(C) Tax Analysts 2008. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

# Setting the Record Straight on the Business Activity Tax Simplification Act

*by Arthur R. Rosen and Jeffrey S. Reed*

Arthur R. Rosen is a partner with McDermott Will & Emery LLP, New York. Jeffrey S. Reed is an associate with the firm.

A recent *State Tax Notes* article by Matt Tomalis of the Federation of Tax Administrators attacks the pending Business Activity Tax Simplification Act (BATSA) legislation (S. 1726 and H.R. 5267) on several different grounds. The title of the article says that BATSA legislation is "fatally flawed," and the article says that the main arguments being made in support of the bill's enactment are invalid. (Matt Tomalis, "Some Fatal Flaws of S. 1726, H.R. 5267, and All BAT Nexus Bills," *State Tax Notes*, Mar. 3, 2008, p. 691, *Doc 2008-3030*, or *2008 STT 43-3*.) Below, using the headings from Tomalis's article, we explain why Tomalis's assertions have no support in fact, logic, or reality.

### Clarification or Codification of the Existing Nexus Standard

In Tomalis's view, sponsors of the BATSA bills are wrong to say that physical presence is the current nexus standard for business activity taxes; Tomalis instead believes that economic presence is the current nexus standard.

To buttress his position, Tomalis relies mainly on two U.S. Supreme Court cases, *Whitney v. Graves* and *International Harvester*. Reliance on those cases is inappropriate. Most fundamentally, both cases involve a due process clause analysis and fail to consider the requirements of the U.S. Constitution's commerce clause. Tomalis is therefore ignoring 60 years of jurisprudence (for example, *Complete Auto*). Further, when they are read closely, it is clear that those two cases do not endorse an economic nexus standard for business activity taxes. *Whitney v. Graves* stands for the unremarkable proposition that a state can tax a nonresident individual on gain derived from property located in the state. *International Harvester* stands for the equally unremarkable proposition that a state can require a physically present corporation to withhold tax on dividends paid to shareholders. Neither case endorses economic nexus.

The state court cases that Tomalis cites to support his position are almost entirely intangible holding company cases involving the same basic fact pattern. There is an unmistakable tax shelter flavor to those decisions, and many of the decisions lack any considered analysis of the substantial nexus requirement. Exhibit A, *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (1993), contains a one-paragraph substantial nexus discussion that cites a few inapposite due process clause cases and a treatise's opinion on the proper jurisdictional standard for state taxes generally, before briskly concluding that "Geoffrey has a 'substantial nexus' with South Carolina." The other intangible holding company cases simply piggyback on each other and on *Geoffrey*'s thin reasoning. See, for example, the New Jersey Superior Court's *Lanco* decision, which summarizes the other intangible holding company cases, including *Geoffrey*, and proclaims that the court is "satisfied that the physical presence requirement is not applicable." (For the decision in *Geoffrey*, see *Doc 93-51468* or *93 STN 133-12*. For the decision in *Lanco*, see *Doc 2006-21177* or *2006 STT 199-22*.) Those cases were presented to judges by the state revenue departments as blatant attempts by businesses to bilk the states of revenue, rather than as commerce clause substantial nexus cases. Accordingly, those cases cannot be legitimately cited for the proposition that economic nexus is the general substantial nexus standard for all businesses.

In the context of an actual operating business, however, there is a split of authority. The Tennessee Court of Appeals said that the reasoning of the *Geoffrey* court, and the arguments advanced by the Tennessee commissioner of revenue, "confuse the analysis between the Commerce Clause and the Due Process Clause." See *J.C. Penney National Bank v. Johnson*, 19 S.W.3d 831 (Tenn. App. 1999). In its well-reasoned decision, the court wrote that due process clause nexus requires only purposeful direction toward residents of another state, whereas

commerce clause substantial nexus requires something more. The court said that it was not its place to determine whether physical presence is the commerce clause substantial nexus requirement, but determined that *Quill* and *Bellas Hess* were the controlling precedents.[1] That remains the law in Tennessee.[2]

The other major state court decision addressing commerce clause substantial nexus in the context of a fully operating business, *MBNA v. West Virginia*, asserts that *Quill* should be limited to sales and use tax and applies a "significant economic presence" commerce clause substantial nexus test for business activity taxes, a test borrowed from a lone law review article, and one that finds no support in any West Virginia or U.S. Supreme Court case. (For the decision in *MBNA*, see *Doc 2006-23668* or *2006 STT 228-18*.)

> ***Many believe that the J.C. Penney court got it right and that physical presence remains the standard for commerce clause substantial nexus.***

Many believe that the *J.C. Penney* court got it right and that, in the absence of any further guidance from the U.S. Supreme Court following *Quill*, physical presence remains the standard for commerce clause substantial nexus. If it were clear that some other standard were the correct standard, then the West Virginia Supreme Court of Appeals would have applied that standard and would not have needed to introduce a new standard for commerce clause substantial nexus jurisprudence.

When the U.S. Supreme Court and Congress have considered state and local tax jurisdictional issues, their normative framework has been that a government's jurisdiction ends at its borders and that physical presence is therefore a prerequisite for taxation; neither institution has even fathomed that merely having customers located in the state is in any way relevant. For example, in *Northwestern States Portland Cement*, 358 U.S. 450 (1959), the Court found the relevant issue to be not whether the company had customers in, or an economic nexus with, the state (which it obviously did) but whether the qualitative nature of the company's physical presence in the state was substantial enough to warrant taxation. Similarly, in enacting P.L. 86-272, Congress clearly ensured that the long-standing rule of physical presence was still the law because Congress based the safe harbor not on any economic nexus exemption, but rather on the qualitative nature of the business' physical presence, which, without the exemption, would have caused taxability. Those precedents show that historically, jurisdiction has been based on a business's presence in the state, not on economic results. Congress has not enacted any new legislation, nor has the U.S. Supreme Court issued any new state tax opinion that shifts this focus.

It is accordingly proper and correct for BATSA supporters to say that physical presence is the current substantial nexus standard. Tomalis is wrong to assert otherwise.

### Unfairness of Taxation Without Benefit of Services in the State

U.S. Rep. Bob Goodlatte, R-Va., a cosponsor of BATSA, was right to say that it is unfair for states to tax businesses that receive little or no benefit from the state. The states that should receive the benefit of a business's tax dollars are the states that provide benefits to the business — for example, water, paved roads, and police and fire protection. States that provide nothing or de minimis benefits should not receive a business's tax dollars.

> ***The ability to use state courts is, even at best, an indirect, negligible benefit for businesses.***

Tomalis argues that states provide businesses a significant benefit: the ability to use state courts. But that benefit is, even at best, an indirect, negligible benefit. The state courts are designed for, and are used primarily by, individual residents and in-state businesses. The state courts are not designed for out-of-state individuals and out-of-state businesses. Perhaps this is why out-of-state individuals and out-of-state businesses avoid state courts when possible. Out-of-state individuals and out-of-state businesses generally opt for the federal courts, rather than state courts, whenever diversity

---

[1]Some people mistakenly believe that *America Online, Inc. v. Johnson* (Tenn. Ct. App. 2002) has undercut the force of *J.C. Penney*. Not so. The issue in *American Online* is whether the in-state physical presence of affiliates and independent contractors can be attributed to the taxpayer. That is an attributional nexus case in which physical presence is used as the governing standard. (For the decision in *J.C. Penney*, see *Doc 1999-39731* or *1999 STT 248-17*. For the decision in *America Online*, see *Doc 2002-17884* or *2002 STT 149-24*.)

[2]*See Meadows v. State of Tennessee*, 849 S.W.2d 748, 752 (Tenn. 1993) (ruling that "the published opinions of the intermediate appellate courts are opinions which have precedential value and may be relied upon by the bench and bar of this state as representing the present state of the law with the same confidence and reliability as the published opinions of this Court, so long as either are not overruled or modified by subsequent decisions.").



(C) Tax Analysts 2008. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

jurisdiction permits.[3] The state courts are used by nonresident individuals and businesses mainly to defend against lawsuits or to bring an action when the amount in controversy is not substantial enough to confer diversity jurisdiction. Use of the state courts is accordingly de minimis, quantitatively and qualitatively. In the context of an out-of-state business using a state court to enforce an out-of-state judgment against an in-state debtor, the state is clearly not providing any new benefit to the business — the state is merely doing what it must do under the full faith and credit clause of the U.S. Constitution.

### Double Taxation and Its Effect on Interstate Commerce

Tomalis criticizes BATSA cosponsor U.S. Sen. Mike Crapo, R-Idaho, for saying that the BATSA bills "would relieve impacted businesses from the burden of double taxation, which results from a varying mix of state tax laws." According to Tomalis, there is no evidence that double taxation occurs, and BATSA proponents are making empty assertions. Crapo is right. Tomalis is wrong.

States have varying apportionment formulas and are increasingly invoking the Uniform Division of Income for Tax Purposes Act section 18 to produce the most antitaxpayer apportionment formula possible given the taxpayer's presence or lack of presence in the state. That, coupled with some states' adoption of throwback and throwout rules, results in some businesses being taxed on over 100 percent of their income.

Economic nexus increases the likelihood of double taxation by making it possible for more states to tax a slice of a business's income. As Crapo accurately notes, the BATSA bills solve that problem by ensuring that only the states that actually provide benefits to a business are able to claim a share of that business's tax dollars.

### The Need for a Clear Bright-Line Standard

Tomalis thinks that the most recent BATSA legislation contains too much fuzzy language and not enough bright lines.

His complaints about the language in the bills seem trifling. For example, he asks why BATSA modifies Public Law 86-272 to protect not only solicitation of orders for sales of tangible personal property, but also the solicitation of orders for "transactions." That should not be confusing. The clear intent of adding the word "transactions" is to modernize P.L. 86-272 to cover solicitation for sales of things besides tangible personal property, such as the solicitation for sales of services and intangible property. Tomalis is wrong to argue that the word "transactions" somehow creates a fatal ambiguity in the bills.

The BATSA bills protect from business activity taxation businesses that merely furnish information to customers or affiliates in a state or are merely covering events or gathering information in a state. That puzzles Tomalis. However, it is clear what the bills are protecting. If a news reporter crosses state lines to cover a story, that activity by itself will not cause the reporter's company to have nexus with the state. It is fine for Tomalis to disagree with that provision on a policy basis. But it is wrong for him to argue that the provision is unclear.

The BATSA bills protect "business activities directly related to [the] potential or actual purchase of goods and services." Again, Tomalis thinks that language is vague and he calls for "firm guidance or certainty about what activities" are directly related to a purchase of goods or services. All legislation assumes a certain amount of common sense. The BATSA bills are no exception. The "potential or actual purchase of goods and services" provision is designed to shield businesses from taxation if they merely enter into a state in the capacity of a customer, so long as the final decision to purchase goods or services is made outside the state. For example, if a business representative travels into a state to examine the potential purchase of goods or services, that trip into the state will not create a taxable nexus for the representative's business in the state so long as any decision to purchase occurs outside of the state.

Those provisions are not cloudy, and it should be clear to businesses and state taxing departments what activities the provisions do and not protect.

### The 'Limited or Transient' Black Hole

Tomalis worries that the provision granting protection to businesses conducting "limited or transient" activity in the state is a black hole that could lead to business activity taxation only for businesses that do not devote sufficient care to their organizational documents. Tomalis imagines that businesses may be able to shield themselves from taxation by merely placing language in their charter or articles of incorporation proclaiming "limited" business objectives.

That is creative thinking rivaling that of even the most imaginative tax auditors.

Of course, as Tomalis himself notes, the limited or transient provision is designed to provide a de minimis exception. Although it is possible to devise

[3]Diversity jurisdiction is conferred when the amount is over $75,000 and the controversy is between citizens of different states. *See* 28 USCS section 1332. A corporation is considered a citizen of the state where it is incorporated and the state where it has its principal place of business. 28 USCS section 1332(c)(1).

(C) Tax Analysts 2008. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

some off-the-wall ways of reading the phrase "limited or transient," it is expected that reasonable people will read the phrase the way it is intended to be read: as providing a de minimis exception. And, as Tomalis himself would likely admit, any business following the tax planning technique described in his article would likely be laughed out of court.

## P.L. 86-272 Abused

### Original Intent of P.L. 86-272

Contrary to Tomalis's assertions, the BATSA bills are consistent with P.L. 86-272. The bills seek to curb the same type of aggressive targeting of out-of-state businesses that outraged the business community and prompted P.L. 86-272's enactment.

The bills modernize P.L. 86-272 by closing loopholes that the states are using to circumvent P.L. 86-272 and to tax businesses that have a minimal presence or no presence in the state.

### Expansion of P.L. 86-272 Beyond Solicitation of Sales of Tangible Personal Property

The U.S. economy is very different now than it was when P.L. 86-272 was enacted. There is an increased focus on intangibles and on services. P.L. 86-272 now protects only the solicitation for sales of tangible personal property: It does not protect the solicitation for other sales. To fill that gap, the BATSA bills modernize P.L. 86-272 to also protect the solicitation for orders or transactions, which would protect the solicitation for sales of intangibles and services.

Tomalis criticizes that modernization, but there is no sound policy basis for his position or for the status quo. To use an example, under current law, P.L. 86-272 shields a bookseller from state income taxation when the bookseller travels into a state to solicit the sale of a book (tangible personal property). However, P.L. 86-272 does not protect that same bookseller from state income taxation if the bookseller is instead soliciting the sale of an electronic book (intangible property).

State revenue departments are aware of that P.L. 86-272 loophole and exploit the loophole to generate assessments and to punish out-of-state businesses. The BATSA bills close that loophole by equalizing the protection afforded sellers of intangibles and services with the protection now afforded sellers of tangible personal property under P.L. 86-272.

### Expansion of P.L. 86-272 Regarding Independent Contractors

Tomalis notes that the BATSA bills provide more protection than P.L. 86-272 in the context of independent contractors. For example, the bills protect from business activity taxation businesses that are merely engaged in the "furnishing of information to an independent contractor ancillary to the solicitation of orders or transactions by the independent contractor on behalf of such person." That makes obvious sense. The provision would protect from business activity taxation, for example, a bubble gum manufacturer that mails to an out-of-state independent contractor information about the types of bubble gum that the manufacturer produces.

Tomalis says that there is an "obvious tax avoidance motivation" for those common sense protections. But many believe that the bubble gum manufacturer is not engaging in nefarious tax planning when it simply mails some information about its business to an independent contractor.

### Expansion of Taxes Covered by P.L. 86-272 to Any Other Business Activity Tax

One of the state revenue departments' favorite loopholes is that P.L. 86-272 protects businesses only from *income* taxation. To exploit that loophole, many states have enacted non-income-based taxes (the Ohio commercial activity tax and the Texas margin tax, for example). New Jersey has even enacted a "special" alternative minimum taxation regime designed specifically for businesses that qualify for P.L. 86-272 taxation.

The states know that imposing non-income-based taxes on businesses will prevent businesses from being able to claim P.L. 86-272 protection. Thus, a business can be doing nothing more than solicit sales of tangible personal property in a state and will still be subject to non-income-based taxes (such as gross receipts taxes) in the state.

> ***BATSA legislation provides protection to businesses that merely solicit sales in a state, regardless of what type of business activity taxation regime the states dream up.***

BATSA proponents think it is wrong for the states to enact statutes designed to deny businesses P.L. 86-272 protection. Accordingly, BATSA legislation provides protection to businesses that merely solicit sales in a state, regardless of what type of business activity taxation regime the states dream up.

Tomalis disagrees with that analysis, saying that P.L. 86-272 was enacted for a limited purpose, was meant to only temporarily restrict the states, and was meant to apply only to income taxes. There are several problems with his position. When P.L. 86-272 was adopted, gross receipts taxes were not as prevalent as they are today, and income taxation was the dominant method of taxing a business's economic activity. It is highly unlikely that the authors of P.L. 86-272 could have foreseen that limiting P.L. 86-272 to income taxes would prove

(C) Tax Analysts 2008. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

(C) Tax Analysts 2008. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

problematic and that the states would react by imposing non-income-based taxes on businesses. If that reaction could have been foreseen, the authors of P.L. 86-272 likely would have changed the bill's language. The authors of the bill did not intend P.L. 86-272's protection to apply only in select states having income taxes; they meant for protection to apply in all states.

Tomalis is correct that P.L. 86-272 was intended to be a stopgap measure to put an end to aggressive state revenue grabs. However, the states have become even more aggressive, and the need for stronger protection against aggressive state taxation is now dire. BATSA legislation provides that protection by modernizing P.L. 86-272 and by providing for a national physical presence requirement that must be met before a state can impose a business activity tax.

## The Physical Presence Standard That Isn't

The BATSA bills provide that a state may not impose a business activity tax on a business unless the business has a physical presence (employees or property) in that state for 15 days or more.

Tomalis takes issue with that standard. He thinks that 15 days or more is not bright-line enough (1 day should be enough to create a filing requirement, in his view) and he thinks that several of the exceptions from taxation (such as the limited or transient activity rule) are problematic.

His apparent wish is for the BATSA bills to have no de minimis standard. That is unacceptable and is contrary to Supreme Court precedent. In *Quill* the Court recognized that the presence of the floppy disks in North Dakota was so minor as to not create a physical presence. And in interpreting P.L. 86-272, the Court in *Wisconsin Department of Revenue v. Wrigley Co.*, 505 U.S. 214 (1992), recognized that some trivial connections with a state should not deprive a business of P.L. 86-272 protection, noting the venerable principle *de minimis non curat lex* ("the law cares not for trifles").

Unfortunately, many state tax administrators are unfamiliar with that principle or reject it in practice. In their response to surveys, some administrators have said that they believe that activities such as making sales to customers in the state using a 1-800 number, having a Web site located on a server in the state, or having employees in the state to attend a trade show can create nexus with the state. Some states even take the position that driving a truck on a state road is sufficient to create nexus with the state.

It is sad and disconcerting that it is necessary for the BATSA bills to contain de minimis provisions. However, given the current climate and the positions that some states are taking, its provisions are necessary.

## Physical Presence Inappropriate as a BAT Nexus Standard

### Tax Planning Encouraged

Tomalis asserts that BATSA legislation encourages the use of intangible holding companies and other gimmicks to avoid state and local taxation. That is a false, unsupportable charge.

The BATSA legislation contains a provision stating that it in no way "modif[ies], affect[s], or supersede[s] the authority of a State to bring an enforcement action against a person or entity that may be engaged in an illegal activity, a sham transaction, or any perceived or actual abuse in its business activities."

Therefore, BATSA does not prevent states from using weapons such as the sham transaction doctrine and addback statutes to attack intangible holding companies. Many states have already met with great success in using those techniques. The BATSA legislation would in no way interfere with those efforts.

### Big Business Favored Over Small Business

Small-business owners, officers, and representatives gathered before the U.S. House of Representatives Committee on Small Business in February to discuss outrageous state tax impositions.

A corporate officer for a chain of sandwich shops testified that some states are attempting to tax the business simply for entering into franchising agreements with independent businesses in the state. The states are arguing that licensing the business's name and trademarks to franchisees makes the franchiser taxable in the state, even though the franchiser has no operations in the state.

A small-business owner noted at the hearing that New Jersey has a practice of impounding trucks until the owners submit New Jersey business activity tax returns, payment, and various lengthy and complicated forms. New Jersey takes the position that merely driving a truck on the state highway provides a sufficient basis for taxation.

The Internet enables even small businesses to have customers throughout the United States, and many Americans now make their income entirely through those e-businesses. An individual in Vermont may collect maple sap from trees in her backyard, process the sap into maple syrup, bottle it, and sell it on a Web site. Assuming that her Web site is professional-looking and shows up quickly on Google, that individual could reasonably be expected to have customers located in every state in the country. It would not be surprising to see many states go after that seller arguing that her business has nexus with every state because of the presence of customers there.

Such aggressive state tax practices can be crippling for a small business. Small businesses do not

have the financial resources to fight bogus assessments at the administrative level or in court. If they are assessed, because of the small amounts at stake, it is often more cost effective for small businesses to simply pay the assessment, even when the assessment appears legally dubious. Many small-business owners support BATSA because they want these dubious assessments to stop and they want to know that they will be protected from business activity taxation in states where they do not operate.

***Small businesses do not have the financial resources to fight bogus assessments at the administrative level or in court.***

Tomalis seems to think that the BATSA legislation will usher in a golden age of tax planning in which big businesses will set up intangible holding companies, shielding all tax dollars from the states, and the state tax burden will shift to small businesses. That will not happen, because the states can continue to use the sham transaction doctrine, addback statutes, and other weapons at their disposal to stamp out illegitimate tax planning.

In sum, the BATSA legislation provides certainty to all businesses, regardless of size, and does not encourage the use of sham structures that might shield big businesses, or small businesses, from state taxation.

**Out-of-State Business Favored Over In-State Business**

Tomalis approaches state taxation in a flawed way. His mindset is that when a company has a good business model that is working, the states must try to find some way to tax that business, even when the business has no apparent connection to the state or operations in the state.

Many think that a more logical approach would be to ask what businesses and individuals are actually operating in the state and to distribute the tax burden among those businesses and individuals. Tomalis may think that approach is old-fashioned, but many still believe that in determining who should be paying tax in any given state, the first question that must be asked is who operates in the state, not who is running a successful business somewhere in the nation.

The example Tomalis uses is ING DIRECT, which offers, according to Tomalis, a high annual percentage yield interest rate on its basic savings account and other customer-friendly rates and benefits. ING DIRECT is able to do that, according to a statement from its Web site that Tomalis quotes, by cutting down on "overhead and high operational costs," by reducing expenses like "managing and maintaining a lot of branches," and by conducting most of its business online.

Most people would applaud ING DIRECT for its customer-friendly rates and good business model. But Tomalis worries that ING DIRECT may take business from local banks. His solution is therefore that every state should impose a direct tax on ING DIRECT, cutting down on ING DIRECT's bottom line and perhaps forcing ING DIRECT to change its rates so that they are the same as those of the local banks.

That is bad for ING DIRECT's customers (who, presumably, would prefer more favorable rates to less favorable rates), bad for its shareholders (including many working Americans whose retirement plans own stock in companies such as ING DIRECT's parent), and it is flawed as a matter of economics. ING DIRECT is offering something different than the local bank. It is offering better rates in exchange for lack of face-to-face contact. In contrast, the local bank is offering increased face-to-face contact in exchange for worse rates. It is up to the customer to decide what is preferable. Some customers may opt for ING DIRECT; others may opt for the local bank or for both.

It is illegitimate for a state to follow Tomalis and go after out-of-state banks like ING DIRECT merely because there is a concern that the out-of-state banks are offering better rates than the in-state banks. That hostility toward out-of-state businesses, not only in rhetoric, but also as evidenced by aggressive state tax assertions, has many people in the business community alarmed, and demonstrates exactly why BATSA legislation is necessary.

**Contradiction With Other Activity by Congress**

Tomalis claims that the BATSA legislation is inconsistent with the Stop Tax Haven Abuse Act (S. 681). His evident argument is that the IRS is trying to shut down abusive shelters, and he thinks that BATSA legislation will, in contrast, pave the way for abusive shelters.

For the reasons already explained, BATSA legislation does not encourage the use of abusive shelters and does not defang the states. BATSA legislation leaves room for states to use the sham transaction doctrine, addback statutes, and other measures to shut down illegitimate shelters. The states are already using those techniques and are meeting with great success in doing so.

**BATs as Different From Sales and Use Taxes**

Contrary to what Tomalis writes, reliance interests for business activity taxes are just as significant as those for sales and use taxes. Since time immemorial, businesses have not been hit with business activity taxes in states where they lacked

(C) Tax Analysts 2008. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

operations. Extraterritorial assessments have not occurred in the past. It is only recently that states have decided to go with all guns blazing after out-of-state businesses, as evidenced by the ramping up of assessments and the enactment of "special" taxes to target out-of-state businesses. Tomalis is simply wrong to suggest that those practices are long-standing and to say that businesses have not been relying on the physical presence standard.

### The Financial Impact

In assessing the financial impact of BATSA legislation, Tomalis relies on studies that have been thoroughly debunked. "Estimates of Impact of H.R. 1956 on State and Local Business Tax Collections," prepared by Ernst & Young LLP for the Council On State Taxation, details the many flaws in the Congressional Budget Office and National Governors Association studies that Tomalis cites.

The NGA study that Tomalis cites fails to take into account that most separate-filing states have now adopted addback statutes that would reduce or eliminate any revenue loss from the BATSA legislation relating to intangible holding companies.

Detailing how slight the impact would be, the Ernst & Young study concludes that for the 12 states examined in detail, the loss in revenue due to BATSA legislation would equal only 0.8 percent of the total business activity taxes paid by businesses in those states.

### Federalism Abused

BATSA legislation recognizes that each state is its own sovereign and that each state should be in control of what transpires within its borders. The corollary is that states should not seek dominion over persons and property outside of their borders. Accordingly, under BATSA legislation the states that have a business operating within their borders are the states that have a right to that business's tax dollars. That shows the utmost respect for the separateness and individuality of each state.

***Economic nexus treats the states as borderless and indistinct.***

Economic nexus, however, treats the states as borderless and indistinct. Under economic nexus, if a company has a customer in State 1, then State 1 has as much right to the company's tax dollars as do States 2 and 3, where the company actually operates, employs a workforce, and owns property.

That is an abuse of federalism. States 2 and 3 should be able to tax the company because the company operates within their borders. State 1 should not be able to reach across its border to tax a company that is operating outside its borders. BATSA legislation recognizes that and comports with federalism by acknowledging that borders matter. ✰



(C) Tax Analysts 2008. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.