

# ManuFACTS: Taxing Out-of-State Businesses

## Manufacturers Need Legislation to Prevent Arbitrary State Taxes

- **Some states currently assess Business Activity Taxes (BAT), e.g. income, franchise, or gross receipts taxes, on out-of-state manufacturers and other businesses that do not have any employees or property in the state. This arbitrary taxation of out-of-state businesses interferes with interstate commerce. Lawmakers last addressed this issue in 1959, when they clarified that a state cannot impose income taxes on an out-of-state company if the company's only contact with the state is to solicit orders for sales of tangible goods.**
- **Business models have changed significantly in the past 50 years, particularly with the advent of new technologies. At the same time, more and more states have taken a more aggressive stance in taxing out-of-state companies.**
- **Recent court decisions have added to the uncertainty. Several state courts have upheld the use of an "economic presence" test to determine whether a state can tax an out-of-state business. The U.S. Supreme Court in 2009 declined to hear appeals of two lower court decisions relying on "economic presence."**
- **Congress needs to act now to clarify when a state can tax a business with little or no physical presence in the state. Legislation also is needed to extend the current legal "safe harbor" for soliciting sales of tangible goods to sales of intangible goods and services.**
- **As other countries reduce their tax rates to compete in the global market, arbitrary state taxation can increase the domestic effective tax rates for U.S.-based companies, making it harder for these companies to compete globally.**

### How Congress Can Help

The NAM urges representatives to cosponsor bipartisan BAT simplification legislation H.R. 1439 (Goodlatte, R-VA/Scott, D-VA) and urge quick House action on the bill.

## BAT Simplification Legislation

- Establishes a bright-line, physical presence test to determine when a state can levy income, franchise, gross receipts and other BATs on out-of-state companies engaged in interstate commerce.
- Updates current law to prevent a state from imposing a BAT on an out-of-state company if the company's only contact with the state is to solicit sales of goods and services. Companies without a physical presence in a state would not be subject to a BAT simply because they have worldwide customers.
- Clarifies that a state should not impose a BAT unless that state provides benefits or protections to the taxpayer.
- Will reduce widespread litigation that inhibits business expansion and innovation. Businesses of all sizes need the certainty of a "uniform state taxation nexus standard," i.e. the minimum amount of activity a business must conduct in a particular state before it becomes subject to taxation in that state.

## How Would BAT Simplification Work?

### Under current law

A manufacturing company has one facility with 100 employees all located in State A. The company sells its finished product into State B for \$5 million. State B assesses a 0.5 percent gross receipts tax on any company that has products delivered into State B even if the company has no property, employees or physical presence in State B. Thus, the manufacturing company would be required to pay State B \$25,000 in gross receipts taxes simply because the company has customers in state B.

### Under BAT simplification legislation

If BAT simplification legislation were enacted, the manufacturing company would not be subject to the \$25,000 gross receipts tax because the company does not have a physical presence in the state.

## Bottom Line

By establishing a bright-line, physical presence test, BAT simplification legislation will clarify when states can impose taxes on out-of-state companies without jeopardizing the ability of states to legitimately tax businesses with operations in the state. Additionally, BAT simplification legislation would extend the "safe harbor" provision for soliciting sales of intangible goods and services, as well as tangible goods, covered by current law.

### More Information

Web: [www.nam.org/tax](http://www.nam.org/tax)

E-mail: [tax@nam.org](mailto:tax@nam.org)