

From: Internet Tax Fairness Coalition (ITFC)
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**THE BUSINESS COMMUNITY'S BUSINESS
ACTIVITY TAX NEXUS PROPOSAL REFLECTS
CURRENT LAW**



The business community has asked that Congress include in any legislation dealing with Internet taxation a provision that would limit the states' ability to impose business activity taxes on out-of-state businesses to those businesses that have a physical presence in the state. We believe that current law imposes the same or a similar limitation.

The proposal would not impose any new restrictions on states' taxing power over out-of-state businesses.

The law is clear that a state cannot impose a tax on an out-of-state business unless that business has a "substantial nexus" with the taxing state. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). The Supreme Court, on at least two occasions, in the context of sales and use taxes, has construed the "substantial nexus" requirement of Complete Auto Transit as requiring that the out-of-state business must have "more than de minimus" physical presence in the taxing state. See National Bellas Hess, Inc. v. Department of Revenue. of Ill., 386 U.S. 753 (1967), Quill Corp. v. North Dakota, 504 U.S. 298 (1992). Recent state level cases have construed the physical presence requirement as applicable to business activity taxes. See J.C. Penny Nat'l Bank v. Johnson, 19 S.W.3d 831 (Tenn. Ct. App. 1999), appeal den. (Tenn. 2000), cert. den. ___ U.S. ___, 212 S.Ct 305 (2000); Rylander v. Bandag Licensing Corporation, 18 S.W.3d 296 (Tex. App. 2000); 9.4 Percent Manufactured Housing Service v. Department of Revenue, No. Corp. Inc. 95-162 (Ala. Admin. Law Div. Feb.7, 1996); MeritCare Hospital v. Commissioner of Revenue, No. C2-94-12818, (D.C. Minn. Sept. 22, 1995).

An older line of Supreme Court precedents holds that taxpayers acquire a substantial nexus with another state through continuous and systematic contacts with the state. See International Shoe Co. v. Washington, 326 U.S. 310 (1945); Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959); Scripto Inc. v. Carson, 362 U.S. 207 (1960). The Supreme Court later added the requirement that the contacts must be related to the establishment and maintenance in the state of a market for the putative taxpayer's products. See Tyler Pipe Industries Inc. v. Washington State Dep't of Rev., 483 U.S. 232, 250 (1987). However, in all of these cases, the taxpayer had an actual physical presence in the state. In addition, all of these cases were decided prior to the Quill case,

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which separated the Commerce Clause analysis from the Due Process clause analysis and held that a physical presence was required under the Commerce Clause.

Thus the current state of the law is that in order for a state to assert a claim for business activity taxes against an out-of-state business, that business must have some physical presence in the taxing state. Testimony presented by the Multistate Tax Commission before the Senate Commerce Committee in March of 2001 made it very clear that its member states reject the existing physical presence requirement with regard to business activity tax nexus. The states are seeking to expand their right to tax out-of-state businesses having only an economic presence in the state. The business community believes that it is critically important to clarify the “physical presence” standard in order to ensure that businesses are not subject to double taxation at the state level.

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