Chairwoman VELAZQUEZ. Thank you, Mr. Godwin.

Our next witness, Mr. Steven Joost, is the Chief Financial Officer for Firehouse Subs, headquartered in Jacksonville, Florida. Firehouse Subs has been in business for 13 years and operates over 300 restaurants across 14 states.

Mr. Joost is testifying on behalf of the International Franchise Association. IFA represents franchisors, franchisees, and suppliers throughout the world.

Welcome, sir. You have five minutes.

Mr. JOOST. Thank you.
Mr. JOOST. Thank you, members of Congress, ladies and gentlemen, for allowing me to testify before your Committee today. Again, my name is Steven Joost. I am the Chief Financial Officer and principal in Firehouse Subs. I am also a Florida C.P.A. and a member of the city council in Jacksonville, Florida.

We have 312 restaurants operating from Las Vegas, Nevada to right here in Washington, D.C. We started in Jacksonville, Florida 13 years ago. Through our franchising efforts we employ over 5,000 people and have achieved the national sales level of over $200 million. Firehouse has helped numerous employees, franchisees, and area representatives achieve their American dream. And yes, some have become very wealthy.

On the national level, franchising also has made a tremendous impact on the economy and the entrepreneurial spirit of Americans. According to a 2008 International Franchise Association Educational Foundation study conducted by PricewaterhouseCoopers, there are over 900,000 franchised businesses currently operating in the United States, employing over 21 million workers. This is responsible for $2.3 trillion in annual economic output.
During that time, over the last 13 years, we have come across various impediments to our growth. There are the usual ones: products, competing for real estate, competing for employees. These are all natural impediments that every business competes for. And we work very hard to outwork our competitors.

However, there have been many artificial barriers, complexities, and tax traps that have been created by government that have hurt my business over the years that have led to unwarranted expenses and wasted money. I am here today to help explain what myself and my company have been through and to add suggestions as to how you may be able to help.

One of the more perplexing problems facing a growing business is that of interstate commerce. Of course, as you are well-aware, with our federal system of government, each state is allowed to make its own laws. This has led to the implementation of many different laws with many different standards.

Examples are differing disclosure requirements for our disclosure documents, differing sales tax methods and rates, differing income tax laws and application thereof, just to name just a few. These differing laws and standards upon which they are applied have necessitated my company to hire a plethora of tax accountants and lawyers to help us comply
with the regulations, file the various tax returns and
documents that each state requires. We have to employ various
strategies to help limit our liabilities. And sometimes,
quite frankly, I wonder what business I am in.

One of the more disturbing problems created by
governments is that of state income taxes and franchise
taxes. As economic growth has slowed, so has state revenue
growth. According to Allison Grinnell of the Rockefeller
Institute, when adjusted for inflation, state revenue
actually dropped .6 of a percent. So, therefore, the squeeze
is on for the states to find more money to help them fund
their budgets.

One of the ways they do this is through nexus. Very
simply, nexus is a connection. It means connection. Certain
activities, as insignificant as they may seem, may establish
a nexus.

A company may have unknowingly had nexus with a state
for many years. It might even be responsible for back sales
tax, franchise tax and/or income taxes, penalty and interest
for past years.

Examples of creating nexus that an ordinary person would
never think of are having a sales representative just solicit
business, traveling for a meeting within a state, traveling
to inspect a store, or even the mere just asking for somebody
for their business in a state can trigger nexus. It depends
which state you’re in and which 50 rule is being applied to
you.
And then, worse yet, the nexus standards between states
vary widely and wildly. Furthermore, the nexus standards
within a state within different years can change depending on
who the latest administration comes in and who is
interpreting the law.
For example the nexus standards for franchise taxes are
much broader than they are for income taxes. This means a
company that could be exempt from paying income taxes in a
certain state and think they’re home free, all of a sudden,
gets a bill for paying a franchise tax liability if they do
business in that state depending on how nexus is defined.
Each state has its own department of revenue and
interpretations on how the laws are applied change. Once a
nexus is established, then the states get into the game of
apportionment. Apportionment is the formula to figure out how
much income is attributable to a specific state’s income tax.
Apportionment rules are often changed by the individual
states to help them garner advantage over other states.
Currently, my view on the subject matter is the way
states are imposing burdensome rules and changing them every
year is an unfair tax on intellectual property rights. And,
secondly, it has created a subsidy for lawyers and
accountants.
I believe the fact that the whole Firehouse concept was created in Jacksonville, Florida—okay? And in its very essence, royalty is paid for our trademarks and the fact that our property is in Jacksonville. I helped create it. I spent 13 years creating it. You know, our business model, our trademarks, our marketing all is created in Jacksonville. And, in essence, a royalty is rent for these trademarks.

So if I own a piece of property in Jacksonville, Florida, why, in essence, am I paying property taxes in all of these other states? It’s beyond me.

So I believe these rules have created an unintended attack on the franchise business. While I am not and my company is not opposed to paying taxes, what we are opposed to is spending hundreds of thousands of dollars to figure out how to do it because we have to hire an army of accountants and lawyers to do so.

What is needed and what I would recommend is either to get rid of nexus or at least apply a single set of rules defining what constitutes nexus and how it will be applied in a uniform manner in all 50 states so when I go into a mine field I at least know where the mines are.

Chairwoman VELAZQUEZ. Mr. Joost, your time is up.

Mr. JOOST. Okay.

Chairwoman VELAZQUEZ. Okay? So during the question and answer period, you will be able to expand on how you feel we
can--
Mr. JOOST. Thank you for hearing me out today. I appreciate it.
[The prepared statement of Mr. Joost follows:]

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Chairwoman VELAZQUEZ. --in the question and answer period. Thank you. Mr. Joost, I would like to address my first question to you. Mr. JOOST. Sure. Chairwoman VELAZQUEZ. You mentioned that certain states have been especially aggressive in attempting to collect business activity taxes from your firm. Have you scaled back operations in these states? And how has this affected the economics of your business? Mr. JOOST. To answer your first question, yes. Specifically I'm not trying to point fingers, but the State of South Carolina comes to mind. Just the fact that we have stepped foot in that state creates what they call a nexus. And now they want part of our income tax, state income tax. While it has not scaled back our activity per se, it does cost us money and, therefore, lowers our profit margins. At the end of the day, you just look at it. And it's the cost of doing business. And what happens, what we have done in our company since we started our company 13 years ago, we did not take a dividend for ten years. We put every dollar and dime we made back into our business. So theoretically answering your question because now we don't have as much money to put back into our business and
Chairwoman VELAZQUEZ. Do you believe it is possible to establish a clear standard that would allow businesses to know that if they do X, Y, or Z in a state, that that will be subject to that state's taxing regime?

Mr. JOOST. Absolutely. And I think the Committee right here is going to do it.

Chairwoman VELAZQUEZ. Thank you.

Mr. Petricone, those in favor of business activity taxes argue that these taxes broaden the tax base and allow for lower taxes for locally owned businesses. What is your reaction to the criticism that a clear jurisdictional standard will limit the tax base to only those in state companies? How would you respond to those who argued that this could lead to higher taxes for local small businesses?

Mr. PETRICONE. Thank you, Madam Chairman.

First of all, I would take issue with any notion that this approach would lead to an aggregate lowering of taxes on businesses because the businesses will still be paying the taxes in the state where they are domiciled.

Beyond that, I think certainly there in any way range of factors that affects any given state's tax revenues at any given time. But I do keep coming back to what I believe is a basic principle of fairness that if a company is not domiciled in a state and does not have a presence in that
Mr. JOOST. Thank you for asking that question.

Going back to the Madam Chairwoman’s question, while you can’t say there is necessarily a direct correlation because you have incurred these higher costs, intuitively you know there is an opportunity cost. 

Like for my company, for example, going back to the fact that we did not pay dividends for the first ten years of our existence, we constantly put the money back in our company, growing company stores, hiring people to build the foundation so we could start our franchising operation.

So, just intuitively, if you know the fact that you don’t have as much money to reinvest in your company, you can’t go out and hire more people. You can’t go out and get more franchisees. And you can’t go out and create more jobs. So there are opportunity costs there. Whenever you impose higher costs on these companies, the opportunity is gone to invest that money to create more jobs and create an economic multiplier.

Mr. CHABOT. Thank you.

Dr. Johnson, those states that are most aggressive in pursuing these types of taxes, do you have an opinion as to whether the ultimate business activity in that state would, in all likelihood, be suppressed in some manner? In other words, those states that are taxing higher, do businesses take their business elsewhere or avoid those states, if
we're paying to are a burden, but it's not a huge burden. My fear is that when it gets to 50 states, that it will be a huge burden and we will have 5 or 6 people on our staff just to deal with the technicalities.

Mr. JOOST. I would also like to comment. I am not so much against the taxes. It is literally we have paid accountants and lawyers hundreds of thousands of dollars to figure out how to comply with the laws. I don't mind paying taxes. I just hate paying an army of people to figure out how to do it. If I could just simplify it even, it would save us a ton of money just from a compliance level.

Mr. AKIN. Thank you, Madam Chair.

Chairwoman VELAZQUEZ. Mr. Chabot, do you have any questions.

Mr. CHABOT. No. Thank you.

Chairwoman VELAZQUEZ. I have two questions. Dr. Johnson, one of the concerns related to a potential qualification of physical presences, that it would lead to tax avoidance or tax sheltering by corporations. For instance, a business located in one state could diversify its operation and have entities operating in another state, thus creating a tax shelter. Would enactment of a physical presence standard or any other standard lead to another round of tax planning and tax avoidance, causing states' revenue streams to erode further?
additional sales and the 44,000 jobs, which would be
necessary to support that additional demand, is something
everybody should be taking very, very seriously in this
period.

Mr. DAVIS. Anyone else want to speak to that?

Mr. JOOST. In our business, in each city, we have seven
pricing tiers. For example, in Orlando, which is more
expensive to do business, say, than Jacksonville or some of
our other cities because of economic factors and one of them
is local taxation, the people in Orlando pay a dollar more
for the same product than they do in Jacksonville because the
cost of business is higher. Any time you make the cost of
business higher, at some point you’ve got to pass it on to
the consumer.

So to break it down in my world, I can see directly
because of all of the different pricing tiers we have to
have, where it costs more to do business, people pay more.

Mr. DAVIS. Anyone else? Mr. Godwin?

Mr. GODWIN. I would like to say that right now the
boating industry in America is down. It is already soft. So
we can’t really pass along additional costs to our dealership
network because boats are a luxury, a pleasure item. And so,
you know, we can’t pass that cost. The boating industry is
down.

In looking forward, you know, we want to keep people
having the ability to come in and buy these boats. And if we
continue to shift the cost down to them, they’re not going to
be able to get into boating.

So thank you.

Mr. DAVIS. Just to follow up on that, then, on the other
side, if you can’t increase the cost to the consumer, you’re
probably going to have to put it on your employees. And you
potentially have a loss of jobs. Is that--

Mr. GODWIN. That is very true, very true.

Mr. JOOST. Or stop paying their health care.

Mr. ROLSTON. Yes. We are in the same situation. We have
a nationwide pricing. So we can’t pass it on to the consumer
in a particular market because that market is more expensive
for us. So any abnormalities we have to eat. And then that
affects our profitability and essentially our employment.

Mr. DAVIS. Well, my time is up. I would just say I have
always believed that you can’t tax and regulate yourself into
prosperity. And I think that is what I hear you saying.

I yield back. Thank you.

Chairwoman VELAZQUEZ. Thank you.

I want to thank all of the witnesses. Clearly this is a
complex and important issue for small businesses when it
comes to interstate commerce and BAT. What I intend to do is
to send a letter to the Judiciary Committee commenting on
this issue so that they could keep the small business