

Resolution One **State Sales Tax Simplification and Fairness Policy**

Background

The U.S. Supreme Court has held in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) that a state may not require a seller that does not have a physical presence in the state to collect sales or use tax on sales into the state. The decision was based in part on the complexity of the sales tax system for remote sellers (nonresident sellers without a physical presence in the state of purchase). The Court also said clearly that Congress could authorize states to require remote sellers to collect tax.

Since the *Quill* decision, online retailing and remote sales have exploded as the Internet has become the preferred way of doing business for many Americans. Online retail sales have increased by 25 percent annually over the last four years and now constitute nearly 4 percent of all retail sales. Estimates from University of Tennessee economists show that the revenue loss to the state and local governments is now upwards of \$15 billion annually. This represents not only a diminution of the ability of states and localities to meet the needs of the citizenry (or increases the burden on other taxpayers), but also constitutes a competitive disadvantage for sellers required to collect tax.

To address the issue of complexity for multistate sellers, states have worked closely with the business community for more than five years to simplify administration of sales and use taxes for fixed-base retailers as well as for remote sellers. A major goal of the Streamlined Sales Tax Project is to reduce the compliance burden for multistate sellers. The Project culminated in the adoption of the Streamlined Sales and Use Tax Agreement. The Agreement sets out the required sales tax law states must adopt and the Agreement's governing rules. It was adopted in November 2003. The Agreement became effective on October 1, 2005, when the requisite number of states simplified their sales and use taxes. At the present time, there are 15 full member states and 6 associate member states. More than 1,000 sellers have voluntarily registered to collect tax under the Agreement. Key simplifications addressed by the Agreement include state-level administration of all local sales taxes, greater uniformity in tax bases, greater use of technology, due diligence safe harbors for sellers and uniform definitions.

Policy

Enactment of federal legislation authorizing states to require remote sellers to collect tax on sales into a state is a matter of the highest importance. A significant number of states have simplified their sales taxes and it is time for Congress to act on remote sales legislation.

The Federation of Tax Administrators (FTA) supports the enactment of federal legislation that would authorize members of the Streamlined Sales and Use Tax Agreement to require remote sellers to collect sales and use taxes on goods and services sold into the state. Any such federal legislation should reflect the actual policies of the Streamlined Sales and Use Tax Agreement and should not condition the grant of authority on compliance with requirements not in the Agreement. Remote sales legislation should be self-activating and not require additional federal authorizations or rulemaking, and it should respect the authority of the states to govern the affairs of the Agreement. FTA believes it is appropriate that certain remote sellers with a limited sales

volume be exempted from the collection requirement. Federal legislation should not incorporate language to limit state tax authority for other types of taxes. FTA supports the widest possible membership in a simplified sales tax system and encourages the Governing Board of the Streamlined Sales Tax Project to work to resolve issues that inhibit non-participating states from becoming members.

This resolution shall automatically terminate three years after the Annual Business Meeting at which it is adopted, unless reaffirmed in the normal policy process.

Hawaii abstains

Missouri abstains

Resolution Two Expanding Federal Refund Offset for State Tax Debts

Background

The U.S. Treasury Department's Financial Management Service offsets federal tax refunds and other government payments for a variety of debts owed the federal government, including child support, student loans and federal tax delinquencies. The IRS Restructuring Act of 1998 (P.L. 105-206) authorized states to join the federal Tax Offset Program. Current law allows states to use the federal offset program to collect their delinquent income tax debts, but from resident taxpayers only (defined as a taxpayer whose address on the federal return is in that state). The restriction was intended to give the program time to prove itself to be effective and non-controversial. Each year states collect more than \$200 million in delinquent tax debts from this program.

The program contains a series of safeguards to insure that residents and nonresidents alike receive adequate notice of the debt that is due and that further inaction will result in the debt being referred to offset. Financial Management Service estimates that states should be able to collect more than \$80 million each year if offsets are allowed from nonresident debtors. Provisions that would have expanded the federal refund offset program to include the debts of nonresident state taxpayers were included in two bills in the 109th Congress, but did not make it to final passage. The provision is not considered controversial.

The Financial Management Service supports expansion of the tax offset program. Increasing the volume of debt the federal government collects permits greater administrative efficiencies through economies of scale. Also, the states pay a fee for each successful offset, which covers the federal government's fully loaded share of the cost of the federal offset program.

Policy

The Federation of Tax Administrators (FTA) supports expanding the federal Tax Offset Program to include income tax debts owed by all taxpayers, not just state residents. FTA believes it is appropriate to maintain the current safeguards to insure taxpayers are aware of the potential for debts being referred to offset and recognizes the need to establish an "ordering rule" (to determine which debt is offset first if a taxpayer owes debts to more than one state) that is consistent with sound tax policy and recognizes the administrative capacity of Financial Management Service.

This resolution shall automatically terminate three years after the Annual Business Meeting at which it is adopted, unless reaffirmed in the normal policy process.

Resolution Three Federal Preemption of State Property Tax Authority

Background

In 1976, Congress passed the Railroad Revitalization and Regulatory Reform Act (the “4-R Act”), which prohibits states and local governments from taxing railroad property at higher rates or ratios of value than those for other commercial and industrial property. It also provides that railroads may pursue claims under the Act in federal court. Similar, but not identical, protections have also been accorded the interstate airline and motor carrier industries.

From the states’ perspective, the 4-R Act and its progeny have had a number of undesirable effects on state and local property tax systems. Thirty years of litigation still has not fully defined the contours of the 4-R Act. Contentious litigation was repeated in many states over the identification of which commercial and industrial property taxes constituted the comparison class for railroads, the jurisdiction and role of the federal courts, what taxes besides property taxes were included and how to deal with exempt property. In May 2007, the U.S. Supreme Court took yet another 4-R case involving whether a taxpayer may use a different valuation methodology than the government in bringing a case of discrimination under the Act.

Beyond the litigation, 4-R Act-like protections have disrupted state property tax systems. This is particularly true in states that have a constitutional system that allows for different classes of property. They have also established a preferred class of taxpayer and they lead to requests for similar treatment by additional industries. The scope of the 4-R preemption vastly exceeds the original stated Congressional intentions because the “any other tax” provisions in the Act have been construed to apply to other taxes besides property taxes.

There have been a variety of state tax restrictions proposed for different types of property or activities that are similar to the 4-R “non discriminatory” prohibitions. Proposals have been made for wireless communications, telecommunications companies, interstate natural gas pipelines, hotel reservation businesses and auto rental companies. Extending these provisions to other industries could cause serious and widespread revenue consequences to the states and localities. The most dramatic impact will be felt in those states where the voters have approved a constitutional amendment authorizing differential treatment of certain types of taxpayers. In effect, Congress will be substituting its judgment for the judgment of state voters.

Policy

The Federation of Tax Administrators (FTA) opposes any federal legislative intrusion into state taxing authority. FTA strongly opposes prohibitions of state taxing authority on the types or level of taxes that states can impose, including the establishment of property tax rates and classes. Decisions about property tax assessments, rates and policies and property tax administration should be left to state and local elected officials and the citizens they represent. Congress should respect the states’ administrative and judicial processes for dealing with tax appeals, which are the appropriate means to protect taxpayers from unconstitutional discrimination.

This resolution shall automatically terminate three years after the Annual Business Meeting at which it is adopted, unless reaffirmed in the normal policy process.

Resolution Four Business Activity Tax Nexus Legislation

Background

Business activity taxes are levied by states for the privilege of doing business in or earning income within a state. These include state corporate income taxes, gross receipts taxes, business license taxes, franchise taxes, business and occupation taxes, and insurance premiums taxes.

Decisions by the U.S. Supreme Court allow a state to tax business activities within the state if there is a substantial nexus between a commercial entity doing business in the state and the taxing state. A number of state courts have held that the taxed entity need not have a physical presence in the taxing jurisdiction in order to be subject to a business activity tax, and the Supreme Court has specifically stated that it has not applied a physical presence requirement to the imposition of business activity taxes.

In the 109th Congress, the Business Activity Simplification Acts (H.R. 1956 and S. 2721) were introduced. The bills would have eliminated state taxation of businesses that have no physical presence in the state, and they further would have provided that certain types of physical presence would not be considered for purposes of determining the jurisdiction to impose business activity taxes. The bills also would have expanded P.L. 86-272 to all forms of business activity taxes (instead of just net income taxes) and to the solicitation of sales of all types of property and services instead of just tangible personal property.

State tax agencies and other officials resisted enactment of legislation such as H.R. 1761 and S. 2721 for several reasons:

- It represents a break from existing U.S. Supreme Court precedent and is a substantial reversal of current law.
- It would allow many companies to engage in tax planning and structuring in order to avoid substantial amounts of tax in their domicile state and the states in which they do business essentially changing their business form, but not the nature of the income-producing activities. In particular, larger companies would be able to transfer intangible assets to holding companies incorporated in no-tax or low-tax states.
- The legislation would impose the largest unfunded tax preemption mandate ever estimated by the U.S. Congressional Budget Office, a state revenue loss of \$3 billion per year within three years.
- The legislation favors out-of-state businesses over in-state businesses. It would allow a large corporation that can conduct business online to go into a state electronically and exploit the market in that state without being subject to the taxes that in-state businesses are required to pay.

- The expansion of P.L. 86-272 is unwarranted and runs counter to the direction that business operations are taking.

Policy

The Federation of Tax Administrators strongly opposes any legislation that would restrict a state's constitutional authority to tax entities doing business in a state. The Federation opposes any legislation that would establish a physical presence nexus requirement for the imposition of state business activity taxes.

This resolution shall automatically terminate three years after the Annual Business Meeting at which it is adopted, unless reaffirmed in the normal policy process.

Resolution Five Preemption of State Authority to Tax

Background

The power to define the state tax system is a core element of state sovereignty, and the United States Constitution establishes the bounds to the sovereignty of the states in the tax arena. The system of federalism that is defined by the United States Constitution further assigns to state and local governments the responsibility for supplying the majority of the daily services due to its citizens and residents. A vibrant state and local tax system is essential to meeting those needs, and the U.S. government has traditionally shown substantial deference to the tax sovereignty of the states.

An increasing number of groups seek to preempt state taxation authority in particular areas. In some cases, these preemption efforts are driven by a desire to establish a preferred tax position for a specific industry, while in other cases, preemption is driven by a desire for greater uniformity or simplification of state and local tax systems. In still other cases, federal preemption is pursued as a means of rectifying perceived discrimination or differential tax treatment at the state and local level.

Beyond the opposition to the incursion on state sovereignty, states have also generally resisted federal preemption efforts because preemption of state tax authority has the effect of establishing a preferred class of taxpayer and shifting the tax burden to other non-preferred taxpayers. Moreover, such preemptions often have unintended consequences that work significant disruptions of state and local tax systems.

Our system of federalism can result in substantial administrative compliance burdens for persons with tax responsibilities in multiple states. Many of the legitimate goals that might be pursued in preemptive legislation can be effectively achieved through cooperative state efforts and improved uniformity among the states. States have an obligation to pursue such efforts.

Policy

Congress and the U.S. federal agencies should refrain from enacting measures, taking actions or making decisions that would abrogate, disrupt or otherwise restrict states from imposing taxes that are otherwise lawful under the U.S. Constitution or from effectively administering those taxes. Congress should undertake an active program of consultation with states as it considers measures that would preempt state tax authority. Finally, states should actively pursue such uniformity and simplification measures as are necessary and effective to address concerns of administrative burden in complying with the tax laws of multiple states.

While federal preemption is generally to be resisted, preemptive legislation can, at times, promote simplification, uniformity, and taxpayer compliance, albeit at some cost to state sovereignty. FTA will evaluate proposed federal legislation that preempts state taxing authority against several criteria. (1) Recognizing that the benefits of federalism will impose administrative burdens on commerce, is there disinterested evidence that the administrative burden and complexity posed by current state and local practices is impeding the growth of commerce? (2) Does the proposed preemption address issues of simplification and complexity?

(3) Can meaningful simplifications and uniformity be achieved through state action? (4) Would preemption disrupt state and local revenue flows and tax systems? (5) Would preemption cause similarly situated taxpayers to be taxed differently; specifically, does the proposal create advantages for multistate and multinational businesses over local business ? (6) Does the preemption support sound tax policy? (7) Does the preemption create unknown or potential unintended consequences? (8) Have state tax authorities and taxpayer representatives together agreed to a beneficial change in federal law?

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Resolution Six Taxation and Withholding of Earnings in Multiple States

Background

The fundamental principle of state individual income taxation is that income is taxable where it is earned or where the services giving rise to the income are performed. In addition, the state of a taxpayer's residence may tax all income regardless of where earned, but is generally required to offer a credit for taxes paid to other states to assure that income is not subject to multiple taxation. This is the same tax policy embraced by the U.S. government and by all other income-taxing governments.

As U.S. work patterns shift to increasingly include telecommuting and multistate travel, more workers find themselves with tax obligations to more than one state. Likewise, employers are faced with an increased responsibility for withholding income taxes for multiple states. State laws and practices vary widely with respect to de minimis thresholds for withholding. There also is wide variance in enforcement programs aimed at compliance among persons (and their employers) who are temporarily in the state.

In the 109th Congress, H.R. 6167, the Mobile Workforce State Income Tax Fairness and Simplification Act, would have authorized a state to impose an income tax liability and a withholding requirement only when a nonresident had been in the state for at least 60 days in a calendar year. The bill contained an exception for professional athletes and entertainers.

In correspondence with proponents of H.R. 6167, FTA made several points. A 60-day threshold is excessive. While states recognized concerns regarding the administrative burdens imposed by current practices, the 60-day threshold is well beyond a level necessary to deal with the vast majority of individuals who would be temporarily in a state. Further, H.R. 6167 would substantially disrupt the current tax system in favor of a system based on taxation by the resident state. Moreover, a simple "days threshold" may expose some states to substantial revenue disruptions; a "dollar threshold" should also be applied. Finally, independent state action is a viable and preferred substitute for federal legislation.

Policy

The ability to tax income where it is earned is fundamental to state tax sovereignty and state income tax systems. Moreover, this ability is absolutely necessary in our federal system, where a state may choose to not employ an income tax. States do, however, recognize the administrative and compliance burdens imposed on individuals and employers under current arrangements and are willing to explore options for addressing those burdens for persons who are in the state for limited periods of time.

FTA will assess any federal legislative measures in this area against the following criteria: (1) Recognizing that the benefits of federalism will impose administrative burdens on commerce, is there disinterested evidence that the administrative burden and complexity posed by current state and local practices is impeding the growth of commerce? (2) Does the proposed preemption address issues of simplification and complexity? (3) Can meaningful simplifications and uniformity be achieved through state action? (4) Would preemption disrupt state and local

revenue flows and tax systems? (5) Would preemption cause similarly situated taxpayers to be taxed differently; specifically, does the proposal create advantages for multistate and multinational businesses over local business ? (6) Does the preemption support sound tax policy? (7) Does the preemption create unknown or potential unintended consequences? (8) Have state tax authorities and taxpayer representatives together agreed to a beneficial change in federal law?

Moreover, any federal legislation in this area should meet the following additional criteria: (1) It should contain a de minimis threshold that minimizes the disruption of state revenues and reduces the exposure of states to such disruptions; and (2) It should not apply to persons paid on a “per event” basis for services performed in the state.

This resolution shall automatically terminate three years after the Annual Business Meeting at which it is adopted, unless reaffirmed in the normal policy process.

Missouri abstains

Resolution Seven **Extension of the Internet Tax Nondiscrimination Act**

Background

In 1998 Congress enacted the Internet Tax Freedom Act, which placed a moratorium on new or increased state and local taxes on charges for Internet access and prohibited “multiple and discriminatory” taxes on electronic commerce. The temporary moratorium has been extended twice. In 2004, the Act was expanded to preempt state and local taxation of purchases of intermediate telecommunications services that are “purchased, used, or sold by a provider of Internet access to provide Internet access.”

The Act, which has been renamed the Internet Tax Nondiscrimination Act, next expires in November 2007. Nine states currently impose transaction taxes on charges for Internet access. These taxes are allowed under a “grandfather” clause authorizing such taxes if they were in place prior to 1998; that “grandfather” protection also will expire in November 2007.

The “grandfather” provision covers all “taxes on Internet access” which is a defined term that means any tax on Internet access services or providers of Internet access – other than net income, property, and franchise taxes. As a result, the grandfather also applies to an unknown number of state and local gross receipts or other general purpose transaction taxes that are levied against Internet service providers to include unemployment taxes, local gross receipts taxes and possibly taxes on machinery and equipment used to provide access. If the moratorium is made permanent without a grandfathering clause it is possible that taxpayers will challenge the imposition of any indirect tax that applies to Internet Access.

Bills have been introduced in the 110th Congress (H.R. 743 and S. 156) to make the Internet Tax Nondiscrimination Act permanent and to repeal the grandfather clause. Also, S. 1453 has been introduced to extend the Act for four years, modify the definition of “Internet access” and preserve the grandfather protections for taxes in place prior to 1998.

The Government Accountability Office has reported that there is no statistically significant relationship between state taxation of charges for Internet access and the adoption of broadband by users or the deployment of broadband by providers.¹ This means the moratorium is not effective in achieving its purported purpose of expanding the availability of Internet access to the American public. A study by economists at the University of Tennessee produced similar results, finding that other issues (e.g., household income and educational levels) were more important in the proportion of a state’s population that had access to the Internet than whether the state imposed tax on access charges.²

In previous discussions of the legislation, states have argued: (a) The current definition of

¹ Government Accountability Office, “Telecommunications – Broadband Deployment is Extensive throughout the United States, but It Is Difficult to Assess the Extent of Deployment Gaps in Rural Areas” (GAO-06-426). In the GAO study, the term “deployment” refers to the offering of broadband services by various types of providers and the term “adoption” refers to the use of broadband services by consumers.

² Donald Bruce, John Deskins and William F. Fox, “Has Internet Access Taxation Affected Internet Use,” *State Tax Notes*, May 17, 2004, pp. 519-526.

Internet access should be narrowed to remove the possibility that Internet Service Providers could bundle a wide range of digital products and services with access and claim exemption for the entire bundle; (b) Any extension should be temporary to insure that Congress periodically evaluates the impact of the Act; and (c) The grandfather protection for pre-1998 taxes should be retained to avoid a disruption of the revenue flows of the states involved and to avoid unintended preemptions of taxes covered by the current definition of “tax on Internet access.” In particular, certain business taxes of general application (such as the Washington State business and occupation tax which is measured by gross income) would be preempted if the grandfather protection is repealed and the definition of “tax on Internet access” is not amended.

Policy

Congress should respect the original agreement and take no action to extend the Internet Tax Nondiscrimination Act. Congress should not further preempt state taxation of charges for Internet access or intermediate telecommunications purchases. If, however, the moratorium is extended, it should be a temporary extension, and the provision of the Act preserving those taxes on Internet access that were “generally imposed and actually enforced” prior to 1998 should be continued. The definition of “Internet access” should be rewritten so as to eliminate the possibility that certain products and services could be bundled with Internet access and claimed as exempt Internet access. A business and occupation tax applicable to general business activity and measured by gross income should be excluded from the definition of “tax on Internet access.”

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