



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

September 14, 2015

H.R. 2584 **Business Activity Tax Simplification Act of 2015**

As ordered reported by the House Committee on the Judiciary on June 17, 2015

SUMMARY

H.R. 2584 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 COST TO THE FEDERAL GOVERNMENT

CBO estimates that enacting H.R. 2584 would have no direct effect on the federal budget. Because enacting 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. 2584 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 more than \$2 billion in the first full year after enactment and at least that amount in subsequent years. The cost would exceed the threshold established in UMRA for intergovernmental mandates (\$77 million in 2015, adjusted annually for inflation).

Current law (notably, Public Law 86-272 and related Supreme Court decisions) prohibits states from levying a tax on the net corporate income of a company whose only activity in the state is pursuing and making sales that would be filled from outside the state (for example, mail order sales). H.R. 2584 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 those 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. 2584 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;
- Allow specific 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 (gross receipts taxes, franchise taxes, and business and occupation taxes);
- Expand the applicability of Public Law 86-272 to services and intangibles (for example, 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 individual members of the group if they do not meet the standard for physical nexus.

ESTIMATED DIRECT COSTS OF MANDATES TO STATE AND LOCAL GOVERNMENTS

CBO estimates that enacting H.R. 2584 would result in revenue losses for states and some local governments and that such losses likely would total more than \$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 estimated to be collected by state and local governments in 2016 and would far exceed the threshold established in UMRA for intergovernmental mandates (\$77 million in 2015, adjusted annually for inflation).¹

1. In fiscal year 2014, states collected about \$865 billion in total taxes. In the year following enactment, the revenue losses resulting from H.R. 2584 would total about 5 percent of collections from corporate income taxes and significantly less than 1 percent of total state tax collections.

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. 2584 would include any taxes that state and local governments would be precluded from collecting under the bill. (UMRA's definition of mandate costs 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 MANDATE COSTS

CBO used information from a variety of sources to estimate the state revenue losses that would result from this legislation.² 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. 2584 to state governments, CBO first estimated the total amount of BATs paid by corporations in each state. Such taxes totaled about \$67 billion in 2014. 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 affected if H.R. 2584 is enacted. To calculate losses for 2016, CBO estimated the likely percentage each state would lose based on its current tax system and applied that percentage to the BATs potentially affected. In general, CBO expects that states would lose

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.

only a small percent of BATs—less than 3 percent in the first year after enactment, nationwide—but that percentage would total more than \$2 billion in lost revenues.

The percent of revenues lost by each state would vary significantly and depend on the characteristics of each state’s tax system and its industrial makeup. A state that imposes 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, also would 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 private-sector mandates as defined in UMRA.

ESTIMATE PREPARED BY:

Federal Costs: Susan Willie

Impact on State, Local, and Tribal Governments: Melissa Merrell

Impact on the Private Sector: Paige Piper/Bach

ESTIMATE APPROVED BY:

H. Samuel Papenfuss

Deputy Assistant Director for Budget Analysis