In the dead of night, as the Trojans were sleeping, the Greeks poured out of the Trojan horse to open the gates of the city of Troy for the rest of the Greek army to enter. Before the Trojans could fully grasp what was happening, Troy was in the control of the Greeks.

We all know about the story, but what is a “nexus questionnaire” and what does a Trojan horse have to do with it? A nexus questionnaire is a request by a state taxing authority for a business to explain the nature of its relationship (or “nexus”) with the state. In essence, the state is “politely” asking the taxpayer to disclose any activities or connections that may cause the taxpayer to be liable for one or several types of tax.

Unaware of the danger associated with these inquiries, businesses often take it upon themselves to respond to these “polite” requests for information. Not long thereafter, such businesses often find that the “Greeks have run amuck” and the state is now asking for sales, income, gross receipts or like taxes. What the business had perceived as an innocuous correspondence from a friendly representative of a department of revenue has now caused untold administrative and financial burdens. This situation could have been avoided if the business had sought guidance before welcoming the Trojan horse into its world.
What triggers a nexus questionnaire? State taxing authorities often have individuals specifically designated to research potential links between out-of-state businesses and the state. This research can be done by looking at property records, informational filings with federal or state agencies, or simple internet research. However, there is another means by which state taxing authorities are able to gather this information – through the audit of other taxpayers. The audit of one taxpayer leads to information about another taxpayer and so on.

What is the significance of the initial response to the nexus questionnaire? Failing to carefully consider and craft responses to nexus inquiries can lead to unmitigated disaster. If a state determines, after receiving the responses to their nexus inquiries, that a business should be paying tax in the state it will most likely require the business to pay back taxes, penalties and interest. This is in addition to going-forward tax obligations and corresponding increases in administrative and compliance costs. While it is true that paying tax to this “new” state may give rise to a refund in another, bear in mind that your refund claim is likely limited by statute – the liability in the “new” state will likely not be so limited.

It is important to inspect nexus questionnaires very carefully. Many of the inquiries are worded in the “active” voice effectively asking a business or individual to merely confirm that they have a tax obligation in the state. In addition, nexus questionnaires often leave very little space for the taxpayer to fully respond. The result is that the taxpayer provides a vague fragmented response without a great deal of explanation. Not surprisingly, a “vague” response will most often be interpreted in the light most favorable to the state taxing authority. It is important to seek counsel before finalizing responses to such questionnaires. This can make the difference between continuing business as usual and fending off a Greek onslaught.

There is great debate as to whether the story of the Trojan horse is fact or myth. However, whether or not the story is based in fact, it is clear that the lessons of the story play themselves out in the tax world one nexus questionnaire at a time. With almost every state and locality looking for sources of revenue, a Trojan horse may be in your inbox in the very near future.
Akerman is ranked among the top 100 law firms in the U.S. by The National Law Journal NLJ 250 (2009) in number of lawyers and is the largest firm in Florida. With more than 500 lawyers and government affairs professionals, we serve clients from major business centers in Florida, New York, Washington, D.C., California, Virginia, Colorado, Nevada, and Texas.

For more information, please contact a member of our Taxation practice.