Considerations for Creating a Gross Receipts Tax

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we've worked for
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on objective
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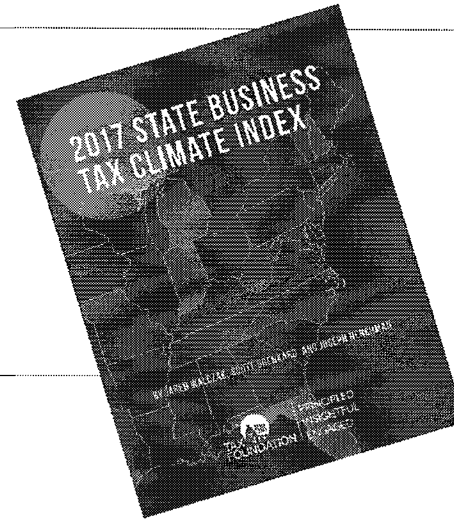

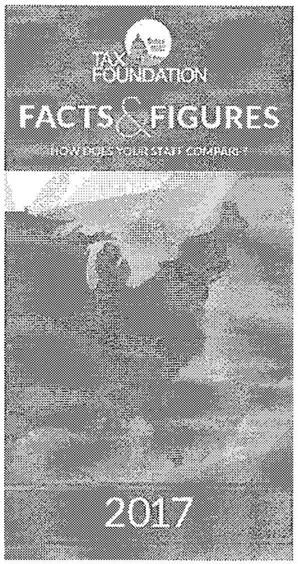

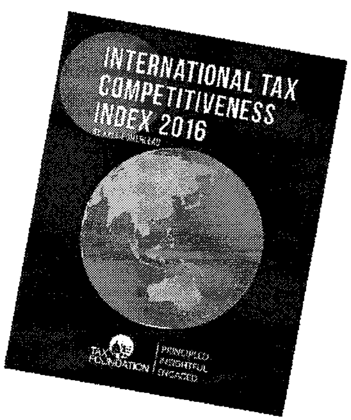

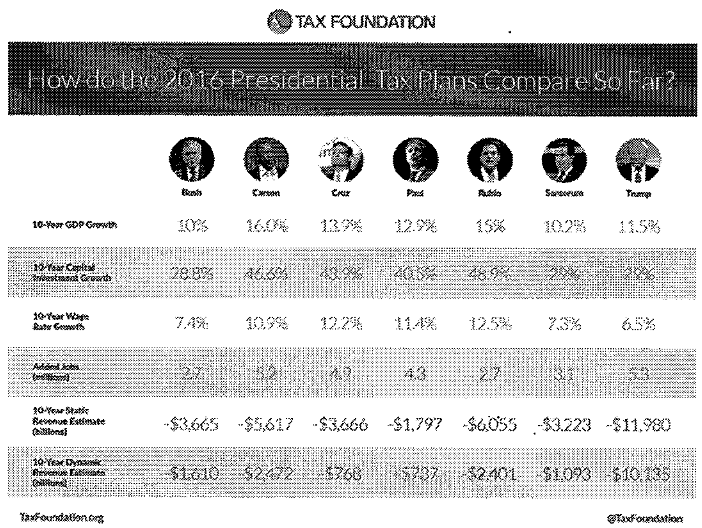
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How do the 2016 Presidential Tax Plans Compare So Far?

	Bush	Carson	Cruz	Paul	Rubio	Santorum	Trump
10-Year GDP Growth	10%	16.0%	13.9%	12.9%	15%	10.2%	11.5%
10-Year Capital Investment Growth	28.8%	46.6%	43.9%	40.5%	48.9%	29%	29%
10-Year Wage Rate Growth	7.4%	10.9%	12.2%	11.4%	12.5%	7.3%	6.5%
Added Jobs (millions)	2.7	5.2	4.9	4.3	2.7	3.1	5.3
10-Year Static Revenue Estimate (billions)	-$3,665	-$5,617	-$3,666	-$1,797	-$6,055	-$3,223	-$11,980
10-Year Dynamic Revenue Estimate (billions)	-$1,610	-$2,472	-$768	+$737	-$2,401	-$1,093	-$10,135

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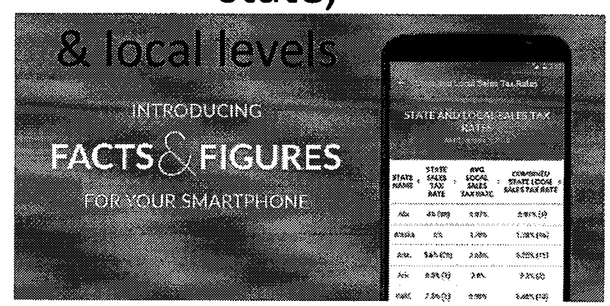


AGENDA

GROSS RECEIPTS TAXES

- The Structure of Gross Receipts Taxes
- History of Gross Receipts Taxes in the United States
- States with Gross Receipts Taxes
- Gross Receipts Tax Structural Elements
  - Rates
  - Tax Thresholds
  - Deductions and Exemptions
  - Nexus
  - Closely-held Firms
- Gross Receipts Tax Creation and Oregon's Experience

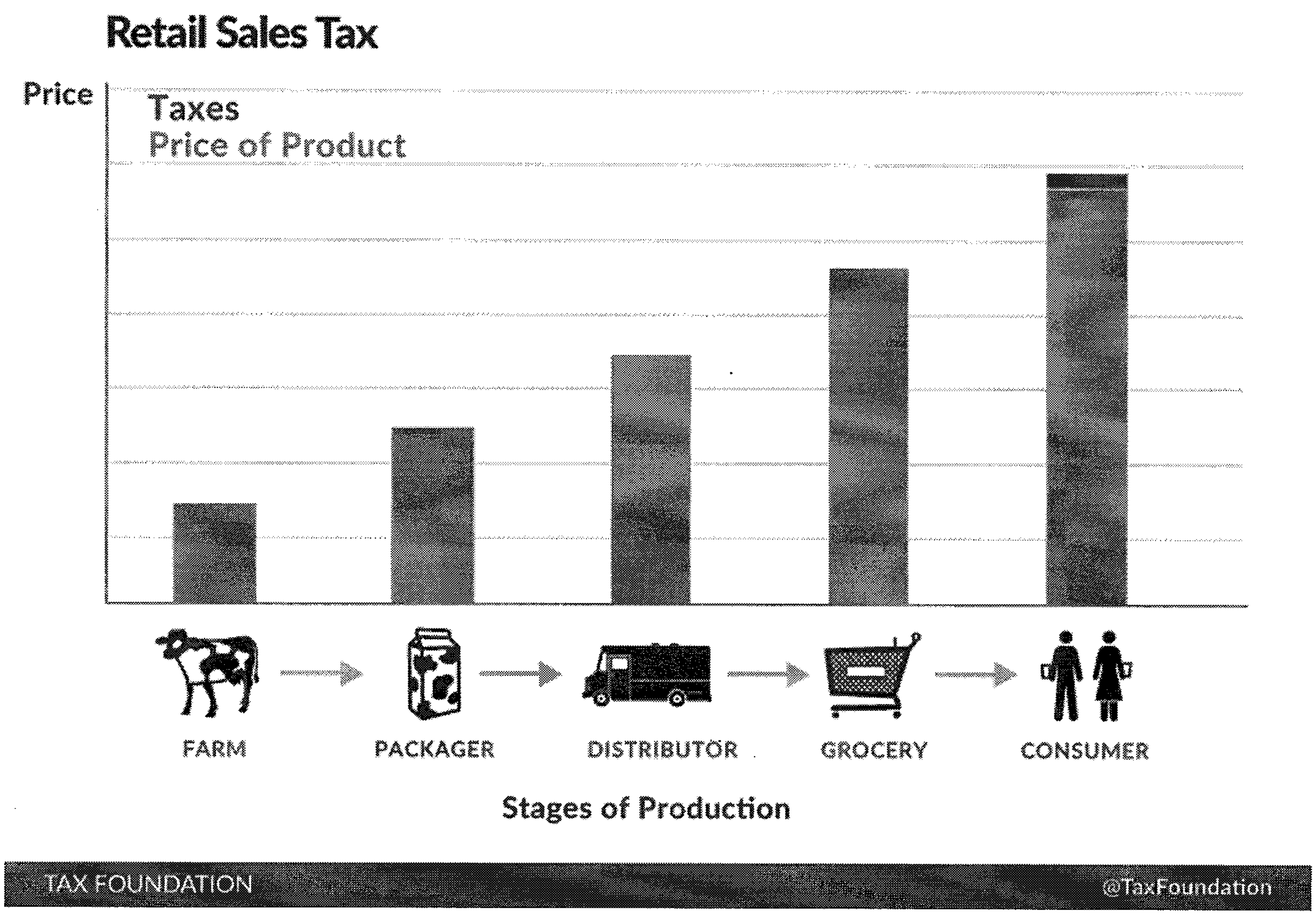
GROSS RECEIPTS TAXES

ECONOMIC IMPACTS

- A gross receipts tax is a tax “levied against the receipts of a sale that results in a change of ownership.”
- Gross receipts taxes fail on numerous measures of sound tax policy, such as neutrality, efficiency, and transparency.

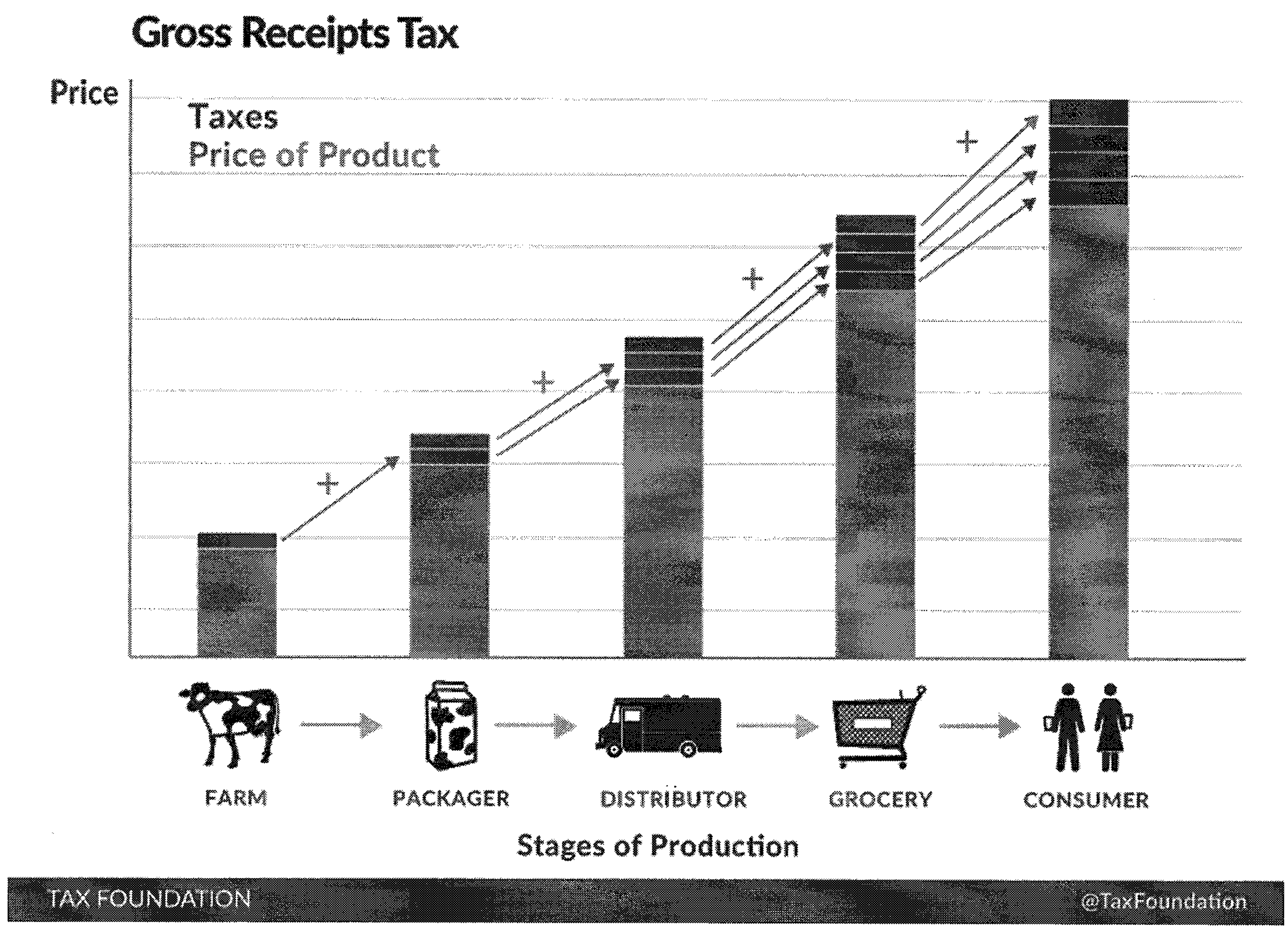
GROSS RECEIPTS TAXES

TAX PYRAMIDING



GROSS RECEIPTS TAXES

TAX PYRAMIDING



GROSS RECEIPTS TAXES
IMPACT OF PYRAMIDING

- Pyramiding affects industries differently. Those with longer production cycles, such as retail or manufacturing, are affected more.
- This encourages firms to vertically integrate even if not economically efficient.
- Gross receipts taxes harm firms with small profit margins.
- Coupled together, these items make gross receipts taxes nonneutral.
- The taxes are then shifted either forward or backward, depending on a variety of factors.

GROSS RECEIPTS TAXES
IMPACT OF PYRAMIDING

- Additionally, gross receipts taxes are not transparent.
  - The taxes are not specifically enumerated on a receipt.
  - The pyramiding is also not evident to the consumer.

GROSS RECEIPTS TAXES
HISTORY OF CREATION

- Gross receipts taxes are an old style of tax, dating to at least the 14th century.
- They were used frequently by states prior to and during the Great Depression, but quickly lost favor in exchange for retail sales taxes.
- By the 1980s, only four states had gross receipts taxes: Delaware, Indiana, Washington, West Virginia.
- By the 2000s, only Delaware and Washington retained their taxes.

GROSS RECEIPTS TAXES
HISTORY OF CREATION

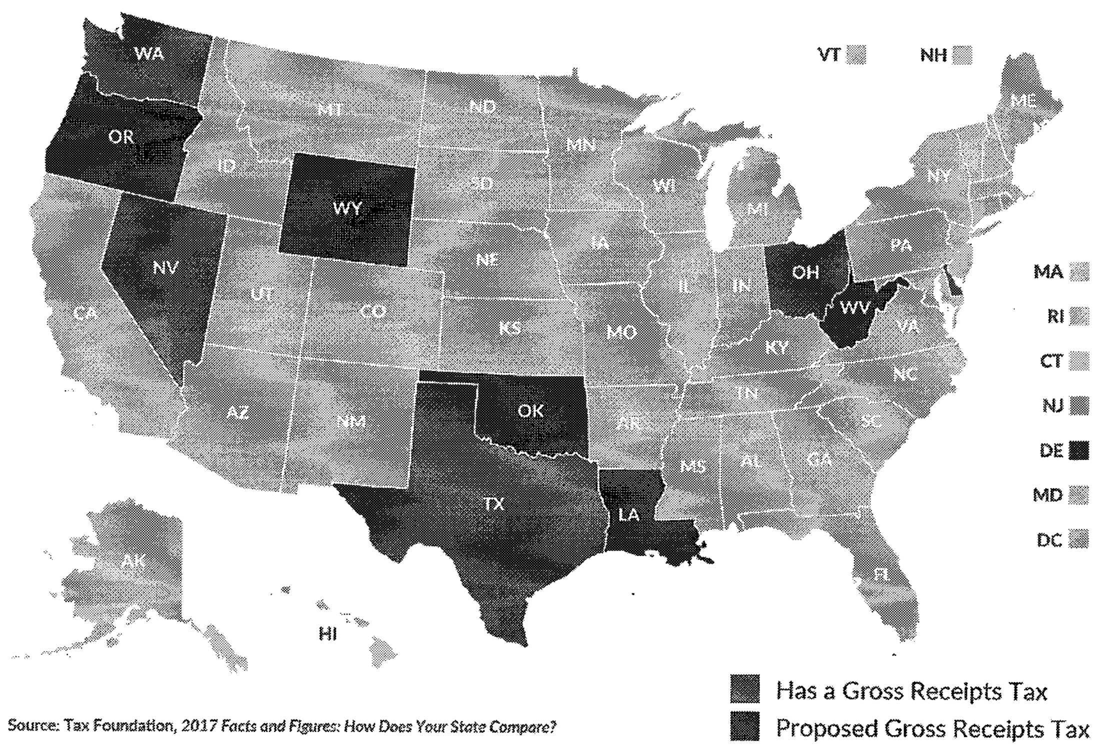
- The mid-2000s saw a flurry of activity. Kentucky, New Jersey, Ohio, and Texas all created gross receipts taxes, but Kentucky and New Jersey quickly repealed theirs.
- Nevada created a gross receipts tax, known as the Commerce Tax, in 2015.
- Since 2016, five other states, Louisiana, Oklahoma, Oregon, West Virginia, and Wyoming, have had legislative consideration of a gross receipts tax. California could be joining that list in 2018.

GROSS RECEIPTS TAXES

STATES WITH GROSS RECEIPTS TAXES

Very Few States Employ Gross Receipts Taxes

Statewide Gross Receipts Taxes, May 2017



Source: Tax Foundation, *2017 Facts and Figures: How Does Your State Compare?*

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GROSS RECEIPTS TAXES
STRUCTURAL ELEMENTS

- The remainder of my presentation will focus on the various structural considerations policymakers face in creating a gross receipts tax.

GROSS RECEIPTS TAXES
SETTING RATES

- Setting the rate of a gross receipts tax is the first important question for policymakers.
- Gross receipts taxes tend to have much lower rates than other types of taxes, such as sales tax. Rates tend to be below 1.5 percent.
- Ideally, a gross receipts tax would level one economy-wide rate, but only Ohio follows this approach.
- States take a variety of approaches on how to structure their rates, mostly trying to minimize pyramiding by setting differential rates.

GROSS RECEIPTS TAXES
SETTING RATES

- Delaware: Rates vary from 0.0945 to .7468 percent
- Ohio: 0.26 percent
- Nevada: Rates vary from 0.051 to .331 percent
  - 25 rates in total
- Texas: Two rates
  - Retail and wholesale: 0.375 percent
  - All others: 0.75 percent
- Washington: Rates vary from 0.13 to 3.3 percent
  - 35 rates in total

GROSS RECEIPTS TAXES
SETTING RATES

NAICS Category	INDUSTRY	Tax Rate
11	Agriculture, Forestry, Hunting	.063%
21	Mining, Quarrying, Oil and Gas Extraction	.051%
22/517	Utilities and Telecommunications	.136%
23	Construction	.083%
31-33	Manufacturing	.091%
42	Wholesale Trade	.101%
44-45	Retail Trade	.111%
481	Air Transportation	.058%
484	Truck Transportation	.202%
482	Rail Transportation	.331%
483, 485-488, 491-492	Other Transportation	.129%
493	Warehousing and Storage	.128%
511, 512, 515, 518	Publishing, Software, Data Processing	.253%
52	Finance and Insurance	.111%
53	Rental & Leasing	.25%
54	Professional, Scientific or Technical Services	.181%
55	Management of Companies and Enterprises	.137%
561	Administrative and Support Services	.154%
562	Waste Management and Remediation Services	.261%
61	Education Services	.281%
62	Health Care and Social Assistance	.190%
71	Arts, Entertainment and Recreation	.24%
721	Accommodations	.20%
722	Food Services and Drinking Places	.194%
81	Other Services	.142%
Unclassified	Unclassified Business	.128%

GROSS RECEIPTS TAXES
TAX THRESHOLDS

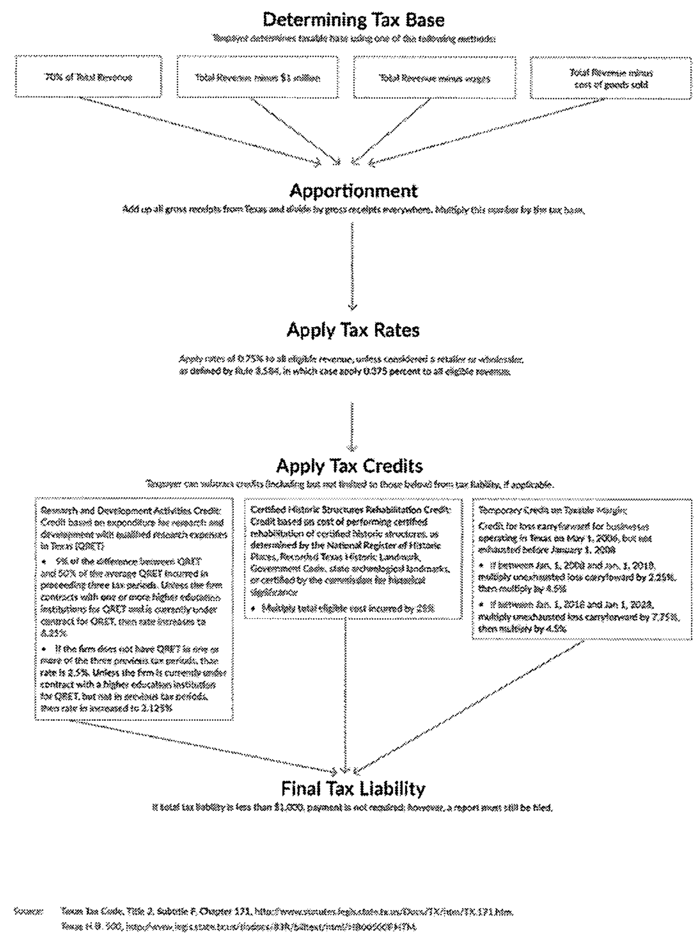
- The next important question is determining at what level of receipts would the tax apply.
- Delaware: Exempts between $100,000 and $1.25 million in monthly receipts
- Ohio: Exempts the first $4 million in annual receipts
  - There is a tiered fee structure below $4 million with fees between $150 and $2,100.
  - Nevada does something similar.

GROSS RECEIPTS TAX
DEDUCTIONS AND EXEMPTIONS

- Traditionally, a gross receipts tax would not have deductions for various costs, but here again, states vary. The most notable is Texas, with its Margins tax.

GROSS RECEIPTS TAX
DEDUCTIONS AND EXEMPTIONS

- Figure 1. Texas Margin Tax Liability Calculation



GROSS RECEIPTS TAX
DEDUCTIONS AND EXEMPTIONS

- Other possible exemptions:
  - Nonprofits
  - Government transactions
  - Financial institutions
  - Pass-throughs
  - Bad debts

GROSS RECEIPTS TAX
NEXUS

- Determining nexus is also required to create a gross receipts tax.
- In general, states apply taxes to those engaging in intrastate commerce.
- In *Complete Auto v. Brady*, the U.S. Supreme Court held that nexus must meet a four-part test:
  - Have substantial nexus with the taxing state,
  - Be fairly apportioned to activities carried out by the taxpayer within the state,
  - Not discriminate against interstate commerce,
  - Be fairly related to the services the state provides
- States must also consider internal consistency.
  - If every state adopted the same approach, would it burden interstate commerce?

GROSS RECEIPTS TAX

NEXUS

- Washington: The state uses both physical presence and economic nexus. Economic nexus is a four-prong test.
  - More than $267,000 in gross receipts in WA
  - More than $53,000 in payroll in WA
  - More than $53,000 in property in WA
  - At least 25 percent of their total property, payroll, or receipts are in/from WA

GROSS RECEIPTS TAX
NEXUS

- Ohio: Ohio uses a similar nexus standard.
  - More than $500,00 in taxable receipts in Ohio
  - More than $50,000 in property in Ohio
  - More than $50,000 in payroll in Ohio
  - Have at least 25 percent of their total payroll, property, or receipts in/from Ohio
- This standard has been subject of multiple court challenges, notably *Crutchfield v. Testa*, *Newegg v. Testa*, and *Mason Companies v. Testa*.
- In both Ohio and Washington, a firm has nexus without any physical presence in the state.

GROSS RECEIPTS TAX

NEXUS

- Similar to nexus, the state would need to consider situsing rules for service-based industries.
  - Would the state adopt something similar to market-based sourcing or cost of performance?

GROSS RECEIPTS TAX
CLOSELY-HELD FIRMS

- States must consider how to handle transactions involving closely-held firms.
- Do transfers within a combined group count as a receipt, or are receipts reported on a unitary basis?
- Ohio, for instance, allows for unitary filings.
- Washington, however, tends to not allow deductions for related transactions.

GROSS RECEIPTS TAX
OREGON'S EXPERIENCE

- Following the failure of Measure 97 in November, the state continued to explore creating a gross receipts tax, led by Senator Mark Hass.
- In May, the legislature created a Joint Committee for Tax Reform to investigate options.
- Their goal was twofold: generate additional revenue for Oregon and add stability to their revenue streams.

GROSS RECEIPTS TAX
OREGON'S EXPERIENCE

BUSINESS TAX REFORM

FRAMEWORK

- Guiding Principles
  - Broad base and low rates to minimize economic distortions.
  - Destination based tax to keep export businesses competitive.
  - Simplify business taxes by repealing complex corporate income tax and replacing with one page corporate activities tax form.
  - Maintain balanced treatment for different business entities by allowing partial credit for pass-throughs.

- Establish corporate activities tax 1-1-18
  - Based on gross receipts derived from destination based sales in Oregon.
  - All business entities are subject to the corporate activities tax.
  - Business entities with annual gross receipts less than $150,000 in Oregon are not required to file a corporate activities tax return.
  - Businesses with gross receipts greater than $150,000 but less than $1 million must file a return and pay a $250 flat amount.
  - Businesses with annual Oregon gross receipts greater than $1 million are subject to a corporate activities tax equal to $250 plus _____% of gross receipts greater than $1 million.
  - Financial institutions are subject to the corporate activities tax with the definition of gross receipts in Oregon determined by rule.
  - Gross receipts derived from the sale of motor fuel is calculated separately with the revenue placed in the Highway Fund.

- Exemptions from the Corporate Activities Tax
  - Government transactions.
  - Donations received by non-profit organizations.
  - Transactions among closely related business entities.
  - Gross receipts of qualified distribution centers.

- Credits
  - Pass through entities are allowed a credit equal to ______% of corporate activities taxes paid at the entity level.

- Repeal of Corporate income tax starting with 2018 corporate tax year
  - Unused corporate tax credits can be applied to corporate activities tax liability and carried forward up to three years.

- Tax Base Description
  - Estimated businesses below $150,000 threshold=100,000
  - Estimated number of filers paying $250 flat amount=37,000
  - Estimated filers paying corporate activities tax rate =18,000
  - % of corporate activities tax paid by filers with gross receipts above $25 million=74%
  - % of corporate activities tax paid by filers with gross receipts above $100 million =55.7%

- Strategies to minimize pyramiding
  - Keep rate low and base broad.
  - Exempt transactions among closely related business entities.
  - Exempt qualified distribution centers.

- Personal income tax adjustments targeted at low income households
  - Expand earned income tax credit.
  - Lower bottom personal income tax rates.
  - Increase standard deduction.
  - Increase personal exemption credit.

LRO: 5-2-17

GROSS RECEIPTS TAX
OREGON'S EXPERIENCE

- The first plan simulation released included an Ohio-style CAT of 0.48 percent on receipts in excess of $1 million.

1. Eliminate Corporation Income Tax
2. Create a Commercial Activities Tax ($250 + 0.48% of sales > $1 million)
3. Change PIT rates from 5/7/9/9.9 to 4.5/6.5/8.5/9.9

2018 Levels	Baseline	New Equilibrium	Change From Baseline	Percent Change
Private Sector				
Nominal Personal Income ($M)	$199,258	$199,187	-$71	-0.04%
Nomical per Capita Personal Income ($)	$47,442	$47,380	-$62	-0.13%
Employment (Thousand)	2,601.0	2,608.5	+7.5	+0.29%
Population (M)	4.200	4.204	+0.004	+0.10%
Investment ($M)	$16,605.97	$16,639.27	+$33	+0.20%
Wage Index	100.0	99.53	-0.47	-0.47%
Return to Capital	100.0	100.05	+0.05	+0.05%
Price Levels	100.0	100.15	+0.15	+0.15%
Public Sector				
State Spending ($M)	$28,184	$28,512	+$328	+1.16%
GF Revenue ($M)	$8,827.92	$9,157.23	+$329	+3.73%
OF Revenue ($M)	$19,356.34	$19,354.59	-$2	-0.01%
Local Govt Revenue ($M)	$17,135.65	$17,147.50	+$12	+0.07%
Federal Tax Paid by Oregonians ($M)	$36,193.71	$36,254.32	+$61	+0.17%

Static Revenue Impact ($ Millions)	+$344
Dynamic Revenue Impact ($ Millions)	-$4
Net Revenue Impact ($ Millions)	+$339
General Fund Change ($ Millions)	+$329
Other Funds Change ($ Millions)	-$2
Local Revenue Change ($ Millions)	+$12

Total Real Disposable Household Income

	Baseline ($M)	New Equilibrium ($M)	Difference ($M)	% Difference	Change in Number of Hholds	Mean Income Change per HH ($)
Above $205,869	$35,944	$35,861	-$83.3	-0.2%	-129	-$403
$137,246 - $205,869	$31,656	$31,568	-$87.7	-0.3%	-106	-$399
$102,934 - $137,246	$24,654	$24,618	-$35.6	-0.1%	86	-$242
$68,623 - $102,934	$30,208	$30,160	-$47.5	-0.2%	216	-$214
$48,036 - $68,623	$19,930	$19,922	-$8.4	0.0%	485	-$168
$34,311 - $48,036	$13,487	$13,497	+$9.5	0.1%	618	-$155
$20,587 - $34,311	$11,806	$11,810	+$4.7	0.0%	563	-$132
Less than $20,587	$9,944	$9,917	-$26.7	-0.3%	-22	-$112
TOTAL	$177,629	$177,354	-$274.9	-0.2%	1,712	

GROSS RECEIPTS TAX
OREGON'S EXPERIENCE

- Quickly, the effects of pyramiding became obvious.
- Even with individual income tax cuts, the tax was regressive. After-tax incomes for almost all income groups were lower than before the change.
- Additionally, specific industries, such as retailing, forestry, and wholesaling, were directly impacted.

GROSS RECEIPTS TAX
OREGON'S EXPERIENCE

HB 2830-6: DRAFT TAX REFORM PLAN

1. COMMERCIAL ACTIVITY TAX(1-1-19)
   - APPLIES TO ALL ENTITY TYPES
   - OHIO BASE INCLUDING FIT
   - FILING THRESHOLD $150,000 IN RECEIPTS
   - $250 MIN FOR RECEIPTS LESS THAN $3 MILLION
   - RATES APPLIED TO RECEIPTS ABOVE $3 MILLION
   - .75% RATE FOR SERVICES
   - .35% RATE FOR RETAIL TRADE
   - .25% RATE FOR WHOLESALE
   - .15% RATE FOR NATURAL RESOURCES
   - .48% RATE FOR ALL OTHER
   - 50% CAT CREDIT FOR PASS THROUGHS IN 2019/25% STARTING IN 20
2. NEW PERSONAL INCOME TAX RATE STRUCTURE: (2019 TAX YEAR)
   - 4.0%, 6.75%, 8.8% FOR TAXABLE INCOME <$25K (S), <$50 K(J), 9.0%, 9.9%
   - INCREASE EITC TO 10% OF FEDERAL CREDIT (1-1-19)
3. ELIMINATE CORPORATE INCOME TAX (1-1-19)

GROSS RECEIPTS TAX
OREGON'S EXPERIENCE

- The legislature quickly learned that even adopting a tax styled on the Ohio CAT was not an easy task.
- Statute had to be amended to fit Oregon's constitutional structure.
- The state had to consider a number of policy choices, such as rate.
- By the end, the bill was dramatically different than the outlined principles, and it was abandoned when it was clear that it would not pass the legislature.

GROSS RECEIPTS TAXES
CONCLUSIONS

- There has been a resurgence of interest and activity in states over creating a gross receipts tax in the last two years.
- Gross receipts taxes have largely been removed from the list of possible state tax options due to their well-documented economic effects.
- If Wyoming were to consider creating a gross receipts tax, the state would need to make numerous policy choices to setup and structure the tax.

CONCLUSION

- Questions?
- For additional information on gross receipts taxes, visit https://taxfoundation.org/state-tax/gross-receipts-and-margin-taxes/

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