



Testimony of Congressman Bob Goodlatte
Subcommittee on Commercial and Administrative Law Hearing on the
"Business Activity Tax Simplification Act of 2008"
June 24, 2008

Madam Chairman and Ranking Member Cannon, thank you for inviting me to testify this afternoon about the Business Activity Tax Simplification Act.

Many states and some 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 constraint of geopolitical boundaries. The growth of the high tech industry and interstate business-to-business and business-to-consumer transactions raise 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 benefits 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. I understand that some of our witnesses on the next panel will detail the specific examples of abuses that are occurring under the current ambiguous legal environment.

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 Corp. 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 purposes of imposing business activity taxes.

In addition, over forty 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 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 Public Law 86-272 was limited to tangible personal property. Our nation's economy has changed dramatically over the past forty years, and this outdated statute needs to be modernized.

The Business Activity Tax Simplification Act of 2008 both modernizes and provides clarity to an outdated and ambiguous tax environment. First, the legislation updates the protections in P.L. 86-272. This legislation reflects the changing nature of our economy by expanding the scope of the protections in P.L. 86-272 from just tangible personal property to include intangible property and services.

In addition, our legislation sets forth clear, specific standards to govern when businesses should be obliged to pay business activity taxes to a state. Specifically, the legislation establishes a "physical presence" test such that an out-of-state company must have a physical presence in a state before the state can impose corporate net income taxes and other types of business activity taxes.

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 the same time, this legislation will protect the ability of states to ensure that they are fairly compensated when they provide services to businesses that do have a physical presence in the state.

H.R. 5267 has been amended from what the Judiciary Committee reported out by voice vote last Congress. Specifically, the legislation has been amended to address some of the concerns expressed by the States. For example, the time period during which an individual or business could be present in a State without constituting a substantial physical presence has been reduced from 21 days to 14 days.

I will end my testimony by mentioning that this legislation has strong bipartisan support from numerous Members of the House Judiciary Committee. I would strongly urge the Chairman of the Subcommittee and Chairman Conyers to move forward with a markup of this legislation in the near future.