Statement for the Record

On Behalf of the

AMERICAN BANKERS ASSOCIATION

For the Hearing


Before the

United States Senate Committee on Finance

April 25, 2012
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The American Bankers Association (ABA) is pleased that the Committee is holding this important hearing (Tax Reform: What it Means for State and Local Tax and Fiscal Policy) and appreciates the opportunity to submit a statement for the record. The American Bankers Association represents banks of all sizes and charters and is the voice of the nation’s $13 trillion banking industry and its two million employees.

We would like to share with the Committee our concerns about the problems raised by state nexus rules under which states extend their taxing powers to out-of-state businesses. These nexus taxation rules relating to business activity taxes can have a significant impact on banks, particularly community banks that operate near state borders. ABA encourages the Senate to act on legislation that would mirror a bill currently introduced in the House – H.R. 1439, the Business Activity Tax Simplification Act – which we strongly support.

Today, banks of all sizes face difficulties associated with the uncertainty of states’ business activity taxes. Over the last few years, states have developed a variety of expansive nexus rules. Some states apply a physical presence rule, some an economic nexus rule, and others a hybrid version that includes both physical presence and economic nexus. The differences in the application of the nexus standard greatly increase compliance and legal expenses for banks – costs that will ultimately be borne by customers and our economy at large.

To address these concerns, ABA strongly supports H.R. 1439, the Business Activity Tax Simplification Act (BATSA), which would modernize existing law to ensure that states and localities can impose business activity taxes only in certain clearly defined situations, such as when an entity has physical presence (i.e., property or employees) and thereby receives related benefits and protections from the jurisdiction. We encourage Congress to enact BATSA in order to provide businesses with more certainty on this issue.

In this statement we detail three key points:

➢ Inconsistent and unclear taxation standards between states subject businesses to litigation and other onerous business costs, which are especially harmful to small businesses.

➢ Greater certainty for businesses will foster a more stable business environment that encourages investment and creates new jobs.

➢ BATSA will help minimize litigation costs and uncertainty for businesses by:
  o Clarifying that entities must have a physical presence in the taxing jurisdiction in order to be subject to state and local taxes; and
  o Providing a clear definition of “physical presence.”

American Bankers Association
I. Inconsistent and unclear taxation standards between states subject businesses to litigation and other onerous business costs, which are especially harmful to small businesses.

An increasing number of states have enacted, or are considering, legislation that would lower the threshold of what constitutes “substantial nexus” for purposes of taxing an out-of-state business’ activity within the state. However, there is no uniform definition or application of substantial nexus among the states and no set rules or parameters for determining how a state would apply the nexus standard – it varies from state to state. Therefore, each state applies its own nexus standard to determine when an out-of-state business that has contacts with the state is required to pay income tax. In fact, in some states, the presence of even one customer within the state would establish the state’s required nexus for applying its business income tax to an out-of-state business.

This type of application of the nexus standard is devastating for small businesses, especially community banks, because they do not possess the substantial resources required to comply with a proliferation of different state tax laws. There are more than 2,500 banks and savings associations with 25 or fewer employees; 750 of these have 10 or fewer employees. Many of these community banks operate near state borders and, therefore, have contacts with consumers residing in different states. Additionally, many financial institutions now provide services to customers online, which allow people nationwide to take advantage of increased competition and better services to fit their individual needs. Without a uniform standard, these banks find themselves subject to different states’ standards, resulting in undue costs and burdens.

II. Greater certainty for businesses will foster a more stable business environment that encourages investment and creates new jobs.

The additional costs resulting from the application of different state taxation standards divert resources businesses could invest in areas such as product innovation, improved customer service, or additional employees. The result would be fewer products offered to consumers at higher prices. Worse yet, without business certainty, some financial service providers may cease doing business in those states where additional tax burdens exist. Therefore, states that aggressively tax out-of-state businesses are creating incentives that may ultimately reduce choices available to consumers in their states. Consumers may experience reduced access to credit and increased credit costs, which is clearly not good for them or the economic health of their communities.

III. BATSA will help minimize litigation costs and uncertainty for businesses by (1) clarifying that entities must have a physical presence in the taxing jurisdiction in order to be subject to state and local taxes, and (2) providing a clear definition of physical presence.

BATSA would remove uncertainty by codifying in federal law that an actual physical presence in a state is required in order for a state to impose a tax on an out-of-state business. It also would include a bright-line test that would establish a minimal amount of activity a business must perform in a state before it is subject to income taxes and additional paperwork. Finally, this bill
would help limit businesses’ exposure to unanticipated taxes, thus reducing compliance and legal costs associated with frivolous nexus claims.

Conclusion

As you continue your efforts on tax reform in the Senate, ABA strongly encourages legislation that would provide a uniform definition for the nexus standard to be employed by states in establishing whether an out-of-state business should be subject to tax for activities conducted within the state. BATSA provides such a mechanism and we urge consideration of a bill in the Senate that mirrors these provisions. Such a bill would greatly help streamline the out-of-state business activity tax within states and limit businesses’ exposure to burdensome and costly taxes.