Blog Post

Cutting the Cord: The Constitutionality of Trailing Nexus for Sales and Use Taxes

July 24, 2017

Since the landmark decision of *Quill Corp. v. North Dakota* in 1992, the law of the land has been that an out-of-state business has sales and use tax nexus with a state only when it is a physical presence. This physical presence can manifest itself in several ways – real or personal property sitused or an employee or independent contractor located in the state. It has been roundly understood that once the business no longer had a physical presence in a state, sales and use tax nexus was terminated simultaneously. However, depending on the particular state, sales and use tax nexus may live on despite the efforts of the business to cut the cord.

There are several states that have trailing nexus provisions. These laws vary as to the length of time sales and use tax nexus continues after the cessation of nexus-creating activities. A representative example of trailing nexus can be found in the laws of the State of Washington. The Washington Department of Revenue has made clear that an out-of-state business continues to have sales and use tax nexus – and, therefore, must continue to collect, report, and remit – for a period of four years after the year in which the stopped the business activity that created nexus – plus the remainder of the current year. For example, Company A has sales and use tax nexus with Washington due to the presence of an in-state employee. On January 2, 2017, the employee resigns from Company A and no one is

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hired as a replacement. Under Washington law, Company A retains sales and use tax nexus for the remainder of 2017 (the current year) plus four additional years. The states of Minnesota and California have similar rules.

Under *Quill*, sales and use tax nexus exists only where the state law passes scrutiny under the Due Process Clause and the Commerce Clause of the United States Constitution. The Court made clear in *Quill* that Due Process considerations relate to "fundamental fairness" and the connections between the out-of-state business and the taxing state. Physical presence is not required under the Due Process Clause. By contrast, for Commerce Clause purposes, the Court held that a bright-line physical presence rule was necessary to prevent burdens to interstate commerce.

How do trailing nexus laws stand up to a challenge under the Due Process and Commerce Clause? Let's find out. Nonexus Co. sells widgets across several states and is looking to expand into the State of Washington. The CEO of Nonexus Co. sends an employee into Washington to meet with a potential customer. The employee flies into Seattle, spends several nights at a Holiday Inn Express, and meets with potential customers. The employee is incredibly successful and lands a multi-year contract with one customer adding substantial sales revenue to Nonexus Co. The employee flies home a hero. It is at least arguable that trailing nexus would be sustained under the Due Process Clause. But, what about the Commerce Clause? Washington will require Nonexus Co. to collect, report, and remit sales taxes for more than fours years after the employee left the state. With physical presence lacking, Washington would appear to have a "tough road to hoe" under the bright-line physical presence test of the Commerce Clause.

The recognition of the strength of Commerce Clause challenges to trailing nexus provisions is by no means theoretical. Back in 1985, Texas enacted a trailing nexus law providing that nexus persists for 12 months after the out-of-state business ceases to do business in the state. However, in 2015, Texas retroactively eliminated this rule. In a public pronouncement, the Texas Comptroller stated that the "trailing nexus" law was contrary to the bright-line physical presence requirement of the Commerce Clause as explained in *Quill*. From a constitutional perspective, there is little question that trailing nexus laws are on shaky ground.