

Before the
House Judiciary Subcommittee on Commercial and Administrative Law
Business Activity Tax Simplification Act of 2008

June 24, 2008

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Chairwoman Sánchez, Ranking Member Cannon and Members of the Subcommittee: on behalf of the Consumer Electronics Association (CEA), thank you for the opportunity to appear before your Subcommittee today to discuss the business activity tax nexus problem and the critical impact it is having on businesses across the country.

CEA is the principal U.S. trade association representing the \$161 billion consumer electronics industry. We are also the owners and producers of America's largest annual event, the International CES, held every January in Las Vegas Nevada.

Our more than 2,200 members are involved in the design, development, manufacturing, distribution and integration of audio, video, in-vehicle electronics, wireless and landline communication, information technology, home networking, multimedia and accessory products, as well as related services that are sold through consumer channels.

While CEA's members include virtually all of America's top technology companies as well as many of the leading retailers, more than half of our members are small businesses.

American businesses today face a host of new challenges from skyrocketing energy costs to the uncertain availability of investment capital. Many of these factors arise from complex market forces which are not amenable to immediate resolution. There is one issue, however, that this Subcommittee can address and resolve: the increasing number of states using dubious

“economic nexus” theories to levy income and franchise taxes against companies that have customers but no physical presence in the taxing state. These punitive taxes harm businesses – especially small businesses, and violate the U.S. constitution by unduly burdening the free flow of interstate commerce.

The problem is bad and getting worse. The number of states with a statute or regulation establishing “economic nexus” without a physical presence has grown to more than a dozen known states. Additionally, at least eight states, including Louisiana, Maryland, New Jersey, New Mexico, North Carolina, Oklahoma, South Carolina and West Virginia have made a similar decision at the administrative or judicial levels.

The problems engendered by this growing “crazy quilt” of state levies are obvious. American businesses, large and small are faced with burgeoning compliance costs. They face an unclear business environment with no way of estimating where and when they will be taxed. Business expansion is chilled, especially when it comes to electronic commerce which inherently crosses state borders. And companies face the risk of duplicative taxation, as they also pay legitimate taxes from the states in which they are domiciled.

While tax advocates claim that requiring a physical presence for the purpose of imposing a business activity tax would cost local and state governments billions of dollars annually, a 2006 study by Ernst and Young demonstrated that the aggregate multi-state revenue loss from all state and local taxes paid by businesses in 2005 would be less than one-tenth of one percent.¹

Earlier this year, the House Small Business Committee examined the impact of the business activity tax on small businesses. Using the Ernst and Young data as a base, Dr. Peter Johnson, Vice President for Research Strategy and Platforms and Senior Economist of the Direct

¹ Ernst & Young, *Estimates of Impact of H.R. 1956 on State and Local Business Tax Collections*, pg. 3 (July 25, 2006).

Marketing Association testified that through a clear physical presence test established by BATSA, the direct marketing industry could produce increased economic activity and add new jobs to the economy.² Such benefits could easily extend beyond direct marketing to those in a host of other industries, including consumer electronics.

Small businesses disproportionately bear the burden of these levies. They operate close to the margin, and their success requires fair and consistent regulatory treatment and a settled business environment. They are ill equipped to comply with multiple demands from multiple taxing entities, and lack the resources to challenge ill-founded levies.

Let me give you some examples from CEA's membership. Atlantic Technology is a small business based in Norwood, Massachusetts. A true model of American ingenuity, Atlantic Technology was founded in 1989 by Peter Tribeman and produces a variety of home entertainment products, including high-performance multi-channel speaker systems and state-of-the-art home theater electronics components.

Although the company has no physical presence and owns no inventory in the state of Washington, Washington's Department of Revenue has continually taxed Atlantic Technology because of their use of independent sales representatives. After the state described Atlantic Technology as a "tax delinquent" to one of its Washington state dealers, the Department of Revenue went a step further, suggesting that they would likely seize Atlantic Technology inventory as payment for taxes that the manufacturer owed the state. The dealer, who was unaware of this situation, was frightened by the prospect of losing their inventory to the state. Rather than wage an expensive legal battle, Atlantic Technology had no other choice, but to pay the taxes that they were alleged to owe.

² Testimony of Dr. Peter A. Johnson, Direct Marketing Association before the House Small Business Committee (Feb. 14, 2008).

Atlantic Technology has also faced additional tax levies by states such as Pennsylvania and Florida. Fighting this barrage of state taxes will require the use of scarce resources that should be going toward building the business.

Mitek, a family-owned and operated business based in Phoenix, Arizona, is facing a similar fight. Mitek produces well-known mobile audio brands such as MTX Audio and StreetWire, and provides good manufacturing jobs in the United States. Mitek has been hit with business activity taxes in several states, including California, Washington and Michigan, strictly based on the use of nonexclusive independent representatives.

It is time for Congress to step in and assume its constitutional responsibility to ensure that commerce is not harmed by unfair taxation. The Business Activity Tax Simplification Act of 2008, H.R. 5267 would provide the much needed relief to American businesses. We applaud the leadership of Representatives Rick Boucher (D-VA) and Bob Goodlatte (R-VA) in introducing this important legislation. H.R. 5267 will provide clarity by providing a bright line definition of physical presence. Most importantly, it provides relief to business by clearly preempting states from taxing corporations with no physical presence.

Our members are good corporate citizens, and we are not asking for relief from legitimate taxation. We are asking to restore a simple principle: a tax should not be imposed by a state unless that state provides benefits or protections to the taxpayer. H.R. 5267 provides that only businesses receiving state and local benefits derived from such taxation like education, transportation, fire and police, should be subject to such taxes. Furthermore, the legislation will not impact states' ability to collect income or other legitimate taxes from its residents.

Congress has historically acted to invoke its Commerce Clause authority in similar situations. For example, Congress enacted the Federal Aviation Act to prohibit states from

imposing “flyover taxes,” ensuring that aircrafts were only taxed by states where they take off and land. Recently, Congress enacted legislation to prohibit taxing Internet access and prohibit multiple or discriminatory taxes on electronic commerce. We urge Congress to act again to provide relief and greater clarity for all businesses, both large and small.

Therefore, I respectfully urge you to say no to taxation without representation and support the Business Activity Tax Simplification Act of 2008 (BATSA).