stored can affect sourcing of receipts from the sale, according to the Commissioner, "to the extent that direct costs of performing the income producing activity are where the customer's data is stored."

The location where a customer's data is stored can affect sourcing of receipts from the sale, according to the Commissioner, "to the extent that direct costs of performing the income producing activity are where the customer's data is stored." The Commissioner cited N.D. Admin. Code 81-03-09-31 as supporting authority for this position. The treatment of bundled transactions depends on the specific facts and circumstances, but "[s]eparately stating the charges for products and services may be one of the relevant facts."

North Dakota uses a property factor in its apportionment formula. Citing N.D. Cent. Code 57-38.1-11, N.D. Admin. Code 81-03-09-15, and N.D. Admin. Code 81-03-09-19, the Commissioner stated: "To the extent [owned custom or canned] software has a cost basis for federal income tax purposes, that amount would be included in the property factor." Leased or licensed custom or canned software is not included in the property factor but payments for use of a server are includable in the property factor as rent, according to the Commissioner's response. Whether a payment is "for a rent or service depends on the specific facts and circumstances."

TENNESSEE

In its 2018 survey responses, the Tennessee Department of Revenue again effectively emphasized facts and circumstances. Several state taxing agencies returned the survey with disclaimers, but the Department of Revenue did not include this kind of cautionary language. Nonetheless, most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Tennessee should seek guidance from the Department or a tax professional.

In its survey responses, the Department did not reply to each transaction individually, but generally noted that "A seller engaging in purely electronic transactions with customers in the state would have nexus in the state if it has substantial nexus as statutorily defined. The definition of substantial nexus references Tenn. Code Ann. 67-4-2012 for sourcing guidance. Tenn. Comp. R. & Regs. 1320-06-01-.42 provides detailed information as to sourcing rules used to determine if the bright-line substantial nexus receipts test has been met. The ownership or lease of servers in the state is not required if substantial nexus is met in another way. For example, receipts in the state greater than $500,000 would be considered substantial nexus, but nexus can be met based on property, payroll, receipts, and other connections. In all cases [posed in the survey questions], nexus consequences are based on the statutory definition of substantial nexus."

As further supporting authority, the Department cited Tenn. Code Ann. § 67-4-2004(49) and Tenn. Comp. R. & Reg. 1320-06-01-.42. The Department noted that Tennessee has not adopted a presumption that a corporation having click-through nexus for sales and use tax purposes would have corporate income tax nexus.

As of July 1, 2016, taxpayers apportion income to Tennessee using a three-factor apportionment formula with a triple-weighted receipts factor.[51] Unlike many other states, Tennessee has adopted detailed regulations for classification and sourcing of common e-commerce transactions.[52] In response to many of survey's apportionment questions, the Department stated that the "seller should classify and source e-commerce according to Tenn. Comp. R. & Reg. 1320-06-01-.42." The Department provided the following classification responses:

TRANSACTION	CLASSIFICATION
Sale of prewritten software for download	Intangible
Sale of custom software for download	Intangible
Sale of apps for cell phones, tablets, computers, and other devices	Intangible
Providing cloud computing (including SaaS, PaaS, and IaaS)	Service
Providing digital storage	Service
Selling downloads of songs, ebooks, video, or games	Intangible
Providing subscriptions for or paid access to streaming video, music, and events, or other entertainment offerings	Intangible
Providing subscriptions for or paid access to games	Intangible
Providing subscriptions to research sites	Intangible
Providing professional services	Service
Providing information services	Service
Providing online educational services	Service
Hosting advertising on its website	Service
Providing customer service or product support	Service
Providing remote maintenance and warranty services	Service
Facilitating hotel arrangements in the state as an online travel company	Service
Facilitating home-sharing in the state through online listings	Service
Facilitating crowd-funding of projects in the state through online listings, in exchange for a fee	Service
Engaging in other purely electronic transactions	Tangible personal property

The Department also clarified that the location where data is stored is not a factor in determining the sourcing of related receipts.

With respect to both canned and custom software (whether owned or rented), the Department's reply states that for "franchise and excise tax purposes, software is considered intangible property and is not included in the property factor." The Department cites Tenn. Code Ann. § 67-4-2012 as supporting authority for this position; classification of software is discussed directly in Tenn. Comp. R. & Reg. 1320-06-01-.42(7)(a).

51 Tenn. Code Ann. § 67-4-2012(a).
52 Tenn. Comp. R. & Regs. § 1320-06-01-.42(1) (eff. 09/26/2016).

TEXAS

In its 2018 survey responses, the Texas Comptroller, continued to take the straightforward position that pure e-commerce transactions do not create nexus in Texas, but emphasized the possibility that nexus could arise through the activities of a related third party. Several state taxing agencies returned the survey with disclaimers, but the Comptroller did not include this kind of cautionary language. Nonetheless, most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Texas should seek guidance from the Comptroller.

In its survey responses, the Comptroller answered straightforwardly that an entity would not have nexus merely because it engaged in the transactions we identified, or because it provided or distributed the products or services using a server located in the state that is owned by an unrelated third party. As supporting authority, the Comptroller cited 34 Tex. Admin. Code Sec. 3.586.

A seller would have nexus, according to the Comptroller, if it distributed the products or services using a server located in the state that is owned by a related third party with whom it contracts to provide ISP services, digital storage, remote access to software, or other remote products or services. "A taxable entity will have nexus and is subject to franchise tax in this state when it has sufficient contact with Texas," the Comptroller said. Texas does not have a click-through nexus provision for sales tax purposes, so our question concerning the relevance of click-through nexus for corporate income tax purposes is inapplicable.

Taxpayers apportion margin to Texas using a single (gross receipts) factor apportionment formula.[53] Sales of services are sourced to Texas when performed in the state; sales of services performed within and outside the state are sourced based on the fair value of services rendered in Texas.[54] The state has specific sourcing rules for internet access fees and computer programs.[55] However, the Comptroller stated in its response that "Texas apportions gross receipts from e-commerce products and services based on the individual facts of each company and its transactions, and this answer may change depending upon the specific facts." The Comptroller noted that "generally, receipts from a service are apportioned to the location where the service is performed, and receipts from the sale of an intangible are apportioned based on the legal domicile of the payor. Receipts from Internet hosting are apportioned to Texas only if the customer to whom the service is provided is located in Texas." The Comptroller reiterated this point about receipts from internet hosting in response to our question regarding whether the location where data is stored is a factor in apportioning receipts.

For bundled transactions, the Comptroller stated that "Texas apportions gross receipts from e-commerce products and services based on the individual facts of each company and its transactions, and this answer may change depending upon the specific facts. The answer does not depend on whether the charges for the products and services are separately stated."

53 Tex. Tax Code Ann. § 171.106(a).
54 Tex. Tax Code Ann. § 171.103(a)(2); Tex. Admin. Code Title 34 § 3.591(e)(26).
55 Tex. Tax Code Ann. Title 34 § 171.103(a)(6); Tex. Admin. Code Title 34 § 3.591(e)(3); Tex. Admin. Code Title 34 § 3.591(e)(12).

WEST VIRGINIA

The West Virginia Department did not submit responses to our 2018 survey but was still intending to reply at press time. The Department participated in our 2017 survey.[56]

WISCONSIN

In its 2018 survey responses, the Wisconsin Department of Revenue continued to emphasize facts and circumstances for purposes of determining the nexus implications of the pure e-commerce transactions we identified. Several state taxing agencies returned the survey with disclaimers, but the Department did not include this kind of cautionary language. Nonetheless, most state taxing agencies do not treat responses to surveys as binding, and companies uncertain of the tax consequences of any activity or transaction in Wisconsin should seek guidance from the Department or a tax professional.

In its survey responses, the Department noted that "Wisconsin law does not have a minimum dollar threshold," and replied "May create nexus" for each of the hypothetical transactions we posed. The answer is unaffected, according to the Department, if the seller provides or distributes the products using a server located in the state that is owned by a related or unrelated third party with whom it contracts to provide ISP services, digital storage, remote access to software, or other remote products or services. As supporting authority, the Department cited Wis. Admin. Code Tax 2.82(4)(a) and (b).

Taxpayers apportion income to Wisconsin using a single (sales) factor apportionment formula.[57] Sales other than sales of tangible personal property are sourced using a market-based method that looks to the location where the benefit of the service is received.[58] The state has specific sourcing rules for sales of computer software.[59]

56 Newton-Clarke, Rebecca and Oaks, Melissa, Special Report: Checkpoint Catalyst State Corporate Income Tax E-Commerce Survey 2017. https://tax.thomsonreuters.com/checkpoint/catalyst-ecommerce-state-survey-results/
57 Wis. Stat. § 71.25(6)(d); Wis. Admin. Code Tax 2.39(3)(d).
58 Wis. Stat. § 71.25(9)(dh)(1); Wis. Admin. Code Tax 2.39(6)(f); Wis. Admin. Code Tax 2.39(6)(i).
59 Wis. Stat. § 71.25(9)(df)(1); Wis. Admin. Code Tax 2.39(6)(e); Wis. Admin. Code Tax 2.39(6)(i).

In its response, the Department classified the specified e-commerce transactions as follows:

TRANSACTION	CLASSIFICATION	SUPPORTING AUTHORITY
Selling apps for cell phones, tablets, computers, and other devices	Sale of computer software	Section 71.25(9)(df), Wis. Stats.
Providing cloud computing (including Software as a Service, Platform as a Service, and Infrastructure as a Service)	Sale of use of software, sale or license of intangible, or sale of service	Section 71.25(9)(df), (dh), (dj), or (dk), Wis. Stats.
Providing digital storage	Sale of service	Section 71.25(9)(dh), Wis. Stats.
Selling downloads of songs, ebooks, video, or games	Sale of use of software, sale or license of intangible, or sale of service	Section 71.25(9)(df), (dh), (dj), or (dk), Wis. Stats.
Providing subscriptions for or paid access to streaming video, music, and events, or other entertainment offerings	Sale of license of intangible or sale of service	Section 71.25(9)(dh), or (dj), Wis. Stats.
Providing subscriptions for or paid access to games	Sale of license of intangible or sale of use of software	Section 71.25(9)(df), or (dj), Wis. Stats.
Providing subscriptions to research sites	Sale of license of intangible or sale of service	Section 71.25(9)(dh), or (dj), Wis. Stats.
Providing professional services (legal, medical, accounting, research, analytical, engineering, or consulting services)	Sale of service	Section 71.25(9)(dh), Wis. Stats.
Providing information services	Sale of service	Section 71.25(9)(dh), Wis. Stats.
Providing online educational services	Sale of service	Section 71.25(9)(dh), Wis. Stats.
Hosting advertising on its website	Sale of service	Section 71.25(9)(dh), Wis. Stats.
Providing customer service or product support	Sale of service	Section 71.25(9)(dh), Wis. Stats.
Providing remote maintenance or warranty services	Sale of service	Section 71.25(9)(dh), Wis. Stats.
Facilitating hotel arrangements in the state as an online travel company	Sale of service	Section 71.25(9)(dh), Wis. Stats.
Facilitating home-sharing in the state through online listings	Sale of service	Section 71.25(9)(dh), Wis. Stats.
Facilitating crowd-funding of projects in the state through online listings, in exchange for a fee	Sale of service	Section 71.25(9)(dh), Wis. Stats.

Any other purely electronic transactions are classified based on the particular facts. The Department's reply also indicated that the state's throwback rule does not apply to any of the e-commerce transactions listed above.

When products or services are delivered electronically through or on behalf of the taxpayer's customer, the sourcing "depends on the facts." The treatment of bundled transactions similarly "depends on the facts."

Non-Participating States

ALABAMA
No reply.

ALASKA
Declined to participate.

ARIZONA
No reply.

COLORADO
Declined to participate, noting that the Department is putting together workshops on digital goods and related location-of-sale issues, and that the workshops will not be finalized in time for participation to be feasible.

DELAWARE
No reply.

DISTRICT OF COLUMBIA
No reply.

FLORIDA
We received confirmation that the survey had been forwarded to the appropriate group, but responses were not forthcoming.

ILLINOIS
The Illinois Department of Revenue replied as follows: "The State of Illinois has not provided any particular guidance on these issues. Our regulation on nexus can be found at 86 Ill. Admin. Code § 100.9720."

LOUISIANA
No reply.

MAINE
No reply.

MARYLAND
At press time, the Office of the Comptroller was still working on the survey.

MASSACHUSETTS
No reply.

MICHIGAN
No reply.

MISSISSIPPI
No reply.

MISSOURI
No reply.

MONTANA
The Montana Department of Revenue replied, noting that a "new market sourcing bill passed in 2017 followed by new administrative rules," and that the Department has not yet been able to do a thorough examination concerning how these new laws and rules apply to e-commerce.

NEVADA
No applicable tax.

NEW HAMPSHIRE
No reply.

NEW MEXICO
No reply.

NEW YORK
The New York Department of Taxation and Finance indicated that it is against department policy to reply to surveys of this kind.

NORTH CAROLINA
No reply.

OHIO
Declined to participate.

OKLAHOMA
The Oklahoma Tax Commission's form reply said, "Please allow adequate time for review and response."

OREGON
No reply.

PENNSYLVANIA
No reply.

RHODE ISLAND
No reply.

SOUTH CAROLINA
The South Carolina Department of Revenue declined due to workload.

SOUTH DAKOTA
No applicable tax.

UTAH
No reply.

VERMONT
No reply.

VIRGINIA
No reply.

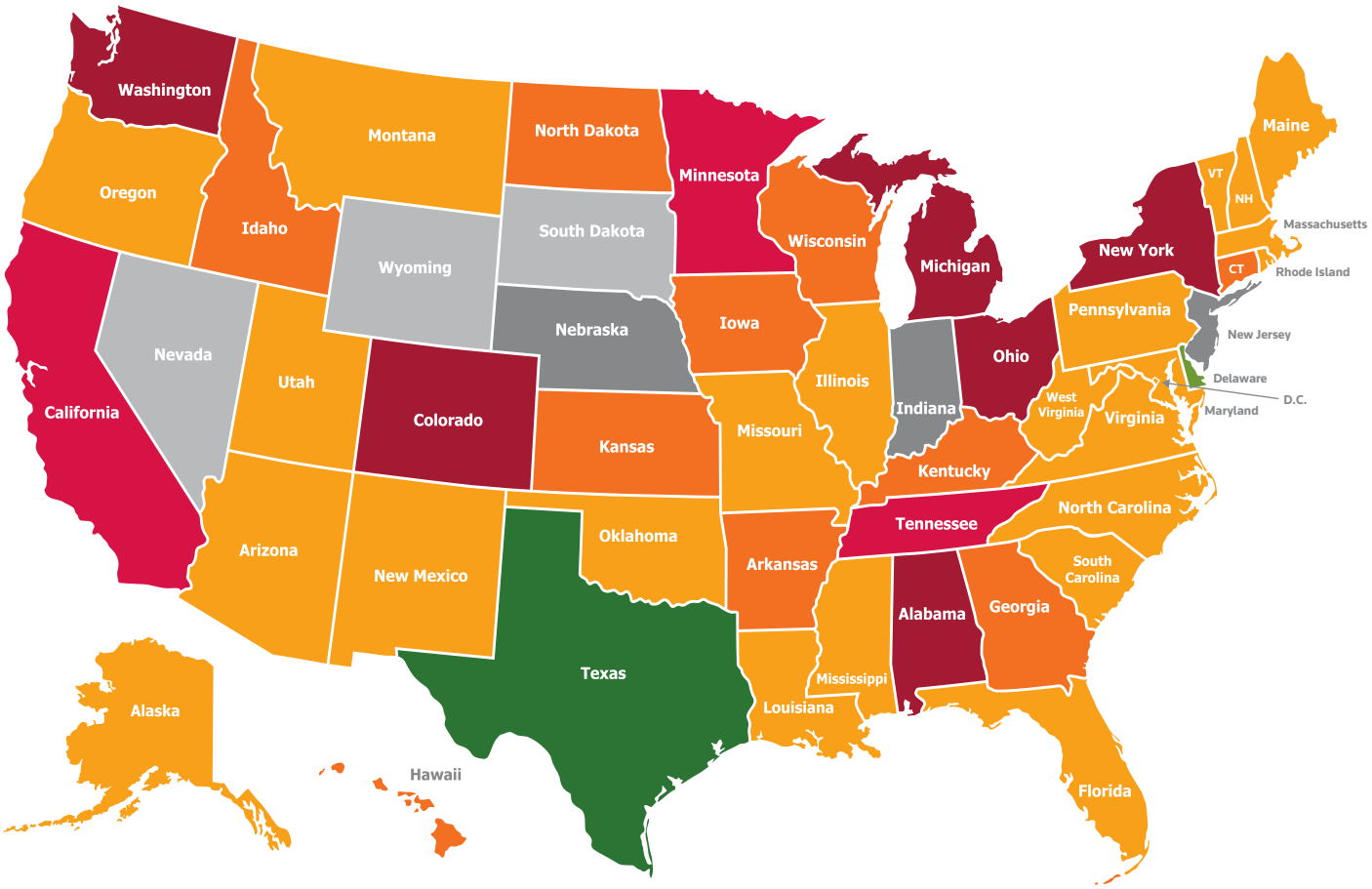
WASHINGTON
No reply.

WEST VIRGINIA
The West Virginia Department of Revenue was still working on the survey at press time.

WYOMING
No applicable tax.

APPENDIX:

Corporate Income Tax Nexus



LEGEND:

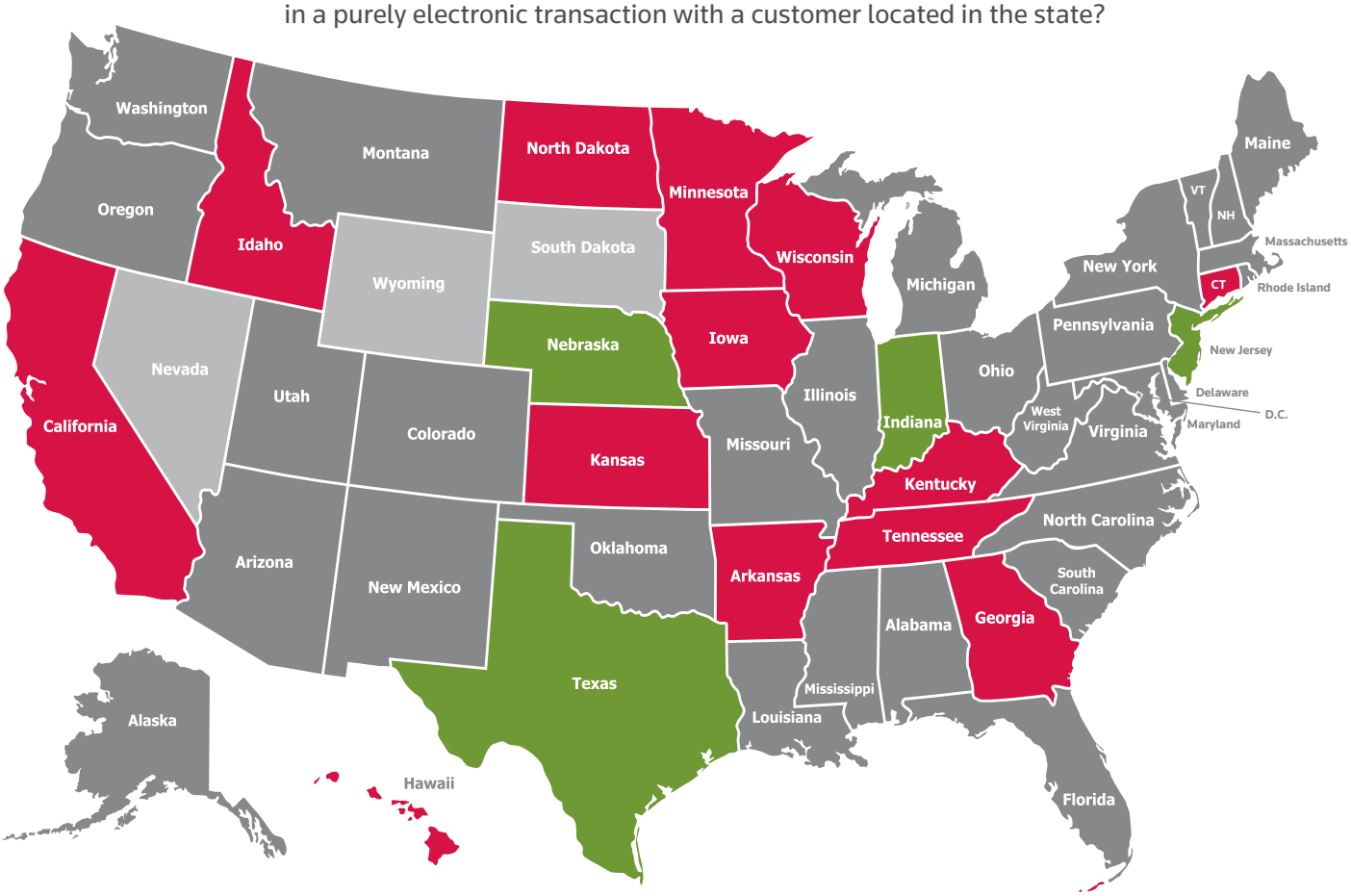
- Bright-line nexus test tied to receipts, sales, or property. Survey responses indicated potential for nexus through e-commerce.
- Bright-line nexus test tied to receipts, sales, or property. Did not participate in survey.
- Economic nexus possible, but no bright-line test. Survey responses indicated potential nexus through e-commerce.
- Economic nexus possible, but no bright-line test. Did not participate in survey.
- Economic nexus possible, but no bright-line test. Survey responses indicated no nexus through e-commerce.
- No economic nexus. Survey responses indicated no nexus through e-commerce.
- No economic nexus. Did not participate in survey.
- No applicable tax.

Survey responses typically are not binding on the state taxing agency.

Return to Special Report ›

Corporate Income Tax Nexus: Electronic Transactions

Can an out-of-state company trigger income tax nexus solely by engaging in a purely electronic transaction with a customer located in the state?



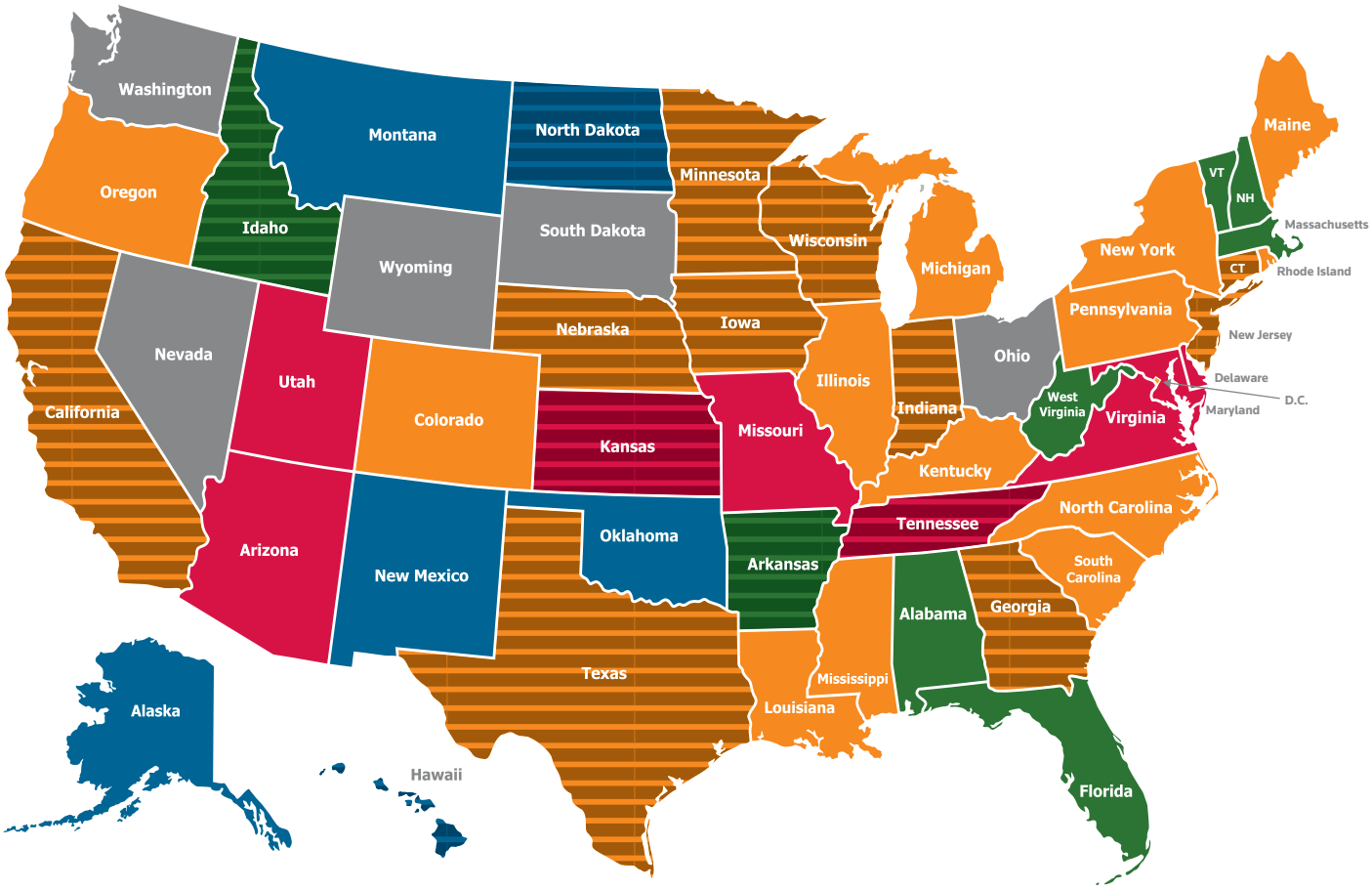
LEGEND:

- No applicable tax
- Did not participate in the survey
- Yes, depending on facts and circumstances
- No

Survey responses typically are not binding on the state taxing agency.

Return to Special Report ›

Apportionment Formula (2018)



LEGEND:

- No applicable tax
- Evenly weighted, three-factor formula
- Single (sales) factor formula
- Three factor formula with double-weighted sales factor
- Other/multiple
- Participated in 2018 Checkpoint Catalyst survey

Survey responses typically are not binding on the state taxing agency.

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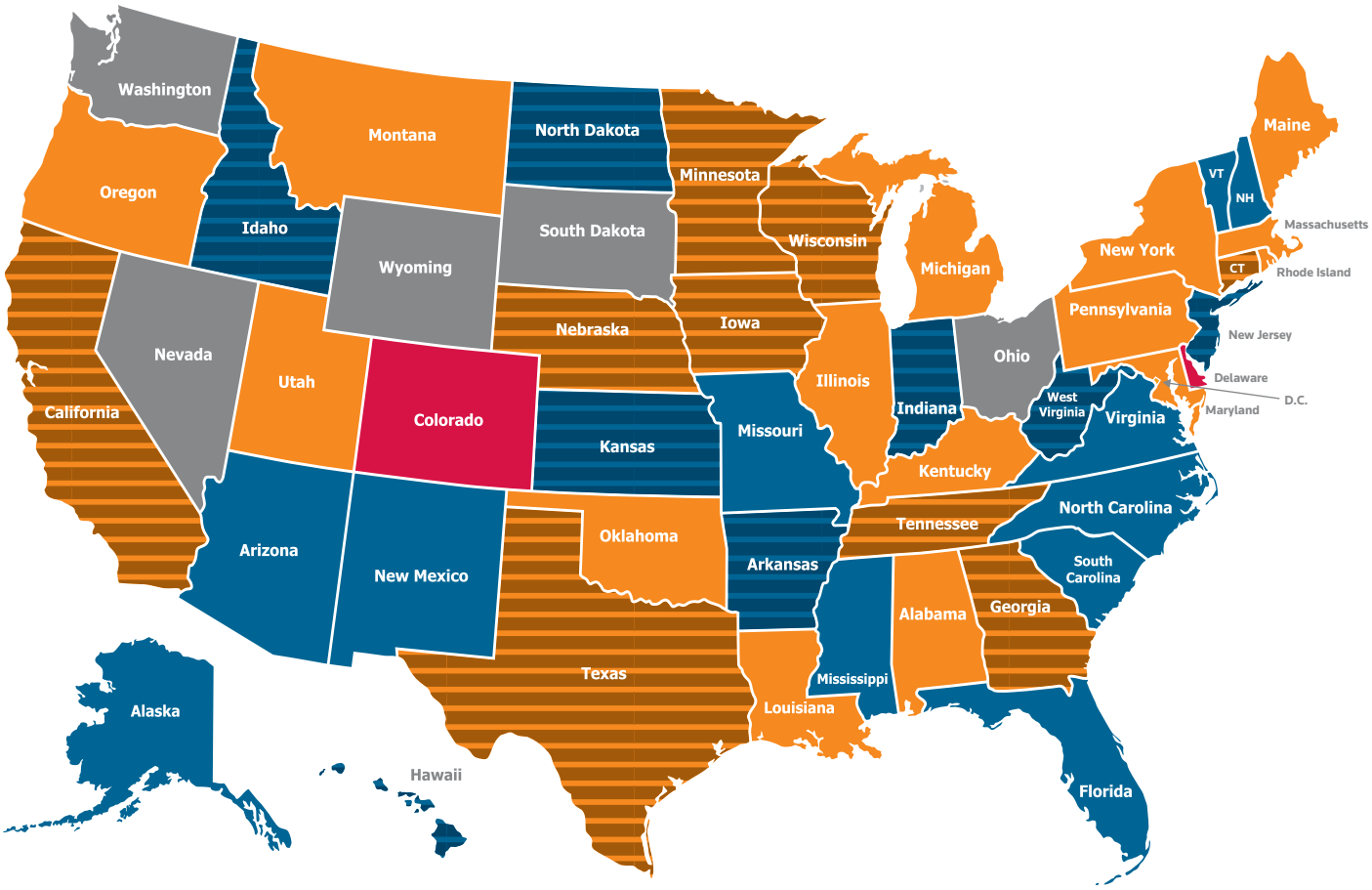
Apportionment: Sourcing Sales of Services

What method does the state use to source sales of services? (2018)



LEGEND:

- No applicable tax
- Cost of performance
- Market-based
- Other
- Participated in 2018 Checkpoint Catalyst survey

Survey responses typically are not binding on the state taxing agency.

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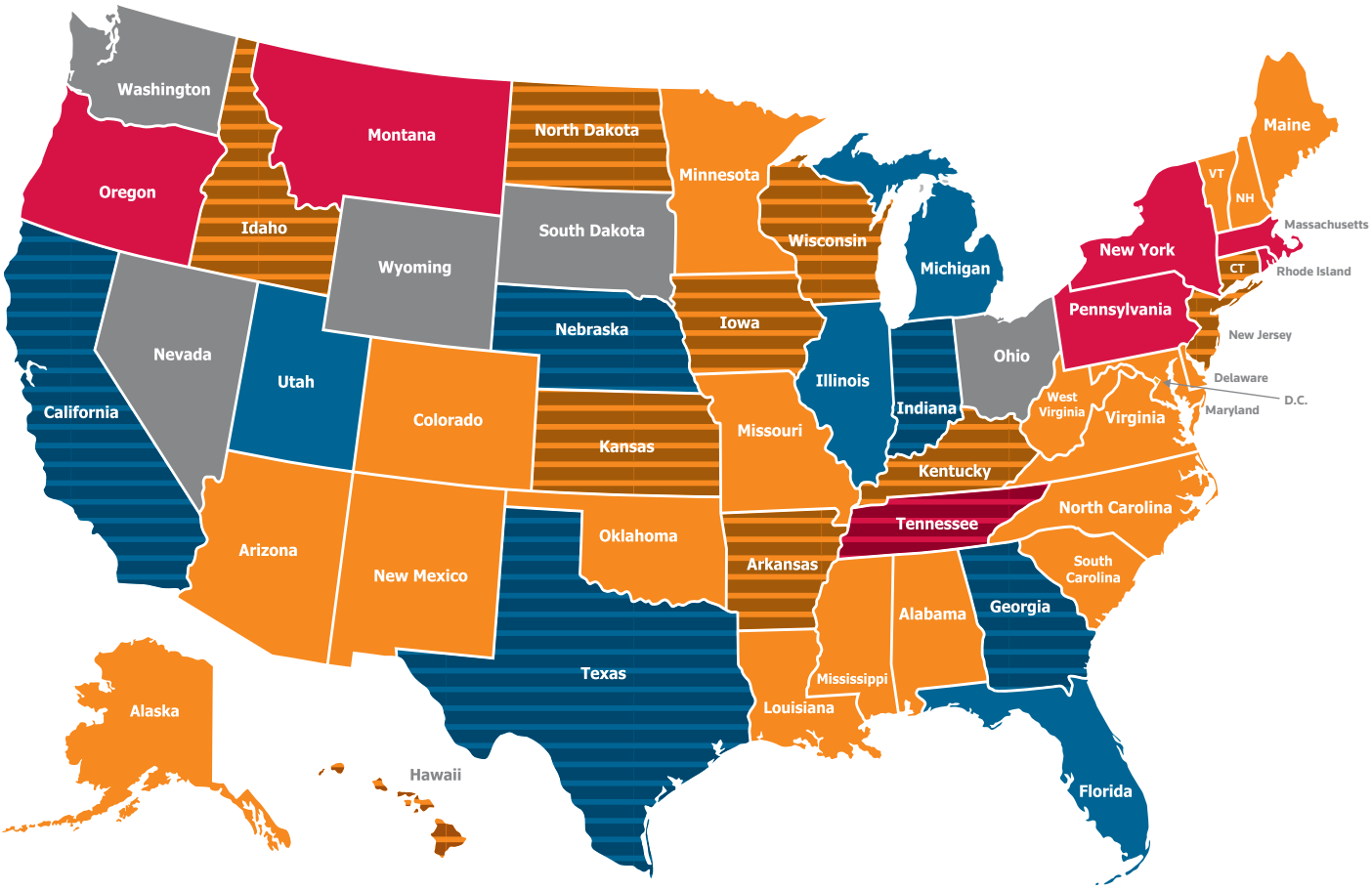
Apportionment: Sourcing Sales of Digital Products and Services

Does the state have guidance on sourcing sales of digital products and services for corporate income tax purposes?



LEGEND:

- No applicable tax
- Yes, comprehensive guidance
- Yes, some guidance
- No or very limited guidance
- Participated in 2018 Checkpoint Catalyst survey

Survey responses typically are not binding on the state taxing agency.

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Apportionment: Property Factor

How, if at all, does the state require a corporation to account for software and data storage arrangements in its property factor?



HAWAII	IDAHO	KANSAS
Depending on the facts and circumstances, owned or leased software may be included in the property factor.	"Depends on the facts. It is possible that the storage of products within the state would be treated as having inventory in state. That is beyond the protection of [P.L.] 86-272."	If any canned or custom software items "are real and/or tangible personal property, they are included in the property factor."



KENTUCKY	NORTH DAKOTA	TENNESSEE
For tax years beginning on or before December 31, 2017, software, custom software, and server space are excluded from the property factor (whether owned, leased, or licensed).	Custom or canned software owned by the taxpayer is included in the property factor if it "has a cost basis for federal income tax purposes." Leased or licensed software is not included in the factor. Payments for use of a server are includable in the property factor as rent.	"[S]oftware is considered intangible property and is not included in the property factor."

Survey responses typically are not binding on the state taxing agency.

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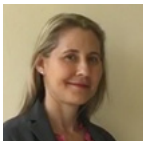
Rebecca Newton-Clarke is a senior editor for Checkpoint Catalyst. She has covered all aspects of state and local taxes at Thomson Reuters for more than 18 years. Rebecca previously worked with the SALT services group at PricewaterhouseCoopers in New York City and as an attorney with the Florida Department of Revenue, where she issued rulings, drafted regulations, and was involved in various multistate initiatives. She received her J.D. from the University of Florida Levin College of Law. Her specialties are complex nexus and e-commerce issues.



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