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HOUSE TO CONSIDER RESTRICTING STATES' AUTHORITY TO TAX CORPORATE PROFITS Bill Would Cost States \$3 Billion Annually, Says CBO

A bill expected to reach the floor of the U.S. House of Representatives tomorrow would strip states of their authority to tax a fair share of the profits of many corporations that are headquartered out of state but do business within their borders.

Under the bill (H.R. 1956, "The Business Activity Tax Simplification Act"), large amounts of corporate profits that are currently taxed would go untaxed by *any* state. The Congressional Budget Office estimates that the resulting state revenue losses would grow to \$3 billion annually by 2011. The National Governors Association, which has issued state-by-state estimates of the bill's effects on state revenues (www.nga.org/Files/pdf/0509BAT.PDF), predicts the bill would cost states even more than that — \$6.6 billion annually. (In making its estimates, NGA used a detailed survey of state revenue departments to which CBO did not have access.)

"This bill would effectively create an array of new tax loopholes for corporations to exploit — especially large corporations that have the resources and expertise to engage in abusive tax-sheltering schemes," said Michael Mazerov, author of a Center report on the bill ("Proposed 'Business Activity Nexus' Legislation Would Seriously Undermine State Taxes on Corporate Profits and Harm the Economy," see www.cbpp.org/9-14-04sfp.pdf.) The bill's supporters include such large corporations as Citicorp, Walt Disney/ABC, Cisco Systems, and American Express.

The bill would impose federal rules on states to determine whether a corporation conducts sufficient activity in a state to allow the state — or a locality within the state — to levy a corporate income tax or other business tax on the corporation. (Forty-five states, the District of Columbia, and New York City impose corporate income taxes.) The federal rules would bar states from taxing many kinds of business activities that they currently tax. For example,

- a television network would not be taxable in a state even if it has affiliate stations and local cable systems within the state that relay its programming;
- a restaurant franchisor like Subway or Dunkin' Donuts would not be taxable in a state, no matter how many franchises it has there; and
- a bank would not be taxable within a state even if it hires independent contractors there to process mortgage loan applications.

"The bill is a recipe for extensive litigation between states and corporations," Mazerov said, "because a number of the new rules that the bill would impose to limit state taxing

authority are arbitrary, vaguely defined, or inconsistent.” For example, a state could tax a corporation that has a million dollars’ worth of inventory in the state, but it could *not* tax a corporation that has a million dollars’ worth of unfinished goods in the state that are being processed into finished goods by another firm.

In addition, by depriving states of billions of dollars each year in revenues, the bill could further impair public services that are important to a healthy economy, such as education and transportation infrastructure.

With more and more businesses taking advantage of the Internet and other technologies to operate in multiple states, it is ironic that supporters of the House bill would try to base state taxing authority on a business’s physical presence in the state, Mazerov noted. “This approach is entirely at odds with the realities of a 21st century economy,” he said.

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