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FEDERAL TAX

## Experts Discuss Evolving Nexus Standard for State Tax Jurisdiction

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The standard for nexus – a state’s jurisdictional authority to impose a tax on a business – has evolved from a clear physical presence requirement to a more complex economic presence test, creating significant compliance challenges. Tax practitioners discussed the constitutional underpinnings of nexus and ongoing controversies during the Federal Bar Association’s Tax Law Conference on March 6.

### Constitutional Foundations of Nexus

A state’s power to tax is limited by the U.S. Constitution – primarily the Due Process Clause and the Commerce Clause – explained Mathew Landwehr, a partner at Thompson Coburn.

The Due Process Clause requires a “definite link, or minimum connection” between the state and the taxpayer it seeks to tax. Meanwhile, the Commerce Clause, as interpreted by the Supreme Court in cases like *Complete Auto Transit, Inc. v. Brady*, (430 U.S. 274 (1977)), requires that a state tax have “substantial nexus” with the activity or taxpayer being taxed.

The substantial nexus standard of the Commerce Clause is generally considered a stronger, or higher, threshold for a state to meet than the “minimum connection” required by the Due Process Clause, said Richard Jones, a partner at Sullivan & Worcester. For decades, what constituted “substantial nexus” was the central question for out-of-state businesses, he added.

### The ‘Physical Presence’ Era

Until recently, the standard for substantial nexus was a bright-line physical presence test, affirmed by the Supreme Court in its 1992 decision in *Quill Corp. v. North Dakota* (504 U.S. 298). Under this rule, a state could only require a business to collect sales tax if that business had a physical presence – such as employees, property, or inventory – within the state.

While *Quill* was viewed as a “bright line standard,” Jones stressed “the bright line wasn’t that bright.” He noted that states continuously pushed the boundaries of this rule.

And courts found that nexus could be created through the in-state activities of agents, even if they were independent contractors, said Jones. He also noted cases involving Scholastic Books where state taxing authorities argued that teachers facilitating student book orders were acting as agents, thereby creating nexus in states where Scholastic otherwise had no physical presence.

## *Wayfair* Overturns Decades of Precedent

In 2018, the physical presence rule for sales tax was officially overturned by the Supreme Court in *South Dakota v. Wayfair, Inc.* (585 U.S. 162). That case reviewed a South Dakota law that was specifically designed to challenge the *Quill* precedent, Landwehr noted. The law required remote sellers to collect and remit sales tax if they had either more than \$100,000 in sales or 200 or more separate transactions into the state within a year. The Supreme Court upheld South Dakota's law, establishing that economic activity alone – an “economic nexus” – was sufficient to “pass constitutional muster,” said Landwehr.

“*Wayfair* is a bomb,” Landwehr stressed. “This physical presence test that had been in place forever was blown up by the U.S. Supreme Court in a 5-4 decision.” Since the *Wayfair* decision, nearly every state with a sales and use tax has adopted similar economic nexus laws, Landwehr said. However, specific sales and transaction thresholds vary from state to state.

Andrew Reiter, a senior manager at Blue J, said that states are looking at the *Wayfair* thresholds as a “safe harbor.” But the Supreme Court in *Wayfair* doesn't describe the thresholds as “the end all and be all,” he added.

Now, states are “continually pushing the envelope” to see what threshold will satisfy the Commerce Clause, Landwehr said. He noted that Illinois just recently eliminated its threshold on the number of transactions. That change **became effective** on January 1, 2026.

## Federal Law Limits Income Tax Nexus

While *Wayfair* changed the game for sales tax, a long-standing federal law continues to limit state jurisdiction for income tax, said Jones. Public Law 86-272, enacted in 1959, prohibits states from imposing a net income tax on a business if its only activity in the state is the solicitation of orders for sales of tangible personal property. To qualify for this protection, the orders must be sent outside the state for approval and filled by shipment from outside the state, Jones explained.

But this protection can be lost if a company's activities exceed mere “solicitation,” Jones added. He described an emerging controversy as the Multistate Tax Commission and some states now argue that certain internet activities – such as providing customer support through an online chatbot or placing tracking “cookies” on a customer's computer – are not ancillary to solicitation and therefore break the protection of P.L. 86-272.

## Modern Nexus Controversies Persist

And states continue to test the limits of nexus for sale and use tax purposes, said the panelists. Jones noted that Massachusetts unsuccessfully attempted to create “cookie nexus” by arguing that software “cookies” downloaded onto a user's computer constituted tangible property in the state, thereby creating physical presence for an otherwise remote business. The state's highest court ultimately struck this down. (*U.S. Auto Parts Network, Inc. v. Commissioner of Revenue*, 199 N.E.3d 840 (2022))

Another major issue has arisen for third-party sellers on platforms like Amazon. Jones said that states have successfully subpoenaed Amazon for information on sellers whose inventory is stored at in-state fulfillment centers, arguing the inventory creates physical presence nexus. The question, he added, is whether a seller has nexus when it has no control over where Amazon chooses to store its products. He noted conflicting court rulings in California, Pennsylvania, and Washington state.

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