AS YOUR BUSINESS GROWS and you begin selling your products or services outside the state of Washington, you need to consider the tax implications. Other state and local governments are, of course, excited to have you selling to their residents and businesses. Each sale means the potential of added revenue to government coffers in the form of numerous taxes, including business taxes, such as income or franchise taxes; transaction taxes, such as sales and use taxes; and taxes associated with a mobile workforce, such as payroll taxes and personal income tax witholding.

A business becomes subject to tax in another state when it establishes what’s known as “nexus.” Nexus refers to the level of activity that must occur within a state in order for the state or local government to have the authority to impose taxes on out-of-state business. Nexus standards vary from state to state and may depend on the nature of your activities in the state and the type of tax involved.

Companies often make a critical mistake in thinking that an in-state employee is required in order for taxes to be due. While having an in-state employee does trigger state and local tax obligations, many taxes have a much lower nexus threshold. For sales taxes, nexus requires that the seller have some form of a physical presence in the taxing state. This includes having employees or independent contractors visit existing or potential customers and can extend beyond the obvious. In most states, attending or exhibiting at trade shows can create nexus.

Physical presence often includes various forms of collaborative marketing agreements with in-state marketing partners. Businesses that make sales of products and services to end users need to be sensitive not only to nexus considerations, but also to whether their products and services are subject to tax in the customer’s state. Here the rules vary widely.

Perhaps the biggest misconception about taxability is in the area of digital goods and services, such as SaaS and other cloud-based services. Companies with nexus that sell taxable products and services are liable for sales taxes they fail to collect. The key is to understand the various state rules so you don’t face a large, unexpected tax liability.

Generally, a physical presence giving rise to a sales tax collection obligation will also subject the business to income or other business privilege taxes. So-called “economic nexus” laws are becoming increasingly popular in states that impose business privilege taxes. These laws provide that companies with sales volume above a certain threshold are required to pay business privilege taxes, regardless of whether any physical activity takes place in the taxing state.

The good news is that federal law generally prohibits states from imposing net income taxes on out-of-state employees that sell tangible personal property where the only activity in the taxing state is soliciting orders for sales. This federal law does not apply to business privilege taxes measured by gross income, gross margin or invested capital.

Income earned by employees while working in states with a personal income tax is usually taxable and the employer is required to withhold and remit the tax. The employees are then required to file nonresident income tax returns in the states where they travel to perform work. This is an issue even if employees are only in the state for a few days a year. Companies with a mobile workforce are advised to seek advice on how best to balance the burden of technical compliance with the potential exposure to tax, penalties and interest for failing to comply.

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