

**Statement of Senator Craig Thomas, Chairman
Subcommittee on International Trade**

**Hearing on
How Much Should Borders Matter?: Tax Jurisdiction in the New Economy**

July 25, 2006

Rapid technological advancement has greatly facilitated the conduct of commerce across both interstate and international borders. Geographic borders have consequently become increasingly artificial. Consumers can now just as easily purchase products directly from New Zealand as New Jersey, and businesses can reach customers all over the world from a single location – or no tangible location at all.

These developments have given rise to whole new sets of issues that have not previously existed. Historically, states were able to reasonably approximate taxing economic activity within the state by taxing businesses that were physically located within its borders and imposing on those same businesses the obligation to collect sales taxes from consumers.

The common underlying question we face today is whether traditional physical presence based on geographic borders is still the most appropriate standard for tax jurisdiction, and, if not, what is the proper standard?

We examine this question today in two separate contexts. The first arises as a result of increasing interstate and international commerce over the Internet. Current law requires that a seller be physically located in the state for the state to be able to impose sales tax collection responsibility. When a state resident makes a purchase directly from an out-of-state seller and sales tax is not paid on the transaction, the purchaser is generally responsible directly to the home state for the tax obligation. However, in practicality, it is almost completely impossible for the states to enforce this obligation. This issue is not a new one, as it also applies to catalog sales, but its importance has grown as Internet commerce has increased.

As a result of concern over lost state and local tax revenue, the states proposed legislatively shifting the sales tax collection burden to the remote seller. The problem of thousands of different tax jurisdictions, each with varying rates, definitions, and procedures for change, made that all but impossible. The states attempted to address these issues by developing the Streamlined Sales Tax Project to try to achieve uniform rates and definitions. The project began in March 2000, and the original agreement was approved in November 2002.

Senators Enzi and Dorgan have each introduced substantially identical legislation that would legislatively shift the burden of sales tax collection to remote vendors. However, many in the business community are concerned that, as drafted, the simplification threshold has been set too low for this duty to be feasibly carried out.

The second issue we are here to examine is business activity taxes (BAT) that are imposed directly by states on businesses or individuals, measured by receipts, income, or profits. The Supreme Court has established that there must be substantial nexus for the state to be able to exercise taxing jurisdiction over an entity, but it is unclear exactly what constitutes “substantial nexus.” In recent years, some states have become more aggressive in their quest for revenue and are asserting increasingly tenuous grounds for nexus.

A number of states are taxing non-resident athletes and performers based on as little as a single game or performance within the state. Some states have also attempted to collect BAT on the basis of trucks passing through the state – even without picking up or delivering goods – or on the basis of a web server or telephone listing. As each state operates by its own rules, the haphazard and uncoordinated imposition of BAT can result in taxation of the same income by multiple jurisdictions.

In response to concerns raised by businesses and individuals regarding nexus certainty, Senators Schumer and Crapo introduced legislation to establish that physical presence is required to provide sufficient nexus for BAT taxing jurisdiction. The states generally oppose this position because they believe physical presence is no longer a reasonable approximation of the economic activity taking place within the state.

The issues raised here are far-reaching – from encouraging healthy competition for investment between various domestic and international jurisdictions, to ensuring that states do not engage in activity that discriminates against interstate business. As a country that values its federalist system, we must take care to guard a state’s ability to establish its own laws and exercise appropriate taxing jurisdiction, while at the same time ensuring that there is a clear line delineating where competition ends and discrimination begins.