

# PUBLICATION

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## Spotlight on SALT: States Extending Income Tax Reach Over Service Providers

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Through recent legislation, a number of states have extended their respective income tax reach over service providers that have no physical presence in the taxing state (i.e., no owned or leased property, no resident employees or representatives, or no employees or representatives regularly traveling into the state to solicit business or maintain a market for services in the state). Examples of such providers are numerous, including testing, businesses which provide laboratory functions, advertising, call center functions, engineering and design, logistics and inventory management, financial planning, web hosting, telecommunications, and even legal, accounting and other professional services. The states of Kentucky, Minnesota, Oregon, Washington (for Washington's Business & Occupation Tax), and Wisconsin will assert income taxing jurisdiction over out-of-state service providers who only provide services to in-state residents or customers, again even though having no traditional physical presence. Further, other states are tying their assertion of income tax jurisdiction to their income apportionment formulas using so-called "factor presence" statutes. Thus, Colorado, Michigan and Ohio (for Ohio's Commercial Activity Tax) will assert income taxing jurisdiction if a service provider has a certain dollar amount of gross receipts from services sourced to that state by such state's apportionment formula, even though such service providers do not have the traditional physical presence in that state. Beginning in 2011, California joins this group. These expansions of taxing jurisdiction go beyond the "economic nexus" case law and regulations applicable to licensors of intangibles, such as patents and trademarks, and financial institutions that apply in 16 other states. We anticipate that more states will use the rationale of the "economic nexus" court decisions to extend taxing jurisdiction over service providers. Indeed, a series of Utah private letter rulings have done just that.

As a result of these developments, service providers are now being pressed to confront a new paradigm of state income taxation not only with respect to the apportionment of their income, but also with respect to their income tax return filing obligations.

If you have questions or concerns regarding these developments, please contact one of the attorneys in our Tax Department.