



Jurisdiction to Impose Business Activity Tax—Constitutional

Policy Position

Position: *In order for a State or locality to impose a business activity tax on a business, that business must have a physical presence in the jurisdiction. Congress must recognize physical presence as the jurisdictional standard for business activity taxes. Physical presence should be defined to include quantitative and qualitative de minimis thresholds. Congress must also prohibit unreasonable attribution of nexus. Finally, Congress must preserve and modernize P.L. 86-272.*

Explanation: The U.S. Supreme Court has ruled that for all state and local impositions, there must be substantial nexus between the state and the taxpayer. In the area of sales and use tax, the Court has ruled that substantial nexus requires physical presence. There currently is a great amount of discussion and debate throughout the tax community, in the Congress, and elsewhere regarding the appropriate nexus standard for business activity taxes.

Determinations of jurisdiction to tax should be guided by one fundamental principle: a government has the right to impose burdens—economic as well as administrative—only on businesses that receive meaningful benefits or protections from that government. In the context of business activity taxes, this guiding principle means that businesses that are not physically present in a jurisdiction and are therefore not receiving meaningful benefits or protections from the jurisdiction should not be required to pay tax to that jurisdiction.

Congress must exercise its authority under the Commerce Clause of the Constitution to recognize physical presence as the nexus standard for business activity taxes. In doing so, Congress should include de minimis thresholds based on the temporary presence of employees, agents and property in the State. The standard should also prohibit states from attributing nexus between entities absent an express or implied agency relationship (where the activities of the agent may otherwise potentially create nexus for the principal). Congress should also modernize P.L. 86-272 by including services and intangibles in its scope, extending its application to all direct taxes, extending its coverage to activities subject to local taxes, and clarifying its definition of independent contractor.

“Business activity tax” refers to a tax imposed directly on businesses measured by receipts, income or profits (not transaction taxes) and includes corporate income taxes, franchise taxes, single business taxes, capital stock taxes, net worth taxes, gross receipts taxes, and business and occupation taxes. Business activity taxes do not include insurance premium taxes or utility user taxes.