MULTISTATE TAX COMMISSION

To: **Demesia Padilla, Commission Chair**
Members of the Commission

From: **Greg Matson, Executive Director**

Re: **Statement of Application of MTC Positions to Federal Legislative Activity**

Date: **July 20, 2016**

Please see the attached information on proposed federal legislation that would affect state taxes in the 114th Congress (2015 – 2016) and any official communication of the Multistate Tax Commission that have been provided to Congress in FY2016. Included with this report are:

- A copy of the materials provided for the Commission's Legislative Day in May 2016

MULTISTATE TAX COMMISSION

ISSUE BRIEFS

LEGISLATIVE DAY, MAY 11, 2016

The Commission is located at:

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ABOUT THE MULTISTATE TAX COMMISSION

The Multistate Tax Commission is the intergovernmental agency formed, funded, and directed by the states to facilitate proper application of state taxes to multistate and multinational enterprises, and to promote uniformity and compatibility of state tax systems. The states created the Commission in 1967 to accomplish these goals and to prevent federal intrusion into state tax policy. Today, 48 states and the District of Columbia participate in the Commission or its programs.

GENERAL POSITION

Use of the Commerce Clause to preempt state taxing authority is needless and undermines our federal system of government. The U.S. Constitution is clear that states are co-sovereigns with the federal government. The power to set tax policy is fundamental to all sovereigns. When the federal government preempts this most fundamental sovereign responsibility, it reduces the constitutionally-protected sovereignty of the states.

The citizens of the states and their elected lawmakers know best how to fund the domestic programs for which they have responsibility. Federal preemption that reduces state revenue damages state budgets. Furthermore, tax bases available to states differ significantly from one state to another; federally-imposed, nationalized tax policies ignore this reality. Federal preemption of state taxation of rental cars, for example, would affect some states more than others.

Federal preemption is not needed to prevent discrimination against interstate commerce – something states have never been allowed to do under the Constitution. Competition motivates state lawmakers to keep overall taxes low, but to do so, they must retain the choice of what and how to tax.

Congress has long recognized these realities and, as a result, has rarely preempted state taxing authority. This practice of restraint respects states and their citizens, supports our federal system of government, and limits the inefficiencies and dangers of centralized decision-making. The Commission believes our country has been well served by this restraint and therefore opposes federal legislation that would interfere with the sovereign right of states to control their own taxes.

S. 698
MARKETPLACE FAIRNESS ACT

POSITION

The Multistate Tax Commission supports removal of the artificial barriers that keep states from requiring large out-of-state sellers to collect sales and use taxes on sales to their residents and that give those sellers an unfair competitive advantage vis-à-vis local businesses. But the Commission opposes "attaching strings" to the authorization of states to require tax collection if those strings would unduly interfere with the existing sales tax system.

BACKGROUND

S. 698 contains the same text as legislation that passed the U.S. Senate on May 6, 2013 on a 69-27 vote. S. 698 would allow states to collect when it meets the following conditions:

- States may impose tax only on remote sellers that have gross annual receipts in total remote sales in the US exceeding $1 million dollars.
- A state that is a member of the Streamlined Sales & Use Tax Agreement (SSUTA) may require remote sellers to collect state and local sales and use taxes, if minimum simplification requirements are met.
- Non-SSUTA states may require remote sellers to collect state and local sales and use taxes only if state adopts minimum simplification requirements.

Minimum simplification requirements and other requirements under the bill include:

- Single entity for administration, return processing and audits;
- Single audit for all state and local taxing jurisdictions within the state;
- Single sales and use tax return used by remote sellers;
- A uniform state and local sales and use tax base;
- Follow sales sourcing rules set out in the bill;
- Provide remote sellers with a database of sales taxability, rates, and boundaries;
- Provide remote sellers free software that calculates tax on each sale and files returns;
- Establish procedures to certify software providers;
- Provide liability relief for remote sellers who rely on a certified provider;
- Relieve certified providers or sellers of liability if they rely on inaccurate information;
- Provide 90 days' notice of a rate change.

H.R. 2775
REMOTE TRANSACTIONS PARITY ACT OF 2015 (RTPA)

POSITION

The Multistate Tax Commission prefers the Marketplace Fairness Act (S. 698) passed by the Senate in 2013 (see above) because in comparison to the RTPA, it creates less interference with the existing state sales and use tax system and fewer disparities between sellers covered by the act and those that are not.

BACKGROUND

The RTPA, like the Marketplace Fairness Act (MFA), would require that states take a number of steps to simplify their sales and use tax systems in order to qualify to impose collection of the tax on remote sellers. The bill shares many of the same requirements and benefits with the MFA. However, some of its provisions appear to be unworkable and present ambiguities or other technical difficulties that would create problems for implementation. Examples include:

- The bill authorizes states to "require all remote sellers" to collect tax but does not grant similar authority to impose tax on remote certified service providers (CSPs). This is critical because, in some cases (when the CSP makes a mistake causing tax not to be collected) the tax must be imposed on the CSP. If the CSP is remote, the state will not be allowed to collect the tax.
- The bill creates an inherent conflict between CSPs and sellers because it imposes the liability for tax on one or the other depending on whose mistake caused tax to be underreported. But the bill also assumes that the CSP will represent the seller in any audit by the state. The specific provisions limiting the state's ability to contact the seller and to rely on the CSP for auditing the seller cannot be reconciled with the inherent conflict between the interests of the CSP and the seller. Moreover, the state cannot audit the seller even for the purpose of determining whose mistake caused the underreporting of tax.
- The protection from consumer suits applies to "remote sellers" regardless of whether the sale to that customer was a remote sale, and to CSP's regardless of whether they are working for a remote seller. So as long as the seller is a remote seller in at least one state, or the CSP is a CSP, the protection from consumer suits applies against all related customers even if the seller and customer are in the same state.

S. 851/ H.R. 1643
DIGITAL GOODS AND SERVICES TAX FAIRNESS ACT OF 2015

POSITION

The Multistate Tax Commission opposes the Digital Goods and Services Tax Fairness Act because (1) it does not allow states to require collection of tax from remote sellers, and (2) its sourcing rules are disruptive. Its failure to grant authority to require collection of tax from remote sellers would allow many sellers of digital goods and services to avoid having to collect tax altogether. In addition, it would grant unwarranted preferences to digital goods and services.

BACKGROUND

The bill has been introduced before. Proponents have made some changes to the original version in response to state concerns. But a number of problems remain. The bill:

- Mandates sourcing a sale based on the customer's address and requires the seller to acquire and maintain that address (the sale may not occur at that address);
- Does not authorize the state to which the sale is sourced to require remote sellers to collect tax on the sale (sales sourced to non-nexus states will escape taxation);
- Preserves some authority to impose use tax collected from the customer;
- Prohibits taxing digital goods and services at a higher rate or less favorably than "similar" non-digital goods and services, a provision that is likely to generate significant litigation;
- Requires that states grant a credit against any type of transaction tax imposed by that state for any type of transaction tax paid by the seller or the customer to another state;
- Prohibits states from requiring that a seller change a customer's sourcing location before the customer is permitted to dispute the change;
- Requires that states allow sellers and purchasers to decide where to source digital goods and services that are "available for use" in multiple locations simultaneously; and
- Preempts state rules when a transaction bundles a digital good or digital service, taxable or not, with another type of taxable sale.

S. 386 / H.R. 2315
MOBILE WORKFORCE STATE INCOME TAX SIMPLIFICATION ACT OF 2015

POSITION

The Multistate Tax Commission opposes the Mobile Workforce State Income Tax Simplification Act of 2015 because it interferes with the most critical enforcement mechanism in any income tax system, including the federal government's – the requirement that employers withhold and pay over taxes owed by employees.

BACKGROUND

The Multistate Tax Commission worked with representatives from the business community to draft a Model Mobile Workforce Statute, which the Commission has recommended to the states for enactment. The model establishes a *de minimis* threshold, below which a state could not exercise its jurisdiction to tax non-resident employees working in the state.

While the federal bill is similar to the Commission's model statute, major differences are: (1) the federal bill would lengthen the threshold from 20 to 30 days, preempting state's from taxing a *physically present person*, even if the state enacts the Commission's reasonable 20-day threshold; (2) it would not make exception for high-income persons, who may earn a great deal of money in a single day; and (3) the federal bill would allow the employee to direct his employer to not withhold based on his own determination, made a year in advance, that he will not work in that state more than 30 days. This rule is obviously ripe for abuse. Moreover, this is a problem that has largely been addressed by technology; remaining issues could be solved by cooperation between states and employers. Under the bill:

- No state except the state of residence and the state where an employee is present and working for more than 30 days may impose an income tax on that person's remuneration.
- Withholding and tax would apply back to the first day of the tax year once an employee has exceeded 30 days working in-state;
- An employer may rely on an employee's determination of time expected to be spent in a state in the coming year absent *actual knowledge* of fraud or collusion;
- Even if the employer *knows* where the employee has worked more than 30 days based on its own records, the employer may still rely on the employee's advance estimate; this and the immediately preceding rule would allow an employee to knowingly underestimate the expected time in-state to avoid tax, and the employer could not be held to account if it turns a blind eye, i.e., avoids actual knowledge of fraud or collusion; and
- Professional athletes, entertainers, and certain public figures are exempted from the rules – but there is still no exception for other high-wage workers.

S. 1164 / H.R. 1528
END DISCRIMINATORY STATE TAXES ON AUTOMOBILE RENTALS ACT OF 2015

POSITION

The Multistate Tax Commission opposes all preemption of sovereign state taxing authority, especially where the preemption would benefit a specific industry or other group and where the state tax policy has been developed for particular policy reasons.

BACKGROUND

Industries that have failed to persuade states and localities to reduce their taxes have asked Congress preempt sovereign state-tax authority in their specific areas of business, even when that business is thriving. This bill exemplifies this kind of legislation.

This bill purports to prohibit taxes that discriminate against interstate commerce, but such taxes are already prohibited by the dormant Commerce Clause. Instead, the bill benefits a narrow interest group by preempting taxes on rental cars when those taxes are not generally applicable to motor vehicles within the state or locality that imposes the tax.

State and local lawmakers have a legitimate and sovereign interest in taxing certain activities more than others, such as car rentals in particular areas, to reflect the costs and benefits related to the specific activity. Federal lawmakers cannot accurately second guess these policy choices. States and localities are better able than the federal government to balance the interests and contributions of car-rental companies, their customers, the contributions of those businesses and customers to the local community, and the related costs to the local community of their activities.

H.R. 2584, BUSINESS ACTIVITY TAX SIMPLIFICATION ACT OF 2015

POSITION

Similar versions of the Business Activity Tax Simplification Act of 2015(BATSA) have been introduced in each of the last six Congresses, but none has passed either chamber. The Multistate Tax Commission has opposed the Business Activity Tax Simplification Act as an entirely unwarranted restriction of state tax authority that would allow multistate and multinational enterprises to shelter income from state tax.

BACKGROUND

BATSA's limitations are unwarranted because the states are only permitted by the dormant Commerce Clause to tax a fairly apportioned share of multi-jurisdictional business income and may not discriminate against out-of-state businesses. See *Complete Auto v. Brady*, 430 U.S. 274 (1977). If a corporation derives an insignificant portion of its income from a state, it will not owe a significant amount of business activity tax to that state.

Problems with BATSA include:

- Although proponents claim the bill simply creates a bright-line, physical presence rule for the application of state business taxes, in reality, its provisions would encourage greater use of tax-sheltering that states and the federal government have worked for years to contain. Tax sheltering under BATSA would primarily benefit large, multijurisdictional entities with greater tax-planning resources, giving them a government-created advantage over small-business competitors.
- The bill would allow a corporation to pay no business activity tax to a state regardless of how many customers it has in the state, how much revenue it derives from sales into the state, and how much profit it earns from certain activities in the state.
- The Congressional Budget Office scored the bill as the largest unfunded mandate upon the states since such mandates were tracked. According to the National Governors Association, federal legislation like BATSA could cost the states at least $4.7 billion and up to $8 billion in its first year. That cost would increase as companies adapt their structures in order to take advantage of the sheltering opportunities offered by the bill.
- It constitutes a serious federal intrusion into state policy choices, flouting the Tenth Amendment. Nor is it justified by the Commerce Clause. The purpose of the Commerce Clause is preservation of national markets and avoidance of local

economic protectionism. BATSA would turn the purpose of the Commerce Clause on its head by giving out-of-state businesses a tax advantage over local businesses.

- BATSA proponents say that they want a bright-line nexus rule. But there is an alternative that would create a true bright-line *and* prevent tax sheltering—the "Factor Presence Nexus Standard for Business Activity Taxes" model statute recommended by the Multistate Tax Commission. The model statute uses *de minimis* thresholds of property, payroll, and sales to determine when a business would be subject to tax—providing clear statutory protections for businesses that fall below these thresholds. The model statute reads in pertinent part:

> A. (1) Individuals who are residents or domiciliaries of this state and business entities that are organized or commercially domiciled in this state have substantial nexus with this state.
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> (2) Nonresident individuals and business entities organized outside the state that are doing business in this state have substantial nexus and are subject to [list appropriate business activity taxes for the state, with statutory citations] when in any tax period the property, payroll or sales of the individual or business in the state, as they are defined below in Subsection C, exceeds the thresholds set forth in Subsection B.
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> B. (1) Substantial nexus is established if any of the following thresholds is exceeded during the tax period:
>
> (a) a dollar amount of $50,000 of property; or
>
> (b) a dollar amount of $50,000 of payroll; or
>
> (c) a dollar amount of $500,000 of sales; or
>
> (d) twenty-five percent of total property, total payroll or total sales.

S. 2555 (SEC. 21)
WIRELESS TELECOMMUNICATIONS TAX AND FEE COLLECTION FAIRNESS ACT OF 2016

POSITION

The Multistate Tax Commission opposes the Wireless Telecommunications Tax and Fee Collection Fairness Act of 2016 (the Act) because (1) there is no problem requiring a federal solution; (2) it broadly defines "wireless telecommunications service" and could preempt far more state taxation than simply prepaid wireless service that proponents claim is its only effect; and (3) it requires exclusive federal court jurisdiction over controversies related to the Act. The Multistate Tax Commission supports removal of the entire Act (section 21) from S. 2555 and has no view on any other section.

BACKGROUND

The bill at a minimum does what its proponents claim—prohibit a state or locality from requiring a provider of prepaid wireless telecommunications service to collect and remit any tax, fee, or surcharge on service it provides, except service it sells directly to a consumer.

But usually prepaid service is sold at a brick and mortar retailer. Nearly all states require the retailer to collect and remit, not the provider. Federal protection of the provider from a collection duty is a solution in search of a problem.

Less frequently, the provider sells service directly to the consumer; the Act does not prohibit a state or locality from requiring that the provider collect and remit on those sales. But prepaid providers typically do not own their physical networks. They lease or license from a major carrier. This allows them to arguably claim that they have no nexus outside their home state and so need not collect and remit even though the Act does not prohibit it.

The Act defines "wireless telecommunications service" very broadly—any mobile service offered for profit, available to the public, that uses the public switched network (public network that allows users to communicate with all other users). There are other taxable services other than prepaid mobile phones that meet this definition. Determining how many will require much wasteful litigation. Assuming a broad interpretation, Texas reported that the immediate annual revenue loss would be $1.391 billion—$979.1 million state sales and use tax on taxable wireless telecommunication services, $274 million local tax, and $138.7 million 911 fees.

The Act gives exclusive jurisdiction to federal district courts over controversies related to the Act without regard to diversity and the minimum dollar threshold. Most distressingly, it deprives states of their rights to adjudicate their own tax matters in their own courts. And it wastes federal resources, particularly in light of the wave of litigation the Act's vague definition of "wireless telecommunications service" will uncork.

FEDERAL TAX REFORM

State governments rely on two primary revenue sources—income and consumption taxes. State income tax systems are heavily dependent on federal income tax rules, including the definition of income, applicable exemptions, deductible expenses and other reductions, and reporting requirements.

This system of state-federal income tax conformity has effectively created a tax system and tax base that is integrated and shared between the federal and state governments. This both eases the burden of compliance on taxpayers and simplifies administration for all parties.

The shared nature of the current income tax system also means that changes in federal laws can have a substantial fiscal and administrative impact on the states. The impact that federal changes can have on state tax systems is evident in some of the federal policy changes in years past, including the phase-out of the federal estate tax, the broadening of allowable deductions for retirement contributions, and the acceleration of depreciation allowances for businesses.

Failure to take into account the fiscal, administrative, and policy implications of federal income tax changes on the states will likely lead to divergent tax rules and considerable new complexities for taxpayers and tax administrators. Failure of the federal rules to adjust to the challenges of a global economy also present challenges for the states—as the difficulties in enforcing income taxes with respect to multinational taxpayers and activities has proven.

The Multistate Tax Commission supports collaboration between the federal and state governments to improve tax policy and tax compliance and reduce unfairness. Rather than the adversarial relationship between the state and federal governments that is often exemplified by the conflict over federal preemptive legislation, the Commission seeks a collaborative relationship—one worthy of our federal system of government.