September 27, 2005

A Statement to the Members of the Commercial and Administrative Law Subcommittee on H.R. 1956, the Business Activity Tax Simplification Act

Dear Subcommittee Members:

On behalf of the 350,000-member National Taxpayers Union (NTU), I am pleased to offer comments regarding legislation that, if passed, would be an important step toward fulfilling our core mission, namely the simplification and clarification of our tax system. The Business Activity Tax Simplification Act is a worthy reform measure that would clarify the nexus rules that govern state assessment of income-based taxes and establish a clear physical presence nexus test to ensure that only businesses having employees or property physically present within a jurisdiction are subjected to business activity taxes in that jurisdiction.

In 1992, the U.S. Supreme Court ruled in *Quill Corp. v. North Dakota* that a state could not impose taxes on an out-of-state business unless that business has a "substantial nexus" within the taxing state. However, the Supreme Court declined to rule on the nexus standard as applied to business activity taxes, and decided to allow Congress to resolve the dispute. To date, it has not done so.

The integration of the Internet and telecommunications technologies has allowed businesses of all sizes to expand across state lines, and interstate business activities are now commonplace. However, these beneficial developments have also highlighted existing confusion over when states are allowed to collect income taxes from out-of-state companies conducting certain activities within their jurisdiction. Unfortunately, jurisdictions are increasingly defining "substantial nexus" differently, leading to a complex matrix of tax rules. If this practice continues, it will have a dire effect on interstate commerce and the entire economy.

In order to illustrate some of the significant problems with lack of clarity in state enforcement of business activity taxes, I would like to offer just a few examples of how arbitrary these policies can become. In Tennessee, the revenue department attempted to tax an out-of-state company engaging in credit card solicitation activities through direct mailings. The department based their authority on the presence of the credit cards and the "substantial privilege of carrying on business" in Tennessee.

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A further illustration of the basic confusion over nexus is that some states assert that a business whose trucks pass through their confines six or fewer times in a year – without picking up or delivering goods – has sufficient connections with the state to trigger business activity taxes. Other states contend that having a website on a server in the state creates a sufficient connection to justify imposing these taxes. Some states even take the position that registering to do business in a state, or listing a phone number in a local phone book in that state, is a sufficient connection to justify taxation. Although it is NTU's belief that these are examples of overzealous tax collection on the part of certain states, there is no question that uniformity is necessary and that the Congress is the correct body to provide such clarity.

H.R. 1956 would end these harmful practices by establishing specific standards that define when firms should be obliged to pay business activity taxes. The legislation ensures fairness, minimizes litigation, and creates a legally certain business climate that encourages companies to invest and expand interstate commerce. This legislation is a common-sense way for Congress to promote economic growth and we urge Members of the Subcommittee to support it.

Sincerely,

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Director of Government Affairs