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SHOP TALK

Not Registered in All States You Operate In-What's the Big Deal? Sometimes It Can Be

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There often comes a time in a business' lifecycle, whether it is a small e-commerce seller or a multinational corporation, when its owners, shareholders or officers realize it is selling a substantial amount of products or services, or has employees or agents, in multiple states, but are unaware of whether it is actually registered or licensed to do business there with the secretary of state or any taxing agency within the state(s).

Given all the things that a business' leadership/ownership must deal with on a daily basis just to keep afloat, let alone grow, multistate registration compliance is often an afterthought. Many business owners and officers treat it simply as another business risk they just have to put in the back of their mind. However, at some point, that business risk may become a reality, for instance when a notice is received out of the blue from a state or local agency asking if you have registered or filed in that jurisdiction, or during due diligence when buying or selling a business or division, or arising from an inquiry from your friendly internal or external accountant or auditor. When such a situation occurs, what do you do next?

While this issue has become more prevalent, now that lack of physical presence is no longer a strong defense after the *Wayfair* decision, the basic issue has plagued businesses for decades. Even worse, many are predicting that the historically relied-upon protection of P.L. 86-272 for multistate solicitations will be the next safeguard to fall, only increasing the frequency and severity of these issues for businesses in the near future. This article attempts to provide what your next steps should be, what should be considered, and whether multistate noncompliance is even a big deal. As discussed below, in many jurisdictions, it really can be.

Am I actually "doing business" in a state or local jurisdiction?

First question: Am I doing enough in a certain jurisdiction to be considered "doing business" and required to register and/or file reports or returns as a result? Answer: It depends.

It depends on what agency you are dealing with. It is typically a much lower standard for registering with a secretary of state to legally engage in business, enter into contracts, obtain needed licenses/permits, sue/be sued, etc. in the state, than the thresholds for registering for state tax departments. This is known as "foreign qualification" or "application for authority," i.e., registering with the secretary of state in a jurisdiction(s) in which the company is not domiciled or incorporated. The general rule of thumb is if the company has a physical location, employees, or regularly binding contracts or business in a state, it should register there to protect against costly fees, penalties, and potential personal or criminal sanctions for not registering (discussed more later). But this is far from an exclusive list, as each jurisdiction's rules can differ.

Regarding registration with state taxing agencies, another common scenario is when the company is registered with a state secretary of state but receives a letter from the state's department of revenue saying it is aware of your business registration and wants to know what your business activities are in the state, any employees or property, etc., to determine if tax accounts need to be assigned to your business. One of the most common questions I get from clients is: do I have to respond to this letter/questionnaire, and if I don't respond, what can they really do to me?

In general, while a business may not need to immediately respond to a first letter like this, eventually that agency will ask again and not only become more demanding, but also threaten to assign multiple tax accounts, and assess penalties and other fees. So, yes, at some point, you likely do need to respond, but one must be very careful *how* you respond and the information you provide, because any inadvertent mistake or answer may result in erroneous tax accounts or assessments following. It is extremely hard to "un-ring the bell" after you answer a certain way to a tax registration/questionnaire, and just as difficult to convince a taxing agency to cancel an account.

Another consideration is in what form do you respond. Do you have to fill out this multi-page, detailed questionnaire? Again, it depends, but it is often advisable to consider whether a dismissive, yet friendly, response letter is the best way to go. For example, if you have already registered in the state for certain taxes (e.g., income or withholding tax) but not another (e.g., sales tax), or if you don't have any activities, employees, offices, property and only de minimis revenue in that jurisdiction, a letter may be the best route, as it can de-escalate the situation, is responsive, and it puts the burden back on that agency to follow-up with you and ask more questions. In many cases, this can be enough to make the "risk" go away, at least initially.

One must also determine whether the company's level of activity even rises to the level of "doing business" or some other vague, fact-intensive or economically focused threshold that requires registration, filing, and/or paying taxes. Common examples of minimal activities in a state which meet these thresholds include performing services there (directly or indirectly), accepting orders in the state, being a member/partner/shareholder of a pass-through entity doing business in the state or a member of a single-member LLC in the state, engaging in litigation, making sales into the state, owning property, securing or collecting debts, selling through agents or independent contractors, maintaining bank accounts, carrying on internal corporate affairs, etc. The possibilities and circumstances are often endless, and while many states view activities similarly, a state-by-state review may be needed in many instances depending on the uniqueness of a company's operations.

What about situations when you don't receive such a notice/inquiry from a state or local jurisdiction, but instead independently discover you may need to register in one, or multiple, states? Again, these situations often pop up in a business deal when a third party performs due diligence. It can also happen when there is a change in the company's leadership or the tax/business division. A new person comes in, asks tough questions, and tries to "right the ship" with any problem areas discovered or that have been internally buried.

In these situations, what options does a company have? It could be proactive by having an internal or external tax or legal advisor perform a multistate review/survey of the situation and recommend what jurisdictions require registration or filing. Another viable option is a multistate voluntary disclosure filing, either with individual jurisdictions or potentially all at once with an intergovernmental agency such as the Multistate Tax Commission, to disclose your facts, get certainty on compliance requirements, and potentially limit your back liability and receive a waiver of interest or penalties. Or, you can continue to roll the dice, cross your fingers, and push off this "business risk" as long as possible. As always, it depends. It depends on the amount at issue, the size of the problem, the level and cost of administrative burdens for compliance, the company's risk tolerance, and the potential consequences of noncompliance.

The latter consideration is often the one that forces the issue, as the consequence for being noncompliant can be much more than just additional taxes, interest, penalties, and fees, as some state and local jurisdictions may deactivate the company or its business name, automatically void contracts, and even impose personal liability or criminal penalties. Examples of the wide variety of potential sanctions in these situations are provided next.

Even if I'm doing business, what can they really do to me? You'd be surprised.

Once you receive a notice/questionnaire, or otherwise become aware of potential or definite noncompliance in a jurisdiction, before a company can attempt to limit the consequences, it must first determine how serious the repercussions are for noncompliance. In addition to potential back state and local *tax* liability, including associated interest, penalties, and other fees, many states have particularly severe sanctions simply for a business continuing to do business in a state without being properly registered, including automatic voiding of contracts.

Often, a state or local jurisdiction will simply impose late filing or collection fees and penalties against the company itself, but many of these can be substantial. For example, Alaska, Indiana, Michigan, Nebraska, Nevada, and Ohio have penalties of up to $10,000, with Alaska imposing these penalties on a per-year basis. [1] Likewise, Colorado, Wisconsin, and Wyoming impose a $5,000 fine, Connecticut has a $3,600 per-year fine, and dozens of states have fines of at least $1,000. [2] Tennessee even has treble-type sanctions, with the ability to impose *three times* the amount of all fees, penalties, taxes, plus interest, that would have been imposed had the corporation been registered.

Another common sanction employed by many states is to allow the attorney general, or another person (e.g., a competitor, vendor, or customer [3]), to bring an action to restrain the business from transacting business (e.g., Alabama, Arizona, Arkansas, Colorado, Delaware, Idaho, New Jersey, Ohio, Oklahoma, Rhode Island, Texas, Utah, etc. [4]), or creating automatic liens (e.g., Illinois [5]).

All the above consequences are serious, but California has one of the most unusual and terrifying sanctions. In addition to costly penalties and fees, California authorizes the automatic voiding of any contracts a company entered into during the period it was out-of-compliance, either with the secretary of state or with the California Franchise Tax Board (FTB). [6] This means a disgruntled customer or vendor that becomes aware of the company not being in good standing in California can attempt to get out of a contract simply due to lack of registration or noncompliance. And all of this is public record. [7] Moreover, during this period, a company is considered "suspended" or "forfeited" and can lose its registered name in California. The good news is that California allows suspended companies to get back into good standing through a revivor process and the company can buy the contract voidability risk away (although it can be costly at a rate of $100/day or a maximum of the tax liability for that year). The bad news is it can take a long time to cure these issues, particularly with the FTB which can take months. [8]

Although California is one of the only state's with statutory contract voidability consequences, it is also important to remember than many private contracts with customers include standard termination provisions if the company violates any representations or warranties, such as by failing to maintain proper licensing or good standing in the states in which it operates or provides property or services to a customer. So, regardless of the state, contract voidability is something that needs to be closely monitored.

Last, even more serious than a company having its contracts voided due to noncompliance is potential personal or criminal liabilities. When you tell an owner or officer that they may be personally liable, or that certain actions are considered criminal in nature, you really get their attention.

For example, transacting business in a state without the authority to do so can result in misdemeanor charges for responsible officers, employees, and agents and can carry heavy fines for the business and these individuals in many states, such as California ($1,000 fine to business and $600 misdemeanor fine for employees and agents), Delaware and Oklahoma ($500 misdemeanor for both the business and employee/agent), Maryland ($1,000 misdemeanor for officers/agents), North Dakota and Utah ($5,000 company penalty, and $10,000 fine for officers and agents), Ohio (officers subject to a fourth-degree misdemeanor which carries fines and possible jail time), and Virginia ($5,000 penalty for officers, directors, or employees). [9]

State-level government agencies aren't the only consideration as most states also have *local* level tax and licensing agencies which likewise can impose hefty fees and criminal charges for lack of registration/noncompliance. For example, in my home state of Kentucky, most localities impose an occupational license tax for the privilege of doing business in the jurisdiction, and willful failure to register constitutes a Class A misdemeanor which is punishable by 90 days to 12 months in jail and a fine.

While the risk of personal liability or criminal sanctions may not be high, at the very least, it will give many business owners, officers, and responsible persons an additional pause before brushing multistate registration off their shoulders. The problem is, many of these business-focused persons don't even know such consequences exist. Knowledge is power, even if it can be scary.

OK, now I'm freaked out-what should I do?

The first thing to do when becoming aware of one or more of the situations discussed above is to perform an internal review and fact-finding mission to verify certain baseline facts (e.g., prior registration or filing; number of customers, employees, sales reps, locations; amount of property, sales, revenue, etc. in a jurisdiction). Then, it is often advisable to contact your trusted, local tax practitioner, who knows or can quickly determine what the rules are and what needs to be done next and is familiar with the customs and how things really work in a particular jurisdiction. Anyone can read the law, but often in these types of situations, those practitioners/advisors who know the right person to call at a jurisdiction to get a straight answer, or potentially get a break, offer the most cost-efficient and effective way to resolve a situation.

Regardless of your approach, being proactive is typically the way to go because the longer you put something off, the bigger it becomes and the more difficult it is to fix (or get sympathy/relief from). At the very least, after reading this article, I hope you no longer shrug off registration or compliance issues as easily, now that you know what a big deal it really can be.

1 *See* Alaska. Stat. §§10.06.710, 713 & 715; Ind. Code §23-0.5-5-2; Mich. Comp. Laws §§450.2051 and 450.2055; Neb. Rev. Stat. §21-2.204; Nev. Rev. Stat. §§80.055 & 80.095; Ohio Rev. Code Ann. §§1703.28-1703.99 & 1703.99.

2 Colo. Rev. Stat. §7-90-802; Wis. Stat. §80.1502; Wyo. Stat. Ann. §17-16-1502; Conn. Gen. Stat. §33-921.

3 Certain states allow "any person" to bring such an action, e.g., Ariz. Rev. Stat. §10-1502.

4 See, e.g., Ala. Code §10A-1-7.23; Ariz. Rev. Stat. §10-1502; Ark. Code. Ann. §4-27-1502; Colo. Rev. Stat. §7-90-802; Del. Code Ann. tit. 8, §§378 & 383-384; Idaho Code Ann. §30-21-502; N.J. Stat.

Ann. §§14A:13-11 & 12; Ohio Rev. Code Ann. §§1703.28-30 & 1703.99; Okla. Stat. tit. 18, §§1134 & 1138; R.I. Gen. Laws §7-1.2-1418; Tex. Bus. Orgs. Code Ann. §9.051; Utah Code Ann. §16 10a-1502.

5 805 Ill. Comp. Stat. 5/13.70.

6 Cal. Rev. & Tax. Code §§23305.1, 23305a, 23305c & 23304.1. See also, State of California Franchise Tax Board, My Business is Suspended: Revise My Business, available at https://www.ftb.ca.gov/help/business/my-business-is-suspended.html.

7 See Cal. Rev. & Tax. Code §§23305a and 23305c.

8 Cal. Rev. & Tax. Code § 3305.1.

9 Cal. Corp. Code §§2203 & 2258; Del. Code Ann. tit. 8, §§378, 383-384; 18 Okla. Stat. tit. 18, §§1134, 1137-1138; Md. Code Ann., Corps. & Ass'ns §§7-301-305; N.D. Cent. Code §10-19.1142; Utah Code Ann. §16 10a-1502; Ohio Rev. Code Ann. §1703.01; Va. Code Ann. §13.1-758.