

Statement for the Record

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Commercial and Administrative Law

Committee on the Judiciary

United States House of Representatives



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Subcommittee on Housing Commercial and Administrative Law
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June 24, 2008

The American Bankers Association (ABA) appreciates the opportunity to submit a statement for the record on the Business Activity Tax Simplification Act of 2008 (BATSA), H.R. 5267. ABA brings together banks of all sizes and charters into one association, and works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$13.3 trillion in assets and employ over 2 million men and women.

Today, banks of all sizes face the growing problem and difficulties associated with the uncertainty of states' business activity taxes. The uncertainty in the application of the taxes greatly increases compliance and legal expenses that will ultimately be borne by customers and our economy at large. ABA strongly supports BATSA, which would modernize existing law to ensure that states and localities only can impose their business activity taxes in situations where an entity has physical presence (i.e., property or employees) and thereby receives related benefits and protections from the jurisdiction. ABA appreciates the leadership of Representatives Rick Boucher (D-VA) and Bob Goodlatte (R-VA) in introducing this legislation, and we encourage Congress to enact it in order to provide businesses with more certainty on this issue. There are three key points we wish to make on this issue:

- Inconsistent and unclear taxation standards between states subjects businesses to litigation and other onerous business costs, which are especially harmful to small businesses.
- Greater certainty for businesses will foster a more stable business environment that encourages investment and creates new jobs.

- BATSA will help minimize litigation costs and uncertainty for businesses by clarifying that entities must have a physical presence in the taxing jurisdiction in order to be subject to state and local taxes.

I. Inconsistent and unclear taxation standards between states subjects businesses to litigation and other onerous business costs, which are especially harmful to small businesses

An increasing number of states have enacted, or are considering, legislation that would lower the threshold of what constitutes “substantial nexus” for purposes of taxing a business’ activity within the state. However, there is no uniform definition or application of “substantial nexus” among the states and no set rules or parameters for determining how a state would apply the nexus standard – it varies from state to state. Therefore, each state *applies its own nexus standard* to determine when an out-of-state business that is operating within the state is required to pay income tax. In fact, in some states, *the presence of even one customer* within the state would establish the state’s required nexus for applying its business income tax to an out-of-state business.

This type of application of the nexus standard is devastating for small businesses, especially community banks, because they do not possess the substantial resources required to comply with a proliferation of disparate state tax laws. There are almost 3,000 banks and savings associations with fewer than 25 employees. Almost 800 of these have fewer than 10 employees. Many of these community banks operate near state borders and serve customers from more than one state. Additionally, many financial institutions now provide services to customers online, which allows people nationwide to take advantage of increased competition and better services to fit their individual needs. Without a uniform standard, these institutions are finding themselves subject to different standards that result in undue costs and burdens.

II. Greater certainty for businesses will foster a more stable business environment that encourages investment and creates new jobs

These additional costs resulting from the application of disparate standards divert resources businesses could invest in areas such as product innovation, improved customer service, or additional employees. Worse yet, businesses may be forced to offer fewer products and services at

higher costs, and some may actually cease doing business in states where additional tax burdens exist. Without business certainty, financial service providers are forced to offer fewer products at higher costs. Financial service providers might also cease doing business in those states where additional tax burdens exist. Therefore, states that aggressively tax out-of-state businesses could have the effect of reducing choices available to consumers in those states. Consumers may experience reduced access to credit and increased credit costs. This could have even broader negative effects on individual states' economies and, possibly, the economy of a larger region.

III. BATSA will help minimize litigation costs and uncertainty for businesses by clarifying that entities must have a physical presence in the taxing jurisdiction in order to be subject to state and local taxes

BATSA would take away uncertainty by codifying in federal law that an actual physical presence in a state is required to create a substantial nexus. It also includes a bright-line test that would establish a minimal amount of activity a business must perform in a state before it is subject to income taxes and additional paperwork. In addition, this bill would help limit businesses' exposure to unanticipated taxes, and thus reduce compliance and legal costs associated with frivolous nexus claims.

Consider the case of one ABA member that *has operations in only four states, but is subjected to tax claims in 31 states*. To avoid burdensome legal costs, this institution has chosen to pay these claims, which last year amounted to roughly \$3 million. This \$3 million could have been put to better use in their local communities for providing homeownership or small business loans. Instead, the institution was forced to use these resources to pay burdensome taxes in states where it has no physical presence.

ABA strongly supports this legislation and hopes that Congress will work quickly to pass it. ABA applauds Representatives Rick Boucher and Bob Goodlatte who have introduced H.R. 5267 to address this issue of the lack of uniformity in the standard for taxing an out-of-state business's activity within a state. This bill provides a uniform definition for the standard to be employed by states in establishing whether an out-of-state business should be subject to tax for activities conducted within the state, which will greatly help to streamline the out-of-state business activity tax within states and limit businesses' exposure to burdensome business activity taxes.