

## Members of Congress, Ladies and Gentlemen

Thank you for allowing me to testify before your committee today. My name is Stephen Joost. I am the Chief Financial Officer and Principle in Firehouse Restaurant Group, Inc. otherwise known as Firehouse Subs. Firehouse Subs is an emerging national chain of sandwich shops. Currently we have 312 restaurants operating from Las Vegas Nevada to Washington D.C. We started in Jacksonville Florida 13 years ago. Through our franchising efforts we employ over 5,000 people and have achieved national sales of over \$200 million. Firehouse Subs has helped numerous employees, franchisees and area representatives achieve their American Dream and yes, some have become very wealthy. On the national level, franchising has also 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 909,000 franchised businesses in the United States, employing 21 million workers (directly and indirectly), responsible for \$2.3 trillion in annual economic output.

However, during that time, we have come across some serious impediments and challenges to our growth. There are always the usual impediments to growing a business such as competitors coming out with a better product, access to capital, real estate locations, paying competitive wages...etc. However, there have been several artificial barriers, complexities and tax traps 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 can help.

One of the more perplexing problems facing a growing business is interstate commerce. With our system of federal government and independent states, each state is allowed to create its own laws.

This has led to the implementation of many different laws with many different standards. Examples are differing disclosure requirements in our disclosure documents, differing sales tax methods and rates, and differing income tax laws and application thereof 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 each state requires, and to help us employ various strategies to limit our liabilities. Sometimes I wonder what business I am in.

One of the more disturbing problems created by state 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, state tax revenue totaled \$147 billion in the third quarter of 2007 — a 4.4 percent increase over the 3rd quarter of 2006. However, when adjusted for legislated tax changes and inflation, total state tax revenue declined by 0.6 percent. Therefore, many states are looking for money. One of the ways they do this is through state income taxes and by taxing corporations who are not located in their state through a mechanism called nexus.

In its simplest form, Nexus means a connection. Certain activities, as insignificant as they may seem, may establish nexus (a connection with a state that subjects you to its tax laws). 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 not think of are having a sales representative solicit business in a state, traveling for a meeting with franchisees in a state, traveling to inspect a store, even the mere solicitation of business in a state without having ever entered the state can trigger nexus rules.

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Worse yet, the nexus standards between states vary widely, and wildly. Furthermore, the nexus standards within a state can also vary depending on what tax is being imposed. For example the nexus standards for franchise taxes can be much broader than they are for income taxes. This means that companies that could be exempt from paying income taxes in a certain state may have a franchise tax liability if they do business in that state depending on how that state defines nexus.

Furthermore, since each state has its own departments of revenue, interpretations on how the laws are applied can change.

Once a nexus is established, states also get into the game of apportionment. Apportionment is a formula to figure out how much income is attributable to a specific state's income tax. These apportionment rules are often changed by the individual states to help them garner an 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, first it is an unfair tax on intellectual property and secondly it has created a subsidy for lawyers and accountants. The fact that the whole Firehouse Subs concept was created in Jacksonville Florida and the fact that franchisees pay us a royalty for the use of our name, our products, our training and methods of operation should not involve other states. All the intellectual property, trademarks, and business practices were created in Jacksonville. When people pay us for the use of this property, that is the essence of franchising. I have not heard of other states taxing the real physical property of other states and yet while intellectual property can not necessarily be consumed or touched, it is none the less of the same and sometimes more value than real physical property.

I believe these rules more specifically have created an unintended attack on the franchise business. While I know I am not, nor my company is opposed to paying taxes, we are opposed to having to

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spend 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 it. What is needed, and what I would recommend is a single set of rules defining what constitutes nexus and how it will be applied in the 50 states. More importantly, nexus should be defined in a more conservative and common sense way than is being commonly applied today. The fact that if I merely step foot in a state creates a taxing event is incredulous. Even at the end of the day, if I did not agree with your definition of nexus, that fact that there was one standard applied across the country would be a great relief to myself, my company and to the franchise world.

Thank you for hearing me out today. I hope my testimony has helped shed some light on this very important topic. If you have any questions I will be happy to answer them.