AICPA®

American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

June 2, 2015

The Honorable Tom Marino
Chairman
Subcommittee on Regulatory Reform,
Commercial and Antitrust Law
U.S. House Committee on the Judiciary
2138 Rayburn House Office Building
Washington, DC 20515

The Honorable Henry C. "Hank" Johnson
Ranking Member
Subcommittee on Regulatory Reform,
Commercial and Antitrust Law
U.S. House Committee on the Judiciary
2138 Rayburn House Office Building
Washington, DC 20515

RE: AICPA Written Statement for the Record of the June 2, 2015 Hearing on Nexus Issues: Legislative Hearing on H.R. 2315, The "Mobile Workforce State Income Tax Simplification Act of 2015," H.R. 1643, the "Digital Goods and Services Tax Fairness Act of 2015," and H.R. __ the "Business Activity Tax Simplification Act of 2015"

Dear Chairman Marino and Ranking Member Johnson:

The American Institute of Certified Public Accountants (AICPA) respectfully submits the attached written statement for the record of the June 2, 2015 hearing of the House Committee on the Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law on Nexus Issues: Legislative Hearing on H.R. 2315, The "Mobile Workforce State Income Tax Simplification Act of 2015," H.R. 1643, the "Digital Goods and Services Tax Fairness Act of 2015," and H.R. __ the "Business Activity Tax Simplification Act of 2015."

The AICPA is the world's largest member association representing the accounting profession, with more than 400,000 members in 128 countries and a history of serving the public interest since 1877. Our members advise clients on federal, state and international tax matters, and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized business, as well as America's largest businesses.

We welcome the opportunity to further discuss these comments on the mobile workforce legislation or to answer any questions that you may have. I can be reached at (801) 523-1051 or tlewis@sisna.com; or you may contact Eileen Sherr, AICPA Senior Technical Manager, at (202) 434-9256, or esherr@aicpa.org.

Sincerely,

Troy K. Lewis

Troy K. Lewis, CPA
Chair, AICPA Tax Executive Committee

American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

WRITTEN STATEMENT FOR THE RECORD

OF THE HEARING BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON THE JUDICIARY

**SUBCOMMITTEE ON REGULATORY REFORM,
COMMERCIAL AND ANTI-TRUST LAW**

On

**Nexus Issues: Legislative Hearing on
H.R. 2315, The "Mobile Workforce State Income Tax Simplification Act of 2015,"
H.R. 1643, the "Digital Goods and Services Tax Fairness Act of 2015," and
H.R. __ the "Business Activity Tax Simplification Act of 2015"**

June 2, 2015

INTRODUCTION

The American Institute of Certified Public Accountants (AICPA) commends Chairman Marino, Ranking Member Johnson, and Members of the Subcommittee for examining the need for, and potential benefits of, H.R. 2315, the Mobile Workforce State Income Tax Simplification Act of 2015. We applaud the leadership taken by the Committee to consider this much needed legislation.

The AICPA is the world's largest member association representing the accounting profession, with more than 400,000 members in 128 countries and a history of serving the public interest since 1877. Our members advise clients on federal, state and international tax matters, and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized business, as well as America's largest businesses.

The AICPA is also an active leader in the National Mobile Workforce Coalition, comprised of more than 260 national businesses and groups that support this legislation.

This written statement will exclusively address our support of H.R. 2315. The AICPA currently has no position on the other proposed legislation that is part of this hearing.

H.R. 2315

The AICPA commends the Subcommittee for their consideration of H.R. 2315, which limits the authority of states to tax certain income of employees for employment duties performed in other states. More specifically, the bill prohibits states from taxing most non-resident employees (there are exceptions for certain professions) unless the employee is present and performing employment duties for more than 30 days during the calendar year. Furthermore, employees would not be subject to state income tax withholding and reporting requirements unless their income is subject to taxation.

AICPA'S POSITION

The AICPA strongly supports H.R. 2315. We believe the bill provides relief, which is long-overdue, from the current web of inconsistent state income tax and withholding rules that impact employers and employees.

After taking into consideration the costs for processing non-resident tax returns with only a small amount of tax liability, we believe states receive a minimum benefit (if any) from the tax revenue that results from an employee filing a return for just a few days of earnings in that state. If non-resident tax returns with minimal income reported were eliminated through a standard, reasonable threshold, such as in H.R. 2315, we think that most states would have an increase in resident income taxes to substantially offset any decrease in non-resident income tax revenue (assuming workers both travel to and out of the state for work). In other words, the current system as a whole unnecessarily creates complexity and costs for both employers and employees, without yielding a substantive benefit to most states.

We believe Congressmen Bishop and Johnson have reached a good balance between the states' right to tax income from work performed within their borders, and the needs of individuals and businesses, and especially small businesses, to operate efficiently in this economic climate. Having a uniform national standard for non-resident income taxation, withholding and filing requirements will enhance compliance and reduce unnecessary administrative burdens on businesses and their employees. In addition to uniformity, H.R. 2315 provides a reasonable 30-day *de minimis* exemption before an employee is obligated to pay taxes to a state in which they do not reside.

H.R. 2315 is an important step in tax simplification for state income tax purposes. Therefore, the AICPA urges this Subcommittee to establish (1) a uniform standard for non-resident income tax withholding and (2) a *de minimis* exception from the assessment of state income tax as provided in H.R. 2315. This legislation should be passed as soon as possible.

BACKGROUND

The state personal income tax treatment of nonresidents is inconsistent and often bewildering to multistate employers and employees. Currently, 43[1] states plus the District of Columbia impose a personal income tax on wages, and there are many different requirements for withholding income tax for non-residents among those states. There are seven states that currently do not assess a personal income tax.[2] Employees traveling into all the other states are subject to the confusing myriad of withholding and tax rules for non-resident taxpayers.

Some of the states have a *de minimis* number of days or *de minimis* earnings amount before requiring employers to withhold tax on non-residents, or subjecting non-residents to tax. These *de minimis* rules are not administered in a uniform manner. For example, currently

[1] Note that New Hampshire and Tennessee, which are included in the 43 states, do not tax wages and only subject to tax interest and dividends earned by individuals.
[2] The seven states with no personal income tax are Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming.

(for 2015), a non-resident is subject to tax after working 59 days in Arizona, 15 days in New Mexico, and 14 days in Connecticut.[3]

Other states have a *de minimis* exemption based on the amount of the wages earned, either in dollars or as a percent of total income, while in the state. For example, currently (for 2015), employers generally are required to withhold in a non-resident state after an employee earns $1,500 in Wisconsin, $1,000 in Idaho, $800 in South Carolina, and $300 a quarter in Oklahoma.[4] Other states that have thresholds before non-resident withholding is required are Georgia, Hawaii, Maine, New Jersey, New York, North Dakota, Oregon, Utah, Virginia, and West Virginia.[5] Some of these states' thresholds are set at the state's personal exemption, standard deduction, or filing threshold, which often change each year.

The remainder of the states tax income earned within their borders by non-residents, even if the employee only works in the state for one day.

Some states exempt, and some do not exempt, from the withholding requirement the income earned from certain activities, including training, professional development, or attending meetings. Note that some of the states only cover exemptions from state withholding; they do not necessarily address the non-resident taxpayer's potential filing requirement and tax liability in a state or local jurisdiction. Furthermore, only a minority of states use day or income thresholds — and without any uniform standard.

It is also important to note that approximately one-third of the states (mostly bordering each other in the Midwest or East) have entered into reciprocity agreements under which one border state agrees not to tax another border state's residents' wages, and vice versa. Accordingly, the in-state resident does not need to file a non-resident border state return, and the employer does not have to withhold non-resident income taxes with respect to the in-state resident, even if the in-state resident primarily works in the non-resident state. Some type of an "exemption form" is often required to be filed in each non-resident border state.

However, not all border states have reciprocity agreements. For example, no reciprocity agreement exists between Maryland and Delaware. Therefore, both Maryland and Delaware require withholding, tax liability and filing for a car salesman who lives and primarily works in Ocean City, Maryland and occasionally has to drive a car to another dealer in Rehoboth Beach, Delaware.

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[3] See *Payroll Issues for Multi-State Employers*, 2015 ed., American Payroll Association, pp. 4-1 et seq.
[4] Ibid.
[5] Ibid.

Unfortunately, the existing reciprocity collaboration between some border states provides only patchwork relief with two-thirds of the country not covered by such agreements. Furthermore, the current agreements are primarily geared toward non-resident employees who ordinarily commute a few miles a day to particular adjoining states in which their employer is located. The reciprocity rules normally do not apply to individuals who regularly travel greater distances.

TYPES OF INDUSTRIES AND TAXPAYERS IMPACTED

These complicated rules impact everyone who travels for work. All types and sizes of businesses are impacted. Large, medium, and small businesses all have to understand each of the states' treatment of non-resident employee withholding and assessment of taxes and the unique *de minimis* rules and definitions. This issue also affects all industries – retail, manufacturing, real estate, technology, food, services, etc.

Some everyday examples include a real estate developer's employee who travels to 20 states to visit prospective sites and spends less than a day in each state, or a store manager who attends a half-day regional meeting in an adjoining state, with some of these meetings occurring only twice a year. Since there are states in which there currently is no minimum threshold, an employee's presence in that state for just one day could subject the employee to state tax withholding.

In addition, accounting firms, including small firms, conduct business across state lines. Many clients have facilities in nearby states that require on-site inspections during an audit. Additionally, consulting, tax or other non-audit services that CPAs deliver are frequently provided to clients in other states, or to facilities of local clients that are located in other states. In essence, all of these entities (small businesses, accounting firms and their clients) are affected by non-resident income tax withholding laws.

HYPOTHETICAL EXAMPLE

For example, assume an employee earns $75,000 per year, resides in Maryland, and travels to work in Indiana, Kansas, Massachusetts, and Ohio for 5 days each. Assume further that the taxpayer earns a pro rata amount of salary in each of the states of $1,500 ($75,000 * 5 days / 250 total workdays = $1,500).

Without the Mobile Workforce legislation, the employer currently must withhold on all of the employee's income in Maryland (the resident state) and the source income from different jurisdictions (which for all practical purposes, will only occur if the employer has a sophisticated time reporting system in place and the employee correctly reports the number of days worked in each state.)

Despite the relatively small amount of income in each of the non-resident states, some amount of tax is likely due in each of the states. The employer must withhold in all five states, and the employee then must file in addition to the federal tax return, income tax returns in Maryland (as a resident), and as a non-resident in Indiana, Kansas, Massachusetts, and Ohio, all of which require non-resident withholding on the first day of work in that state. Depending on the tax withheld, the non-resident state income tax returns may yield a small refund or a small additional tax payment.

While the Maryland return yields a refund, it becomes particularly complex because the employee is required to file forms showing the credit for taxes paid to each non-resident state, and Maryland does not always provide the employee with a dollar-for-dollar credit when factoring in the Maryland county-level tax required to be paid. The federal tax return also becomes more difficult because of the numerous state tax payments and refunds that impact deductions and adjustments for the state tax deduction (for alternative minimum tax purposes, for example).

The administrative burden of filing in five non-resident states, along with the complexity of the withholding rules for each state, would probably require utilization of a third-party service provider that assists with processing payroll for businesses (resulting in additional costs to the employee). The Mobile Workforce legislation makes it far easier for the employer and the employee from a compliance perspective. The taxpayer files one state income tax return in Maryland, and it is a more straightforward return (without calculations and credits for non-resident state taxes paid), and the federal income tax return is simpler as well.

CHALLENGES FOR EMPLOYERS

Employers currently face unnecessary administrative burdens to understand and comply with the variations from state to state. For example, employers are responsible for determining whether to subject an employee to withholding in a state if the employee attends out-of-state training for a couple of days, or how to account for an employee responding to business calls and e-mails on a layover in an airport. Employers also need to consider whether to withhold taxes in a state for when an employee is working on a train that travels into multiple states and jurisdictions in the Northeast Corridor, or what happens when an employee working at a business located close to a state border must cross the border for a quick mundane task.

The issue of employer tracking and complying with all the differing state and local laws is quite complicated. The employer and employee need to be aware of the individual income tax and withholding rules of each state to which that the employee travels, including whether the state has, and if the employee has exceeded, a *de minimis* threshold of days or earnings, and if there is a state reciprocity agreement that applies. Some states have extremely complicated rules for determining when to withhold for a non-resident. For example, Georgia requires withholding when a non-resident employee works more than 23 days in a calendar quarter in Georgia, or if five percent of total earned income is attributable to Georgia, or if the remuneration for services in Georgia is more than $5,000. The employer must determine and calculate each of the three thresholds to determine when to withhold for each employee working occasionally in that state.

The recordkeeping, especially if business travel to multiple states occurs, can be voluminous. The recordkeeping and withholding a state requires can be for as little as a few moments of work in another state. The research to determine any given state's individual requirement is expensive and time-consuming, especially for a small firm or small business that does not have a significant amount of resources. This research needs to be updated, at least annually, to make sure that the state law has not changed. Of course, a small firm or business may choose to engage outside assistance to research the laws of the other states; however, the business will incur an additional cost.

Many small firms and businesses use third-party payroll services rather than performing the function in-house. However, we understand that many third-party payroll service providers cannot handle multi-state reporting. For example, third-party payroll service providers generally report on a pay period basis (e.g., twice per month, bi-weekly) as opposed to a daily basis, which is necessary to properly report the performance of interstate work. Due to the software limitations, employers must track and manually adjust various employees' state income and withholding amounts to comply with different state requirements. The alternative is to pay for a more expensive payroll service.

CHALLENGES FOR EMPLOYEES

Employees face many challenges with complying with the multitude of state tax laws and requirements. When an employee travels for work to many states, even for short periods of time, each non-resident state tax return that is required is usually for a minimal amount of income and tax liability. Often, the employee is below the filing threshold, but since withholding is required, a non-resident state tax return is required, even if only to claim a refund of the withheld taxes.

UNIFORMITY AND *DE MINIMIS* EXCEPTION NEEDED

In addition to uniformity, there needs to be a *de minimis* exemption. AICPA has supported the 60-day limit contained in previous versions of similar legislation, but believes that the 30-day limit contained in H.R. 2315 is fair and workable. The 30-day limit in the bill ensures that the interstate work for which an exemption from withholding is granted does not become a means of avoiding tax or shifting income to a state with a lower tax rate. Instead, it ensures that the primary place(s) of business for an employee are where that employee pays state income taxes.

For example, employees of many small businesses often travel to other states as part of their training, research, or operations. A prime example is a business located in South Carolina, which is on the border of North Carolina and Georgia, where no reciprocity agreements exist. It is easy for an employee to travel into three states within a few hours timeframe. For example: a small bike shop that has to occasionally cross state borders to buy a part, a catering company that delivers, and a roofing company that drives to the nearest home-improvement store (which is located across the state line).

CONCLUDING REMARKS

The current situation of having to withhold and file many state non-resident tax returns for just a few days of work in various states is too complicated for both employers and employees. The AICPA urges this Committee to pass H.R. 2315 and help all the taxpayers in the country ease their non-resident state income tax withholding and compliance burdens. The bill provides national uniformity and a reasonable 30 day *de minimis* threshold. Therefore, the AICPA strongly supports H.R. 2315 and respectfully commends the co-sponsors of this legislation for the development of this reasonable and much needed bi-partisan bill.

The AICPA appreciates the opportunity to submit this written statement in support of H.R. 2315.

AllianceData

June 1, 2015

The Honorable Tom Marino, Subcommittee Chairman
Cannon House Office Building
Room 410
Washington DC 20515

Re: Supporting H.R. 2315 the Mobile Workforce State Income Tax Simplification Act

Sent by facsimile to (202)225-9594, hard copy to follow.

Dear Chairman Marino:

I am Calvin Hilton, VP of Human Resources for Alliance Data and its subsidiary companies, on behalf of my multistate employer, and our over 12,000 U.S. based associates I am writing to urge your support and passage of H.R. 2315 the Mobile Workforce State Income Tax Simplification Act of 2015. This needed legislation would enhance compliance with state personal income tax laws and simplify the onerous burdens placed on associates who travel outside of their resident states for temporary projects, assignments and for a variety of other purposes; and on their employers who have corresponding withholding and reporting requirements.

H.R. 2315, a bipartisan bill, would establish a uniform 30-day threshold and other equitable rules to help ensure that the appropriate amount of tax is paid to state and local jurisdictions. These new rules would apply equally to employees of government, unions and businesses and would benefit local taxing authorities by eliminating *de minimis* tax returns and refunds for non-residents.

Efficient work force management practices today, demand leveraging flexible teams and individual resources that every day results in thousands of associates traveling outside of their home states for temporary work assignments. H.R. 2315 would make the tax rules fairer and less onerous on employer and employee alike. After nearly 10 years of good faith negotiations with state government officials and tax professionals, the time has come for this legislation to become law.

I thank you for your consideration of this important legislation and commit to rallying the support of your colleagues in the House and for the companion legislation S. 386 that has been reintroduced in the Senate.

Respectfully,

Calvin Hilton, VP Human Resources
Alliance Data Inc.

Cc: The Honorable Bob Goodlatte, Chairman
The Honorable John Conyers, Ranking Member
The Honorable Mike Bishop
The Honorable Hank Johnson
The Honorable Sam Johnson
The Honorable John Thune
The Honorable Orin Hatch
The Honorable Ron Wyden

Alliance Data® (NYSE: ADS) is a leading global provider of data-driven marketing and loyalty solutions serving large, consumer-based industries. The Company creates and deploys customized solutions, enhancing the critical customer marketing experience; the result is measurably changing consumer behavior while driving business growth and profitability for some of today's most recognizable brands. Alliance Data helps its clients create and increase customer loyalty through solutions that engage millions of customers each day across multiple touch points using traditional, digital, mobile and emerging technologies. An S&P 500 company headquartered in Plano, Texas, Alliance Data consists of three businesses that together employ more than 15,000 associates at approximately 100 locations worldwide.

Alliance Data's Card Services business is a leading provider of marketing-driven branded credit card programs. Epsilon® is a leading provider of multichannel, data-driven technologies and marketing services, and also includes Conversant, the leader in personalized digital marketing. LoyaltyOne® owns and operates the AIR MILES® Reward Program, Canada's premier coalition loyalty program, and holds a majority interest in Netherlands-based BrandLoyalty, a global provider of tailor-made loyalty programs for grocers.

The Computing Technology Industry Association

Testimony Before the

House Judiciary Committee

Subcommittee on Regulatory Reform, Commercial and Antitrust Law

"Digital Goods and Services Tax Fairness Act of 2015"

"Business Activity Tax Simplification Act"

"Mobile Workforce State Income Tax Simplification Act of 2015"

June 2, 2015

Chairman Marino and Ranking Member Johnson,

We greatly appreciate your willingness to hold a hearing on several important bills, including the "Digital Goods and Services Tax Fairness Act," the "Business Activity Tax Simplification Act," and the "Mobile Workforce State Income Tax Simplification Act." On behalf of CompTIA, thank you for the opportunity to provide comments on interstate tax issues that affect the technology industry and its workers.

CompTIA is a nonprofit trade association representing more than 2000 member companies. Our members include computer hardware manufacturers, software publishers, and a large number of small and medium sized IT service providers, as well as the distribution partners that bring these products and services to market. We greatly appreciate the committee's willingness to explore legislation that would help ease burdens by establishing consistent interstate rules that will bring consistency and simplification to many interstate tax issues, which, in turn, will allow our industry to continue to grow and remain globally competitive.

Digital Goods and Services Tax Fairness Act.

According to recent data, eighty seven percent of Americans are using the Internet and over 200 million Internet users will make an online purchase this year alone. The digital economy continues to play a strong role in both the growth of the Internet and the ability for businesses to better deliver digital goods and services. Given the importance of the digital economy to our member companies and the need to ensure we can continue to foster innovation and economic growth within this sector, we strongly support the Digital Goods and Services Tax Fairness Act (H.R. 1643). This legislation will prevent hurdles to growth and create a much needed tax framework that will provide certainty to consumers, providers, and state/local governments.

Simply, this legislation accomplishes two key objectives. First, the legislation sources the purchase of a digital good or service to the consumer's home address. Therefore, only one state would have the ability to tax the transaction – if that state chose to do so. Congress took a similar approach in 2000 when it passed the Mobile Telecom Sourcing Act, which essentially sourced wireless and mobile telecommunications services to the consumer's home address to eliminate confusion around which taxing jurisdiction had the right to tax wireless services.

Secondly, the legislation would prohibit discriminatory taxes. If a state decides to tax a downloadable song, for example, the rate should be the same as if that same song was purchased in a "brick and mortar" store. Prohibiting discriminatory taxes simply brings parity between digital products and their tangible counterparts.

As the digital economy continues to play a major role in our economic growth, Congress should make sure there is a clear framework in place that prevents the potential for confusion or – even worse – duplicative taxation. Consumers and providers alike deserve certainty and H.R. 1643 provides that for all stakeholders. We greatly appreciate the Committee's interest in this important issue and look forward to working with the Committee to ensure H.R. 1643 is signed into law.

Business Activity Tax Simplification Act of 2015.

As states seek to maintain or expand both their tax bases and collections, we note ever-increasing attempts by some state taxing authorities to tax interstate transactions. As established by the U.S. Supreme Court, the principle requirement allowing a state to require a non-resident business to collect and pay over sales and use taxes is "physical nexus." In Quill Corp. v. North Dakota, 504 U.S. 298 (1992), the Court ruled that a state is not permitted to require a non-resident seller to collect and remit sales and use taxes, unless that seller has a physical presence in the state. Therefore, a business that resides in State A cannot be required by State B to collect and remit sales taxes on sales made to customers in State B, unless that business has a real physical presence in State B. Commonly, physical presence has been interpreted as having an office or place of business in the state, or employing workers that operate within the state.

One of the basic principles of the Quill decision is fairness. That is, it is principally unfair and burdensome for a state to require a business to collect sales and use taxes, when that business has no physical presence in the taxing state. The fairness of Quill is made all the more evident by the fact that most states permit local jurisdictions to impose separate transaction taxes, which can have varying requirements within a single state or jurisdiction. Clearly, for the typical small business, collecting and remitting taxes from states other than their own would impose a massive administrative burden. In addition to monitoring, collecting and remitting sales taxes to multiple jurisdictions, the business would also be burdened with multiple compliance requirements. So, under the Quill decision, the physical nexus standard has served to bring both certainty and simplicity to the complicated patchwork of interstate taxation.

However, while the Quill decision requires a physical nexus in situations involving sales and use taxes, this decision did not specifically address other forms of taxation. Therefore, while physical nexus continues to control sales and use tax collections, some states are now seeking to ignore this requirement for other forms of taxation – asserting that an "economic nexus" is sufficient. Under this theory some states have attempted to tax any transaction that has an economic nexus to that state. This is bad tax policy, which will result in unmanageable tax and compliance problems for all businesses.

Imposition of business activity taxes under the economic nexus theory imposes a particularly burdensome regime on the tech industry. For example, a tech company located in State A is engaged by a customer in State B to solve a software issue. The tech company has no place of business in State B and has never done business in State B; but, without ever entering State B, the tech company connects to the customer's computer via the Internet, the computer is repaired, and the customer is billed for this service. Under the economic nexus theory, State B could assert that income earned by the tech company is subject to income and franchise taxes in State B. Also, because the tech company is a resident and is physically present in State A, State A would likewise seek to tax these earnings.

This issue will be further compounded as cloud computing grows in usage. Consider the example of the delivery of business applications online to a user in State X, where these business applications are stored on a server owned by the vendor in State Y, while the data generated from use of the business applications is stored on another server located in State Z. From this example, it is easy to see how adoption of the economic nexus will usher in a burdensome and complex new multiplicity of tax regimes for all businesses. This would be most devastating for small and medium size businesses that have neither (i) the expertise to learn the tax requirements of all states, nor (ii) the money to pay the taxes or the compliance costs for a professional to monitor and comply with dozens, hundreds or thousands of taxing authorities.

It now seems apparent that the tax authorities of some states are seeking to bypass the Supreme Court's decision in Quill. Because Quill prohibited the imposition of unfair *sales taxes*, some states are now seeking to bypass this by assessing *transaction taxes*. The emphasis must be placed on the term "unfair" – without respect to the type of tax a state seeks to impose on out-of-state businesses. This issue needs to be addressed before the nation's small businesses suffer any further.

Before any more states move to collect unfair taxes from out-of-state businesses, we urge the Congress to require distinct physical presence requirements to the taxation of interstate business activities. The emergence of a duplicative and overlapping patchwork of state and local tax filing and payment requirements will seriously damage America's business community. It would inflict a substantial burden and cost on all businesses with a disproportionate impact on small and medium size businesses, especially those engaging in electronic commerce.

Accordingly, we call on Congress to pass the "Business Activity Tax Simplification Act" which would establish consistent rules concerning nexus to (i) expand the federal prohibition against state taxation of interstate commerce to include taxation of out-of-state transactions involving all forms of property (such as intangible personal property and services) and (ii) prohibit state taxation of an out-of-state entity unless such entity has a physical presence in the taxing state.

Mobile Workforce State Income Tax Simplification Act of 2015.

Some states are imposing income taxes on non-residents after very brief work-related stays. This makes tax compliance more complicated for individuals and their employers and deters business-related travel.

Accordingly, CompTIA supports H.R. 2315/S. 386, the Mobile Workforce State Income Tax Simplification Act of 2015, which will establish national standards for state income taxation of non-residents. This legislation would allow employee wages or compensation to be taxed by only the (i) state of the employee's residence, and (ii) the state within which the employee is present and performing employment duties for more than 30 days during the calendar year.

Employees who are required to move from state to state should not be required to file and pay state income taxes for brief periods of work, i.e., 30 days or less. This legislation does not exempt the employee from state taxes; it just provides that only the employee's state of residence or any state in which the employee worked for more than a 30 days are permitted to require the employee to file and remit state taxes.

Conclusion.

Increasingly, businesses and individuals are being burdened by the variety and amount of taxes that must be paid, as well as the costs of compliance. While we fully support the notion that all businesses should pay their rightful share of taxes, we believe this goal can and should be accomplished in the most orderly and least burdensome method. Accordingly, we ask this Subcommittee to support efforts to clarify and simplify the increasing tax and tax compliance burdens for businesses. If not, businesses, especially small and medium-size technology businesses, cannot continue to drive the American economy.

ENTERTAINMENT, INC.

Statement for the Record
By Thomas L. Albert, Vice President for Government Affairs, Feld Entertainment

U.S. House of Representatives Judiciary Committee
Subcommittee on Regulatory Reform, Commercial and Antitrust Law Hearing on "H.R. 2315, the Mobile Workforce State Income Tax Simplification Act of 2015"
June 2, 2015

Feld Entertainment, Inc. respectfully submits the following comments for the inclusion in the record of the U.S. House of Representatives Subcommittee on Regulatory Reform, Commercial and Antitrust Law's Hearing on "H.R. 2315, the Mobile Workforce State Income Tax Simplification Act of 2015."

Feld Entertainment Inc.(FEI) is the world's leading producer of live family entertainment spectaculars including *Ringling Bros. and Barnum & Bailey®, Disney On Ice, Disney Live!, Marvel Universe Live,* and Feld Motor Sports events including *Monster Jam®*. We respectfully urge you to support H.R. 2315, "The Mobile Workforce State Income Tax Simplification Act of 2015."

Currently, states have varying and inconsistent standards regarding the requirements for employees to file personal income tax returns when traveling to a nonresident state for temporary work periods. These employees are subject to onerous administrative burdens because, in addition to filing federal and resident state income tax returns, they may also be legally required to file an income tax return in every other state into which they traveled, even if they were there for only one day. In addition, employers must also comply with the states' widely divergent withholding requirements for these traveling employees. States likewise expend considerable resources in processing *de minimis* tax returns and refunds for non-residents.

H.R. 2315 would establish a 30-day threshold for employees traveling outside of their state for business purposes and would establish other fair, administrable and uniform rules to help ensure that the appropriate amount of tax is paid to state and local jurisdictions without placing undue burdens on employees and their employers.

Feld Entertainment has over 1,400 traveling show employees across our motor sports, circus, ice, and stage productions. Over the course of a year, our mobile workforce typically travels to 45 states, with 38 of those states requiring some sort of income tax withholding. Of those 38 states, 22 require income tax withholding on the first day the employee travels to the state, even though many times the employee is only in the state for ten or fewer days. The remaining 16 states in which FEI's mobile workforce visits all require tax withholding based on differing thresholds or requirements. For example, one state requires withholding if the employee is in the state for more than 60 days, while another state sets the threshold at 23 days, and yet another at 15. Some states use a monetary threshold based on the nonresident's in-state earnings, such as requiring withholding if the employee earns in-state wages of more than $300 in a calendar quarter, or if the employee earns in-state wages of more than $800 in a calendar year, or if the employee's in-state wages are less than his/her personal exemption in a calendar year. Our company spends a significant amount of time and resources to ensure that we are complying with the various state employer withholding requirements for our traveling employees, in addition to helping our employees navigate through the patchwork of non-resident state income tax filing rules.

Feld Entertainment urges you to support H.R. 2315 which would greatly simplify the onerous burdens placed on states, employees traveling for business and their employers.

June 2, 2015

The Honorable Tom Marino
U.S. House of Representatives
Committee on the Judiciary
Chairman, Subcommittee on Regulatory Reform, Commercial and Antitrust Law
517 Cannon House Office Building
Washington, D.C. 20515

The Honorable Hank Johnson
U.S. House of Representatives
Committee on the Judiciary
Ranking Member, Subcommittee on Regulatory Reform, Commercial and Antitrust Law
517 Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Marino and Ranking Member Johnson:

The International Franchise Association (IFA) would like to express its strong support for the Business Activity Tax Simplification Act, "BATSA." BATSA would create a much needed fair, clear, and uniform nexus standard for the imposition of state and local taxes on business activity. We want to thank you for convening a hearing on this important topic.

The International Franchise Association is the world's oldest and largest organization representing franchising worldwide. Celebrating over 50 years of excellence, education, and advocacy, IFA works through its government relations and public policy, media relations, and educational programs to protect, enhance and promote franchising. IFA promotes the economic impact of the more than 780,000,000 franchise establishments, which support nearly 8.9 million direct jobs and $890 billion of economic output for the U.S. economy. IFA members include franchise companies in over 300 different business format categories, individual franchisees, and companies that support the industry in marketing, law, and business development.

IFA members support BATSA because it would stop individual states from using a questionable "economic nexus" theory to levy income and franchise taxes against companies that do not have a physical presence in the state. The current situation threatens the ongoing relationship between franchisors and franchisees.

In *Quill Corp. v. North Dakota*, the United States Supreme Court ruled states cannot force an out-of-state corporation to pay certain taxes unless it has established a physical presence in the taxing state. However, in recent years, states have ignored the ruling and have established an "economic nexus" standard for taxation. This standard has created tremendous hardships and confusion for businesses that use the franchise business model and has hampered franchise businesses' ability to expand the brand and create jobs.

Most franchisors own no property in the state in which their franchisees operate, do not maintain offices there, and do not employ residents of those states. A franchisor's employees may make occasional visits to its franchisee's place of business to assist the franchisee in opening his or her business, to inspect the franchisee's performance, and to furnish training advice and guidance, but the duration of such visits normally is limited to a few hours or days. The services a franchisor furnishes to its franchisees and communication between a franchisor and its franchisees, are implemented almost entirely at the franchisor's principal offices and through interstate communications media. Most franchisors do not rely on the states of their franchisees' domicile for any services and impose no costs on those states.

Franchisees are indistinguishable from any other small business domiciled in that state. Franchisees are legally distinct from their franchisors - they pay taxes, hire and fire their own employees, and are responsible for abiding by state and local laws. While a franchisee pays for the right to use a franchisor's brand and trademarks within a defined geographic area and applies standards set by the franchisor in order to maintain that brand, the franchisee location is an independently owned and operated small business.

Enactment of BATSA is important to the franchise industry due to the unique business relationship between a franchisor and its franchisees. Central to this relationship is a shared trade identity. That shared trade identity is established and maintained by the franchisor's license of its trademark, trade dress, and other intellectual property (*i.e.*, intangible property) to each of its franchisees. Thus, each of the hundreds of thousands of franchise relationships that exist in the U.S. involves a license of intangible property, and the great majority of those licenses cross state lines.

The franchise relationship evolved over the last half century based on the understanding that the franchisor is not subject to state income taxes (other than those imposed by the franchisor's domicile state and any state where it maintains a physical presence) on the royalty income paid to the franchisor by franchisees located in a different state. Prior to the late 1980s, with rare exception, states did not seek to tax such income unless the franchisor clearly established a traditional nexus by owning or leasing real estate, operating its own outlets, or maintaining an office or employees in the taxing state.

Franchise brands exist across a multitude of political boundaries in most franchise systems, but the franchisor is often a single entity with a clearly defined corporate residence. Some state revenue officials and, increasingly, legislators view the presence of a franchised outlet of a national or regional brand in their state, as sufficient for the establishment of economic, rather than a physical, nexus of the out-of-state franchisor. It has been incorrectly argued that the mere presence of intangible property in a state's jurisdiction satisfies the "substantial nexus" requirement under the Commerce Clause for the imposition of state income and related business activity taxes. Such arguments radically expand the classes of persons, relationships, and transactions potentially subject to state income taxation, and they threaten the livelihoods of hundreds of thousands of entrepreneurs who have chosen franchising as the route to small business ownership.

This issue has enormous implications for the businesses engaged in interstate franchising, a rapidly expanding part of the American economy. If permitted to continue, such assessments would subject licensors of intangible property in interstate commerce to income taxation by every state in which goods or services are sold. If a tax return is not filed, taxes, interest, and penalties may accrue indefinitely since no statute of limitations applies. Such a result would represent a radical departure from the historical understanding of the reach of taxing authority and a significant increase in the tax liability and burden of compliance of thousands of American small businesses.

The franchising business model is at risk if aggressive nexus audits continue to threaten the ongoing relationship between franchisors and franchisees. The two are separate entities, and the steps necessary to maintain the shared brand do not constitute a presence in every state where that brand appears. The cost associated with compliance and preparation of the tax returns is significant and is a major financial burden for smaller franchisors and in many cases eclipses the taxes being paid. Franchisors and franchisees should no more be tied together for purposes of determining nexus, than they should under other business and employment-related statutes because it would undermine decades of established law and threaten the model that has served as a driving force for the expansion of so many American businesses and brands.

If every state where a franchisor has granted franchises may tax its income attributable to that state, non-resident franchisors will be subject to costly compliance burdens and overlapping taxes. Under these circumstances, there is no doubt that franchisors will be forced to consider passing this cost of business on to their franchisees by increasing the royalty fees. If this were to occur, the party most harmed is the resident franchisee. Thus, enactment of BATSA is critical for thousands of businesses, including franchising companies, their franchisees and other licensors and licensees of intangible property across state lines.

Thank you for holding this hearing and for considering this crucial legislation.

Sincerely,

Stephen J. Caldeira

Stephen J. Caldeira
President and CEO

June 2, 2015

An Open Letter to the House Committee on the Judiciary's Subcommittee on Regulatory Reform, Commercial and Antitrust Law Regarding "Nexus" Issues

Dear Chairman Marino, Ranking Member Johnson, and Members of the Subcommittee:

Thank you for examining "nexus" issues as they pertain to the taxation of interstate commerce. It is imperative for the federal government to clarify matters in this area so as to ensure that taxpayers are treated fairly, that income and transactions are not taxed multiple times, and that burdens on interstate commerce are minimized to the greatest possible extent. With this in mind, we respectfully submit the following recommendations.

Support H.R. 1643, the Digital Goods and Services Tax Fairness Act. The dizzying rise of music downloads, mobile-phone apps, and other digital products has been viewed by some state and local tax officials as merely an opportunity to collect additional revenues. Given that consumers can now be charged taxes from several jurisdictions on the same purchase (e.g., from the state where the seller's server is located, from the state where the customer's phone bill is sent, from the location where the consumer downloads the item), Congress should establish boundaries for these practices. H.R. 1643 prudently prevents states from piling on repetitive download taxes, and requires an affirmative legislative act by a state (as opposed to an administrative edict) in order to tax digital goods.

Support H.R. 2315, the Mobile Workforce State Income Tax Simplification Act. In today's economy, millions of Americans accept temporary assignments outside their state of residence or traditional workplace location. Yet, some state and local tax laws are horrendously out of touch with this fact, causing unnecessary compliance headaches for workers and employers alike. H.R. 2315 would set federal guidelines for the way states and localities can impose earnings taxes on most nonresidents, including a minimum threshold of time spent in-state (more than 30 days) before compliance requirements are triggered. All other tax obligations in the worker's or employer's home state would remain unchanged. Such legislation, which would help cut down on the billions of hours and dollars that are spent on tax compliance by employees and employers every year, is vital in today's increasingly mobile economy.

Support H.R. 2584, the Business Activity Tax Simplification Act. The Business Activity Tax Simplification Act is a worthy reform measure that would clarify the nexus rules governing state assessment of income-based taxes. By establishing a clear nexus test, the bill would ensure that only businesses having employees or property physically present within a jurisdiction are subjected to business activity taxes in that jurisdiction. The legislation would promote fairness, minimize litigation, and create a legally certain business climate that encourages companies to invest and expand interstate commerce.

NTU applauds the Subcommittee for the consideration of these important, pro-taxpayer bills. As it evaluates the need for federal legislation to clarify interstate tax coordination and nexus issues, we strongly urge the Subcommittee to also examine three related issues.

Support H.R 1087, the Wireless Telecommunications Tax and Fee Collection Fairness Act of 2015. This bipartisan legislation would require that a financial transaction exist between a buyer and seller in order for a state government to compel the seller to collect taxes. Such a policy would benefit consumers and businesses alike by providing much-needed clarity to the tax treatment of certain purchases. By requiring this type of nexus to exist before taxes can be collected, H.R. 1087 would effectively end the arbitrary and unfair attempts of some state governments to collect taxes from businesses that were not directly involved in a commercial transaction. Additionally, establishing a financial exchange test would help to properly delineate the appropriate boundaries between interstate and intrastate transactions.

Support the Multi-State Worker Tax Fairness Act. This bill would prohibit states from taxing nonresident remote workers during periods in which they are physically present in a different state. In doing so, the legislation would bar states from using a "convenience test" to tax multi-state workers. Passage would prevent a potential tax nightmare for the millions of telecommuters (and counting) across the nation, as well as for their employers. By addressing the contentious issue of tax apportionment, this bill is a logical and necessary complement to the Mobile Workforce State Income Tax Simplification Act.

Address Internet Sales Tax Issue in a Pro-Taxpayer Manner. The tax treatment of interstate retail transactions is a complex issue that requires Congressional action. However, several of the proposals that have garnered attention would be disastrous. Most notably, the so-called Marketplace Fairness Act would force the average impacted household to pay an additional $360 in state and local sales taxes annually, according to research by our educational affiliate, National Taxpayers Union Foundation. Additionally, the compliance burden on an individual, small Internet retailer could amount to tens of thousands of dollars and hundreds of hours of staff time. This is simply untenable.

Congress must find a better solution that provides states with clarity while avoiding harm to small businesses. To this end, we would suggest pursuing a solution that adheres to the seven principles set forth by Chairman Bob Goodlatte in 2013. They are: 1) Tax Relief, 2) Tech Neutrality, 3) No Regulation Without Representation, 4) Simplicity, 5) Tax Competition, 6) States' Rights, and 7) Privacy Rights.

Abiding by these principles will give all stakeholders the best opportunity to achieve a fair, pro-taxpayer solution that allows the Internet economy to continue to flourish.

Thank you for considering our comments as the Subcommittee addresses these issues of critical importance to taxpayers.

Sincerely,

Brandon Arnold
Executive Vice President

Software Finance & Tax Executives Council

www.softwarefinance.org

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON REGULATORY REFORM, COMMERCIAL AND ANTITRUST LAW

HEARING ON:

NEXUS ISSUES: LEGISLATIVE HEARING ON H.R. 2315, THE "MOBILE WORKFORCE STATE INCOME TAX SIMPLIFICATION ACT OF 2015", H.R. 1643 THE "DIGITAL GOODS AND SERVICES TAX FAIRNESS ACT OF 2015", AND H.R. __ THE "BUSINESS ACTIVITY TAX SIMPLIFICATION ACT OF 2015"

JUNE 2, 2015

STATEMENT OF THE SOFTWARE FINANCE AND TAX EXECUTIVES COUNCIL

Chairman Marino and Ranking Member Johnson, the Software Finance and Tax Executives Council ("SoFTEC") is pleased to provide this statement for the record of the June 2, 2015 Subcommittee hearing entitled: Nexus Issues: Legislative Hearing On H.R. 2315, The "Mobile Workforce State Income Tax Simplification Act Of 2015", H.R. 1643 The "Digital Goods And Services Tax Fairness Act Of 2015", And H.R. __ The "Business Activity Tax Simplification Act Of 2015." SoFTEC supports both the Mobile Workforce bill and the Business Activity Tax Simplification Act ("BATSA") because they would enact needed reforms to and simplification in the application of state income and other business activity taxes to multistate businesses. While SoFTEC generally supports the goals of the Digital Goods bill, it does not support it because it fails to address key issues effecting the delivery of software functionality to customers by way of the so-called "cloud computing" business model. SoFTEC could support the Digital Goods bill if certain changes, outlined below, were made.

SoFTEC is a trade association providing software industry focused public policy advocacy in the areas of tax, finance and accounting. Because SoFTEC members conduct their business in a multistate environment, they have an interest in the subject matter of both the Mobile Workforce bill and the BATSA. Because the software products developed and marketed by SoFTEC members are "digital goods" within the definitions provided in the Digital Goods bill, that bill would have a direct impact on all SoFTEC members. Thus, SoFTEC has an interest in providing this statement for the record of the Subcommittee's hearing.

1. Mobile Workforce Bill:

Under current state income tax law, whenever an employee of an out of state business travels to another state to conduct the business of his or her employer, the employer is required to allocate a portion of the employees compensation to that state, withhold that state's income tax from the compensation and forward it to that state. Likewise, the employee must file an income tax return with the state and report the appropriate amount of income to the state and show the tax withheld by the employer, for each state the employee visited during the tax year. In addition, the employee must display this detail on the income tax return filed with his or her home state and claim credits for the taxes withheld by the employer and forwarded to the other states. Naturally, this system imposes burdensome recordkeeping and tax administration requirements on both the employer and the employee whenever an employer sends an employee to another state on an assignment, regardless of the length of the assignment.

The Mobile Workforce State Income Tax Simplification Act, H.R. 2315, would establish a 30-day threshold and other fair, administrable and uniform rules to help ensure that the appropriate amount of tax is paid to state and local jurisdictions without placing undue burdens on employees who travel outside of their resident states for temporary periods, and their employers who have corresponding withholding and reporting requirements.

Because the Mobile Workforce bill would reduce existing recordkeeping and tax administration burdens on multistate business, without any significant change in the amount of state income tax an employee would owe, SoFTEC supports it and urges the Subcommittee to mark it up and report it to the full committee at it earliest opportunity.

2. Business Activity Tax Simplification Act:

The law is clear that a state cannot impose a tax on an out-of-state business unless that business has a "substantial nexus" with the taxing state. The Supreme Court, in the context of sales and use taxes, has construed this "substantial nexus" requirement as requiring that the out-of-state business must have "more than de minimis" physical presence in the taxing state. Courts generally have found that the substantial nexus standard also applies to state and local business activity taxes such as business income taxes.

In addition, federal statutory law, found in P.L. 86-272 (15 U.S.C. Sec. 381, et. seq.), enacted in 1959, generally prohibits a state from subjecting an out of state vendor to an income tax liability if the vendor's contacts with the state are limited to "the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State." BATSA would codify the physical presence standard established by the Supreme Court precedents. It also would define certain activities as de minimis by delineating certain types of activities that a business can conduct in a state and not trigger liability for tax in that states. For instance, BATSA would permit a business to send employees into a state for 21-days in any year and not give rise to an obligation for that state's income tax. This is designed to permit business to send employees to conventions, training seminars and similar transitory assignments and not trigger unintended tax obligations. Firm guidance on what activities can be conducted within a state that will not trigger that state's taxing power will provide certainty to business and tax administrators and will reduce compliance and enforcement costs.

BATSA also is would bring the 1959 statutory law up to date by expanding it to encompass the broader array of business transactions that now take place in interstate commerce, such as services. It also would expand it to encompass other types of business activity taxes other than income taxes.

BATSA is needed because elimination of the physical presence standard for sales taxes, which is contemplated by the Marketplace Fairness Act (S. 698) would be taken as repeal of the Supreme Court precedents which underlie the physical presence standard for business activity taxes. In addition, overzealous tax administrators, in some states, contend that the mere presence of a customer is all that is needed to trigger an income tax obligation of an out-of-state business. This overzealousness typically is visited on small businesses which lack the resources to contest tax assessments in distant states and locales.

In addition, some states contend the physical presence nexus standard of the *Quill* decision, a case involving state sales and use taxes, does not apply to state income and business activity taxes, and their courts have adopted this reasoning. See *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 SE2d 13 (Sup Ct), cert denied 510 US 992 (1993). The validity of this conclusion is dubious in light of the Supreme Court's recent decision in *Comptroller of Treasury of Md. v. Wynne*, No. 13-485, (May 18, 2015), holding that for purposes of Commerce Clause analysis, there is no difference between taxes on gross receipts (sales taxes are a form of gross receipts tax) and taxes on net income.

BATSA would not cause states to lose any significant tax revenue because it merely would codify the existing physical presence standard. Any revenue that might be lost would be offset by the apportionment of more income to businesses physically present in that state.

SoFTEC supports the Business Activity Tax Simplification Act and hopes legislation will be filed soon, marked up by the subcommittee, and reported to the full committee at its earliest opportunity.

3. Digital Goods and Services Tax Fairness Act:

The goals of the Digital Goods bill are to prevent multiple and discriminatory taxation of sales of digital goods and services and to provide a consistent framework for the application of state sales and use taxes to sales of digital goods and services. SoFTEC supports these goals. However, because the bill does not address the emerging software distribution model known as "cloud computing," SoFTEC does not support the bill itself. SoFTEC could support the bill if certain changes were made that clearly delineated the distinctions between digital goods and digital services and provided clear rules for how to "source" sales of digital goods and services.

a. Characterization as the sale of a good or as the sale of a service:

Generally, state sales and use taxes are confined to sales and uses of tangible personal property ("TPP") and certain enumerated services. A few states, such as New Mexico and South Dakota, impose their taxes on sales both of TPP and of services. Most state sales and use tax laws were enacted in the 1930, long before the ability to transfer software functionality electronically was conceived. Application of these old laws to sales of digital goods and services has proved problematic, given the rapid pace of technological advance.

In the early day so of the computer, only mainframe computers were available and were purchased by large companies who used them to process large volumes of data. The computers were sold without any, what we refer to today as, application software. Application type software generally was custom developed by the customer or the few commercial computer vendors. In the late 1960's, a few developers of "prewritten" software, sprang up and began selling programs for use on mainframes. The software was transferred on reels of magnetic tape. The medium on which software was transferred from the developer to the customer evolved from the reel-to-reel tapes to hard-disk platters, to floppy disks (which steadily decreased in size) to CD-ROMs and DVDs. In the late 1990's with the advent of the Internet, electronic distribution of software became the norm, where no intermediate storage media was needed.

The software industry exploded in the 1970's with the development of the personal computer. Retail stores selling application software sprang up where customers could browse the shelves and examine boxes containing copies of software on storage media, along with a printed user manual. When electronic software distribution became the norm, many of these stores disappeared.

Prior to the advent of the personal computer, access to computer software functionality was limited to the people who ran the computers. In 1971, IBM released remote access functionality called "Time Sharing Option" or "TSO." Users outside the environment where the mainframe computer was stored could access the mainframe through the use of teletypewriter-type terminals connected to the mainframe computer using a communications network. This gave large numbers of users access to the computer's functionality. This made it possible for individuals and organizations to use a computer without owning one.

When computers became affordable and plentiful and software was widely available, access to computer functionality became widespread. While mainframe computers are still used by large businesses to process large volumes of data and transactions, computing power exceeding that available on 1960's era mainframes resides in the pockets and purses of anyone carrying a smartphone.

But the way in which computer software functionality is delivered to consumers continues to evolve and no longer depends on the delivery of a copy of the software to the customer. Instead of delivering copies of software to the customer, the customer accesses computer and software functionality remotely using the Internet. This is the so-called "cloud computing" model that soon may overtake electronic software distribution as the prevailing way of delivering software functionality.

Under many cloud computing models, the vendor stores the software on its computers, which are connected to a communications network, such as the Internet. Customers transfer their data to the vendor's cloud computing environment using the communications network. The vendor's software processes the data and returns the result to the customer using the same communications network. It may very well be the vendor has its software stored on a mainframe computer.

The cloud computing business model is markedly different than the "sale of software" business model prevalent since the late 1970's. Most prewritten software is distributed using a license agreement that transfers a copy of the software to the customer along with a license to use the software for either a stated period of time or perpetually, for a one-time fee.

Under Cloud computing business models that do not result in the transfer of any copy of the software to the customer, the customer is allowed to utilize the vendor's computing capability for a fee. These fee arrangements take a variety of forms. For instance, some vendors charge a fee for each user. Other vendors might charge based on how much computing power is used. Another vendor might charge a "per session" or "per use" fee. Some might charge a variable fee based on time. Some might employ a combination of these billing models.

State sales and use tax laws have struggled to keep up with the rapid changes in the way software functionality is distributed to customers. When software was sold in boxes in retail stores, the sales were treated like any other transaction occurring in a store. When electronic delivery of software, and other digital products such as movies, music and books, became prevalent, the states saw their sales and use tax base eroding. But, rather than go to the state legislature so it could address the problem, the state tax administrators merely reinterpreted their existing sales tax impositions on sales of TPP and began applying them to these digital products.

It was this type of behavior, the reinterpretation of decades old telecommunications tax laws as applying to the retail sale of dial-up Internet access by state tax administrators, which led to the enactment of the Internet Tax Freedom Act of 1998. That law grandfathered a handful of states that already were collecting taxes on sales of Internet access. Recently, the state of North Dakota, a grandfathered state, amended its telecommunications taxes statute and clarified that it did not apply to sales of Internet access, the first time the state legislature had ever considered the matter.

Similar behavior is occurring with respect to cloud computing services. Because the distribution of software functionality has migrated from sales of copies of prewritten software on disk or by download to a model where no copy of the software is delivered to the customer, some state revenue departments have re-characterized the transactions as sales of TPP, when no TPP is ever delivered to the customer.

The relationship between technological advance and state tax law is akin to a horse-race where technological advance is a horse named “Lettuce,” which is always leading by a head, the state tax law is a horse named “Tomato,” which is always trying to catch-up, and the state revenue departments are a horse named “Rubber Band,” which is always trying to stretch into the lead. By failing to address how cloud computing should be treated for state sales and use tax laws, the Digital Goods bill dooms the outcome of the horse-race to repeat itself in perpetuity.

The chief problem with the Digital Goods bill is its failure to draw a clear line between when a transaction involves the sale of a digital good and when it involves the sale of a digital service. As noted above, most state sales tax laws are limited to sales of TPP and certain enumerated services. Most state legislatures have not considered whether sales of cloud computing services should be subject to tax so sales of cloud computing services are outside the tax base in most states. For this reason, the state tax administrators are busy issuing interpretations characterizing sales of cloud computing as taxable sales of TPP. This causes uncertainty and litigation.

SoFTEC believes the line of demarcation between a taxable sale of a digital good and a sale of a digital service, not subject to tax in states that have not addressed the issue, is whether the transaction contemplates that the customer will receive a complete copy of a digital good with the right to use it permanently or for a specified period of time. If the customer is to receive no copy of the digital good then the transaction should be characterized as the sale of a digital service. A prior version of the bill contained language that provided the requisite clarity on this point. If the Digital Goods bill were amended to restore this line of demarcation between sales of digital goods and digital services, SoFTEC would support it.

b. Sourcing Hierarchy:

The Digital Goods bill would mandate use of the destination approach to sourcing sales of both digital goods and digital services, an approach SoFTEC prefers for transactions where the seller has a physical presence in the customer's state. The approach taken in the Digital Goods bill generally follows the hierarchical approach taken in the Streamlined Sales and Use Tax Agreement ("SSUTA"). This is where the problem comes in; the final rung in the sourcing hierarchy of both the Digital Goods bill and the SSUTA is next to impossible to apply to sales of both digital good and digital services.

The last rung in the SSUTA's sourcing hierarchy applies when all else fails. This section applies when the seller does not have sufficient information to source the sale using any of the other provisions of the sourcing hierarchy. In such circumstances, the sale of the digital good or digital services is to be sourced to

> the location from which the digital good was first available for transmission by the seller (disregarding for these purposes any location that merely provides for the digital transfer of the product sold), or from which the digital service was provided by the seller.

(Digital Goods and Services Tax Fairness Act, Sec. 7(2)(A)(vi))

This language was taken almost verbatim from Section 310.A.5 of the SSUTA. This section only applies when the seller has no address whatsoever for the purchaser. With respect to cloud computing, we believe resorting to this level of the hierarchy will be rare indeed with respect to business-to-business customers. One scenario, applicable to business-to-consumer sales of cloud computing and possibly common, is where the customer uses and the seller accepts a financial intermediary, such as PayPal, to pay for the transaction. In such cases, the purchaser's address may not be disclosed to the seller.

This leads to an analysis regarding what a seller is to do when sourcing under this provision is required. The first clause of the section, "the address from which tangible personal property was shipped" likely is not applicable because no tangible personal property gets "shipped" in digital goods and digital services transactions. The second clause "from which the digital good or the computer software delivered electronically was first available for transmission by the seller" seemingly could apply in those states that treat cloud computing as the sale of computer software, raising the question what "first available for transmission by the seller" means. The Streamlined Sales Tax Governing Board has issued no guidance with respect to this clause. The Digital Goods bill does provide that it "does not include the location of a server, machine, or device, including an intermediary server, that is used simply for routing or storage." (Sec. 7(2)(B)).

The third clause of the provision requires sourcing to the location "from which the service was provided." This clause should apply in those states that treat cloud computing as the supply of a service. However, most cloud computing service providers maintain multiple data centers from which they provide their service and may not maintain in their books and records the specific data center from which their service was provided at any given time. The

Streamlined Sales Tax Governing Board has provided no guidance on how this provision might apply to cloud computing.

The last clause of provision "disregarding for these purposes any location that merely provided the digital transfer of the product sold" is enigmatic. About the only things we know about the meaning of this parenthetical is was intended to apply to sales of digital goods and it was intended to disregard "ghost servers," whatever that might mean.

We believe this confusing sourcing provision should be replaced with sourcing guidance that is more clear-cut. This will reduce uncertainty for sellers and tax administrators alike. We suggest that in cases where the seller has no address for the customer that would support a decision to source as sale to the state of the address, that the sale be sourced to one of the following locations, so long as the seller uses one of these locations for sourcing all of the sales that fall into this category:

(a) the location where the seller's business has its headquarters,
(b) the location where the seller has the most number of employees, or
(c) a location from which the seller makes digital goods available for electronic delivery or from which digital services are provided electronically.

We believe use of one of these locations should provide an acceptable sourcing result in most cases and suggest that the Subcommittee consider replacing the existing language with something along these lines.

Conclusion:

SoFTEC thanks the Chairman and Ranking Member for the opportunity to subject this statement for the record and looks forward to working with the Subcommittee and its staff as these bills move forward.