109TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
109–575

BUSINESS ACTIVITY TAX SIMPLIFICATION ACT OF 2006

JULY 17, 2006.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. SENSENBRENNER, from the Committee on the Judiciary, submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 1956]

[Including cost estimate of the Congressional Budget Office]

The Committee on the Judiciary, to whom was referred the bill (H.R. 1956) to regulate certain State taxation of interstate commerce; and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Business Activity Tax Simplification Act of 2006".

SEC. 2. REMOVAL OF CERTAIN LIMITATIONS ON THE APPLICATION OF PUBLIC LAW 86–272.

(a) SOLICITATIONS WITH RESPECT TO SALES AND TRANSACTIONS OF OTHER THAN TANGIBLE PERSONAL PROPERTY.—Section 101 of the Act entitled "An Act relating to the power of the States to impose net income taxes on income derived from interstate commerce, and authorizing studies by congressional committees of matters pertaining thereto", approved September 14, 1959 (15 U.S.C. 381 et seq.) is amended—

(1) in subsection (a)(1) by striking "of tangible" and all that follows through "State; and" and inserting the following:

"or transactions, which orders are sent outside the State for approval or rejection and, if approved, are—

"(A) in the case of tangible personal property, filled by shipment or delivery from a point outside the State; and

"(B) in the case of all other forms of property, services, and other transactions, fulfilled from a point outside the State;

and";

49–006

(2) in subsection (c)—

(A) by inserting "or fulfilling transactions" after "making sales";

(B) by inserting "or transactions" after "sales" the other places it appears;

(C) by striking "of tangible personal property" the first place it appears; and

(D) by striking ", of tangible personal property"; and

(3) in subsection (d)(1) by striking "the sale of, tangible personal property" and inserting "a sale or transaction,".

(b) APPLICATION OF PROHIBITIONS TO OTHER BUSINESS ACTIVITY TAXES.—Title I of the Act entitled "An Act relating to the power of the States to impose net income taxes on income derived from interstate commerce, and authorizing studies by congressional committees of matters pertaining thereto", approved September 14, 1959 (15 U.S.C. 381 et seq.) is amended by adding at the end the following:

"SEC. 105. Beginning with taxable periods beginning on or after the first day of the first calendar year that begins after the date of the enactment of the Business Activity Tax Simplification Act of 2006, the prohibitions of section 101 that apply with respect to net income taxes shall also apply with respect to each other business activity tax, as defined in section 4 of the Business Activity Tax Simplification Act of 2006. A State or political subdivision thereof may not assess or collect any tax which by reason of this section the State or political subdivision may not impose.".

(c) EFFECTIVE DATE OF SUBSECTION (a) AMENDMENTS.—The amendments made by subsection (a) shall apply with respect to the imposition, assessment, and collection of taxes for taxable periods beginning on or after the first day of the first calendar year that begins after the date of the enactment of the Business Activity Tax Simplification Act of 2006.

SEC. 3. JURISDICTIONAL STANDARD FOR STATE AND LOCAL NET INCOME TAXES AND OTHER BUSINESS ACTIVITY TAXES.

(a) IN GENERAL.—No taxing authority of a State shall have power to impose, assess, or collect a net income tax or other business activity tax on any person relating to such person's activities in interstate commerce unless such person has a physical presence in the State during the taxable period with respect to which the tax is imposed.

(b) REQUIREMENTS FOR PHYSICAL PRESENCE.—For the purposes of subsection (a), a person has a physical presence in a State only if such person's business activities in the State include any of the following, collectively and on more than 21 days in the aggregate, during such person's taxable year:

(1) Being an individual physically in the State, or assigning one or more employees to be in the State, except that the following shall be excluded in determining whether such 21-day limit has been exceeded:

(A) Activities in connection with a possible or an actual purchase of goods or services, for consumption by the person's business.

(B) Gathering news for print, broadcast, or other distribution through the news media.

(C) Meeting government officials for purposes other than selling goods or services, for consumption by such government.

(D) Merely attending educational or training conferences, seminars or other similar functions.

(E) Nonprofit participation in charitable activities.

(2) Using the services of an agent (excluding an employee) to establish or maintain the market in the State, if such agent does not perform business services in the State for any other person during such taxable year.

(3) The leasing or owning of tangible personal property or of real property in the State, except that the following shall be excluded in determining whether such 21-day limit has been exceeded:

(A) Tangible personal property located in the State for purposes of being assembled, manufactured, processed, or tested by another person for the benefit of the owner or lessee, or used to furnish a service to the owner or lessee by another person.

(B) Marketing or promotional materials distributed in the State.

(C) Any property to the extent used ancillary to an activity excluded from the computation of the 21-day period based on paragraph (1) or (2).

(c) TAXABLE PERIODS NOT CONSISTING OF A YEAR.—If the taxable period for which the tax is imposed is not a year, then any requirements expressed in days for establishing physical presence under this Act shall be adjusted pro rata accordingly.

(d) EXCEPTIONS.—

(1) DOMESTIC BUSINESS ENTITIES AND INDIVIDUALS DOMICILED IN, OR RESIDENTS OF, THE STATE.—Subsection (a) does not apply with respect to—

(A) a person (other than an individual) that is incorporated or formed under the laws of the State (or domiciled in the State) in which the tax is imposed; or

(B) an individual who is domiciled in, or a resident of, the State in which the tax is imposed.

(2) TAXATION OF PARTNERS AND SIMILAR PERSONS.—This section shall not be construed to modify or affect any State business activity tax liability of an owner or beneficiary of an entity that is a partnership, an S corporation (as defined in section 1361 of the Internal Revenue Code of 1986 (26 U.S.C. 1361)), a limited liability company, a trust, an estate, or any other similar entity, if the entity has a physical presence in the State in which the tax is imposed.

(3) PRESERVATION OF AUTHORITY.—This section shall not be construed to modify, affect, or supersede the authority of a State to bring an enforcement action against a person or entity that may be engaged in an illegal activity, a sham transaction, or any perceived or actual abuse in its business activities if such enforcement action does not modify, affect, or supersede the operation of any provision of this Act or of any other Federal law.

(4) CERTAIN ACTIVITIES.—With respect to the following, subsection (b) shall be read by substituting "at least one day" for "more than 21 days in the aggregate":

(A) The sale within a State of tangible personal property, if delivery of the property originates and is completed within the State.

(B) The performance of services that physically affect real property within a State.

(5) EXCEPTION RELATING TO CERTAIN PERFORMANCES AND SPORTING EVENTS.—With respect to the taxation of the following, subsection (b) shall be read by substituting "at least one day" for "more than 21 days in the aggregate":

(A) A live performance in a State, before a live audience of more than 100 individuals.

(B) A live sporting event in a State before more than 100 spectators present at the event.

(e) RULE OF CONSTRUCTION.—This section shall not be construed to modify, affect, or supersede the operation of title I of the Act entitled "An Act relating to the power of the States to impose net income taxes on income derived from interstate commerce, and authorizing studies by congressional committees of matters pertaining thereto", approved September 14, 1959 (15 U.S.C. 381 et seq.).

SEC. 4. DEFINITIONS.

The following definitions apply in this Act:

(1) NET INCOME TAX.—The term "net income tax" has the meaning given that term for the purposes of the Act entitled "An Act relating to the power of the States to impose net income taxes on income derived from interstate commerce, and authorizing studies by congressional committees of matters pertaining thereto", approved September 14, 1959 (15 U.S.C. 381 et seq.).

(2) OTHER BUSINESS ACTIVITY TAX.—

(A) The term "other business activity tax" means—

(i) a tax imposed on or measured by gross receipts, gross income, or gross profits;

(ii) a business license tax;

(iii) a business and occupation tax;

(iv) a franchise tax;

(v) a single business tax or a capital stock tax; or

(vi) any other tax imposed by a State on a business for the right to do business in the State or measured by the amount of, or economic results of, business or related activity conducted in the State.

(B) The term "other business activity tax" does not include a sales tax, a use tax, or a similar tax, imposed as the result of the sale or acquisition of goods or services, whether or not denominated a tax imposed on the privilege of doing business.

(3) STATE.—The term "State" means any of the several States, the District of Columbia, or any territory or possession of the United States, or any political subdivision of any of the foregoing.

(4) TANGIBLE PERSONAL PROPERTY.—The term "tangible personal property" does not include computer software that is owned and licensed by the owner to another person.

SEC. 5. EFFECTIVE DATE.

Except as provided otherwise in this Act, this Act applies with respect to taxable periods beginning on and after the first day of the first year that begins after the date of enactment of this Act.

PURPOSE AND SUMMARY

H.R. 1956, the "Business Activity Tax Simplification Act of 2006,"[1] provides a bright-line physical presence nexus requirement in order for States to collect net income taxes or other business activity taxes on multistate enterprises. H.R. 1956 would amend Public Law 86–272,[2] enacted in 1959, which prohibits States from imposing taxes on the net income of interstate sellers of tangible personal property if the only business activity within the State consists of the solicitation of certain sales orders. H.R. 1956 lists the conditions that a business must meet in order to establish a physical presence for the purposes of a State imposing business activity taxes. It also cites those conditions that should be disregarded in determining whether a business has established physical presence within a State. H.R. 1956 promotes interstate commerce by creating certainty for both States and businesses to know when a business has a taxable nexus within a State.

BACKGROUND AND NEED FOR THE LEGISLATION

Legislation similar to H.R. 1956 was introduced in the 107th[3] and the 108th[4] Congresses. On September 11, 2001, the Subcommittee on Commercial and Administrative Law held a hearing on H.R. 2526. While the hearing was adjourned prematurely due to the terrorist attacks in New York and Washington, D.C., testimony was received from the following witnesses: Stanely Sokul, Member of the Advisory Commission on Electronic Commerce and Principal of Davidson & Company; Fred Montgomery, Director of State and Local Tax of Sara Lee Corporation; Arthur Rosen, Chairman of the Coalition for Rational and Fair Taxation and partner at the law firm of McDermott, Will & Emery; and June Summer Haas, Commissioner of Revenue of the Michigan Department of Treasury.[5] The Subcommittee, by voice vote, favorably reported the bill, as amended, to the full committee.[6]

In the 108th Congress, the Subcommittee on Commercial and Administrative Law once again held hearings on business activity tax legislation, H.R. 3220. Testimony was received from: Rick Clyburgh, the Tax Commissioner for the State of North Dakota; Jamie Van Fossen, State Representative for the 81st House District of the State of Iowa; Arthur Rosen, Chairman of the Coalition for Rational and Fair Taxation and partner at the law firm of

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[1] H.R. 1956 was introduced by Representative Bob Goodlatte (R–VA) on April 28, 2005.

[2] Pub. L. No. 86–272, 73 Stat. 555 (1959) (codified, as amended, at 15 U.S.C. § 381 et seq. (2004)).

[3] Internet Tax Fairness Act of 2001, H.R. 2526, 107th Cong. (2001) (introduced by Representative Bob Goodlatte (R–VA) on July 17, 2001). In addition to the physical presence nexus requirements, this bill originally included a permanent ban on Internet access taxes, as well as a ban on multiple or discriminatory taxes levied on goods sold online.

[4] Business Activity Tax Simplification Act of 2003, H.R. 3220, 108th Cong. (2003) (introduced by Representative Bob Goodlatte (R–VA) on October 1, 2003).

[5] Internet Tax Fairness Act of 2001: Hearing on H.R. 2526 Before Subcomm. on Commercial & Admin. Law of the H. Comm. on the Judiciary, 107th Cong. 4–6 (2001) (Statement of Rep. Bob Barr, Chairman, Subcomm. on Commercial & Admin. Law of the H. Comm. on the Judiciary).

[6] The substitute amendment struck the title and Internet tax language in the bill and renamed the measure the "Business Activity Tax Modernization Act of 2002." There was no further action on H.R. 2526 in the 107th Congress.

McDermott, Will & Emery; and Vernon Turner, Corporate Tax Director of SmithField Foods, Inc.[7]

Most States and some local governments levy a range of business activity taxes on companies that either operate or conduct business activities within their jurisdictions. With the exception of Nevada, South Dakota, Washington, and Wyoming, all States and the District of Columbia levy general corporate income taxes. The rates for income taxes range from 1 percent in Alaska to 9.99 percent in Pennsylvania.[8] In 2004, corporate income taxes imposed by the States accounted for only 5.19 percent of all of the taxes collected by the States.[9] Most States also require nonresident corporations to remit taxes if they reach out or otherwise "purposefully avail" themselves of the privilege of doing business in the taxing State. The conceptual and legal bases for this taxing authority are often somewhat tenuous, resting upon imprecise formulations and shifting jurisdictional theories. The determination of the outer limits of State taxing power over nonresident businesses has given rise to substantial litigation between State taxing authorities and multistate business enterprises. While State and local governments may tax transactions occurring within their jurisdictions, this authority is not unlimited. More specifically, the Constitution imposes constraints on a State is power to compel nonresident business entities to collect and remit taxes.

1. CONSTITUTIONAL LIMITATIONS ON STATE TAXING AUTHORITY

Dormant commerce clause

The Commerce Clause of the Constitution authorizes Congress to "regulate Commerce with foreign Nations, and among the several States."[10] While the Commerce Clause establishes a predicate for Congressional regulation, the Supreme Court has also interpreted the Commerce Clause to create a negative limitation on State power to regulate in areas that might adversely affect interstate commerce. This limitation on State power is referred to as the Dormant Commerce Clause. Since State taxation of commerce may burden interstate commerce, the Court has placed constitutional constraints on State taxing authority.[11]

The fullest legal explanation of Dormant Commerce Clause limitations on State taxing authority is contained in Quill Corp. v. North Dakota.[12] Quill concerned North Dakota's attempt to require an out-of-state mail order catalog retailer to collect and pay a use tax on goods purchased for use within the State. Quill Corporation, a Delaware corporation, grossed more than $1 million a year in mail order catalog sales to North Dakota residents, but lacked a physical presence in the State. When North Dakota moved to com-

[7] Business Activity Tax Simplification Act of 2003, Hearing on H.R. 3220 Before the Subcomm. on Commercial & Admin. Law of the H. Comm. On the Judiciary, 108th Cong. 6–7 (2004) (Statement of Rep. Chris Cannon, Chairman, Subcomm. on Commercial & Admin. Law of the H. Comm. on the Judiciary).

[8] Federation of Tax Administrators, Range of State Corporate Income Tax Rates (2005), http://www.taxadmin.org/fta/rate/corp_inc.html.

[9] U.S. Census Bureau, State Government Tax Collections: 2004 (2005), http://www.census.gov/govs/statetax/0400usstax.html.

[10] U.S. Const. art. I, sec. 8, cl. 2.

[11] Ronald Rotunda, Modern Constitutional Law 135 (5th ed. 1998).

[12] 504 U.S. 298 (1992). While traditional "brick and mortar" sales outlets are required to collect State and local sales taxes, remote electronic sellers may escape State taxation if they lack a "substantial nexus" with the buyer's State.

pel Quill Corporation to collect and remit use taxes, the corporation resisted on the grounds that such action by the State was unconstitutional. The Supreme Court concluded North Dakota's efforts to compel a remote seller to collect and remit use taxes to that State without a physical presence or other "substantial nexus" violated the Commerce Clause.[13] By requiring a remote seller to have a physical presence in the taxing State, the Court maintained a previously enunciated use tax safe harbor for remote vendors "whose only connection with customers in the taxing State is by common carrier or United States mail."[14]

Due process clause

The Fourteenth Amendment of the Constitution has been interpreted to limit the power of a State government to assert taxing jurisdiction over parties who do not reside in the forum State. A State statute imposing taxes on nonresident businesses will withstand Due Process challenge if the taxing State demonstrates "some definite link, some minimum connection, between a State and the person, property or transaction it seeks to tax."[15] As long as the business entity (be it a remote seller or a nonresident corporation) "purposefully avails itself of the benefits of an economic market in the forum State, it may be subject to the State's jurisdiction even if it has no physical presence in the State."[16]

To curb perceived prospective tax revenue losses, some States have begun to consider novel theories for expanding their taxing authority over remote sellers. For example, some tax officials have speculated that an Internet service provider (ISP), which connects consumers to the Internet, acts as an agent of online sellers and therefore creates a "nexus" for electronic merchants "doing business" in the taxing State. But, the existence of a plethora of conflicting jurisdictional taxing criteria for out-of-state businesses burdens interstate commerce.

2. PUBLIC LAW 86–272

To provide a measure of jurisdictional clarity over State efforts to tax out-of-state businesses on sales of tangible goods, Congress passed Public Law 86–272 in 1959[17]. This law prohibits States from imposing taxes on the net income of interstate sellers of tangible personal property if the only business activities within the State consist of:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and if approved, are filled by shipment or delivery from a point outside the State; and (2) the solicitation of orders by such person, or his rep-

[13] The Quill Court reiterated the four part test enunciated in *Complete Auto Transit Inc.* v. *Brady,* 430 U.S. 274 (1977), holding that State taxation survives Dormant Commerce Clause challenge if the tax:

(1) is applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned;

(3) does not discriminate against interstate commerce and;

(4) is fairly related to services provided by the State.

Quill, 504 U.S. at 311.

[14] National Bellas Hess, Inc. v. Dept. of Revenue of Illinois, 386 U.S. 753 (1967).

[15] Quill, 504 U.S. at 306 (quoting Miller Bros. Co. v. Maryland, 311 U.S. 457, 463 (1940)).

[16] Id. at 307. See also International Shoe v. Washington, 326 U.S. 310 (1945).

[17] 15 U.S.C §381 et seq. (2004).

resentative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation.

This law provides that a State lacks authority to tax a nonresident business if its only activities in the taxing State consist of the solicitation or delivery of orders for tangible personal property.

3. CONTINUED LEGAL UNCERTAINTY FOR NONRESIDENT MULTISTATE BUSINESSES

Enactment of Public Law 86–272 helped c1arify the necessary jurisdictional predicates for taxing nonresident corporations on the sale of tangible goods. However, this law did not resolve all questions in this area because it did not define the term "solicitation," and state decisions have conflicted on this point. More critically, today's economy is drastically different from that of 1959 and is based much more upon services and commerce in intangible property. The rise of the digital, service-based economy has made nonresident sellers of intangible goods and services vulnerable to taxation by distant state and local taxing officials. For example, states have imposed business activity taxes on an out-of-state bank simply because these banks issued credit cards to state residents.[18]

The importance of the service sector to the United State's economy cannot be overlooked. The percentage of the economic output that is serviced based continues to increase every year. In 2005, the service sector of the country's GDP grew by 4.1 percent, as opposed to the goods sector that grew at only 2.6 percent. The group of industries including finance, insurance, real estate, rental, and leasing contributed 24 percent to the real GDP growth in 2005. Over the last 4 years, the service industries sector of the GDP has grown at a greater rate than that of the goods sector. It is important to encourage policies that nurture the growth of this vital sector of the Untied State's economy.[19]

The current situation of uncertainty concerning the tax liabilities of business and how aggressive the State revenue departments may become has "placed a real drag on American business, hurting American job growth and harming the entire U.S. Economy."[20] During the hearings held by the Subcommittee on Commercial and Administrative Law, Lyndon William testified that the current taxation standards have "lead to a great uncertainty and unpredictability in the manner in which multi-state businesses are taxed * * *"[21] A physical presence standard for the creation of a business activity taxing nexus would remove this taxing uncertainty by prohibiting states from taxing corporations if they lack tangible property or employees in the taxing jurisdiction for a set period of

[18] J.C. Penney National Bank v. Johnson, No. MI998–00497–COA–R3–CV (Tenn. Ct. App. Dec. 17, 1999), appeal denied, (Tenn. May 8, 2000).

[19] See Bureau of Economic Analysis, U.S. Department of Commerce, Services and Goods Sectors Strong in 2005: Advance Estimates of Gross Domestic Product (GDP) by Industry (April 27, 2006), http://www.bea.gov/bea/newsrelarchive/2006/gdpind05.pdf

[20] Business Activity Tax Simplification Act of 2003: Hearing on H.R. 3220 Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary, 108th Cong. 8 (2004) (statement of Arthur Rosen, Chairman of the Coalition for Rational and Fair Taxation and partner at the law firm of McDermott, Will & Emery).

[21] Business Activity Tax Simplification Act of 2005: Hearing on H.R. 1956 Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary, 109th Cong. 28 (2005) (statement of Lyndon Williams, Tax Counsel for Citigroup Corp).

time within a taxing period. It would provide certainty regarding when a state can tax a business, providing the stability and predictability needed by business, especially small businesses.

HEARINGS

The Committee's Subcommittee on Commercial and Administrative Law held one day of hearings on H.R. 1956 on September 27, 2005. Testimony was received from the following witnesses: Carey J. "Bo" Horne, President of ProHelp Systems, Inc. a home-based software business in South Carolina; Earl Ehrhart, State Representative for the 36th House District of the State of Georgia and National Chairman of the American Legislative Exchange Council; Joan Wagnon, Secretary of Revenue for the State of Kansas and Chair of the Multistate Tax Commission; and Lyndon D. Williams, Tax Counsel for Citigroup Corp. Additional material was submitted by other individuals and organizations.

COMMITTEE CONSIDERATION

On December 13, 2005, the Subcommittee on Commercial and Administrative Law met in open session and ordered favorably reported the bill H.R. 1956, as amended, by a voice vote, a quorum being present. On June 28, 2006, the Committee met in open session and ordered favorably reported the bill H.R. 1956 with an amendment by voice vote, a quorum being present.

VOTE OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the Committee notes that there were no recorded votes during the committee consideration of H.R. 1956.

COMMITTEE OVERSIGHT FINDINGS

In compliance with clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee reports that the findings and recommendations of the Committee, based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

NEW BUDGET AUTHORITY AND TAX EXPENDITURES

Clause 3(c)(2) of rule XIII of the Rules of the House of Representatives is inapplicable because this legislation does not provide new budgetary authority or increased tax expenditures.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the Committee sets forth, with respect to the bill, H.R. 1956, the following estimate and comparison prepared by the Director of the Congressional Budget Office under section 402 of the Congressional Budget Act of 1974:

JULY 11, 2006.

Hon. F. JAMES SENSENBRENNER, Jr.,
Chairman, Committee on Judiciary,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 1956, the Business Activity Tax Simplification Act of 2005.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Sarah Puro (for the state and local impact) and Barbara Edwards (for federal revenues).

Sincerely,

DONALD B. MARRON,
Acting Director.

Enclosure.

H.R. 1956—Business Activity Tax Simplification Act of 2005

Summary: H.R. 1956 would amend current law to prohibit state and local governments from taxing certain business activities that are currently taxable. Specifically, it would prohibit those governments from taxing certain services, intangible goods, media activities, and some financial activities unless businesses have a "substantial physical presence"—as defined in the bill—in a jurisdiction.

CBO estimates that enacting H.R. 1956 would increase federal revenues by $106 million in 2007, by $1.2 billion over the 2007–2011 period, and by $3.1 billion over the 2007–2016 period. The bill would have no other impacts on the federal budget.

By prohibiting state and local governments from taxing certain business activities, H.R. 1956 would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). CBO estimates that the costs—in the form of forgone revenues—to state and local governments would exceed $1 billion in the first full year after enactment and would likely grow to about $3 billion, annually, by 2011. These costs would exceed the threshold established in UMRA for intergovernmental mandates ($64 million in 2006, adjusted annually for inflation).

This bill contains no new private-sector mandates as defined in UMRA.

Estimated effect on the Federal Government: The estimated budgetary impact of H.R. 1956 is shown in the following table.

	By fiscal year, in millions of dollars—									
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
CHANGES IN REVENUES										
Estimated Revenues	106	225	280	301	319	340	355	367	379	390

CBO expects that enacting H.R. 1956 would reduce payments of certain state and local taxes by corporations. These lower payments would, in turn, reduce deductions made by corporations for federal taxes and raise taxable income for federal purposes. State and local governments are expected to adjust their finances as a result of these lost revenues. They would likely achieve this through some mix of reduced spending and higher taxes and fees—both deductible and non-deductible. This response by state and local governments would mute, but not eliminate, the revenue gain to the federal government. CBO estimates that, on balance, H.R. 1956 would increase federal revenues by $106 million in 2007, by $1.2 billion over the 2007–2011 period, and by $3.1 billion over the 2007–2016 period.

Intergovernmental mandates contained in the bill: H.R. 1956 would amend current law to prohibit state and local governments from taxing certain business activities that are taxable under current law. Specifically, it would prohibit those governments from taxing certain services, intangible goods, media activities, and some financial activities unless businesses have a "substantial physical presence"—as defined in the bill—in a jurisdiction.

Current law (Public Law 86–272) and certain Supreme Court decisions prohibit states from levying a tax on the corporate (net) income tax of a company whose only activity in the state is pursuing and making sales that would be filled from outside the state (e.g., mail order sales). H.R. 1956 would expand the prohibition under Public Law 86–272 to certain other types of business activity taxes (BATs), including additional corporate income taxes, franchise taxes, single business taxes, capital state taxes, gross receipt taxes, and business and occupation taxes. Corporations currently pay these taxes to a state only if the state can establish "nexus" with the firm. ("Nexus" is the connection between a firm and a state that allows the state to legally impose taxes on the firm.) H.R. 1956 would redefine "nexus" and preempt state laws that are different from that definition. Such a preemption would constitute a mandate as defined in UMRA and would result in forgone revenues to state and local governments because of the new definition.

Specifically, provisions in the bill would:

- Define physical presence for firms not based in a state;
- Establish a uniform nexus standard nationwide—an entity would need to be physically present in a state for 21 or more days to establish nexus;
- Create "carve outs" from the 21-day standard that would allow certain industries or activities (including banking and media) to exceed the standard without establishing nexus with a state;
- Expand the prohibitions in Public Law 86–272 to include certain taxes not based solely on the income of a company (i.e., gross receipts taxes, franchises taxes and business and occupation taxes); and
- Expand the applicability of Public Law 86–272 to services and intangibles (e.g., the trademark for a retail store or the patent for a formula for soda).

Estimated direct costs of mandates to state and local governments: CBO estimates that enacting H.R. 1956 would result in revenue losses for states and some local governments and that such losses likely would total more than $1 billion in the first full year after enactment. We estimate that forgone revenues would grow to about $3 billion annually by 2011. These forgone revenues are about 2 percent of the total BATs collected by states in 2006 and about 4.5 percent of the amount expected to be collected in 2011, and would far exceed the threshold established in UMRA ($64 million in 2006, adjusted annually for inflation.) In 2005, states collected almost $650 billion in total taxes. In the year following enactment, the revenue losses resulting from H.R. 1956 would total significantly less than one percent of total state tax collections and about 3 percent of collections from corporate income taxes.

UMRA includes in its definition of the direct costs of a mandate the amounts that state and local governments would be prohibited from raising in revenues as a result of the mandate. The direct mandate costs of H.R. 1956 would be the tax revenues that state and local governments are currently collecting but would be precluded from collecting under the bill. Further, UMRA's definition of the net costs of a mandate excludes additional revenues that state and local governments might raise in reaction to enactment of that mandate.

CBO expects that all states and some local governments would see an immediate revenue loss because they are currently collecting taxes from firms that would be exempt from taxation under the bill. This initial effect would likely exceed $1 billion, annually, nationwide. Subsequently, it is likely that corporations would rearrange their business activities to take advantage of beneficial tax treatments that would result from the interaction of the new federal law and certain state taxing regimes. CBO expects that these reorganizations would occur during the first five years after enactment of the legislation and estimates that forgone revenues to state and local governments would likely total about $3 billion, annually, by 2011.

While virtually all states would lose revenues, about 70 percent of the estimated losses would come from ten states: California, Florida, Illinois, Michigan, New Jersey, New York, Pennsylvania, Tennessee, Texas, and Washington. These states would experience the largest losses because of the size and organization of their economies, or the current structure of their state tax systems.

Basis of estimate for intergovernmental mandates costs: CBO used information from a variety of sources to estimate the state revenue losses that likely would result from enactment of this legislation.[1] Using data from the states, industry, and the Census Bureau, CBO estimated potential losses based on current receipts, projected receipts (when available), the industrial and commercial profile of state economies, and the structure of state taxing systems—including information from precedents issued by state tax departments.

States use a variety of rules to determine whether a company is subject to taxation—if it has nexus—and if so, how the activities in which that company engages are taxed. The differences in state taxing systems affect how much revenue each state or local government would likely forgo under the provisions of the bill. CBO examined both characteristics of the corporate tax structure of each state and data about the economic makeup of each state in order to estimate potential revenue losses.

To estimate the costs of enacting H.R. 1956 to state and local governments, CBO first estimated the total amount of BATs paid by corporations in each state. Such taxes totaled about $60 billion in 2005. Since certain industries are significantly less likely to be operating from outside the state than others, CBO used informa-

[1] Although the bill's provisions also would affect collection of taxes by some local governments, CBO has not separately estimated the potential loss for such governments. Relatively few local governments (in fewer than 10 states) impose significant business taxes.

tion about the industrial and commercial makeup of states to calculate BATs that could be at risk if H.R. 1956 is enacted. Overall, we estimate that about 75 percent of total income from BATs could be at risk under the bill. The portion at risk, however, would vary significantly from state to state.

As noted above, CBO expects that states would lose only a small percent of BATs—about 2 percent in the first year after enactment and about 4.5 percent in 2011, nationwide. Further, those loses would be a very small percentage of total state tax collections. To calculate losses for 2006 and 2011, CBO estimated the likely percentage that states would lose based on their current tax systems and applied that to the BATs potentially at risk.

Losses also would depend on the current characteristics of each state tax system. For example, a large state with a heavily information-based economy that does not currently require a company to have a physical presence to establish nexus and only assesses corporate income tax based on the amount of sales in the state would see a significant loss of revenue. In contrast, a small state that requires physical presence to establish nexus and that has a predominately agrarian or manufacturing economy would see a much smaller loss.

In the absence of this legislation, it is possible that some state and local governments would enact new taxes or change the way they tax businesses. Since such changes are difficult to predict, for the purposes of estimating the direct costs of the mandate, CBO considered only the revenues from taxes that are currently in place and actually being collected or estimates for changes that are already in statute and will be implemented over the next five years.

Impact on the private sector: The bill contains no new private-sector mandates as defined in UMRA.

Estimate prepared by: Impact on State, Local, and Tribal Governments: Sarah Puro. Federal Revenues: Barbara Edwards. Impact on the Private Sector: Paige Piper/Bach.

Estimate approved by: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis. G. Thomas Woodward, Assistant Director for Tax Analysis.

PERFORMANCE GOALS AND OBJECTIVES

The Committee states that pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, H.R. 1956, provides a physical presence nexus standard that business would have to meet before a State could determine that the business is within the State's taxing jurisdiction for business activity taxes.

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Committee finds the authority for this legislation in article I, section 8 of the Constitution.

SECTION-BY-SECTION ANALYSIS AND DISCUSSION

The following discussion describes the bill as reported by the Committee.

Section 1. Short title

This section sets forth the title of the bill as the "Business Activity Tax Simplification Act of 2006".

Section 2. Removal of certain limitations on the application of Public Law 86–272

This section amends Public Law 86–272 by striking references to "tangible personal property," thereby extending the prohibition on the imposition by States of net income taxes where the only business activity of a company is the solicitation of orders for a sale in that State. This section also extends the prohibition to "other business activity taxes" as defined in Section 4.

Section 3. Jurisdictional standard for State and local net income taxes and other business activity taxes

Subsection (a) presents the jurisdictional standard of "physical presence" for State and local income taxes and other business activity taxes. Specifically, it provides that no State may impose a net income or other business activity tax on any business engaged in interstate commerce unless that business has a physical presence within the taxing jurisdiction during the taxable period.

Subsection (b) provides that "physical presence" is established only if the business activities within the State include any of the following:

(A) Being an individual physically within the State, or assigning one or more employees to be in the State, on more than 21 days. The following activities are disregarded in determining whether the 21-day limit has been exceeded:

- Activities in connection with possible purchase of goods or services, for consumption by the person's business.
- Gathering news for print, broadcast, or other distribution through the news media.
- Meeting government officials for purposes other than selling goods or services, for consumption by such government.
- Merely attending educational or training conferences, seminars or other similar functions.
- Nonprofit participation in charitable activities.

(B) Using the services of an agent (excluding an employee) to establish or maintain the market in the State, if such agent does not perform business services in the State for any other person during such taxable year.

(C) The leasing or owning of tangible personal property or of real property in the State, except that the following shall be excluded in determining whether the 21-day limit has been exceeded:

- Tangible property located in the State for purposes of being assembled, manufactured, processed, or tested by another person for the benefit of the owner or lessee, or used to furnish a service to the owner or lessee by another person.
- Marketing or promotional materials distributed in the State.
- Any property to the extent used ancillary to an activity excluded from the computation of the 21-day period under paragraph (1) or (2).

Subsection (c) clarifies that any requirements for establishing physical presence for taxable periods not consisting of a year shall be adjusted pro rata.

Subsection (d) delineates the exceptions to the bill's general requirements. It specifies that States are not prohibited from taxing the following: (a) entities incorporated or formed under the laws of the State or commercially domiciled in the State in question; (b) individuals domiciled in the State; (c) or the owner or beneficiary of an entity that is a partnership, an S corporation, a limited liability company, a trust, an estate or any other similar entity that has a physical presence in the State. Subsection (d)(3) stipulates that nothing in the bill is to be construed to supercede a State's authority to bring enforcement actions against entities or persons acting illegally. For example, a State will still be allowed to enforce its laws regarding tax shelters or "sham transactions."

Further, the 21-day rule is reduced to one day for live performances and sporting events in a State when the audience is more than 100 individuals, when sales of tangible personal property are made within a State if the delivery is completed within the State, and for the performance of service that physically affects real property within the State.

Section 4. Definitions

Section 4 sets forth the operative definitions for the Act. "Other business activity tax" is specifically defined as:

- a tax imposed on or measured by gross receipts, gross income, or gross profits
- a business license tax
- a business and occupation tax
- a franchise tax
- a single business tax or capital stock tax, or
- any other tax imposed by a State on a business for the right to do business in the State or measured by the amount of, or economic results of, business or related activity conducted in the State.

The term excludes any sales, use or similar taxes imposed as the result of a sale or acquisition of a good. Further, subsection (4) excludes computer software owned and licensed by the owner to another person from the definition of tangible personal property.

Section 5. Effective date

This section provides that the effective date for the Act begins on the taxable period beginning on or after the first day of the first year after the enactment of this Act.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

ACT OF SEPTEMBER 14, 1956

AN ACT Relating to the power of the States to impose net income taxes on income derived from interstate commerce, and authorizing studies by congressional committees of matters pertaining thereto.

Be it enacted by the Senute and House of Representatives of the United States of America in Congress assembled,

TITLE I—IMPOSITION OF MINIMUM STANDARD

SEC. 101. (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales ⟦of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and⟧ *or transactions, which orders are sent outside the State for approval or rejection and, if approved, are—*

(A) in the case of tangible personal property, filled by shipment or delivery from a point outside the State; and

(B) in the case of all other forms of property, services, and other transactions, fulfilled from a point outside the State;

and

* * * * * * *

(c) For purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales *or transactions* in such State, or the solicitation of orders for sales *or transactions* in such State, ⟦of tangible personal property⟧ on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales *or fulfilling transactions*, or soliciting orders for sales *or transactions* ⟦, of tangible personal property⟧.

(d) For purposes of this section—

(1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for ⟦the sale of, tangible personal property⟧ *a sale or transaction,* for more than one principal and who holds himself out as such in the regular course of his business activities; and

* * * * * * *

SEC. 105. Beginning with taxable periods beginning on or after the first day of the first calendar year that begins after the date of the enactment of the Business Activity Tax Simplification Act of 2006, the prohibitions of section 101 that apply with respect to net income taxes shall also apply with respect to each other business activity tax, as defined in section 4 of the Business Activity Tax Sim-

plification Act of 2006. A State or political subdivision thereof may not assess or collect any tax which by reason of this section the State or political subdivision may not impose.

MARKUP TRANSCRIPT

BUSINESS MEETING

WEDNESDAY, JUNE 28, 2006

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Committee met, pursuant to notice, at 10:07 a.m., in Room 2141, Rayburn House Office Building, the Honorable F. James Sensenbrenner, Jr. (Chairman of the Committee) presiding.

[Intervening business.]

Chairman SENSENBRENNER. The next item on the agenda is H.R. 1956, the "Business Activity Tax Simplification Act."

[The bill, H.R. 1956, follows:]

I

109TH CONGRESS
1ST SESSION

H. R. 1956

To regulate certain State taxation of interstate commerce; and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

APRIL 28, 2005

Mr. GOODLATTE (for himself, Mr. BOUCHER, Mr. CROWLEY, Mr. FORBES, Mr. MEEKS of New York, Mr. CHABOT, Mr. BACHUS, Mr. BOEHNER, Mrs. DRAKE, Mr. TIBERI, Mr. CANTOR, Mr. MORAN of Virginia, and Mr. SMITH of Texas) introduced the following bill; which was referred to the Committee on the Judiciary

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A BILL

To regulate certain State taxation of interstate commerce; and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Business Activity Tax Simplification Act of 2005".

SEC. 2. REMOVAL OF CERTAIN LIMITATIONS ON THE APPLICATION OF PUBLIC LAW 86–272.

(a) SOLICITATIONS WITH RESPECT TO SALES AND TRANSACTIONS OF OTHER THAN TANGIBLE PERSONAL

PROPERTY.—Section 101 of the Act entitled "An Act relating to the power of the States to impose net income taxes on income derived from interstate commerce, and authorizing studies by congressional committees of matters pertaining thereto", approved September 14, 1959 (15 U.S.C. 381 et seq.) is amended—

(1) in subsection (a)(1) by striking "of tangible" and all that follows through "State; and" and inserting the following:

"or transactions, which orders are sent outside the State for approval or rejection and, if approved, are—

"(A) in the case of tangible personal property, filled by shipment or delivery from a point outside the State; and

"(B) in the case of all other forms of property, services, and other transactions, fulfilled from a point outside the State;

and";

(2) in subsection (c)—

(A) by inserting "or fulfilling transactions" after "making sales";

(B) by inserting "or transactions" after "sales" the other places it appears; and

(C) by striking "of tangible personal property" each place it appears; and

(3) in subsection (d) by striking "the sale of, tangible personal property" and inserting "a sale or transaction,".

(b) APPLICATION OF PROHIBITIONS TO OTHER BUSINESS ACTIVITY TAXES.—Title I of the Act entitled "An Act relating to the power of the States to impose net income taxes on income derived from interstate commerce, and authorizing studies by congressional committees of matters pertaining thereto", approved September 14, 1959 (15 U.S.C. 381 et seq.) is amended by adding at the end the following:

"SEC. 105. Beginning with taxable periods beginning on or after the first day of the first calendar year that begins after the date of the enactment of the Business Activity Tax Simplification Act of 2005, the prohibitions of section 101 that apply with respect to net income taxes shall also apply with respect to each other business activity tax, as defined in section 4 of the Business Activity Tax Simplification Act of 2005. A State or political subdivision thereof may not assess or collect any tax which by reason of this section the State or political subdivision may not impose.".

(c) EFFECTIVE DATE OF SUBSECTION (a) AMENDMENTS.—The amendments made by subsection (a) shall apply with respect to the imposition, assessment, and collection of taxes for taxable periods beginning on or after the first day of the first calendar year that begins after the date of the enactment of the Business Activity Tax Simplification Act of 2005.

SEC. 3. JURISDICTIONAL STANDARD FOR STATE AND LOCAL NET INCOME TAXES AND OTHER BUSINESS ACTIVITY TAXES.

(a) IN GENERAL.—No taxing authority of a State shall have power to impose, assess, or collect a net income tax or other business activity tax on any person relating to such person's activities in interstate commerce unless such person has a physical presence in the State during the taxable period with respect to which the tax is imposed.

(b) REQUIREMENTS FOR PHYSICAL PRESENCE.—For the purposes of subsection (a), a person has a physical presence in a State only if such person's business activities within the State include any of the following during such person's taxable year:

(1) Being an individual physically within the State, or assigning one or more employees to be in the State, on more than 21 days, except that the fol-

lowing shall be disregarded in determining whether such 21-day limit has been exceeded:

(A) Activities in connection with a possible purchase of goods or services for the business.

(B) Gathering news and covering events for print, broadcast, or other distribution through the media.

(C) Meeting government officials for purposes other than selling goods or services.

(D) Participation in educational or training conferences, seminars or other similar functions.

(E) Participating in charitable activities.

(2) Using the services of another person, except an employee, in the State, on more than 21 days to establish or maintain the market in the State, unless such other person performs similar functions on behalf of at least one additional business entity during the taxable year.

(3) The leasing or owning of tangible personal property or of real property in the State on more than 21 days, except that the following shall be disregarded in determining whether such 21-day limit has been exceeded:

(A) Tangible personal property located in the State for purposes of being assembled, manufactured, processed, or tested by another person for the benefit of the owner or lessee, or used to furnish a service to the owner or lessee by another person.

(B) Marketing or promotional materials distributed in the State using mail or a common carrier, or as inserts in or components of publications.

(C) Any property to the extent used ancillary to an activity excluded from the computation of the 21-day period under paragraph (1) or (2).

(c) TAXABLE PERIODS NOT CONSISTING OF A YEAR.—If the taxable period for which the tax is imposed is not a year, then any requirements expressed in days for establishing physical presence under this Act shall be adjusted pro rata accordingly.

(d) EXCEPTIONS.—

(1) DOMESTIC BUSINESS ENTITIES AND INDIVIDUALS DOMICILED IN THE STATE.—Subsection (a) does not apply with respect to—

(A) a person (other than an individual) that is incorporated or formed under the laws of the State, or domiciled in the State, in which the tax is imposed; or

(B) an individual who is domiciled in the State in which the tax is imposed.

(2) TAXATION OF PARTNERS AND SIMILAR PERSONS.—If a taxing authority is not prohibited by this section from taxing an entity that is a partnership, an S corporation (as defined in section 1361 of the Internal Revenue Code of 1986), a limited liability company, a trust, or an estate, or another similar entity, that taxing authority is also not prohibited by this section from taxing the owners or beneficiaries of the entity, if State law imposes the tax not on the entity itself but on the entity's owners or beneficiaries, whether or not they are in the State, with respect to their ownership interest in the entity.

(3) CERTAIN ACTIVITIES.—With respect to the following, subsection (b) shall be read by substituting "one day" for "more than 21 days":

(A) The sale within a State of tangible personal property, where delivery of the property originates and is completed within the State.

(B) The performance of services that physically affect real property within a State.

(4) EXCEPTION RELATING TO CERTAIN PERFORMANCES AND SPORTING EVENTS.—With respect to the taxation of the following, subsection (b) shall be read by substituting "one day" for "more than 21 days":

(A) A live performance in a State, before a live audience of more than 100 individuals.

(B) A live sporting event in a State before more than 100 spectators present at the event.

(e) RULE OF CONSTRUCTION.—This section shall not be construed to modify, affect, or supersede the operation of title I of the Act entitled "An Act relating to the power of the States to impose net income taxes on income derived from interstate commerce, and authorizing studies by congressional committees of matters pertaining thereto", approved September 14, 1959 (15 U.S.C. 381 et seq.).

SEC. 4. DEFINITIONS.

The following definitions apply in this Act:

(1) NET INCOME TAX.—The term "net income tax" has the meaning given that term for the purposes of the Act entitled "An Act relating to the power of the States to impose net income taxes on income derived from interstate commerce, and au-

thorizing studies by congressional committees of matters pertaining thereto'', approved September 14, 1959 (15 U.S.C. 381 et seq.).

(2) OTHER BUSINESS ACTIVITY TAX.—

(A) The term ''other business activity tax'' means—

(i) a tax imposed on or measured by gross receipts, gross income, or gross profits;

(ii) a business license tax;

(iii) a business and occupation tax;

(iv) a franchise tax;

(v) a single business tax or a capital stock tax; or

(vi) any other tax imposed by a State on a business for the right to do business in the State or measured by the amount of, or economic results of, business or related activity conducted in the State.

(B) The term ''other business activity tax'' does not include a transaction tax.

(3) STATE.—The term ''State'' means any of the several States, the District of Columbia, or any territory or possession of the United States, or any political subdivision of any of the foregoing.

SEC. 5. EFFECTIVE DATE.

Except as provided otherwise in this Act, this Act applies with respect to taxable periods beginning on and after the first day of the first year that begins after the date of enactment of this Act.

Chairman SENSENBRENNER. In the absence of the gentleman from Utah, Mr. Cannon, who is the Chairman of the Subcommittee on Commercial and Administrative Law, the chair recognizes the gentleman from North Carolina, Mr. Coble, for a motion.

Mr. COBLE. I thank the Chairman.

Mr. Chairman, the Subcommittee on Commercial and Administrative law reports favorably the bill, H.R. 1956, with an amendment, and moves its favorable recommendation to the full House.

Chairman SENSENBRENNER. Without objection, the bill will be considered as read and open for amendment at any point.

And the Subcommittee amendment in the nature of a substitute, which the Members have before them, will be considered as read, considered as the original text for purposes of amendment, and open for amendment at any point.

The chair recognizes the gentleman from North Carolina, Mr. Coble, to strike the last word.

Mr. COBLE. I thank the Chairman.

Mr. Chairman and colleagues, H.R. 1956, the "Business Activity Tax Simplification Act of 2005," is designed to create a clear and concise standard to determine when a business entity has a taxable nexus in a State.

The Subcommittee on Commercial and Administrative law, under Chairman Cannon's leadership, held a hearing last September to learn more about the need for this bill and the likely effects it will have on the States, businesses, both large and small, and our constituents.

This is not a new issue for the Subcommittee. We conducted hearings on this topic, you will recall, on both the 107th and 108th Congresses, reporting legislation in the 107th Congress.

I want to commend the diligent efforts of my colleague from Virginia, Mr. Goodlatte, the bill's sponsor, who has labored on this legislation for three Congresses.

Prior to yielding my time to him, Mr. Chairman, I ask unanimous consent that Members may submit their written statements to be included in the record and to the extent I have time remaining, I yield to my colleague from Virginia.

Chairman SENSENBRENNER. Without objection, the gentleman's request is so ordered. And without objection, all Members may place opening statements in the record.

The gentleman yields to the gentleman from Virginia.

Mr. GOODLATTE. Thank you, Mr. Chairman.

I thank the gentleman from North Carolina for yielding to me. My full written statement will be made a part of the record.

I also want to thank the Chairman for scheduling this markup on the Business Activity Simplification Act. I introduced this legislation with my good friend and colleague, Congressman Boucher of Virginia, to provide a bright line rule to clarify the issue of when State and local authorities may impose business activity taxes on out-of-State entities.

Many States and local governments levy corporate income franchise and other taxes on out-of-State companies that conduct business activities within their jurisdictions. While providing revenue for States, these taxes also serve to pay for the privilege of doing business in a State.

However, with the growth of the Internet, companies are increasingly able to conduct transactions without the constraints of geopolitical boundaries. The growth of the high tech industry and interstate business-to-business and business-to-consumer transactions raises questions over where multi-State companies should be required to pay corporate income and other business activity taxes.

Over the past several years, a growing number of jurisdictions have sought to collect business activity taxes from businesses located in other States, even though those businesses receive no appreciable benefit from the taxing jurisdiction and even though the Supreme Court has ruled that the Constitution prohibits a State from imposing taxes on businesses that lack substantial connections to the State.

This has led to unfairness and uncertainty, generated contentious, widespread litigation, and hindered business expansion as businesses shy away from expanding their presence in other States for fear of exposure to unfair tax burdens.

In order for businesses to continue to become more efficient and expand the scope of their goods and services, it is imperative that clear and easily navigable rules be set forth regarding when an out-of-State business is obliged to pay business activity taxes to a State.

Otherwise, the confusion surrounding these taxes will have a chilling effect on e-commerce, interstate commerce generally, and the entire economy as the tax burdens, compliance costs, litigation and uncertainty escalate.

Previous actions by the Supreme Court and Congress have laid the groundwork for a clear, concise and modern bright line rule in this area. In the landmark case of *Quill v. North Dakota*, the Supreme Court declared that a State cannot impose a tax on an out-of-State business unless that business has a substantial nexus with the taxing State.

However, the court did not define what constituted a substantial nexus for the purposes of imposing business activity taxes.

In addition, over 40 years ago, Congress passed legislation to prohibit jurisdictions from taxing the income of out-of-State corporations whose in-State presence was nominal.

Public Law 86–272 set forth clear, uniform standards for when States could and could not impose such taxes on out-of-State businesses, when the businesses' activities involved the solicitation of orders for sales.

However, like the economy of its time, the scope of P.L. 86–272 is limited to tangible personal property. Our nation's economy has changed dramatically over the past 40 years and this outdated statute needs to be modernized.

The Business Activity Tax Simplification Act both modernizes and provides clarity in an outdated an ambiguous tax environment. First, the legislation updates the protections of P.L. 86–272. In addition, our legislation sets forth clear, specific standards to govern when businesses should be obliged to pay business activity taxes to a State.

The clarity that the Business Activity Tax Simplification Act will bring will ensure fairness, minimize litigation and create the kind of legally certain and stable business climate that encourages businesses to make investments, expand interstate commerce, grow the economy and create new jobs.

At this time, I thank the Chairman for holding——

Chairman SENSENBRENNER. The time of the gentleman from North Carolina has expired.

The gentleman from Michigan?

Mr. CONYERS. Mr. Chairman, I rise to oppose the legislation and speak in behalf of our Ranking Member, Mr. Watt, who is conducting a CBC meeting.

If only the National Governors Association would support this bill, we would realize that it might have some real significance for the several States. But as drafted, what we are doing here is virtually creating tax shelters for non-resident businesses doing a great deal of business in a State, while burdening the State's traditional brick and mortar companies.

We are creating tax shelters in this bright line legislation, as it was referred. The exemption of non-resident businesses from State and local taxation allows out-of-State companies, who often conduct major economic activities within the State, to take full advantage of State resources while shifting all the State corporate income tax burden on the in-State businesses.

Thus, resident businesses that contribute to the community by creating jobs, paying other taxes, are now further burdened, or would be, while those companies headquartered elsewhere, but doing substantial business in a State would essentially get a free ride.

This isn't fair. The National Governors Association describes this bill as a huge unfunded mandate that will result in the loss of billions of State dollars and that is across the country.

But in my State of Michigan, the State treasurer did a revenue analysis, calculating a potential loss of more than $417.5 million annually if this legislation was enacted.

In an era where our States are in desperate need for revenue for the protection of citizens, should we enact legislation that would reduce their funds? I think not. This is patently unfair legislation which would have a clear detrimental effect on State revenue.

Please consider this with great care and I think the Committee will reject House Resolution 1956.

I return my unused time.

Chairman SENSENBRENNER. Are there any amendments to the amendment in the nature of a substitute?

Mr. FORBES. Mr. Chairman?

Chairman SENSENBRENNER. The gentleman from Virginia, Mr. Forbes, for what purpose do you seek recognition?

Mr. FORBES. I have an amendment at the desk.

Chairman SENSENBRENNER. The clerk will report the amendment.

The CLERK. "Amendment offered by Mr. Forbes to the Amendment in the Nature of a Substitute to H.R. 1956. Page 5, line 23, insert 'warehoused in accordance with Article 7 of the Uniform Commercial Code, as in effect in the State,' after"——

[The amendment by Mr. Forbes follows:]

AMENDMENT OFFERED BY MR. FORBES TO THE AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 1956

Page 5, line 23, insert "warehoused in accordance with Article 7 of the Uniform Commercial Code as in effect in the State," after "processed".

Chairman SENSENBRENNER. The gentleman is recognized for 5 minutes.

Mr. FORBES. Thank you, Mr. Chairman.

Mr. Chairman, I want to first compliment Congressman Goodlatte for his hard work on this bill, which I think is an important bill, but there is one concern that I have with it and that is as it deals with public warehouses.

Currently, public warehouses are not currently taxed on goods and products that are held for a third party. And under Article 7 of the UCC, they are classified as baileys for hire, but there is a real concern that this bright line that we are putting down with this bill could be misinterpreted as a green line and a green light for States to tax warehouses after the 21-day period of time.

This amendment would make it clear that when they are holding goods under Article 7 for distribution in interstate commerce, they would not be taxed under the provisions of the bill.

However, I have had discussions with Congressman Goodlatte. It is my understanding that he is going to continue to work on trying to close this gap.

And so, Mr. Chairman, I would request unanimous consent to withdraw the amendment and to yield the balance of my time to Congressman——

Chairman SENSENBRENNER. The amendment is withdrawn.

Are there further amendments to the amendment in the nature——

Mr. SCOTT. Mr. Chairman?

Chairman SENSENBRENNER. The gentleman from Virginia, Mr. Scott?

Mr. SCOTT. Move to strike the last word.

Chairman SENSENBRENNER. The gentleman is recognized for 5 minutes.

Mr. SCOTT. Mr. Chairman, I just wanted to say this bill may not be perfect, but it certainly solves many problems that are worse than no bill at all.

I would ask unanimous consent to introduce a letter from Smithfield Foods, near our district.

Chairman SENSENBRENNER. Without objection.

[The letter follows:]

Smithfield

Smithfield Foods Inc.
200 Commerce Street
Smithfield, VA 23430

(757) 365-3000 tel
(757) 365-1835 fax

September 26, 2005

The Honorable Chris Cannon
U.S. House of Representatives
Chairman, Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
B-353 Rayburn House Office Building
Washington, DC 20515

Re: Business Activity Tax Simplification Act (H.R. 1956)

Dear Chairman Cannon:

I would like to thank you for the opportunity to submit this letter for the record on behalf of Smithfield Foods, Inc. ("Smithfield") for the September 27, 2005 legislative hearing on H.R. 1956, the Business Activity Tax Simplification Act of 2005 ("BATSA"). Smithfield is the world's largest pork processor and hog producer, with sales in all fifty states and globally in excess of $11 billion.

Current U.S. Federal legislation on state income taxation where no physical presence exists is found in Public Law 86-272. This Federal law provides that states cannot impose a net income tax on the interstate solicitations of tangible personal property. The U.S. Supreme Court further provided a brightline physical presence test for state use tax collection (*Quill Corporation v. North Dakota)*. The states and other tax experts have ranged widely in their interpretation on the breadth or limits, as the case may be, on when state income taxes can be imposed in the years since the enactment of Public Law 86-272 and the Quill decision. The gap in the law has a chilling effect on interstate commerce because of the uncertainty, confusion and inconsistencies in application of the current state tax law found across the U.S.

The consequences of uncertain state tax laws are evidenced in the high costs for companies to comply with numerous state tax laws and possibly protracted litigation, delays in product shipments due to seizures of goods, assessment of penalties in cases where interpretations differ, the loss of productivity with the numerous and complicated filings, and even unfairness against small businesses that seek to expand their sales across state lines. Small businesses do not necessarily have the resources of large corporations to deal easily with protracted litigation or navigating the myriad state tax requirements. BATSA seeks to fill the gap in legislation and remove bureaucratic arbitrariness and inconsistencies in application, making more transparent state tax requirements across the U.S. It seeks to do no more than what U.S. Federal tax law requires in international tax situations, with the "permanent establishment" theory.

Smithfield had the privilege of testifying at least year's hearing on H.R. 3220, the Business Activity Tax Simplification Act of 2003. We were asked to testify because our company knows firsthand the difficulties of doing business on a day-to-day basis across state lines due to the many interpretations of current interstate tax law (i.e.: *Public Law 86-272 and Quill*). During the hearing we recounted an illustrative incident that occurred in September 2002, when the New Jersey

Department of Taxation stopped one of our trucks and demanded money in return for the release of the truck and its driver. The demand was made despite the fact that Smithfield has no physical presence in the state and that, in the end, the New Jersey Department of Taxation agreed that Smithfield owed no such taxes.

A full account of the incident and our responses to questions is available on pages 36-38, and 61-64 of the *Hearing before the Subcommittee on Commercial and Administrative Law of the Committee on the Judiciary House of Representatives One Hundred Eighth Congress Second Session on H.R. 3220*, May 13, 2004, available at the following web address:
<http://judiciary.house.gov/media/pdfs/printers/108th/93657.PDF>.

Unfortunately, our story did not end there. Rather than being just an isolated incident, it happened again, not long after our May 2004 testimony. In December of 2004, a truck belonging to one of our subsidiaries was seized at a Costco distribution facility in New Jersey. To resolve the situation, we spoke with a person who was part of a special tax force within the New Jersey Department of Revenue (the "Special Tax Agent").

The Special Tax Agent had detained the truck for the alleged non-payment of New Jersey taxes. This person demanded $80,000 to release the truck. After hours of difficult discussion, $13,400 was mutually agreed to as a jeopardy assessment in order to release the truck. Smithfield filed a refund claim with New Jersey and ultimately received most of the $13,400, less processing costs and some fees. Smithfield was again exonerated but there is no assurance that it will not happen once, twice, or multiple times, with perhaps with even more disruptive consequences. These events demonstrate the surprise and unfairness in the state tax assessment process.

BATSA seeks to establish a clear physical presence standard that is easy to follow, comply with, and enforce. BATSA will resolve inconsistencies in the interpretation and application of current state tax laws on interstate sales of tangible personal property when no physical presence exists. Passage of BATSA will serve to reduce bureaucratic arbitrariness in the imposition of business net income taxes, and reduce the inherent unfairness toward small businesses that are discouraged from expansion by onerous, complicated and burdensome interstate tax laws. This promotes the expenditure of limited resources on what businesses are meant to do—make sales and build revenues.

Business Activity Tax Simplification Act (H.R. 1956)
September 26, 2005
Page 3 of 3

Smithfield strongly supports passage of BATSA and stands ready to provide support and information to help ensure that a more transparent and consistent physical presence standard becomes part of the law on business activity taxes. Thank you for your time and attention to our concerns.

Sincerely,

Richard J.M. Poulson
Executive Vice President, General Counsel & Senior Advisor to Chairman

Vernon T. Turner
Corporate Tax Director

Mr. SCOTT. That outlines part of the problems. And I will just recite a couple of paragraphs from the letter.

One of the problems they encountered was in New Jersey. "The Department of Taxation in New Jersey stopped one of our trucks and demanded, in return, the release of the truck and its driver. The demand was made despite the fact that Smithfield has no physical presence in the State and that, in the end, New Jersey's Department of Taxation agreed that Smithfield owed no such taxes."

A full account and our response to questions was made available in the hearing record of the Subcommittee.

Unfortunately, the story did not end there. Rather than being just an isolated incident, it happened again not long after the testimony.

In December 2004, a truck belong to one of our subsidiaries was seized at a Costco distribution facility in New Jersey. To resolve the situation, they spoke to a person who was part of the special task force within the New Jersey Department of Revenue.

That agent demanded $80,000 for the release of the truck. After hours of discussion, $13,400 was mutually agreed upon. And then, Mr. Chairman, they filed a refund and got most of their $13,400 back.

I think, Mr. Chairman, this bill outlines a formula whereby everybody will know what the taxes are and it is a rational way of dealing with the situation and I would hope that we would pass the bill.

And I would yield to my colleague from Virginia, if he wanted time.

Mr. GOODLATTE. I thank the gentleman for yielding.

I just want to briefly respond to the gentleman from Virginia, Mr. Forbes. First of all, his interest in the issue regarding public warehouses is well taken.

We have focused on this very closely, because it is our intention and our belief that the bill does not in any way jeopardize public warehouses and we certainly do not want that to happen.

So we will continue to work with the gentleman and anybody else who is interested in having input on that to make sure that that is the case.

We also have to be very careful that we do not change the treatment that private warehouses receive or others receive under the legislation. So we have to be very careful that we are not doing a carve-out for anybody.

The purpose of this legislation is to create a clear bright line, not to create major exceptions under the rule.

So with that understanding that we do want public warehouses to be treated the same under this law as they have been treated and remain competitive in the warehousing industry, I would look forward to working with the gentleman.

Mr. SCOTT. Reclaiming my time.

Mr. Chairman, again, I would say it is not perfect, but I think of all the problems that can occur without the bill, I think this is a rational way of dealing with a complex situation and my colleagues from Virginia, Mr. Goodlatte and Mr. Boucher, have done an excellent job working through as many details as possible.

I think they have the best possible way to deal with the taxation situation and I would urge the Committee to adopt the bill.

And yield back the balance of my time.

Chairman SENSENBRENNER. Are there amendments to the amendment in the nature of a substitute?

Mr. GOODLATTE. Mr. Chairman, I have an amendment.

Chairman SENSENBRENNER. The clerk will report the amendment.

The CLERK. "Amendment offered by Mr. Goodlatte of Virginia and Mr. Boucher of Virginia to the Amendment in the Nature of a Substitute to H.R. 1956. Page 5, strike line 9 through 16"——

[The amendment by Mr. Goodlatte and Mr. Boucher follows:]

Amendment Offered by Mr. Goodlatte of Virginia and Mr. Boucher of Virginia To the Amendment in the Nature of a Substitute To H.R. 1956

Page 5, strike lines 9 through 16, and insert the following:

(2) Using the services of an agent (excluding an employee) to establish or maintain the market in the State, if such agent does not perform business services in the State for any other person during such taxable year.

Chairman SENSENBRENNER. Without objection, the amendment is considered as read and the gentleman is recognized for 5 minutes.

Mr. GOODLATTE. Mr. Chairman, very briefly. This is a technical amendment that clarifies the language in the bill regarding when the nexus of a person or business inside of a State can be attributed to an out-of-State business that would not otherwise have a nexus in the State.

The original intent of the attribution provision in the bill was that attribution would only occur when an in-State person acted as an agent of an out-of-State business and was not performing business for anyone else.

This amendment clarifies the language to ensure that it complies with the intentions behind that provision.

And I yield back.

Chairman SENSENBRENNER. The question is on agreeing to the amendment offered by the gentleman from Virginia, Mr. Goodlatte.

Those in favor will say, "Aye."

Opposed, "No."

The ayes appear to have it. The ayes have it. The amendment is agreed to.

Are there further amendments? If not, without objection, the Subcommittee amendment in the nature of a substitute, laid down as the base text, is adopted, as amended.

A reporting quorum is present. The question occurs on the motion to report the bill H.R. 1956 favorably, as amended.

All in favor say, "Aye."

Opposed, "No."

The ayes appear to have it. The ayes have it and the motion to report the bill favorably, as amended, is agreed to.

Without objection, the bill will be reported favorably to the House in the form of a single amendment, in the nature of a substitute, incorporating the amendments adopted here today.

Without objection, the staff is directed to make any technical and conforming changes and all Members will be given 2 days, as provided by the House rules, in which to submit additional dissenting, supplemental, or minority views.

[Intervening business.]

[Whereupon, at 1:40 p.m., the Committee was adjourned.]

DISSENTING VIEWS

We strongly oppose H.R. 1956, the "Business Activity Tax Simplification Act of 2005," which would impose a federal physical presence standard for determining when a state can impose a business activity tax. While proponents of H.R. 1956 maintain that federal legislation is needed to clarify the nexus standard for state business activity taxes to minimize litigation, this legislation is more likely to have the opposite effect. In fact, if H.R. 1956 were enacted, it would legalize certain tax sheltering practices and income shifting methods. This legislation is strongly opposed by the National Governors Association, the National Association of Counties, and the National School Boards Association and the Center on Budget and Policy Priorities.[1]

H.R. 1956 is problematic for several reasons. First, the proposed legislation would severely limit the ability of state and local governments to levy their corporate income and similar taxes on multi state corporations which are earning income within the state but lack a permanent or physical presence there. Second, while proponents claims that H.R. 1956 will minimize litigation, in fact, the legislation would create reorganization opportunities that could provide new ground for litigation. Third, the legislation that is likely to result from the "physical presence" standard established by H.R. 1956, would have a significant impact on the state revenue creating an issue of federalism and result in an unfunded mandate.

DESCRIPTION OF THE LEGISLATION

H.R. 1956, introduced by Rep. Goodlatte in April 2005, would establish "physical presence" as the nexus standard for levying state and local business activity taxes on interstate commerce. Specifically, this legislation would preempt state law to provide that an out-of-state company must have a physical presence in a state before the state can impose franchise taxes, business license taxes, and other business activity taxes. The physical presence threshold is the minimum amount of activity a business must conduct in a particular state to become subject to taxation in that state.

[1] Letter from Governor Mike Huckabee, Chairman of the National Governors Association and Governor Janet Napolitano, Vice Chair of the National Governors Association to Representative Sensenbrenner, Chairman of the House Judiciary Committee and Representative Conyers, Ranking Member of the House Judiciary Committee (March 19, 2006)(on file with the House of Representative Committee on the Judiciary, Democratic Staff). Letter from Larry Naake, Executive Direction of the National Association of Counties to Representative Sensenbrenner, Chairman of the House Judiciary Committee and Representative Conyers, Ranking Member of the House Judiciary Committee (March 28, 2006) (on file with the House of Representative Committee on the Judiciary, Democratic Staff). Letter from Michael A. Resnick, Associate Executive Director, National School Boards Association to Representative Sensenbrenner, Chairman of the House Judiciary Committee (June 27,2006) (on file with the House of Representative Committee on the Judiciary, Democratic Staff). Electronic letter from Martha Coven, Senior Legislative Associate, Center on Budge and Policy Priorities (June 20, 2006) (on file with the House of Representative Committee on the Judiciary, Democratic Staff).

H.R. 1956 would also amend P.L. 86–272, which limits the power of states to impose net income taxes on interstate commerce. Under this legislation, P.L. 86–272 would apply to services and intangible property of all in state businesses. In addition, H.R. 1956 would generally require use of employees of services for more than 21 days per calendar year in a state to establish nexus. These regulations would exacerbate underlying inefficiencies because the nexus threshold for businesses—the 21 day rule, which is higher than currently exists in most states—would increase the opportunities for businesses to manipulate their activities to avoid paying state taxes. Finally, H.R. 1956 would enumerate exempt activities, allowing certain tax shelters or income shifting methods that a number of states consider questionable.

BACKGROUND

Generally, both in-state and out-of-state businesses that are "doing business" in a state, pay corporate income taxes (business activity taxes or BAT) on the money earned in that state. These taxes may only be imposed on those businesses that have a "substantial nexus" with the state. A state may, therefore, tax a transaction if there is an appropriate level of connection of the transaction to the state. BAT taxes differ from the obligation to collect sales or use taxes imposed on non-resident businesses. Both, however, are governed by the Constitution.

The Due Process [2] Commerce Clause [3] of the U.S. Constitution limit a State from imposing tax liability or collection responsibilities on a business unless there is a substantial nexus with the state. [4] Thus the issue of when a state has the authority to impose a tax upon an non-resident corporation depends upon whether that corporation has sufficient connection with the state to warrant the tax obligation. In Quill Corp. v. North Dakota,[5] the Supreme Court set out a bright-line test of "physical presence" to satisfy the necessary connection with a state under the dormant commerce clause but explicitly limited that test to the duty of mail order houses to collect use taxes from customers. The Quill Court did not, however, clearly address the question whether "physical presence" is required to impose other types of taxes on non-resident businesses, including BAT, or under what standard.[6]

[2] U.S. Const. Amend. XIV § 1.

[3] U.S. Const. Art. I § I 8, cl. 3.

[4] Generally, the Due Process Clause relates to the fairness of the tax burden and whether a business has sufficient contacts with the taxing jurisdiction to justify the tax. The Commerce Clause is concerned with the effect of the tax on interstate commerce. See Walter Hellerstein, Supreme Court Says No Use Tax Imposed on Mail-order Sellers . . . for Now, 77 J. Tax'n 120, 120 (Aug., 1992)

[5] 504 U.S. 298 (1992).

[6] Business interests argue that the Quill standard should apply to all taxes, while states have employed an apportionment standard that is based on what is referred to as "economic nexus." The Supreme Court has refused to clarify whether "economic nexus" is sufficient under the Constitution. In Geoffrey, Inc. v. South Carolina Tax Commission, 313 S. C. 15, 437 S.E.2d 13, cert. denied, 510 U.S. 992 1993, for example, the Supreme Court denied certiorari in a case in which the South Carolina Supreme Court found sufficient connection between a Delaware corporation and the state of South Carolina to justify a business activity tax. The Delaware corporation's contact with the state consisted of intangible property.

I. H.R. 1956 limits the ability of state and local governments to levy their corporate taxes on out-of-state companies

Under current law, both in-state and non-resident businesses that are doing business in a state may be subject to business activity taxes on income earned in that state. Each state independently implements rules for economic activities—which are not covered by P.L. 86–272—that establish nexus. State rules are very similar for most services and activities.

The "physical presence" standard adopted by the bill favors businesses with limited physical presence but often with major economic activity within the state, while shifting the state corporate income tax burden to small businesses, manufacturing, and natural resource and service industries—businesses that create jobs, pay local property taxes, and sponsor little league teams. Furthermore, out-of-state businesses often benefit substantially from public services provided by the states such as roads and police protection. In addition, these companies benefit from states in which they have no physical presence but do have customers and can reasonably be expected to pay some amount of business activity tax. For example, when an out-of-state bank makes mortgage loans in a state, the value of the houses that serve as collateral depends on the quality of local schools and the safety of the community. Furthermore, that same out of state bank would use the local court system is used if legal action necessary for non payment of loans. Each of these services is provided by the state, notwithstanding a company's physical presence in that state.

The adoption of a physical presence standard will also permit the creation of tax shelters for non-resident businesses and discriminate against traditional "brick and mortar" companies within the state. A Congressional Research Service analysis of H.R. 1956 concludes:

> The new regulations as proposed in H.R. 1956 would have exacerbated underlying inefficiencies because the threshold for business—the 21-day rule, higher than currently exists in most states—would increase opportunities for tax planning leading to more "nowhere income." In addition, expanding the number of transactions that are covered by P.L. 86–272 also expands the opportunities for tax planning and thus tax avoidance and possibly evasion.[7]

Finally, in an increasingly borderless economy, taxing authorities argue that a bright line standard is outdated, inappropriate, and would impede, rather than promote economic growth by encouraging business entities to evade their tax responsibilities.

II. Although proponents claim that H.R. 1956 could mitigate litigation, it is more likely to provide new ground for litigation

The proponents state that the legislation is needed to correct the trend of federal and state court decisions which strongly imply that "physical presence" is the nexus needed to levy business activity tax under the Constitution. Specifically, they claim that H.R. 1956

[7] See Congressional Research Service Report for Congress, RL32297, State Corporate Income Taxes: A Description and Analysis (March 23, 2004). (A copy is on file with the House of Representative Committee on the Judiciary, Democratic Staff).

would establish a clear physical-presence nexus standard that would reduce the amount of litigation that is occurring. Instead, the legislation contains numerous undefined terms and confusing provisions that would no doubt spark litigation in the quest to ascertain what Congress meant. In H.R. 1956, physical presence is described as, "Using the services of an agent (excluding an employee) to establish or maintain the market in the State, if such agent does not perform business in the State for any other person during such taxable year," with no explanation or interpretation of its meaning.[8] among other things, the bill fails to elaborate on the meaning of such critical terms as "services," "establish or maintain," "market," or "perform business."

Additionally, the legislation is likely to spawn costly litigation by allowing new opportunities for businesses to reorganize in order to avoid taxes. The bill is drafted to limit physical presence to "collectively and on more than 21 days in the aggregate, during such person's taxable year," and to excluded those who are conducting, "activities in connection with a possible or an actual purchase of goods or services for consumption by the person's business."[9] This construction will likely spur corporations to shelter their profits from taxation by changing their business practices so that they fall within the guidelines of the legislation. In reaction, the states will be forced to use alternative means to enforce the state taxation laws. Further, many states have discretionary authority to treat in-state and out-of-state subsidiaries for tax purposes as if they are one corporation. To protect their revenues, the states are more likely to use this authority, creating addition litigation.

III. H.R. 1956 reduces states tax revenue affecting the states ability to provide traditional state and local government services and is an unfunded mandate

As a policy matter we would note that State and local governments work with the federal government, both providing essential government services like education and transportation. However, states are restricted from providing these services if their power of taxation is truncated or interfered with. Furthermore, it will be state officials and not Congress who will be held accountable if public services are reduced or personal income or property taxes are increased to compensate for the reduction in tax revenue resulting from the enaction of this legislation.

H.R. 1956 would also create an enormous unfunded mandated resulting in a several billion dollar loss for state revenues.[10] According to a survey conducted by the National Governors Association, the business activity tax proposal would cost states more than several billion annually. As state governments, unlike the federal government, are required to balance their budget, the lost of such a significant amount of revenue must be replaced by either increasing taxes or cutting programs. The Congressional Budget Office Cost estimates that the cost of this bill to state and local govern-

[8] H.R. 1996, Section 3(b)(2).
[9] H.R. 1956, Section 3.
[10] According to the CBO, "While virtually all states would lose revenues, about 70 percent of the estimated losses would come from ten states: California, Florida, Illinois, Michigan, New Jersey, New York, Pennsylvania, Tennessee, Texas, and Washington."

ment would exceed $1 billion the first full year after enactment and would likely grow to approximately $3 billion annually in 2011. Thus, these costs would exceed the threshold under UMRA for intergovernmental mandates by $64 million in 2006.

CONCLUSION

H.R. 1956 is ill-considered legislation that would provide unnecessary tax exemptions resulting in a huge revenue loss to states. In an era when our states are in desperate need of revenue for the protection of our citizens, it seems irresponsible that should we enact legislation that would reduce their funds.

JOHN CONYERS, Jr.
WILLIAM D. DELAHUNT.
HOWARD L. BERMAN.
JERROLD NADLER.
SHEILA JACKSON-LEE.

ADDITIONAL DISSENTING VIEWS

I oppose the BATSA bill in its current form. Although I believe that valid concerns have been raised by all stakeholders in this debate, I do not believe H.R. 1956 adequately addresses those concerns or proposes a workable solution. Therefore, I respectfully dissent.

MELVIN L. WATT.