AMERICANS for TAX REFORM

**Statement of**

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**House Committee on the Judiciary**

# Hearing on Examining the *Wayfair* Decision and its Ramifications for Consumers and Small Businesses

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Chairman Goodlatte, Ranking Member Nadler, and Members of the committee, thank you for the opportunity to testify before you today. My name is Grover Norquist and I am President and Founder of Americans for Tax Reform. ATR advocates on behalf of taxpayers for simpler, flatter, more visible, and most importantly lower taxes than they are today.

While the most obvious check on taxation without representation is our republican form of government, the concept of "physical nexus" established a critical check on state power. A person or business has to have some kind of physical presence – employees, own or lease property – within a state in order to be subject to the taxation authority of a state. Colorado, for example, cannot just impose a business income tax on Florida businesses. Makes sense. The Florida business would derive no benefit from any Colorado policy nor would it contribute to the formulation of policy.

Unfortunately, in its recent *Wayfair* decision, the Supreme Court said 'yes—you can be taxed by politicians you do not elect and who act knowing you are powerless to object.' This power can now be used to export sales taxes, personal and corporate income taxes, threatens retroactive taxes, and opens the door for the European Union to export its tax burden onto American businesses.

If physical nexus is no longer required, as the *Quill* decision demanded, for sales taxes, then it is no longer required for personal or corporate income taxes.

Now, California (or any state or city that loses population through exit) can tax people and businesses who do their best to avoid that state or city.

State governments were panicked over the idea that they are losing revenue – in its oral arguments, South Dakota claimed that all states and jurisdictions are missing out on $34 billion dollars, as reported by a University of Tennessee study. But the Government Accountability Office estimates a range of $8 - $13 billion. We are doing an awful lot to damage business models and the balance among the states based off of shoddy data.

We fought the American Revolution in large part to oppose the very idea of taxation without representation. However, the Supreme Court decided that governments can now tax those outside their borders on those who have no political power, no vote, no voice.

## **No Taxation without Representation**

The laws that establish tax nexus - the legal connection a state has with an individual, a business, or a vendor that gives the state the ability to compel tax collection on behalf of that state – have been trending away from the protection of individual rights and towards expanding state power. Tax hungry state and local governments constantly search for ways to construe digital changes as reasons to

advance their reach into taxpayer pockets. Congress must set real boundaries on taxation authority.

Without stopping the economic nexus trend now, states will continue to try to expand their tax base by assessing business, income, franchise, and sales taxes across borders on businesses that have customers, but no property or employees in the taxing state. Shifting the cost of government to non-residents poses a direct threat to the principle of republican governance by the people. It also violates the "benefits principle" by pushing the tax burden onto those that receive no direct benefit from the state.

States, as laboratories of democracy, should compete as to who can provide the best government at the lowest cost, not who can steal the most tax revenue from their neighbors.

Five states chose not to institute a statewide sales tax – Alaska, Delaware, Montana, New Hampshire, and Oregon. These states should not be required to substitute their own sales and use tax statutes for the sales and use statutes of other states, as it violates their own legitimate public policy.

These residents have elected officials that have maintained a policy of no sales tax collection. These residents and businesses do not have the ability to influence policy in other states, nor would they benefit from any public program, project, or service funded by sales taxes in other states

New Hampshire is holding special session right now to pass legislation protecting their own state sovereignty and in-state businesses from foreign state auditors forcing New Hampshire businesses to act as tax collectors. However, unlike South Dakota, New Hampshire wants to respect precedent. They need Congress to take action to clarify their authority to their own legitimate public policy within New Hampshire's borders. It is baffling that foreign state governments can reach into New Hampshire, and New Hampshire can do nothing.

**The Threat of Retroactive Taxes**

All of the states should be concerned about out-of-state auditors looking for retroactive taxes.

While several states have informally indicated that they will not do so, and a few states have enacted legislation specifically prohibiting retroactive assessments, most states do have laws on the books — some dating back to the 1970s — that apply an economic/minimum contacts nexus standard that could conceivably be used as a basis to assert a claim for a period before the *Wayfair* decision.

While South Dakota suggests that other states are "likely" not to apply a ruling in its favor retroactively, it offers no guarantees. Similarly, more than 40 states and

territories filed an amicus brief with the Court in this case, and they noted their "incentives" not to apply a ruling in South Dakota's favor retroactively but stopped well short of promising not to do so. The states' history of retroactive tax assessments provides substantial reason to doubt that the "incentives" toward fairness will hold the states back from a money grab.

After an unfavorable court decision against its Department of Revenue, the Washington State Legislature enacted legislation with 23 years of retroactive application.[1] Likewise, the Michigan Legislature recently enacted retroactive income tax legislation to deny corporate taxpayers the financial benefit of a decision by the State's highest court.[2] In an ironic twist, the attorneys general of both of those States— along with the AGs of other states that have issued egregious retroactive tax assessments in recent years, including Arizona and Kentucky—signed on to an amicus brief in this case. In that brief, they acknowledge the "thorny" issues of retroactivity raised by the possibility of reversing Quill but assert that existing guidance would "limit retroactive enforcement" and add that "other legal and pragmatic safeguards will address any constitutional concerns." Yet those "legal and pragmatic safeguards" have done nothing to stop those same States in numerous cases of retroactive tax liability in the years since Quill.

The States and Territories that filed the amicus brief carefully avoid a promise not to apply a ruling in South Dakota's favor retroactively; rather, they note their "incentives" to implement regulatory changes "carefully and fairly" and weakly state that they "generally" provide advance notice of substantial legal changes. This is little comfort to taxpayers familiar with the consistent pattern of retroactive state taxation.

In fact, the overreaches are already happening. Based off of its cookie nexus regime, which requires online vendors to collect state sales tax if they have property interests in or use in-state apps and cookies, the Massachusetts Department of Revenue sent a letter to at least one businesses to file tax returns from Oct. 1, 2017, (when the cookie nexus regime took effect) to April 30, 2018.[3]

## Nexus Expansion to Business and Personal Income

I believe the goal of the online sales tax debate was never only about sales tax, but to also set a precedent for "remote collection" of business and individual income tax. This is not an unfounded prediction.

[1] See *Dot Foods Inc. v. Washington Dep't of Revenue*, (September 10, 2009).
[2] See, *Gillette Commercial Operations N.* Am *and Subsidiaries v. Mich. Dep't of Treasury,* (September 29, 2015)
[3] Ryan Prete, "Many State Online Sales Tax Laws Leave Door Open for Retroactivity," *Bloomberg BNA,* July 3, 2018, https://www.bna.com/state-online-sales-n73014477104/.

While Wayfair applies to sales and use tax nexus, state corporate income taxes are most certainly affected.

Wayfair may encourage more states to enact factor-presence based nexus standards for income tax purposes. Alabama, California, Colorado, Connecticut, Michigan, New York, and Tennessee are all states that currently have such a test under which out-of-state corporations are deemed to have nexus for corporate income tax purposes where they have property, payroll, or sales in those states that exceed statutory thresholds.[4]

In fact, Wells Fargo has already adjusted its state income tax reserves to include a $481 million net discrete income tax expense, driven by the U.S. Supreme Court's decision in *South Dakota v. Wayfair Inc.*

During an earnings call, Wells Fargo CFO, John Shrewsberry, said "While the ruling addressed whether a state can require an out-of-state seller to collect sales taxes or use taxes even when the seller lacks an in-state physical presence, it has an income tax implication as well. Following the ruling, some of [Wells Fargo's] affiliated entities may be considered to be taxable based on an economic presence in the state, even if they have no physical presence in the state."[5]

Using sales as the nexus to tax income threatens business generally and will severely affect pass-through entities (including s-corps, sole-proprietors, partnerships and LLDc). As the no-sales tax states are threatened, the 9 no income tax states should be worried as well (Florida, Texas, Alaska, Washington, New Hampshire, Nevada, Wyoming, South Dakota, Tennessee). How will they protect small businesses, start-ups and entrepreneurs within their borders?

## Threats from Abroad

Europeans continue to regulate away business and block job creation with their "innovative" regulatory policies. Now they look across the Atlantic and rather than decrease their own regulatory barriers to compete with American business on merit, they scramble to export their failures and siphon off taxes.

EU leaders have called for a discriminatory tax known as the Digital Services Tax (DST) that is predominately aimed at iconic American companies out of Silicon Valley.[6] The tax would be imposed in the form of a 3 percent tax on the digital

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[4] Bruce Chang, "Tax Reform Friday: How Will Wayfair Impact Corporate Income Tax Nexus?" *Bloomberg BNA ,* July 6, 2018, https://www.bna.com/tax-reform-friday-b73014477119/.
[5] Andrea Muse, "Wells Fargo Adjusts Income Tax Reserves Following Wayfair," *Tax Notes,* July 17, 2018, https://www.taxnotes.com/editors-pick/wells-fargo-adjusts-income-tax-reserves-following-wayfair.
[6] Ali Breland, "Tech lobby speaks out against EU digital tax proposal," *The Hill*, June 25, 2018, http://thehill.com/policy/technology/394040-big-tech-lobby-pressures-eu-to-not-pursue-digital-tax-increases.

revenue of tech companies, based on the concern from Europe that companies are paying too little.[7]

The DST comes in two forms: (1) companies will be taxed after either exceeding 7 million euros in annual revenue in an EU member country, having at least 100,000 members in a member country over the course of a year, or 3,000 business contracts for digital services in a year. (2) an interim tax would be placed on revenue from online advertising, facilitating the sale of goods between platforms and the sale of user-generated data. The Commission said it would want these taxes in place until it could develop larger "comprehensive reform."

These conditions would be imposed regardless of whether or not a business has a physical presence in an EU country. The DST will limit tax competition between the US and EU countries by effectively shifting from an origin-based tax system (with businesses taxed where they produce) to a destination-based tax system (with businesses taxed where their customers are located).[8] This completely breaks from long recognized international tax policy.

While countries like Ireland, Germany, Sweden, Denmark, and Finland ask the EU to slow down on its rushed interim DST proposal, Spain and France are plowing ahead. France looks forward to "taxing the digital giants," through its own efforts to provide "a basis for co-ordinated EU action to effectively align the taxation of highly digitalised business profits with the place where value is created."[9]

The design of the tax is troubling and it is no surprise that the DST proposal lacks supporting evidence that it is even in the EU Member States' economic and fiscal interest to deviate from traditional international policy and begin taxing digital business models differently.[10]

It is hard to believe that the DST proposal evolved from pure rationale at the European Commission. Rather, the economic activities targeted, particularly the

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[7] Reuters Staff, "EU leaders to urge progress on digital tax despite concerns, draft says," *Reuters,* June 19, 2018, https://www.reuters.com/article/us-eu-tax-digital/eu-leaders-to-urge-progress-on-digital-tax-despite-concerns-draft-says-idUSKBN1JF1LC.

[8] Stan Veuger, "The future of corporate taxation in a digital world," *American Enterprise Institute,* April 11, 2018, http://www.aei.org/publication/the-future-of-corporate-taxation-in-a-digital-world/.

[9] Mehreen Khan and Rochelle Toplensky, "Berlin gets cold feet over EU tech tax promoted by Macron," *Financial Times*, March 21, 2018, https://www.ft.com/content/6d5f5ea8-2d29-11e8-9b4b-bc4b9f08f381.

[10] Dr. Matthias Bauer, "Five Questions about the Digital Services Tax to Pierre Moscovici," *European Centre for International Political Economy*, February 2018, http://ecipe.org/app/uploads/2018/06/Five-Questions-about-the-Digital-Services-Tax-to-Pierre-Moscovici.pdf.

activities and companies affected by the interim proposal, are ones where the European Union is a net importer, not a net exporter.[11]

We must be careful of the standards we set. European countries and the European Union are "innovating" regulation. This month the European finance leaders are pressing for rules to tax digital companies at a meeting of the G-20, just as they pushed these rules at the OECD. They work tirelessly to tax and regulate American companies.

**What Congress Can Do**

This Committee previously examined bills that would establish the bright-line nexus standards that prevent states from reaching across their borders to force out-of-state businesses or individuals to comply with their tax codes – whether it be collecting, remitting, or paying taxes. Tax collectors audit. Tax collectors litigate. Tax collectors threaten. Individual recourse is at the ballot box or with our feet, but economic nexus laws take away that recourse.

The **Business Activity Tax Simplification Act** is the most important piece of legislation that you can pass in response to the Wayfair decision to stop the rapid expansion of state taxes across borders. It establishes a clear physical presence standard for taxing multistate businesses engaged in cross-border transactions. The bill will help to foster inter-state economic activity by eliminating the burden for businesses of having to comply with varying and complex state income tax laws. It was sponsored by Representative Chabot in the 114th Congress and has not yet been introduced this Congress.

The **Mobile Workforce State Income Tax Simplification Act**, which passed the House over a year ago on voice vote and is still awaiting consideration in the Senate Committee on Finance establishes a clear physical presence standard for employees engaged in cross-border work by keeping states from taxing most nonresident employees unless the employee is present and working in the state for more than 30 days during the year. This legislation sponsored by Representative Bishop allows workers to work more efficiently with fewer hurdles and keep more of their own paycheck.

These two bills should arrive on the President's desk as soon as possible.

Congress should keep in mind the principles include in Representative Sensenbrenner's Legislation **H.R. 2887 No Regulation Without Representation**, which is the best possible solution at hand.

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[11] Stan Veuger, "How reasonable are the EU's digital taxation plans?" *American Enterprise Institute,* May 9, 2018, http://www.aei.org/publication/how-reasonable-are-the-eus-digital-taxation-plans/.

In the interim, Congress should at the very least block tax collection in the wake of *Wayfair* until legislation is passed, and legislation should prevent retroactive tax collection.

States who do not wish to avail themselves to foreign auditors should not enforce its citizens to act as tax collectors for foreign states.

State resources should be prohibited from being used to enforce a tax judgment of a foreign state against its instate businesses with no physical presence in the foreign state-based business.

A business should have the right to right to challenge foreign state attempts at tax collection in it's home state courts based on its home-state law, especially if audit and collection tactics are outside of the normal audit and collection procedures of the home state or are abusive and harassing.

As individuals, businesses, and goods are increasingly mobile and incorporate digital aspects, some politicians think they have found the holy grail of tax collection: taxing people who can't vote against them or leave.

If various economic nexus laws are set to dismally shape the future, Congress must reiterate that a state is not required to substitute its sales and use tax statute for the sales and use statute of another state, as it violates the first states own legitimate public policy.

Thank you for the opportunity to provide testimony and I look forward to your questions.