

Back to the Future: The Hope for Enactment of BATSA Legislation

by Marjorie Gell



Last weekend was my 30th high school reunion. As part of the festivities, someone assembled a list of the memorable events of 1979. The shah was ousted from Iran and Iranian militants seized the U.S. embassy in Tehran and took hostages. The worst commercial nuclear accident in U.S. history occurred at the Three Mile Island nuclear power

plant near Middletown, Pa. President Jimmy Carter and Soviet leader Leonid Brezhnev signed the SALT II agreement. Gas prices hit a then-record high of 85 cents a gallon.

This weekend I will attend my niece's high school graduation festivities. I can't help but wonder what events from 2009 will be remembered at *her* high school reunion, 30 years hence. The first African-American president of the United States is inaugurated. The world experiences the worst economic downturn since the Great Depression. The swine flu virus leads to a global pandemic. Is it possible that included on this list will be the historic passage of national nexus legislation for business activity taxes? The time seems ripe.

BATSA Legislation

The nexus legislation in question addresses the jurisdictional standard by which a state determines when an out-of-state business will be subject to a state's taxing authority. When and under what circumstances a state has jurisdiction to tax out-of-state businesses have historically been anything but clear. A patchwork of ever-changing and expanding standards exists throughout the United States, making it almost impossible for businesses to determine with certainty what activities or connections with a particular state will trigger tax. Unlike the permanent establishment standard that

applies internationally, there is no a certain, clear, and uniform standard for state business activity taxes.

It has long been recognized that the only solution for stopping the never-ending wrangles over state nexus standards lies with Congress. Indeed, as there has been for the last several congressional sessions, there is pending legislation in the House of Representatives that would clarify when a business is subject to a state's business activity tax by creating a clear and uniform nexus standard applying to all business activity taxes in all states. The Business Activity Tax Simplification Act of 2009 — commonly known as BATSA — was introduced as H.R. 1083 on February 13 by Rep. Rick Boucher, D-Va. It enjoys wide bipartisan support with 17 cosponsors of the bill.

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BATSA as introduced would require that all states adhere to a clear physical presence standard applying to all taxpayers for all business activity taxes. Those taxes would include corporate income taxes, gross receipts taxes, franchise taxes, gross profits taxes, and capital stock taxes. BATSA would ensure that physically present businesses that receive the benefits of state and local taxes (including the benefits of education, roads, fire and police protection, water, sewers, and so forth) would alone bear the business tax burdens. A business having minimal connection and not receiving the benefits and protections of that state would be assured that it is not subject to that state's business activity tax. That standard would prevent a business from being caught off guard by ever-changing and increasingly aggressive jurisdictional standards imposed by states across the country. It would reduce the uncertainty, confusion, and unexpected and exorbitant costs associated with defending a company from unfair tax assessments.

The Boat Manufacturers

If one doubts the seriousness of the threat posed to U.S. multistate businesses by the absence of a federal nexus standard, one needs only to talk to members of the U.S. boating industry. Take Barry Godwin, controller of Stingray Boat Corp. He testified last year before the House Small Business Committee, urging the enactment of BATSA. During his testimony, Godwin related three nightmarish experiences that involved three different states — Maine, Washington, and New Jersey. Each of those experiences involved state assertion of nexus created by Stingray's inadvertent actions. Stingray had no offices, property, or employees in Maine, Washington, or New Jersey. Careful to stay within boundaries set forth by P.L. 86-272 (a federal law applying to state income taxes), Stingray filled orders from its offices in South Carolina, collected payment in South Carolina, and shipped the boats from South Carolina to out-of-state, independent dealers. It therefore neither filed returns nor paid any business activity or income taxes in Maine, Washington, or New Jersey.

All was well until 2006, when Stingray's run-ins with state revenue departments began. First was the revenue department from Maine, a state that claimed Stingray owed taxes retroactively to 2003 based on warranty payments the company made to independent dealers — payments on which the dealers would also have paid Maine income tax. Though Stingray itself did not do the warranty work, that it reimbursed its independent dealers for work performed on Stingray boats subjected the company to Maine income tax. According to Godwin, "I objected to the revenue agent, but we decided it would be less costly to pay the retroactive taxes and fines than to pursue the matter in the courts."

Did the New Jersey Department of Revenue's actions rise to the level of extortion?

Stingray's second experience, with Washington state, involved the assertion of business tax nexus based on the company's membership in the Northwest Marine Trade Association. Washington claimed that the membership established that Stingray maintained a market in the state such that nexus was created. Though Stingray joined the association primarily as a means of obtaining dealer discounts for boat show floor space, the company has since canceled its membership to avoid future nexus tangles.

While the Maine and Washington experiences are disconcerting, they pale in comparison to what happened to Stingray in New Jersey. According to Godwin, in 2007 he received a call from a New Jersey

revenue agent informing him that a Stingray truck had been detained at a New Jersey weigh station and would be impounded if the company did not wire money by 1 p.m. that day. Godwin, on request of the revenue agent, looked up New Jersey sales from the past seven years and was informed that the amount that had to be wired was \$46,200, representing jeopardy assessment taxes. Though the company had no outstanding legal issues with the state, nor any business activities in New Jersey aside from deliveries of boats to independent dealers, Stingray was forced to wire the money and appeal the matter later.

In his testimony, Godwin said:

The manner in which the State of New Jersey acted is commonly defined as extortion. Fortunately, I have never been the victim of crime in my life. But, that day in July, I believe I was strong-armed by a state of the United States of America.

Did the New Jersey Department of Revenue's actions *really* rise to the level of extortion? The *Random-House Dictionary* defines extortion as "the crime of obtaining money or some other thing of value by the abuse of one's office or authority." Applying the term under these circumstances may be going a bit far, but it is not hard to understand how a company like Stingray might feel this way.

The Economy Begg for a Clear and Uniform Standard

No doubt, the experiences described by Stingray are not unusual, nor are the problems isolated to Maine, Washington, or New Jersey. Indeed, the condition of our nation's economy only increases the odds that more and more states will exploit the nonexistence of federally mandated nexus standards.

The Nelson A. Rockefeller Institute of Government recently reported that state income tax revenue dropped 26 percent in the first quarter of 2009, compared with the same period last year. It doesn't take much imagination to see what lies ahead. Once stimulus package funds run out and state programs are trimmed to the bone, there would seem to be little choice but to raise taxes. And what better source of those taxes than out-of-state businesses?

Think about it. State funds are needed. Desperately. Local governments can look within or look without to make up for lost revenue. Can anyone blame a state for venturing into neighboring states' backyards in search of funds to replenish the local coffers? State governments naturally act to further their constituents' best interests, even at the expense of the collective national marketplace. You know it. I know it. And the Framers of the U.S. Constitution knew it, too.

Enter the commerce clause of the Constitution. Its original purpose to give Congress the power to protect the national marketplace, the commerce clause was put into place in part as a reaction to the patchwork of out-of-control fees and taxes imposed by states on incoming commerce. In the late 1770s, states were struggling to stay afloat amid losses in subsidies previously provided by the English government. Recognizing the existence of major confrontations among states regarding their discriminatory tax practices, which were not prohibited by the existing Articles of Confederation, the Framers adopted the commerce clause as part of the Constitution to give Congress the power to intercede when appropriate to protect the economic marketplace as a whole. Though Congress has used that power only occasionally in the state tax context — the most notable instance being the passage of P.L. 86-272 — it seems imperative that a clear and uniform standard be set for asserting state business activity taxes when states are struggling to breathe and the U.S. economy itself is on a ventilator. Businesses must have clear-cut assurance of when they will be subjected to a state's taxing jurisdiction. Congress has dragged its feet — as it has in so many other areas

— for too long. The legislation continues to be reintroduced. The list of sponsors continues to grow. Now is the time for Congress to act as our forefathers did: with thoughtful consideration and appreciation of the devastating consequences of allowing states to erect barriers to interstate commerce. A clear, uniform, and definitive physical presence nexus standard applying to all states and all taxpayers would go a long way to ensure a healthy and stable national economy.

Parting Thoughts

As I ready to leave for my niece's graduation, my thoughts are with her, and my hopes are high. May the road rise to meet her. May the wind always be at her back. And may BATSA legislation be passed in her lifetime — at least by the time her 30th reunion descends upon her, and hopefully well before. ☆

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