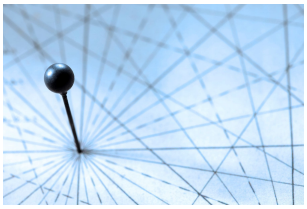

Not Registered in All States You Operate – What's the Big Deal? Sometimes it Can Be.

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There often comes a time in a business' lifecycle – whether it be 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 is 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 of 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, but at some point, that business risk may become a reality – by receiving a notice out of the blue from a state or local agency asking if you have registered or filed in that jurisdiction, during due diligence when buying or selling a business or division, or 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

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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 or not 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 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.

In regard to 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, 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

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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 "unring 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 I 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 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.

And finally, 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 doing business in the state or a member of a single-member LLC in the state, engaging in litigation, 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 recognize similar activities, a state-by-state review may be needed in many instances depending on the uniqueness of a company's operations.

But 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,

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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 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 is 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 other jurisdictions, before a company can attempt to limit the consequences of same, 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,

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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.

Oftentimes, 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 fine 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 corporate 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 therein (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 of the above consequences are serious, but California has one of the most unique and terrifying sanctions, as 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] Meaning 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 that state. 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), but the bad news is it can

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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 reps or warranties, such as 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 state, contract voidability is something that needs to be closely monitored.

Lastly, even more serious than a company having its contracts voided due to noncompliance is potential personal or criminal liabilities associated with same. 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 authority to do so can result in misdemeanor charges for responsible officers, employees and agents which 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 to officers and agents), Ohio (officers subject to a fourth-degree misdemeanor which carries fines and possible jail time), and Virginia ($5,000 penalty on 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 do so constitutes a Class A misdemeanor which is punishable by 90 days to 12 months in jail, and a fine.

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While in reality 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 of 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 many 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, property, sales, revenue, etc. in a jurisdiction). Then, it is often advisable to contact your trusted, local tax practitioner who not only understands or can quickly determine what the rules are and what needs to be done next, but is familiar with the customs and how things really work in a particular jurisdiction. Anyone can read the law, but oftentimes in these types of situations, those practitioners/advisors who knows the right person to call at a jurisdiction to get a straight answer, or potentially get a break, is the most cost efficient and effective way to resolve same.

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). But at the very least, after 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.

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[1] See Alaska. Stat. §§ 10.06.710, 713 & 715; Ind. Code Ann. § 23-0.5-5-2; MCLS §§ 450.2051 & 450.2055; R.R.S. Neb. § 21-2.204; Nev. Rev. Stat. Ann. §§ 80.055 & 80.095; ORC Ann. §§ 1703.28-1703.99 & 1703.99.

[2] C.R.S. § 7-90-802; Wis. Stat. Ann. §180.1502; Wyo. § 17-16-1502; Conn. Gen. Stat. § 33-921.

[3] Certain states allow "any person" to bring such an action, such as Arizona. A.R.S. § 10-1502.

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[4] See e.g., Ala. Code § 10A-1-7.23; A.R.S. § 10-1502; A.C.A. § 4-27-1502; C.R.S. § 7-90-802; 8 Del. C. §§ 378 & 383-384; Idaho Code § 30-21-502; N.J. Stat. §§ 14A:13-11 & 12; Okla. Stat. Ann. Tit. 18, §§ 1134 & 1138; ORC Ann. §§ 1703.28-30 & 1703.99; RI. Gen. Laws § 7-1.2-1418; Utah Code Ann. § 16 10a-1502; Tex. Bus. Org. Code §§ 9.051.

[5] 805 ILCS 5/13.70.

[6] Cal. Rev. & T. 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. & T. Code §§ 23305a & 23305c.

[8] Cal. Rev. & T. Code § 23305.1.

[9] Cal. Corp. Code §§ 2203 & 2258; 8 Del. C. §§ 378, 383-384; 18 Okl. St. §§ 1134, 1137-1138; Md. Corporations & Associations Code Ann. §§ 7-301-305; N.D. Cent. Code § 10-19.1142; Utah Code Ann. § 16 10a-1502; Ohio Rev. Code §1703.01; Va. Code Ann. § 13.1-758.

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