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LEGAL ALERT

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BATSA Up: Congress Once Again Considers Nexus Legislation

Would Thomas Jefferson approve of Congress imposing its will on state efforts to collect income tax from out-of-state companies? That was the question posed by Rep. Steve Cohen (D-TN) to two sponsors of the Business Activity Tax Simplification Act of 2011 (BATSA) (H.R. 1439) who both happen to be from Jefferson's home state of Virginia. Rep. Robert C. Scott (D-VA) and Rep. Bob Goodlatte (R-VA) both replied that Jefferson would approve of this bill. This new version of BATSA was introduced on April 8, 2011, and is the latest attempt to enact federal nexus legislation. A hearing on the bill was held on April 13 before the Subcommittee on Commercial and Administrative Law of the House Judiciary Committee with the two sponsors from Virginia testifying along with state and industry representatives. The Subcommittee members signaled whether they were supportive or opposed to BATSA in opening statements, with a clear split among those in favor and those who felt it would hurt states' abilities to address budget deficits.

BATSA is generally promoted as a much-needed update and expansion to Public Law 86-272. Public Law 86-272, enacted in 1959, serves to prohibit a state from imposing a net income tax if a company's only in-state activities are solicitation of orders for sales of *tangible personal property* which are sent outside the state for approval or rejection and are filled from outside the state. BATSA extends Public Law 86-272 in several ways, including to solicitation of sales of other than tangible personal property (e.g., sales of intangible property and services).

BATSA is substantially the same as previous versions of this proposed legislation with one notable change: Section 4 of H.R. 1439 codifies the *Joyce* approach to apportioning income in a combined report, where only sales by those individual group members that are individually subject to taxation are included in the numerator of the apportionment formula.[1] The alternative *Finnigan* approach (which is preempted by BATSA if enacted) requires all members of a unitary group to include sales in the numerator of the apportionment formula, regardless of whether the individual members have nexus.[2]

The two sponsors of BATSA emphasized the importance of clarity for businesses selling goods and services in multiple states and the need for a "bright line rule" regarding a state's ability to assess income tax on out-of-state companies. Rep. Goodlatte was especially focused on small businesses that cannot afford "teams of lawyers" to comply with the multitude of nexus standards among the states.

Witnesses at the hearing were Bruce Johnson, Commissioner of the Utah State Tax Commission, testifying on behalf of the Federation of Tax Administrators; Corey Schroeder, Vice President and Chief Financial Officer of Outdoor Living Brands, Inc., testifying on behalf of the International Franchise Association; and Joseph Henchman, Tax Counsel and Director of State Projects at the Tax Foundation.

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[1] See *Appeal of Joyce, Inc.*, No. 66 SBE 069 (Cal. SBE Nov. 11, 1966).

[2] See *Appeal of Finnigan Corporation*, Cal. St. Bd. of Equal., August 25, 1988 (*Finnigan I*); Opin . on Pet. for Rhrg, Cal. St. Bd. of Equal., January 24, 1990 (*Finnigan II*).

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Mr. Schroeder shared with the Subcommittee the difficulty Outdoor Living has with its compliance efforts. With franchisees in 34 states and $4.6 million in revenue and with only 28 employees, Mr. Schroeder provided testimony about the lack of clarity among state nexus standards and the burden the tax system places on Outdoor Living. Mr. Henchman took a philosophical approach, stressing that establishing nexus standards for the states is an appropriate and, indeed, necessary role for Congress to take to encourage greater business development and growth in the United States. From an economic perspective, he discussed the "benefits principle" which supports the idea that only those individuals and companies that "live and work" within the borders of a state reap the benefits of that state's government services and, therefore, only those individuals and entities should fund those government services.

On the other side of the debate was Utah Commissioner Bruce Johnson testifying on behalf of the Federation of Tax Administrators. Noting the current budget stress states are under, Mr. Johnson emphasized the impact of this bill on state revenues, citing a 2005 study by the National Governors Association that estimated the lost revenue from BATSA at $8 billion. He also testified that BATSA's nexus standard goes beyond the physical presence standard described by its proponents. Rather, he noted that BATSA limits nexus to companies with a physical presence of employees *other than* those soliciting sales or collecting information in the state, thus allowing a physical presence by some employees without establishing nexus for the company.

Subcommittee members appeared to be split on whether to support or oppose BATSA. Rep. Howard Coble (R-NC) questioned why Congress should treat receipts from sales of tangible goods differently than those from intangibles. Rep. Cohen agreed that a national standard was a good idea, but rejected the physical presence standard as too restrictive. Rep. John Conyers (D-MI) expressed a concern with "tax planning opportunities" that would "drastically alter the tax landscape." Rep. Conyers closed by affirming his agreement with Commissioner Johnson, stating that he was "sufficiently disturbed" by the prospects of a physical presence standard. Finally, Rep. Trent Franks (R-AZ) noted that "murky rules" were not fair to businesses trying to comply with the various state laws.

Sutherland Observation: H.R. 1439 is the latest attempt to put in place standardized nexus rules. In an era of evolving business models, undefined nexus rules place businesses at increasingly greater risk of audit assessments. Unless and until Congress or the U.S. Supreme Court acts to provide guidance and certainty, businesses will continue to be hindered by the lack of nexus certainty.

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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