



## CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

September 13, 2011

### **H.R. 1439** **Business Activity Tax Simplification Act of 2011**

*As ordered reported by the House Committee on Judiciary on July 7, 2011*

#### **SUMMARY**

H.R. 1439 would prohibit state and local governments from taxing certain business activities that are taxable under current law. Specifically, it would prohibit those governments from taxing certain services, intangible goods, and media activities unless businesses providing those services have a “physical presence”—as defined in the bill—in the taxing jurisdiction.

#### **ESTIMATED IMPACT ON THE FEDERAL BUDGET**

CBO estimates that enacting H.R. 1439 would have no direct impact on the federal budget. Because the bill would not affect direct spending or revenues, pay-as-you-go procedures do not apply.

#### **ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS**

H.R. 1439 would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA) by prohibiting state and local governments from taxing certain business activities. CBO estimates that the costs—in the form of forgone revenues—to state and local governments would be about \$2 billion in the first full year after enactment and at least that amount in subsequent years. The cost would far exceed the threshold established in UMRA for intergovernmental mandates (\$71 million in 2011, adjusted annually for inflation).

Current law (notably, Public Law 86-272 and related Supreme Court decisions) prohibits states from levying a tax on the corporate (net) income of a company whose only activity in the state is pursuing and making sales that would be filled from outside the state (e.g., mail order sales). H.R. 1439 would expand that prohibition to other types of business activity taxes (BATs), including additional corporate income taxes, franchise taxes, single business taxes, capital taxes, gross receipt taxes, and business and occupation taxes. Corporations

currently pay these taxes to a state only if the state can establish “nexus” with the firm. (“Nexus” is the connection between a firm and a state that allows the state to legally impose taxes on the firm and is based on some measure of physical presence or economic activity in a state.) H.R. 1439 would redefine “nexus” and preempt state laws that are different from that definition. Such a preemption would constitute a mandate as defined in UMRA and would result in forgone revenues to state and local governments.

Specifically, the bill would:

- Define physical presence for firms not based in a state;
- Establish a uniform nexus standard nationwide—an entity would need to be physically present in a state for 15 or more days to establish nexus;
- Create “carve outs” from the 15-day standard that would allow certain industries or activities (such as media) to exceed the standard without establishing nexus with a state;
- Expand the prohibitions on taxation in Public Law 86-272 to include taxes not based solely on the income of a company (i.e., gross receipts taxes, franchise taxes, and business and occupation taxes);
- Expand the applicability of Public Law 86-272 to services and intangibles (e.g., the trademark for a retail store or the patent for a formula for soda); and
- Prohibit states that require businesses to file group returns from imposing BATs on members of the group that, by themselves, do not meet the standard for physical nexus.

## **ESTIMATED DIRECT COSTS OF MANDATES TO STATE AND LOCAL GOVERNMENTS**

CBO estimates that enacting H.R. 1439 would result in revenue losses for states and some local governments and that such losses likely would total about \$2 billion in the first full year after enactment and at least that amount in subsequent years. Those forgone revenues would equal about 3 percent of the total BATs in 2012 and would far exceed the threshold established in UMRA for intergovernmental mandates (\$71 million in 2011, adjusted annually for inflation.)<sup>1</sup>

UMRA includes in its definition of mandate costs any amounts that state and local governments would be prohibited from raising in revenues as a result of the mandate. The mandate costs of H.R. 1439 would include any taxes that state and local governments would be precluded from collecting under the bill. (UMRA’s definition of mandate costs

---

1. In fiscal year 2010, states collected about \$700 billion in total taxes. In the year following enactment, the revenue losses resulting from H.R. 1439 would total about 5 percent of collections from corporate income taxes and significantly less than 1 percent of total tax collections by states.

excludes increases in revenues that state and local governments might raise in reaction to enactment of a mandate.)

CBO estimates that all states and some local governments would see an immediate revenue loss because they are currently collecting taxes from firms that, under the bill, would be exempt from taxation. Subsequently, corporations likely would rearrange their business activities to take advantage of beneficial tax treatments that would result from the interaction of the new federal law and certain state taxing regimes. Those changes in business activities would likely result in additional revenue losses to the states. However, CBO has no basis for estimating the extent to which such reorganizations would occur.

## **BASIS OF ESTIMATE FOR INTERGOVERNMENTAL MANDATES COSTS**

CBO used information from a variety of sources to estimate the state revenue losses that would result from enactment of this legislation.<sup>2</sup> Using data from the states, industry, and the Census Bureau, CBO estimated potential losses based on current tax collections, the industrial and commercial profile of state economies, and the structure of state taxing systems.

States use a variety of rules to determine whether a company is subject to taxation—that is, if it has nexus—and if so, how the activities in which that company engages are taxed. The differences in state taxing systems affect how much revenue each state or local government would likely forgo under the provisions of the bill. CBO examined both the characteristics of the corporate tax structure of each state and data about the economic makeup of each state in order to estimate potential revenue losses.

To estimate the costs of enacting H.R. 1439 to state and local governments, CBO first estimated the total amount of BATs paid by corporations in each state. Such taxes totaled about \$65 billion in 2011. Since some industries are significantly less likely to be operating from outside the state than others (for example mining companies), CBO used information about the industrial and commercial makeup of states to calculate the portion of BATs that could be at risk if H.R. 1439 is enacted. In general, CBO expects that states would lose only a small percent of BATs—less than 3 percent in the first year after enactment, nationwide. To calculate losses for 2012, CBO estimated the likely percentage each state would lose based on its current tax system and applied that percentage to the BATs potentially at risk.

The percent of revenues lost by each state would vary significantly and would depend on the characteristics of each state's tax system and its industrial makeup. A state that imposes

---

2. Although the bill's provisions also would affect collection of taxes by some local governments, CBO has not separately estimated the potential losses for such governments. Relatively few local governments impose significant business activity taxes.

taxes on companies that make sales in the state—regardless of whether those companies have property or employees in the state—would lose a higher percentage of their BATs than would a state that only taxes companies that have a physical presence in the state. Similarly, a state that has an economy that is concentrated in an industry that does not rely on property or employees in the state to carry out business activities, such as the information services industry, would also lose a higher percentage of their BATs than would a state where the economy relies more heavily on agricultural or manufacturing industries.

In the absence of this legislation, it is possible that some state and local governments would enact new taxes or change the way they tax businesses. Since such changes are difficult to predict, for the purposes of estimating the direct costs of the mandate, CBO considered only the revenues from taxes that are currently in place and actually being collected, or estimates for changes that are already in statute and that will be implemented over the next five years.

### **ESTIMATED IMPACT ON THE PRIVATE SECTOR**

This bill contains no new private-sector mandates as defined in UMRA.

### **ESTIMATE PREPARED BY:**

Impact on State, Local, and Tribal Governments: Elizabeth Cove Delisle

Federal Revenue: Kalyani Parthasarathy

Impact on the Private Sector: Paige Piper/Bach