Multistate Tax Commission Meeting
Galt House Hotel
140 North Fourth Street
Louisville, Kentucky

Rich Jackson, Chair

Statement of Application of MTC Positions to Federal Legislative Activity

Please see the attached information on proposed federal legislation that would affect state taxes in the 115th Congress (2017 – 2018) and any official communication of the Multistate Tax Commission that have been provided to Congress in FY2017. Included with this report are:

- A copy of the materials provided for the Commission's Legislative Day in May 2017

ISSUE BRIEFS

LEGISLATIVE DAY, MAY 10, 2017

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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 enterprises, to promote uniformity and compatibility of state tax systems, and to prevent federal intrusion into state tax policy. Forty-nine 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, national tax policies ignore this reality. Federal preemption of state taxation of rental cars, for example, would disproportionately affect states whose economies rely on tourism.

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 avoids the inefficiencies and dangers of centralized decision-making. Our country has been well served by this restraint. The Commission opposes federal legislation that would interfere with the sovereign right of states to control their own taxes.

S. 540 / H.R. 1393

MOBILE WORKFORCE STATE INCOME TAX SIMPLIFICATION ACT OF 2017

POSITION

The Multistate Tax Commission opposes the Mobile Workforce State Income Tax Simplification Act of 2017 because it interferes with states' fundamental right to tax what is physically present in the state. It also interferes with the most critical enforcement mechanism in any income tax system, including the federal government's –that employers withhold and pay over taxes owed by employees.

BACKGROUND

H.R. 1393 and S. 540 would prevent a state from taxing a *physically present person on work he or she performed in that state when it does not exceed 30 days*. It also allows employees to self-certify to employers in advance that they will not exceed more than 30 days in any particular state. And it relieves employers from liability for failure to withhold except in cases of fraud or collusion, which are hard to prove. It is fundamental that a state may tax what is, and what occurs, within its physical borders.

On March 22, 2017, the House Judiciary Committee reported H.R. 1393 to the full House. On April 10, 2017, the CBO scored H.R. 1393 as an intergovernmental mandate that would cost states $78 million in 2020. H.R. 1393 and S. 540:

- No state except the state of residence and the state where an employee is physically present in-person and working for more than 30 days may impose a tax on that person's income.

- Employers may rely on an employee's self-declared intention made up to a year in advance that he or she will not exceed 30 days in a state, even when the employer knows otherwise. The bill prohibits only actual fraud or collusion. This makes the bill ripe for abuse. Technology can solve any remaining problems when employees and employers work together.

- Professional athletes, entertainers, and certain public figures may be taxed based on short periods of physical presence, such as for a single show or a professional game– but there is no exception for other high-income workers.

Federal preemption is unnecessary. The Multistate Tax Commission worked with representatives from the business community to draft a Model Mobile Workforce Statute. The model prohibits a state from taxing the income of a non-resident who works in that state for no more than 20 days. Given a chance, states will adopt this standard over time, especially with support from the business community.

The state model is preferable to the federal bill –

(1) Most importantly, the model preserves states' sovereignty over their own tax bases. Most states will adopt the standard over time;

(2) H.R. 1393 does not exempt high-income persons, who may earn a great deal of money in a state in a single day; and

(3) the model does not depend on difficult-to-prove fraud or collusion to prevent abuse.

The bill passed the House on June 20, 2017, and was received in the Senate and referred to the Committee on Finance on June 21, 2017.

S. 19(SEC. 20)
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 a portion of 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 federal Tax Injunction Act, 28 U.S.C. 1341, *has long required that state courts have jurisdiction over controversies regarding their states' taxes. S.19 overrides the Tax Injunction Act. The Senate Commerce Committee reported it out favorably on January 24, 2017. It was placed on the Senate Legislative Calendar under General Orders on March 21, 2017. There is no House companion bill.*

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 on service it sells directly to a consumer. Usually prepaid service is sold at a brick and mortar retailer in conjunction with a loaded calling card. Nearly all states require the retailer of the card to collect and remit, not the provider of the telephone service. The major reason states do this is that it would be difficult for a telephone service provider to 'look through' its customer (the retailer) to collect tax from its customers' customers. 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, such as when a consumer loads additional value onto a card. Section 20 would probably not prevent a state from requiring the service provider to collect the tax, but the definition of the tax is so broad that it could be applied to many communication services beyond telephone, severely crippling state revenues. This ambiguity encourages wasteful litigation. Assuming the broadest interpretation of 'wireless communications', 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. This does not include technology that has not yet been invented or an even wider interpretation of the definition.

Since 1940 the federal Tax Injunction Act (28 U.S.C. 1341) has prohibited federal courts from hearing state tax cases except in unusual circumstances. But S. 19 ignores this long-standing law by requiring all litigation about sec. 20 to be heard exclusively in federal court. Sec. 20 even waives the federal law that requires cases in federal court to involve over a certain dollar amount and be between citizens of more than one state. States are fully capable to adjudicate their own taxes, even when involving federal laws. Federal court involvement costs the federal government money by consuming the resources of its already over-burdened courts and disrupts the balance of powers between the states and the federal government. State courts are capable to impartially litigate their own states' taxes and with few exceptions have long done so without federal involvement.

S.976
THE MARKETPLACE FAIRNESS ACT OF 2017

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, which gives them an unfair price 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 functioning of the existing sales tax system.

BACKGROUND

Identical legislation passed the U.S. Senate in the 113th Congress but then languished in the 114th with no hearing or markup. S. 976 would allow states to require remote vendors to collect their sales and use taxes under the following conditions:

- 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.
- Non-SSUTA states may require remote sellers to collect state and local sales and use taxes if the state adopts minimum simplification requirements.
- Remote sellers that have gross annual receipts from U.S. remote sales of $1 million or less in the preceding calendar year are exempt. Rules limit division of sales between affiliated entities for the purpose of avoiding tax collection.

Minimum simplification requirements and other requirements under the bill include:

- Single entity for administration, return processing, and audits in a state.
- Single audit for all state and local taxing jurisdictions within a state.
- Single sales and use tax return for by remote sellers for a state (no local returns).
- A uniform state and local sales and use tax base within a state.
- Conform to sourcing rules (where sale is taxed) as set out in the bill.
- Provide remote sellers a database of sales taxability, rates, and boundaries.
- Provide remote sellers free software that calculates tax on each sale and files returns.
- Create certification procedures to approve certified software providers. The software must be capable of calculating and filing use taxes in all qualified states.
- Provide liability relief for remote sellers who rely on a certified provider.
- Relieve certified providers and sellers of liability if they rely on inaccurate information from the state.
- Provide 90 days notice of a rate change.

On May 18, 2017, hearings on the bill were held by the Committee on Banking, Housing, and Urban Affairs.

H.R. 2193
REMOTE TRANSACTIONS PARITY ACT

POSITION

The Multistate Tax Commission prefers the Marketplace Fairness Act passed by the Senate in 2013 and reintroduced in 2015 and 2017 to the Remote Transactions Parity Act (RTPA) because it interferes less with the existing state sales and use tax systems and treats more equitably those sellers covered by the act and those not.

BACKGROUND

The RTPA of 2017 is identical to the RTPA of 2015. Like the Marketplace Fairness Act (MFA), it 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 tax on remote sellers. While the bill shares many of the same requirements and benefits with the MFA, some of its provisions appear to be unworkable and create ambiguities or other technical difficulties that would make implementation difficult. Examples include:

- The bill authorizes states to "require all remote sellers" to collect tax but does not grant similar authority to impose a tax-collection duty 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 CSPs regardless of whether they are working for a remote seller. When 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.

On May 5, 2017, the bill was referred to the House Subcommittee on Regulatory Reform, Commercial And Antitrust Law.

DIGITAL GOODS AND SERVICES TAX FAIRNESS ACT

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 many times. 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.
- Preempts state rules when a transaction bundles a digital good or digital service, taxable or not, with another type of taxable sale.

H.R. 2024
END DISCRIMINATORY STATE TAXES FOR AUTOMOBILE RENTERS ACT OF 2017

POSITION

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

BACKGROUND

This bill has been referred to the House Committee on the Judiciary with no action to date.

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 differently from others, such as car rentals in particular areas, to reflect the effect on the state related to the activity. 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.

On May 1, 2017, the bill was referred to the House Subcommittee on Regulatory Reform, Commercial And Antitrust Law.

BUSINESS ACTIVITY TAX SIMPLIFICATION ACT

POSITION

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

BACKGROUND

This bill has not yet been introduced in the 115th Congress.

BATSA would allow businesses to have a large physical presence in a state without being subject to its taxes by following a few simple rules, such as using independent contractors rather than employees. 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. State supreme courts have nearly unanimously upheld laws that impose state income taxes on businesses that derive substantial economic benefit from a state without regard to its physical presence. BATSA would overturn those holdings.
- The Congressional Budget Office scored the bill as the largest unfunded mandate on 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 sheltering opportunities.

- It constitutes a serious federal intrusion into state policy choices, flouting the Tenth Amendment. Nor is it justified by the Commerce Clause, given that state business income taxes are imposed solely on an apportioned basis. 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.
>
> (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.
>
> 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.

FEDERAL TAX REFORM

State governments rely on two primary revenue sources—income and consumption taxes. State income tax systems generally adopt most federal income tax rules, such as 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 state-tax administration for taxpayers and states.

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. In fact, the problem of transfer pricing abuse has grown so large that the Commission and states have begun a project to address it because the federal government has not fully addressed the problem.

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.