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Nexus and the Expanding Reach of the State Taxing Authorities

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The cookie monster famously devours handfuls of cookies. Thanks to recent developments in states' thinking on physical presence, nexus, and internet commerce, states may use technology "cookies" to devour ever larger shares of companies' revenues.

In our current technological environment, the term "cookies" is commonly understood. A "cookie" is a small text file that is created by an application or website and stored on the user's device – desktops, laptops, tablets, smartphones, etc. Cookies are commonly used to store login information such as usernames and passwords. However, they are capable of much more. Have you ever placed items in a virtual shopping cart, moved on to another webpage or application and come back to the original site? Cookies are used to "remember" the returning user and the items in their shopping cart.

Cookies come in two types – "session" and "persistent" cookies. A "session" cookie is deleted once you leave the originating site or application. A "persistent" cookie remains on the user's device for a period of time following its creation. The expiration of a "persistent" cookie could be days, weeks, or months. Once the expiration date is reached, the "persistent" cookie is deleted from your device. So, what do "cookies" have to do with claims of state tax nexus? Read on.

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By now, most state tax practitioners are aware of the recent case of *Crutchfield Corp. v. Testa*. The critical issue in the case was whether a taxpayer must have a physical presence in Ohio for purposes of the Commercial Activity Tax (CAT). Crutchfield argued that under U.S. Supreme Court precedent in *Quill Corp v. North Dakota*, a taxpayer must have a physical presence in a state before a state may validly claim tax nexus. The Ohio Department of Taxation argued that *Quill*, which dealt with sales and use tax, did not apply in the context of gross receipts-based tax like the CAT. However, the Department also had a backup plan.

In the event a court were to conclude that physical presence is required for CAT nexus purposes, the Department argued that the presence of cookies on the devices of Ohio residents meets that standard. A creative theory, indeed. Recently, this nexus position has caught the attention of other states as they seek to expand their tax bases. The most recent state to pursue this approach is Massachusetts in Department Directive 17-1 (April 3, 2017).

Tax nexus based on the presence of cookies is certainly controversial. State courts will need to be educated on the nuance of cookies in order to make nexus determinations. Is nexus dependent on whether the taxpayer uses “session” or “persistent” cookies? Are all cookies proprietary to the taxpayer? Does it matter? Regarding “persistent” cookies, how will taxing authorities address situations where the cookies remain on a user’s device as it crosses many state borders before deletion on its expiration date? One thing is for sure, we should all keep our eye on the cookie monster. If we don’t, the resulting assertions of nexus will surely gobble up profits.

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