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PROPOSED "BUSINESS ACTIVITY TAX NEXUS" LEGISLATION WOULD SERIOUSLY UNDERMINE STATE TAXES ON CORPORATE PROFITS AND HARM THE ECONOMY

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Highlights

A bill under consideration in both houses of Congress would take away from the states authority they currently have to tax a fair share of the profits of many corporations that are based out-of-state but do business within their borders. The Senate version of the "Business Activity Tax Simplification Act" ("BATSA"), S. 1726, was re-introduced in the 110th Congress by Senators Charles Schumer and Mike Crapo on June 28, 2007. The House version, H.R. 5267, was re-introduced on February 7, 2008 by Representatives Bob Goodlatte and Rick Boucher. H.R. 5267 will be the subject of a hearing in the Subcommittee on Commercial and Administrative Law of the House Judiciary Committee on Tuesday, June 24, 2008.

BATSA defines many activities commonly conducted by corporations within a state as being no longer sufficient to obligate the corporation to pay several different kinds of taxes to the state (or to its local governments). Moreover, these "safe harbors" from taxation are defined in a highly ambiguous, arbitrary and inconsistent manner. These new restrictions on state and local taxing authority would have far-reaching, adverse impacts on the revenue-generating capacity and fairness of state and local tax systems. The most significantly affected taxes would be the corporate income taxes levied by 44 states, the District of Columbia, and New York City. If enacted, BATSA would have the following effects:

- The legislation would cause state and local governments collectively to lose substantial tax payments from out-of-state corporations that would be freed from their current obligations to pay taxes on their profits and gross sales to particular jurisdictions. A significant share of currently-taxable corporate profits would go untaxed by *any* state, leading to a net revenue loss for the states as a whole. According to a Congressional Budget Office estimate done in 2006 on a substantially similar version of the bill, state revenue losses would grow to \$3 billion annually within five years of enactment.
- BATSA would block particular states from taxing particular corporations on income earned in those states. Even if those corporations' profits might ultimately be taxed by their home states, BATSA still would unfairly deprive other states and localities of their right to tax the profits of

specific out-of-state corporations that benefit from services these jurisdictions provide.

- BATSA would stimulate a wave of new corporate tax sheltering activity aimed at cutting state and local business taxes.
- The legislation would mire state and local governments and corporations alike in a morass of litigation over whether particular businesses are or are not protected from taxation under the numerous vaguely-defined provisions of BATSA.
- BATSA would reward major multistate corporations that have the resources to engage in aggressive tax-avoidance behavior with much lower tax burdens than their small, locally-oriented competitors.

For example, if BATSA were enacted:

- A television network would not be taxable in a state even if it had affiliate stations and local cable systems within the state relaying its programming and regularly sent employees into the state to cover sporting events and to solicit advertising purchases from in-state corporations.
- A bank would not be taxable within a state even if it hired independent contractors there to process mortgage loan applications and the loans were secured by homes located within the state.
- A restaurant franchisor like Pizza Hut or Dunkin' Donuts would not be taxable in a state no matter how many franchisees it had in the state and no matter how often its employees entered the state to solicit sales of supplies to the franchisees or to train the franchisees in company procedures.

These are just a few examples of the types of corporations that would be protected from state corporate income taxes by the provisions of BATSA. That corporations engaging in such extensive in-state activities would be immunized from taxation suggests why a congressionally-imposed BAT nexus threshold even loosely based on the current text of BATSA would be a prescription for further litigation, inequity among businesses, and erosion of a vital source of funding for state and local services.

A compelling case for federal intervention into BAT nexus issues at this time has not been made, but if Congress does decide to act in this area, workable and fair alternatives to BATSA are available. A proposed nexus standard developed by the Multistate Tax Commission, for example, would base the creation of nexus on relatively objective measures of the dollar amount of a business' sales occurring in a state, the dollar amount of property located in a state, or the dollar amount of payroll paid to employees working in a state.¹ Such an approach balances the legitimate objective of preventing states from imposing the burdens of complying with a BAT on a company that has relatively little activity in the state — and therefore little tax liability — with the right of states to tax income earned within their borders by businesses that are benefiting from state and local services and the organized marketplace the state provides.