Businesses go to Congress for the relief of state taxes

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It sounds like a scene from "The Sopranos": a truck carrying boats up the East Coast was held hostage in New Jersey until the boats' manufacturer paid more than $46,000.

Organized crime, however, wasn't behind this operation. It was a revenue agent for the state of New Jersey who stopped the truck last July at a weigh station on Interstate 295. The agent informed Hartsville, S.C.-based Stingray Boat Co. that she wouldn't let the truck continue its journey to Massachusetts until the company paid taxes to New Jersey. The company owed business activity taxes to New Jersey because it had a dealer there, the agent said.

Stingray Controller Barry Godwin disagreed, since the dealer was an independent business that already paid taxes to New Jersey. But he wired the state the money anyway, because that was the only way he could free his boats.

"I didn't have a choice," Godwin told the House Small Business Committee at a Feb. 14 hearing. "It was show me the money and I'll let you go, or you're stuck."

Rep. Todd Akin, R-Mo., was shocked.

"I've never sat in a hearing on highway robbery before," Akin said.

New Jersey is one of many states that assert that out-of-state businesses owe them corporate income taxes, gross receipts taxes or franchise taxes even if they don't have employees or facilities there. Doing business in their state is enough to make them liable for these taxes, these states contend.

Businesses disagree, and some have challenged their tax bills in court. Many small businesses can't afford to litigate this issue, however. So businesses have asked Congress for help. They're pushing legislation that would exempt out-of-state companies from a state's business activity taxes unless they have a physical presence in that state.

The House Judiciary Committee approved this legislation in 2005, and it was scheduled for a vote by the full House. But it was pulled from consideration after the National Governors Association strongly objected to the bill. The association contended the legislation would cost states billions of dollars in lost revenue and shift more of the tax burden onto locally owned businesses.

The Business Activity Tax Simplification Act (H.R. 5267) was reintroduced this month by Rep. Rick Boucher, D-Va., and Rep. Bob Goodlatte, R-Va.

Boucher said the bill "will bring certainty to the increasingly chaotic tax environment for businesses."

The legislation would establish a national standard for when business activity taxes would apply to out-of-state companies. Under the bill, businesses wouldn't owe these taxes unless they use employees or services in a state for 15 days or more in a calendar year.

A single standard could save hundreds of thousands of dollars in compliance costs alone for Firehouse Restaurant Group Inc., a Jacksonville, Fla.-based franchiser of 312 sub sandwich shops, said Chief Financial Officer Stephen Joost. Current nexus standards vary widely from state to state, Joost said.

"We have to hire an army of accountants and lawyers" to keep track of them, he said.

The situation could get worse as more states impose business activity taxes, said David Rolston, president and CEO of Hatco Corp. in Milwaukee.

Hatco, which manufactures commercial food-warming equipment and water heaters, sells its products through independent manufacturers' representatives who represent other companies as well. Four states have imposed business activity taxes on Hatco because it has representatives there.

"We don't know what other states will come at us next," Rolston said.

Financial pressure on states is growing as the economy weakens. At least 25 states face budget shortfalls for fiscal 2009, according to the Center on Budget and Policy Priorities.

The National Governors Association estimated in 2005 that the Business Activity Tax Simplification Act would cost states more than $6 billion in lost revenue a year. That amount could be even higher now, said David Quam, director of federal relations for the National Governors Association.

This lost revenue "is not something states need to be trying to make up for at this point in time," he said.

Congress should leave state tax decisions up to states, he said. Now that the Internet allows companies to conduct business anywhere in the world, it doesn't make sense to demand that companies have a physical presence in order to be subject to business activity taxes, he said.

"Economic presence is a much better model for a modern economy," he said.

BUSINESS ACTIVITY TAXES

ISSUE: Some states impose income, franchise or gross receipts taxes on out-of-state companies that sell products or services there.

PROBLEM: These businesses complain these taxes are unfair since they don't have any employees or facilities in these states and don't benefit from state services there.

SOLUTION: Proposed federal legislation would exempt companies from business activity taxes if they don't have a physical presence in a state -- the same test already applied to sales taxes.

OPPOSITION: States contend this legislation would cost them billions of dollars in lost revenue and shift the tax burden onto locally owned businesses.