

Transcript Prepared by Clerk of the Legislature Transcribers Office  
Revenue Committee April 3, 2019

**FRIESEN:** Welcome, everyone, to the Revenue Committee hearing. I'm Curt Friesen from District 34. I'll be the Chairman today. The committee will take up the bills in the order posted. There's one. We're not gonna go through some of this stuff here. I'd ask you all to please turn off cell phones and electronic devices. If you'll be testifying, please complete the green form and hand it to the committee clerk when you come up to testify. If you have written materials that you would like distributed to the committee, please hand them to the page to distribute. We need 11 copies for all committee members and staff. If you need additional copies, please ask the page to make copies for you. When you begin to testify, please state and spell your name. Please be concise and we will use the lights today, five minutes. I don't think that's gonna be a problem. What else here-- to my immediate left is Mary Jane Egr Edson, is the committee legal counsel. And further over is Kay Bergquist, she is the research analyst. And Grant Latimer over there, is the committee clerk. With that, I will let the committee introduce themselves starting with Senator Kolterman.

**KOLTERMAN:** Senator Mark Kolterman in Seward, representing District 24.

**LINDSTROM:** Brett Lindstrom, District 18, northwest Omaha.

**McCOLLISTER:** John McCollister, representing District 20, central Omaha.

**CRAWFORD:** Good afternoon, Senator Sue Crawford, representing District 45, which is eastern Sarpy County.

**BRIESE:** Tom Briese, District 41.

**FRIESEN:** And we will-- Senator Groene, may join us at some point in time. And with that, we will open the hearing on AM974. Welcome, Senator Linehan.

**LINEHAN:** Thank you, Chairman Friesen. For the record, my name is Lou Ann Linehan, spelled L-o-u A-n-n L-i-n-e-h-a-n. I represent the 39th Legislative District. Today, I am introducing AM974 to LB288, which is my bill dealing with certain income tax changes. It's the placeholder bill. The easiest way to explain this amendment is that it is very similar to what we have already addressed with regard to the remote sellers and sales tax under Senator McCollister's LB284. The only difference is that we are dealing with income tax on corporations that

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do not have a physical presence in the state. Just as we created a threshold for remote sellers without a physical presence to begin, to begin collecting our sales tax, this amendment sets a threshold for corporations without a physical presence to be subject to our income tax. The threshold is set at \$500,000 from the sale or lease or licensing of intangible assets or for providing services to customers in Nebraska. Think in terms of licensing trademarks, trade names, software, or various types of consulting services. Introducing a bill on this subject has been suggested to the Revenue Committee several times, but it wasn't included in any of the bills we heard this session. That's why we're having a special session on-- special hearing on this amendment. We will try to answer your questions. I will try to answer your questions. But there are people that would be more knowledgeable about the specifics that will be testifying behind me. So thank you.

**FRIESEN:** Thank you, Chairman Linehan. Any questions from the committee? Seeing none, proponents who wish to testify in favor of AM974? Welcome.

**STACY WATSON:** Thank you, Chairman. My name is Stacy Watson. It's S-t-a-c-y W-a-t-s-o-n, and I'm testifying on behalf of the GNTC Committee. First of all, I want to thank you. I really appreciate this bill. I think it moves Nebraska forward and will help the states clarify statutes that I think have always been there. I think we've always had the right to tax people. So I think this just really helps clarify that and allows the state to pursue these opportunities to bring monies into our state from these out-of-state entities. I think that the Wayfair Supreme Court decision that you guys have moved forward on the sales tax side, that on the income tax side this is going to help bring parity into both of those worlds. And from a tax policy perspective, I think the more you can link sales tax and income tax. And I believe that the businesses are expecting these types of statutes after the Wayfair decision. So I'm excited that you guys have brought this language forward and that we'll have the opportunity to do that, I think, in a more clear and concise way. The only thing I have passed out is maybe some additional language to add to the bill. And I believe that the Department of Revenue has always felt they've had the full backing of the constitution to tax, to tax companies that are out-of-state in this manner. The reason I'm at-- I would suggest adding the additional languages. I'm on the other side of the table a lot. I'm not always in agreement with the Department of Revenue position. And so when I am on that other side of the table, the

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clearer the statute is the, the less opportunity I have to argue against it or fight about it with someone. If it's clear and concise-- I mean, here you have your \$500,000 in sales, that's pretty clear. For the sales tax side-- you know, it's \$100,000. But when you give us a bright line test in the language that I'm proposing adds even more to that bright line test, when you can slide that across the table to someone and say, OK, these are our rules. We've been clear about them. It's really hard for the person who's arguing against the Department of Revenue to say, oh well, we didn't know that was your rule or we don't plan on following it or what does the full backing of the constitution mean. So I am a taxpayer of the state. And so that's why I like it to be as clear as possible. And that's the only reason I've offered up the additional language. But we are in full support of this amendment to this bill. I don't know if you guys have any questions.

**FRIESEN:** Thank you, Ms. Watson. Senator McCollister.

**McCOLLISTER:** Yeah, thank you, Senator Friesen. And I'd just like to thank you for coming. It's your testimony at an earlier hearing which kind of alerted us to the opportunity to do this. So thank you for your, your, your testimony. I'm very grateful, and I think the state of Nebraska will benefit greatly.

**STACY WATSON:** Oh, thank you.

**FRIESEN:** Thank you, Senator McCollister. Senator Briese.

**BRIESE:** Thank you, Senator Friesen. Thank you for your testimony. The \$500,000 threshold, how and why was that arrived on?

**STACY WATSON:** That's in other state statutes currently. That's what-- other states have used this threshold. And I think that early on-- you know, everybody knew economic presence was kind of coming down the pipeline at the Supreme Court level. And so people were trying to decide what-- what's the best level. Is it \$500,000? Is it the \$100,000 you have in the sales tax bill? I think that's for the committee to decide. But that was kind of what other states had used as their language.

**BRIESE:** OK. But then you're proposing that over 25 percent of the total sales everywhere. And those could be two completely different standards.

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**STACY WATSON:** They could be. And other states use that as well. That's-- you know, it could be a small-- I mean, if you're a smaller business sitting right across the river in Iowa and you put your headquarters over there on purpose and you're selling \$300,000 worth of stuff into our state. But that's 90 percent of your business. That doesn't quite feel fair either. So it's just finding a way to be fair about how we're taxing companies and-- you know, what's the best policy for the state.

**BRIESE:** OK. But it could be a far lesser amount total.

**STACY WATSON:** It could absolutely be a far lesser amount. But 25 percent of someone's sales is significant. So we're trying to find where that significant number is, either a dollar amount or a percentage.

**BRIESE:** OK. Thank you.

**FRIESEN:** Thank you, Senator Briese. Senator Groene.

**GROENE:** When it says-- thank you, Vice Chair. When it says license of services, is that franchise?

**STACY WATSON:** That's franchise, yes.

**GROENE:** Now tell me if I'm wrong, Avon ladies send a fee back to the corporate.

**STACY WATSON:** Correct.

**GROENE:** We're not taxing that now, but now we will?

**STACY WATSON:** I'm assuming you're not taxing it under the current tax structure. I don't know how Avon structured themselves. But yes, that would be a fantastic example.

**GROENE:** The, the headquarters have-- Runza they are probably paying because their headquarters are here.

**STACY WATSON:** Correct.

**GROENE:** McDonald's, we'll pick up.

**STACY WATSON:** Yep, you should pick up their franchise fees and royalty fees that go out of state.

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**GROENE:** Subway, all of those.

**STACY WATSON:** Yep.

**GROENE:** And I don't know what the fiscal note would be, but the estimate is only \$20 million for all that. There's huge-- I mean, you're talking Amway, you're talking all of those.

**STACY WATSON:** Yeah, I'm, I'm not sure how they arrived at the fiscal note, but I think that it will just depend on-- part of it may be where we set the threshold or where the threshold is set, too. If you lower that, do you get more monies? Yeah, I'm not sure how they calculated the fiscal note.

**GROENE:** Threshold is \$500,000. But if you go over it, you pay all the way back to zero.

**STACY WATSON:** Um-hum.

**GROENE:** Thank you.

**FRIESEN:** Thank you, Senator Groene.

**McCOLLISTER:** One more.

**FRIESEN:** Senator McCollister.

**McCOLLISTER:** Yeah, thank you, Senator Friesen. How many states have adopted similar legislation to this AM974?

**STACY WATSON:** Gosh, off the top my head, 10 or 12 is kind of where they're at now. The estimate is that-- you know, everybody's going kind of through their current legislative session. And so what-- you know, you guys have done with the remote sales tax, all other states are doing that, too. And we're expecting pretty much all other states to fall in line from an income tax perspective. Because before I guess states weren't sure whether or not they had permission. I guess if you may want to put it that way from the statutes to tax income in this manner. With the Wayfair decision, it really opens the doors for-- you know, all the states that have an income tax-- you know, to go ahead and have a similar law to their sales tax law and go down this path.

**McCOLLISTER:** But there have been no legal challenges to this specific provision. Correct?

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**STACY WATSON:** So the-- so Iowa has like the Toys R Us case, the Geoffrey Giraffe case-- it wasn't this exact provision but it was similar. They went after the licensing of intangibles. You know, the big giraffe in the state, and Iowa was able to tax those intangibles based on their statute. So they had survived a legal challenge to theirs.

**McCOLLISTER:** How did you develop the legislation? Is this model legislation from what, three or four states?

**STACY WATSON:** Yep. We went and picked out wording from three or four different states to offer it for the legislative committee to draft and decide what they wanted to do.

**McCOLLISTER:** Thanks, again.

**STACY WATSON:** Yeah.

**FRIESEN:** Thank you, Senator McCollister. Any other questions from the committee? So would, would this bill have even been possible before the Wayfair decision?

**STACY WATSON:** You know, I think when market-based sourcing was originally introduced that this was part of that bill in some way, shape, or form. And I think it would-- my understanding is the Legislature was under the impression that there was that ability to tax under that language. Some of this language was removed from that market-based sourcing bill so it made it vague. I think the Department of Revenue believes they've always had the ability to tax it under the-- you know, the constitutionality and how our statutes are written. I just feel like this makes it entirely clear that you do.

**FRIESEN:** So you're-- I mean, obviously when a sales tax issue they, they said they had the authority to start collecting it before we passed any legislation. So I assume that the same thing happened here is there-- they had the authority to collect it but chose not to?

**STACY WATSON:** I, I believe they have the authority to collect it, and I'm not aware of them collecting it.

**FRIESEN:** OK. All right. Thank you. Any other questions from the committee?

**GROENE:** One more.

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**FRIESEN:** Senator Groene.

**GROENE:** Thank you, Vice Chair. Are-- now are these folks paying taxes on this income they derive in Nebraska in the state of their headquarters or they're just not claiming it?

**STACY WATSON:** Some of them may be paying tax and some of them wouldn't be, it depends on their corporate tax structure. But if they, if they are paying tax in their home state, they'll get a credit for the tax that they pay here so they, they won't be double taxed.

**GROENE:** That's what I wanted to know. Thank you.

**STACY WATSON:** But some aren't paying it at all.

**FRIESEN:** Thank you, Senator Groene. Seeing no other questions, thank you for your testimony.

**STACY WATSON:** Thanks, have a great day.

**FRIESEN:** Other proponents who wish to testify? Seeing none, are there any who wish to testify in opposition? Seeing none, anyone wish to testify in a neutral capacity?

**ADAM THIMMESCH:** Good afternoon, Senators. My name is Adam Thimmesch, A-d-a-m T-h-i-m-m-e-s-c-h. I'm an associate professor of law at the University of Nebraska College of Law. Where you might remember, I focus on state and local tax matters. And specifically, federal restrictions on state taxing power. Should note at the outset of my comments reflect my own views, do not necessarily represent the views of the University of Nebraska or the College of Law. I wanted to come over and testify in a neutral capacity today. This is something that I've spent a lot of time researching and writing on and I thought I might be able to provide some background and answer some questions on the provision. As you're probably aware and as you've heard, Nebraska law, the legislation in effect currently seems to already impose tax on the companies that would be subject to tax under this bill. We impose corporate income tax on taxpayers who are doing business in the state. Doing business is defined by reference to what is commonly referred to as the public law, Public Law 86-272. Our statute says, if you're not protected by that public law, we impose our corporate income tax on you. That public law was enacted in the late 1950s after some Supreme Court decisions apprised a very narrow exception from state taxation for companies that do no more than solicit sales of

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tangible personal property in the state. So if you think that the common business model 1950s you send your solicitors across the country, they solicit sales. They send the orders back to the, the headquarters for acceptance or rejection orders fulfilled from out of state. If that's all you're doing in the state, the public law protects you and says that the states cannot impose an income tax on you. So what our, our current statute Department's regulations say we impose corporate income tax on you if you do anything greater than that. And that would include these companies that are licensing or selling intangible goods. So in that way, this particular amendment is, is helpful to clarify. But it also in a sense represents a little bit of a restriction on state law as it currently exists to the extent that it imposes that \$500,000 threshold. It appears to restrict what the state can currently do. So why might you want to enact that? As you've heard, the \$500,000 threshold is in effect in other states. It comes out of the multistate tax commission's model factor nexus standard. A number of states have adopted it. Some have gone lower. I know Michigan, I think, adopted a \$350,000 threshold. Other states have adopted purely qualitative standards. And say, look if you derive income from sources within our state you have to pay the, the income tax. They leave it to the Department of Revenue to determine where, where they want to push and figure out where the constitutional thresholds are. So I think this legislation would be beneficial in that it would clarify the legislative intent to impose the corporate income tax on these businesses. As you've heard, it does help taxpayers. And I've spent a lot of time advising-- you know, in private practice advising taxpayers bright lines are great. They're very helpful. So it'd be helpful in that regard. It would help the Department to know what the standard is. But I think it's worth recognizing that it does in some form represent a restriction on what our statutes currently allow. There was a reference to the 25 percent. That is also a part of the multistate tax commission's model standard. A recognition that, yes, for larger enterprises, if you're over \$500,000 of sales that's appropriate. But for smaller businesses, if you've done-- you know, a quarter of your business in a state it also seems appropriate to impose tax on that basis. So sort of in some, and I'm happy to answer any questions that you might have. I'll spare you the long legal history of the Supreme Court's movements on this. It's very clear to me at this point in time that this would be perfectly constitutional. I think it's been clear since-- you know, between 2005 and 2010 there was a lot of litigation across the country, states had these standards. There was a case in Iowa in 2010-11. The constitutionality of this, especially post Wayfair, is, is very clear.



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The only real question is the, the dollar threshold, and this legislation helps to provide guidance on that. Five hundred thousand dollars is very consistent with what states have done across the country. So I think in a sense this is a good move. It's a good clarifying move. It's helpful to the Department. It's helpful to taxpayers. But worth recognizing that it does in a sense represent a restriction on what the statutes already currently impose and allow the state to do. So with that, it's what I prepared to say, but I'm happy to answer any questions you might have.

**FRIESEN:** Thank you, Mr. Thimmesch. Senator McCollister.

**McCOLLISTER:** Yeah, thank you, Mr. Vice Chair. The first testifier handed out a document. Have you seen this document?

**ADAM THIMMESCH:** I don't think I have.

**McCOLLISTER:** OK. We'll have to give you a copy at some point. As laws evolve on this particular topic, we can certainly amend our existing statute to make it more current or topical with what other states have done like reducing the-- lowering the limit.

**ADAM THIMMESCH:** Sure.

**McCOLLISTER:** OK. Thank you.

**ADAM THIMMESCH:** Yep.

**McCOLLISTER:** Thank you, Professor.

**FRIESEN:** Thank you, Senator McCollister. Senator Briese.

**BRIESE:** Thank you, Vice Chair Friesen. Thank you for your testimony. We could eliminate that \$500,000 dollar threshold and still have no constitutional issues?

**ADAM THIMMESCH:** So eliminating the threshold, then the question would be how far the department in the state were to press this. There is a point at which presumably the Supreme Court would say that the state has overstepped its bounds. If the state were to go after retailers making a dollar of sales into the state, you'd probably face a challenge where the lines are not currently clear. There are a number of states that don't have dollar thresholds. It's a qualitative standard if you do business in the state, if you drive income from sources in the state, if you have a substantial economic presence in

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the state and they leave it to the Department of Revenue and sort of the, the audit and administrative process to figure that out. So sort of a long-winded way of saying, yes, but. It depends on how the statute would actually be administered.

**BRIESE:** OK. And you suggested we're a little more restrictive possibly than existing statutes because if the new language read doing business in the state includes but not limited to these following items that would take care of that. Right?

**ADAM THIMMESCH:** Yeah. So if you-- the, the amendment as, as drafted says doing business includes exceeding the protection of the public law and includes these activities. If you were to say includes but is not limited to certain would certainly leave that possibility open. The downside of that, of course, is you lose that guidance for taxpayers, that bright line threshold. So you know, it depends which hat you want to put on. It certainly provides the most flexibility for the state, for the Department of Revenue. It certainly doesn't raise constitutional issues in my mind. It, it raises administrative issues for the Department and-- you know, takes away that bright line guidance for out-of-state businesses.

**BRIESE:** OK. Thank you.

**ADAM THIMMESCH:** Yeah.

**FRIESEN:** Thank you, Senator Briese. Senator Groene.

**GROENE:** Does this-- what part of this statute-- if I can get back to the page or amendment, would cover Internet sales for sale, lease, or license of services intangible of digital products? So you're not Amazon, but you're selling candles into the state. Does that cover this, the income off of that?

**ADAM THIMMESCH:** So those would be sales of tangible personal property that might be otherwise protected by this public law. So if somebody is doing no more-- they're not doing anything more than soliciting sales of tangible personal property, the public law could protect them still. It depends on how they structure their operations. What this is more specifically aimed at would be somebody selling digital property into the state, digital downloads, things of that nature, intellectual property, franchising relationship, software.

**GROENE:** Norton and there-- has to pay us now.

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**ADAM THIMMESCH:** Right. Other cases, other situations that have been litigated across the country have been credit card companies deriving millions of dollars of interest fees.

**GROENE:** This doesn't include getting on the Internet and ordering a boat or something.

**ADAM THIMMESCH:** Yeah. So sales of tangible personal property, you would still have to do the analysis under that public law. That's a congressionally imposed restriction on state taxing power. This wouldn't change that. And so you'd have to analyze the specifics of that particular business and how they are selling that tangible personal property.

**GROENE:** Because you would collect the sales tax now and the income generated by that-- if they sold enough.

**ADAM THIMMESCH:** So the sales tax might be covered by the recent change. The income tax you really-- that's where, because of this public law, states have to look more specifically at the structure of a particular business's operations. Chances are that many vendors are still going to structure their operations to be protected by the public law if they're doing no more than selling tangible personal property.

**GROENE:** And that's due to interstate commerce or--

**ADAM THIMMESCH:** That's-- well, that's a congressional enactment under its commerce clause power from the 1950s. It's, it's still kicking along. Congress hasn't really talked about or considered changing that. So states are still limited by that Public Law 86-272. It still does restrict the state's power over sales of tangible personal property. So what this bill really gets at--

**GROENE:** So, so we can't tax the income Amazon makes off their sales under the state, we can only put sales tax on it.

**ADAM THIMMESCH:** So whether--

**GROENE:** The, the margins and profits.

**ADAM THIMMESCH:** Yeah. So whether the state can tax the income of an entity like an Amazon depends on whether they are protected by the public law or not, whether they do more than merely solicit sales in

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the states. So if you have a warehouse here, if you're selling other products so Amazon does a large number of services.

**GROENE:** Um-hum.

**ADAM THIMMESCH:** Those types of activities would not be public law protected. Those types of businesses could be subject to the state income tax. It's only those businesses that have structured themselves to do no more than send their sales people into the state, solicit sales of tangible personal property, they send the orders back to headquarters for acceptance or rejection and fulfillment. So it's more complicated than we might like. But those businesses, old school tangible personal property sales still governed by the public law services intangibles, things of that nature, governed by this economic nexus construct.

**GROENE:** Thank you.

**ADAM THIMMESCH:** Yeah.

**FRIESEN:** Thank you, Senator Groene. Any other questions from the committee? Senator Kolterman.

**KOLTERMAN:** So do you do private practice as well as teach?

**ADAM THIMMESCH:** Not currently.

**KOLTERMAN:** OK. I was gonna suggest you send a bill to Senator Groene. [LAUGHTER] All this free advice you're giving him.

**GROENE:** For the better good of the committee.

**FRIESEN:** Thank, thank you, Senator Kolterman. So again, under our current statutes as you read them, do you feel we have the ability to collect this tax without any passage of statutes or regulation?

**ADAM THIMMESCH:** Yes. Yeah. The current law says that we impose the corporate income tax on any business that exceeds the protections of the public law.

**FRIESEN:** OK. Seeing no other questions from the committee, thank you very much for your testimony.

**ADAM THIMMESCH:** Thank you.

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**FRIESEN:** Any others who wish to testify in a neutral capacity? Seeing none, Senator Linehan, do you wish to close?

**LINEHAN:** I'd like to thank everybody that came to testify. Appreciate it very much. And thank you for using part of your short noon hour, for being here. So I think you have good questions, Senator Briese. All of you will have to Exec and see what we think.

**FRIESEN:** Any questions from the committee?

**LINEHAN:** [INAUDIBLE]

**FRIESEN:** Senator McCollister.

**McCOLLISTER:** Yeah, what bill will this amendment be attached to?

**LINEHAN:** We're attaching it to the income tax placeholder bill.

**McCOLLISTER:** OK. Thank you.

**FRIESEN:** I think we didn't have any letters for the record. So with that, we'll close the hearing on AM974.

**LINEHAN:** Thank you.