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Legislative Bulletin…………………………….………July 25, 2006

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H.R. 1956—Business Activity Tax Simplification Act

H.R. 1956—Business Activity Tax Simplification Act—*as reported* (Goodlatte, R-VA)

Order of Business: The bill is scheduled to be considered on Tuesday, July 25th, subject to a rule. If the rule makes in order any amendments, they will be summarized in a separate RSC document.

Summary: H.R. 1956 would forbid states from imposing a corporate tax on virtually any corporation that has no physical presence in the taxing state. More specifically, the bill would expand the federal prohibition against state income taxation or other business activity taxation (BAT) of interstate commerce (15 U.S.C. 381 et seq.) to prohibit state taxation of:

- out-of-state transactions involving all forms of property, including *intangible* personal property and services (currently, only sales of tangible personal property are protected); and
- any out-of-state entity, unless such entity has a physical presence in the taxing state during the relevant taxable period.

Physical presence in a state would be defined as a person having business activities in the state that 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).

The bill would make various exceptions for the physical presence requirements above, including:

- incorporated business entities in the state in which the tax is imposed;
- individuals domiciled in the state in which the tax is imposed; and
- partnerships, S corporations, limited liability companies, trusts, estates, or other similar entities (this bill would not affect their BAT liabilities).

The 21-day standard would be reduced to just one day for:

- the sale within a date of tangible personal property, if delivery of the property originates and is completed within the state;
- the performance of services that physically affect real property within a state;
- a live performance in a state, before a live audience of more than 100 individuals; and
- a live sporting event in a state before more than 100 spectators present at the event.

The bill explicitly states that this legislation should 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."

A business activity tax (BAT) is 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 a 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.

A BAT 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. "Tangible property" does not include computer software owned and licensed to another person, and "state" includes the District of Columbia and the U.S. territories.

Additional Background: The Judiciary Committee, in House Report 109-575, provides the following background information on the need for this legislation:

> 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.
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> In 2004, corporate income taxes imposed by the States accounted for only 5.19 percent of all of the taxes collected by the States.
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> 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.

Committee Action: On April 28, 2005, the bill was introduced and referred to the Judiciary Committee. On December 13, 2005, the Committee's Subcommittee on Commercial and Administrative Law marked up and forwarded the bill by voice vote to the full Committee. On June 28, 2006, the full Committee marked up and ordered the amended bill reported to the full House by voice vote.

Administration Position: A Statement of Administration Policy on this bill is not yet available.

Cost to Taxpayers: CBO reports that this legislation would increase federal revenues by $106 million in FY2007, by $1.231 billion over the FY2007-2011 period, and by $3.062 billion over the FY2007-2016 period. PLEASE NOTE: Americans for Tax Reform issued a written statement emphasizing that "**the projected increase in federal tax revenue IS NOT a tax increase and IS NOT a violation of the ATR Taxpayer Protection Pledge.**" CBO further notes that, "CBO projects the federal government will realize an increase in tax revenues **only because the amount of a company's state and local tax deduction on their federal income tax will be reduced**. In simple terms, companies will be paying less state and local taxes and as a result will have a smaller federal tax deduction. The savings generated from the elimination of the tax at the state level overwhelms the federal deduction the company would receive."

Does the Bill Expand the Size and Scope of the Federal Government?: No.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: CBO reports that, "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)."

Constitutional Authority: The Judiciary Committee, in House Report 109-575, in an extensive discussion of constitutional authority, cites Article I, Section 8, Clause 3 (the congressional power to regulate interstate commerce). Specifically, the Committee references U.S. Supreme Court interpretation of the Commerce Clause to create a negative limitation on state power to regulate in areas that might adversely affect interstate commerce (known as the Dormant Commerce Clause). The Committee notes that, since state taxation of commerce could burden interstate commerce, the Supreme Court has placed constitutional constraints on state taxing authority.

Outside Organizations: Entities supporting this legislation include Americans for Tax Reform, the National Taxpayers Union, the Tax Foundation, the Business Roundtable, the U.S. Chamber of Commerce, the National Association of Manufacturers, the Financial Services Roundtable, the Motion Picture Association of America, and the National Restaurant Association.

Entities opposing this legislation include the National Governors Association and the National Council of State Legislatures.

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