



CORPORATION TAX BULLETIN 2019-04¹

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Nexus for Corporate Net Income Tax Purposes

The federal underpinnings of a state's jurisdiction to tax is based on both the Due Process and the Commerce Clauses of the U.S. Constitution. Per applicable precedent, a state's jurisdiction to tax under the Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Quill Corp. v. North Dakota*, 504 U.S. 298, 306, 112 S.Ct. 1904 (1974) (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45, 74 S.Ct. 535, 98 L.Ed. 744 (1954)). This threshold has traditionally been deemed to have been met by a showing that the entity has purposefully directed its activity into a jurisdiction. In *Quill* the Supreme Court noted that the Commerce Clause of the United States Constitution imposes a similar but more rigorous standard than that of Due Process; thus, "a tax may be consistent with due process and yet unduly burden interstate commerce." *Quill Corp. v. North Dakota*, 504 U.S. 298 at 313-14 n.7 (1992).

Historically, the U.S. Supreme Court has held that in order for a state tax to be constitutionally valid under the Commerce Clause it must:

- (1) Apply to an activity with a substantial nexus with the taxing State;
- (2) Be fairly apportioned;
- (3) Not discriminate against interstate commerce; and,
- (4) Be fairly related to the services the State provides.

Complete Auto Transit v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977).

In June 2018 the U.S. Supreme Court issued its decision in the matter of *Wayfair v. South Dakota*, 138 S. Ct. 2080, 201 L. Ed. 2d 403 (2018). As part of that decision the Court found that:

¹ To the extent this bulletin conflicts with Pennsylvania Corporation Tax Bulletin No. 2004-01 (05/19/2004), that bulletin is superseded.

First, the physical presence rule is not a necessary interpretation of the requirement that a state tax must be “applied to an activity with a substantial nexus with the taxing state.” *Complete Auto*, 430 U.S. at 279. Second, *Quill* creates rather than resolves market distortions. And third, *Quill* imposes the sort of arbitrary, formalistic distinction that the Court’s modern Commerce Clause precedents disavow.

The Court went on to conclude “that the physical presence rule of *Quill* is unsound and incorrect.”

As a result, the Commerce Clause analysis set forth in *Complete Auto Transit* remains valid, but the physical presence rule, which was previously held in *Quill* to be a necessary part of the substantial nexus prong is incorrect. While taxpayers contested for years whether the physical presence nexus standard in *Quill* was limited to sales taxes or also applied to corporate net income taxes, the decision in *Wayfair* has made certain that, at least prospectively, no physical presence standard exists for purposes of limiting the ability of a state to impose a net income tax on an out of state taxpayer so long as the constitutional requirements under the Due Process and Commerce Clauses of the United States Constitution are satisfied.

The corporate net income tax is imposed under Article IV of the Tax Reform Code (TRC). 72 P.S. §§7401 et seq. upon corporations:

[E]xercising, whether in its own name or through any person, association, business trust, corporation, joint venture, limited liability company, limited partnership, partnership or other entity, any of the following privileges:

- (1) Doing business in this Commonwealth.
- (2) Carrying on activities in this Commonwealth, including solicitation which is not protected activity under the act of September 14, 1959 (Public Law 86-272, 15 U.S.C. Section 381 et seq.).
- (3) Having capital or property employed or used in this Commonwealth.
- (4) Owning property in this Commonwealth.

For Pennsylvania Corporate Net Income Tax purposes the decision in *Wayfair* has confirmed that out of state corporations are considered to be doing business in this Commonwealth and/or carrying on activities in this Commonwealth to the extent they are taking advantage of the economic marketplace of the Commonwealth regardless of whether they are physically present in Pennsylvania. As a result, the Department will require such taxpayers to begin filing Corporate Tax Reports so long as they meet the minimum thresholds for nexus under the Constitution of the United States. While the

Court in *Wayfair* did not express a bright line threshold of economic activity which would satisfy the nexus requirements existing under the Due Process and Commerce Clauses, it did approve the approach of South Dakota whereby an out of state taxpayer was subjected to a sales tax collection requirement where it had in excess of either 200 sales or \$100,000 worth of sales of goods or services to South Dakota customers during the course of a tax year. While all taxpayers with nexus under the Constitution of the United States should file a Corporate Tax Report with Pennsylvania, the Department will deem there to be a rebuttable presumption that corporations without physical presence in the state, but having \$500,000 or more of gross receipts sourced to Pennsylvania per year pursuant to the sales factor rules contained in 72 P.S. § 7401, have a filing requirement with the Commonwealth for purposes of the Corporate Net Income Tax:² Examples include gross receipts from:

- (1) the sale, rental, lease, or licensing of tangible personal property;
- (2) the sale of services;
- (3) the sale or licensing of intangibles, including franchise agreements;
- (4) interest and other intangibles not included above.

In interpreting this standard, the Department recognizes that taxpayers with or without physical presence in the Commonwealth can still potentially claim exemption from the imposition of the Corporate Net Income Tax under the provisions of P.L. 86-272.³ To the extent protection under this federal law is claimed, taxpayers should continue to file a Pennsylvania Corporate Tax Report (Form RCT-101) and complete the necessary schedules to claim this exemption from tax.

This approach does not change the reporting requirements for pass-through entities with corporate partners, except in regard to the Form PA-65 Corp. Pass-through entities with corporate partners that previously did not file the PA-65 Corp may be required to do so for tax year 2020 and later periods depending upon the activities and receipts of the pass-through entity. The receipts from all pass-through entities held by a corporate entity will be combined in determining whether the corporate entity has exceeded the \$500,000 rebuttable presumption of nexus for CNIT purposes. However, for purposes of a pass-through entity determining whether the Form PA-65 Corp. is required, each such entity will need to make its own determination based on its gross receipts sourced to Pennsylvania.⁴

Consistent with the standards in this bulletin, the Department will require taxpayers without physical presence in the Commonwealth, but having nexus with Pennsylvania under the Constitution of the United States, to file Corporate Tax Reports for tax periods starting on or after January 1, 2020. Similarly, for these same periods taxpayers with \$500,000 or more of gross receipts per year sourced to Pennsylvania, but who claim to

not have nexus, should file a Corporate Tax Report including sufficient required information, either on the form or the attachments, to permit verification of the tax liability and information to support the position that the entity is not subject to the CNIT.

² Note that in keeping with existing law and practice this standard will apply to taxpayers regardless of whether or not the entity is subject to federal income tax.

³ See Pennsylvania Corporation Tax Bulletin No. 2004-01 (05/19/2004). If a taxpayer qualifies for protection under the provisions of P.L. 86-272 it is entitled to such protection regardless of whether or not it has Pennsylvania sourced sales in excess of \$500,000.

⁴ This calculation should include not only the receipts of the pass-through entity itself, but also any receipts from its own lower tier pass-through entities.