



03 SR 001

## WYOMING LEGISLATIVE SERVICE OFFICE

# ***Short Report: Background & Framework for Business Taxation***

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by:

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Attachment A: State and Local Revenue by Industry (FY2002)

Attachment B: Relative Contribution of Major State Tax Collections, by State and Source (2002)

### **SUMMARY**

This report begins with a brief overview of Wyoming's current revenue collections, identifying that an average of 85 percent of all General Fund revenues in recent years has come from sales and use taxes, investment income, and severance taxes. Largely benefiting from the state's mineral wealth, Wyoming's tax structure is unusual in that it lacks both an individual and corporate income tax. In 1999, the Tax Reform 2000 Committee recommended, among other things, that the state adopt a corporate income tax. This report examines a number of business taxes currently imposed by other states including: a corporate income tax; a value-added tax; a gross receipts tax; and the business and occupation tax. This state-by-state research is supplemented by general tax theory as well as preliminary revenue estimates, specific to business taxes in Wyoming. The report concludes with policy and technical considerations to help guide future deliberations and provide a framework for additional discussions and examinations of a potential business tax in Wyoming.

## TOPIC

Provide a conceptual framework for possible business taxes in Wyoming, including a summary of selected state business taxes.

## PURPOSE

This report considers the foundations of an efficient, equitable, and stable tax structure that generates sufficient resources. Specifically, this report explores a number of possibilities for a business tax in Wyoming based upon selected models from other states. This report does not recommend any one alternative over another. Given the variety of tax structures in other states, only selected types of taxes, representing the most common or progressive forms, as they might apply in Wyoming, are presented. It should be further noted that states use more than one type of tax and consideration should be given to the entire tax structure when examining a business tax. At the request of LSO, the Economic Analysis Division (EAD) and the Department of Revenue contributed estimates of potential revenues and administrative costs, respectively. However, the projections are limited by a number of factors. Since this research is exploratory in nature, additional research and specifications would be required in order to provide a thorough analysis of the revenue potential (and administrative costs) for any chosen business tax.

## PRIMER ON THE TAX STRUCTURE IN WYOMING

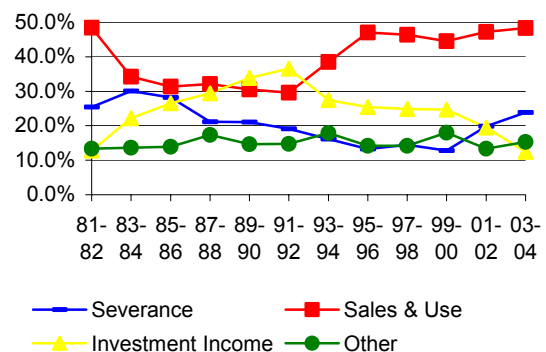
Prior to assessing business tax alternatives and considering how one might be applied in Wyoming, it might be helpful to examine the revenue sources supporting Wyoming governments. The existing tax structure may be an important policy consideration prior to evaluating various business taxes.

Literally dozens of sources of revenue support state and local governments in Wyoming. A sampling of the multiple sources of revenues includes taxes (e.g., sales taxes, property taxes, severance taxes, tobacco taxes, and fuel taxes); fees; investment income; and federal sources such as intergovernmental grants and federal mineral royalties. At the state level, the *Joint Legislative-Executive Revenue & Expenditure Study* prepared in 1999 offered a standard, three-tier approach for categorizing all state revenue sources: dedicated, earmarked, and discretionary. Using this

framework, many existing taxes are dedicated to specific functions of government. For example, fuel taxes are dedicated to highways and some severance taxes are earmarked to cities and towns. Alternatively, revenues not tied to a specific purpose are "discretionary."

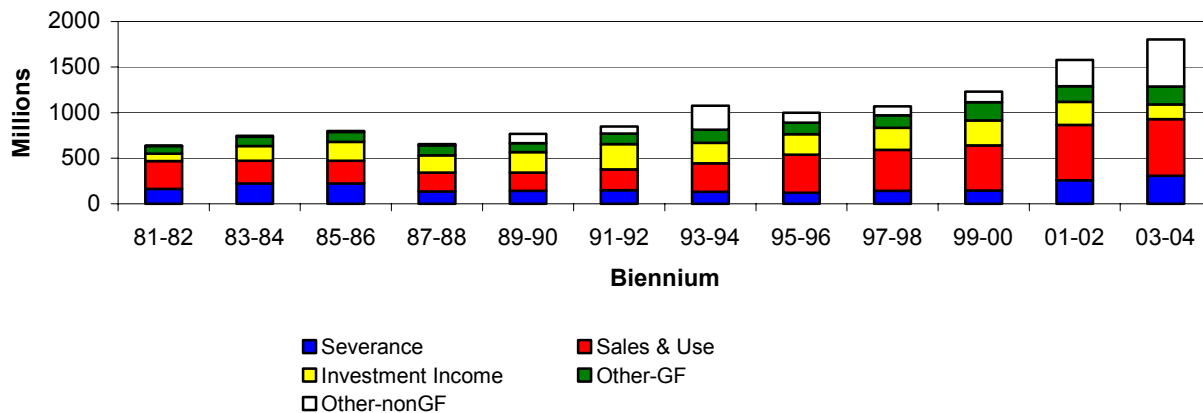
The General Fund is the single largest repository of discretionary revenue for the state. Since the 1981-82 biennium, an average of 85 percent of all General Fund revenues has come from just three sources: (1) sales and use taxes (39%), (2) investment income (26%), and (3) severance taxes (20%). All other revenues combined accounted for an average of just 15 percent of historical General Fund revenues. Figure 1 illustrates the historical relationship and relative contributions of these three revenue sources, along with "other" revenues over the past 12 biennia.

**Figure 1. Contributions of Major GF Revenue Sources.**



**Source:** LSO analysis of CREG data, including 2003-04 estimated revenues.

In addition to General Fund revenues, state discretionary revenues are derived from the Budget Reserve Account, and (previously) the Legislative Government Royalty Impact Assistance Account, which are funded by severance taxes and federal mineral royalties. In addition, the state has received several one-time, miscellaneous discretionary revenues such as GAAP interest, GNMA interest, etc. Figure 2 shows the contribution of all state discretionary revenues, by source, since the early 1980s. The significant increase in the last two biennia of non-General Fund discretionary revenue reflects relatively high mineral prices and statutory changes related to de-earmarking.

**Figure 2. Sources of Discretionary Revenues.**

**Source:** *Revenue and Expenditure Study – Update, 2001* and LSO analysis of October 2003 CREG data.

**Notes:** Figures for the 2003-04 biennium are estimates. Amounts are not adjusted for inflation.

By way of comparison, according to the Office of Management and Budget, the major contributors to federal receipts, by source, for FY02 were individual income taxes (46%), social insurance receipts (38%), corporate income taxes (8%), excise taxes (4%), and other receipts (4%).

#### **Payment of State Taxes in Wyoming, by**

**Industry Sector.** Attachment A illustrates the major taxes paid by consolidated major industry sector (except fuel taxes). This is a crude methodology with significant limitations as the emphasis is on the industry that remits the taxes, which is not necessarily the industry that bears the entire burden of the tax. This phenomenon is best illustrated by sales and use taxes that are collected by the counties for such goods as personal vehicles. Further, the commerce industry is assigned all sales taxes generated from retail trade. Certainly this industry sector provides the foundation for this retail activity. However, even though the commercial sector collects taxes on tobacco and sales, customers likely share at least a portion, if not most, of the burden of these taxes. (This concept of economic incidence is discussed later in this report.) Despite these significant limitations, the illustration does demonstrate Wyoming's reliance on the mining sector for tax revenue. Specifically, this analysis suggests the mining sector remits more than \$800 million, or 54 percent, of severance, sales and use, ad valorem, and other defined taxes.

**Constitutional considerations.** Although exhaustive research of constitutional issues was not the focus of this report, some provisions are worth noting. Article 15, Section 18 of the Wyoming Constitution requires any income tax allow full credit of sales, use, and ad valorem taxes paid. Further, Article 1, Section 28 was amended in 1988 by removing the sentence "All taxation shall be equal and uniform." The remaining requirement relating to uniformity (Art. 15, Sec. 11) appears to be limited to property tax assessment. These requirements differ from those of many other states; therefore, when comparing tax structures, fundamental limitations and opportunities should be noted.

#### **HOW DOES WYOMING'S TAX STRUCTURE COMPARE TO OTHER STATES?**

Wyoming is one of just seven states that do not impose an individual income tax at the state level, according to the National Conference of State Legislatures (NCSL). Two other states, New Hampshire and Tennessee, impose an individual income tax limited to interest and dividends. Likewise, Wyoming is among the few states that do not impose some type of corporate income tax. Based on an LSO analysis of U.S. Census Bureau data, individual income taxes accounted for an average of 36.1 percent and corporate income taxes accounted for an average of 5.1 percent of total tax collections in FY02, among states imposing such taxes.

Comparisons among state tax systems are complicated by a number of factors including special definitions as well as the differing relationships between state and local governments. In some ways, each state's tax system is unique. Attachment B is an LSO analysis of U.S. Census Bureau data related to state government tax collections. This table illustrates the percent of state government tax collections, by major tax; nonetheless, caution must be exercised when interpreting this table. While this Census Bureau data appears to be among the best available nationwide revenue data, it is based on a U.S. government survey, and state responses differ depending on whether the state collects revenue to distribute to local governments or local governments collect tax revenue themselves.

Aside from Alaska and Delaware, Wyoming currently collects a disproportionately large amount in "other" taxes, due to the significant contribution of severance taxes in Wyoming. Moreover, Wyoming reports a comparatively large proportion of state-collected property taxes. This is likely due to the state's collection and redistribution of monies for K-12 education.

### **TAX REFORM 2000**

Wyoming's economy has historically been susceptible to cycles of boom and bust, often at the whim of the markets for the state's major industries. Along with the downturn in the cycles of the state's economy have come projections for budget deficits. The state has historically met the challenges posed by these projections through a number of solutions. In 1997, the Wyoming Legislature created the Tax Reform 2000 Committee and charged it to provide recommendations for "developing a fair, viable and economically competitive state and local tax structure capable of generating sufficient revenues to meet expected needs in the future" ('97 Laws, Chap. 161).

The Committee found that households with lower incomes paid a larger percentage of their income in state taxes than households with higher incomes; taxes on mineral production were subject to volatile markets; and the state relied heavily on mineral taxes to fund the daily operation of government. As a result, the

Committee argued that Wyoming's tax structure lacked equity, stability, and balance. The Committee also found that Wyoming residents did not contribute as much to the services that they received compared to residents of other states. Instead, the state relied on mineral taxes and federal funds to provide services to Wyoming's residents. Further, the Committee suggested that the state's inability to fund public services with current revenues contributed to the lack of economic growth within the state as businesses, unsure of future tax liabilities, would hesitate to locate or expand in Wyoming.

The Committee recommended that the state adopt corporate and individual income taxes; broaden the sales and use taxes to include more services; and implement a real estate transfer tax. It suggested that the state maintain its mineral taxes, diverting more to the Permanent Wyoming Mineral Trust Fund (PWMTF) rather than to the General Fund. To maximize earnings potential of state permanent funds, the Committee advocated limiting Legislatively Designated Investments to those that earned at least a market rate of interest and continuing progress toward investing more of the PWMTF in a stock portfolio. Further, the Committee recommended maintaining the fourth cent of the state's sales and use taxes; increasing sin and consumptive taxes to be comparable to those of surrounding states; limiting property tax increases that burdened individuals on low and fixed incomes; exploring new revenue sources such as temporary nuclear fuel rod storage, a state lottery, and increased state land use fees; and exploring the expenditures and revenue generating authority of local governments. The Committee also addressed the tax administration system of the state, making recommendations to improve its management.

### **THEORIES OF TAXATION**

Economic theory and public policy principles provide a framework upon which lawmakers may wish to evaluate a variety of business tax systems. The following discussion presents some of the more widely accepted principles and concludes with an overview of the concept of tax incidence.

**Economic efficiency.** The imposition of taxes can distort the efficient allocation of resources in an economy. Taxes can encourage or discourage

consumption of one good over another, or alternatively, between capital and debt financing for many business taxes. Further, not all tax systems influence the allocation of resources equally. As a basic example of this phenomenon, economic theory suggests that a lower rate and a broader tax base results in less economic distortions than a narrow base with a high tax rate.

**Equity.** In economic theory, there are two principles for determining how the burden of a tax ought to be distributed: the *ability to pay* principle and the *benefit* principle. The first states that the tax burden should be positively related to a taxpayer's economic welfare, or those with higher incomes should pay more. The second states that the tax burden should relate to a taxpayer's return from a government good or service funded by the tax. The fuel tax is a common example of the *benefit* principle, whereby drivers support highway construction and maintenance through fuel taxes since they directly benefit from having quality transportation systems. To the extent businesses benefit from government infrastructure, a well-educated workforce, and safe and healthy communities, the *benefit* principle suggests that businesses should bear some burden of the cost of government.

Further, the notion of equity has two dimensions: vertical equity and horizontal equity. Vertical equity compares individuals with different incomes. Horizontal equity suggests that taxpayers with equal incomes in similar circumstances should be treated equally under the tax code. However, it is important to note that the notion of vertical equity is not applied to corporations, only individuals. Therefore, it is of little value when assessing business taxes. The principle of horizontal equity, however, broadly suggests similar businesses should be treated equally.

A common tool used by economists to assess equity is distributional analysis. There are a wide variety of methods applied for distributional analysis, but most traditionally measure the proportionate amount of taxes paid by individuals in different income groups. Expanding the analysis further, some public policy practitioners apply a modification of traditional distributional analyses to compare the tax payments made based

on marital status, residency, or other characteristics besides income. Unfortunately, because of the complexity of tax incidence (to be discussed later), such analyses generally do not apply to business taxes. Nonetheless, distributional assessment of taxes by business sector is a crude example of how this tool is occasionally applied to the business community.

**Administrative Simplicity.** From both the collection perspective as well as the perspective of the taxpayer (individual or business), the complexity of the tax system should be minimized to the greatest extent possible. Complex tax systems foster confusion, reduce compliance, are costly to administer, and waste resources of both taxpayers and tax collectors. While administrative simplicity cannot always be accomplished, it is clearly preferred by general tax theory.

**Other Principles.** In addition to these widely accepted economic principles, a recent NCSL study cited reliability, responsiveness to interstate and international competition, and accountability as other important principles of taxation. NCSL includes three components in the definition of reliability: (1) the need for stability of tax revenues, (2) the need for business predictability in the number and size of potential tax changes, and (3) the need for a tax system to supply sufficient resources for government expenditures. NCSL further contends that due to the inherent volatility, corporate income taxes are not among the most reliable taxes. The principle of responsiveness to other states recognizes that economic decisions by both consumers and businesses may be influenced by differences in state tax systems. Finally, accountability, according to NCSL, occurs when states impose an explicit tax burden. Since customers often cannot distinguish between a business tax and other costs of doing business, many business taxes are not transparent.

**Tax Incidence.** In addition to the economic and public policy principles of taxes, tax incidence is an important concept when exploring tax alternatives. There are two distinct interpretations of tax incidence: statutory incidence and economic incidence. Statutory incidence is fairly straightforward. It is the identification of who, by

law, must pay a tax. For example, individuals are responsible for paying income tax, even though an employer may remit the tax to the federal government. Likewise, corporations are responsible for paying corporate income taxes, as identified in federal law.

In contrast, economic incidence is the identification of who actually *bears the burden* of a tax, regardless of the entity obligated to make payment to the government. This concept is summarized in the common statement that businesses don't pay taxes, people do. Specifically, three groups of individuals could theoretically bear the economic incidence of a business tax: labor, customers, or owners of capital. Depending upon the circumstances, type of business, competitiveness of the industry, etc., businesses could shift the burden of the tax to labor through reduced compensation. Alternatively, customers may share the burden through increased prices. Finally, owners of capital (shareholders) could bear the burden through reduced returns. Assessing the economic incidence of different business taxes is a complex undertaking and can differ from business to business as result of several factors. At least at the federal level, most corporate income taxes are generally believed by economists to fall largely on capital income, but may fall partially on compensation to labor.

### **TYPES OF BUSINESS TAXATION: THE CORPORATE INCOME TAX**

The federal government taxes the income of corporations just as it taxes the income of individuals. The taxation of a business entity may vary depending upon how the business is organized. Most states, as well as the District of Columbia, impose a corporate income tax. Wyoming is among the few states that do not impose some type of corporate income tax. Among states that do impose a corporate income tax, the most common practice is to do so at a flat rate. Some states impose a graduated tax with different rates applied depending on the level of corporate income. Most states with a corporate income tax impose a minimum tax regardless of income. Some states impose different rates on financial institutions or have other special rates.

**Colorado.** Colorado provides an example of the corporate income tax and is an appropriate model for a number of reasons. Colorado uses a flat rate for taxing corporate income and illustrates the lowest such rate currently imposed by any state. Further, Colorado is a neighboring state to Wyoming, providing a regional comparator. However, the economy of Colorado is markedly different from that of Wyoming.

Every corporation, including S corporations, doing business in Colorado or deriving income from Colorado sources must file a corporate income tax return with the state. However, businesses filing as an S corporation are taxed as a partnership and are exempt from paying corporate income tax. Annually, the corporation is required to figure its net taxable income or net loss. Gross income is reduced by operating expenses and allowable deductions.

**Basis.** Generally speaking, Colorado applies its state corporate income tax to federal corporate taxable income. Adding or subtracting various adjustments to the corporation's federal taxable income determines Colorado taxable income.

**Rate.** Colorado taxes corporate income at a flat rate of 4.63 percent. If the corporation does business in multiple states, the income may be apportioned accordingly.

**Adjustments.** Credits are allowed for qualified investments, certain activity or investments within enterprise zones, Colorado coal, alternative fuel, conservation easements, child care, investment in a qualified school-to-work program, post consumer waste equipment, historic property preservation, expenditures to employ recipients of public assistance, redevelopment of contaminated land, low-income housing developments, and for the deferred sale of livestock for weather related reasons.

**Legal citation.** The statutory authority for the taxation of the income of C corporations in Colorado can be found at C.R.S. §§ 39-22-300.1 through 39-22-310.

## **TYPES OF BUSINESS TAXATION: THE SINGLE BUSINESS TAX**

The single business tax, or modified value-added tax, imposes a tax on the profit, capital, and labor inputs that add value to goods in the production process or to services. The tax is imposed on a business activity that enhances the benefit to the consumer of a product or service.

**Michigan.** Michigan is the only state to use the single business tax (SBT), the only general business tax levied by the state. The SBT replaced net income based taxation with value-added taxation. All persons engaged in a business activity in the state are subject to the SBT. Business activity is defined as the sale of real or personal property; property rental; and the performance of a service for a fee, except services rendered as an employee or services rendered as a director of a corporation. Any person engaged in business activity whose adjusted gross receipts are \$250,000 or more per year is required to file a return. A "person" is defined as an individual, firm, bank, financial institution, partnership, limited partnership, corporation, joint venture, association, co-partnership, limited liability company, receiver, estate, trust or any other combination acting as a unit.

**Basis.** The SBT liability starts with the calculation of the total tax base. The tax base consists of three basic components: labor, capital, and profit. Labor is measured by the compensation and benefits an employer pays to its employees, including retirement benefits, pensions, and profit sharing plans; capital used is measured by depreciation, interest, dividends and royalties paid by the taxpayer; and profit is measured by the taxpayer's federal taxable income as adjusted for SBT purposes.

**Rate.** The SBT is being phased out over a 23-year period. The 2.3 percent rate in 1999 is to be reduced by one-tenth of a percentage point in each year that the State's Rainy Day Fund exceeds \$250 million. The most recent rate was 1.9 percent.

**Adjustments.** Additions to business income include depreciation, taxes based on income, net operating loss carryover or carry back and any dividend, interest and certain royalty expenses taken on the federal return. Subtractions include

dividend, interest and certain royalty income reported on the federal return. Deductions are allowed for the cost of capital assets acquired in the state during the tax year. Furthermore, there are numerous exemptions, deductions and credits that may be allowed. These adjustments modify the value-added nature of the SBT and reduce the tax liabilities for firms that qualify to use them.

**Legal citation.** The statutory authority for the SBT in Michigan can be found at M.C.L. §§ 208.1 through 208.145.

## **TYPES OF BUSINESS TAXATION: THE GROSS RECEIPTS TAX**

A gross receipts tax is generally levied on the total amount of money derived from a business activity. This may include income from the sale of tangible personal property at both the wholesale and retail level; sale of intangible property such as licenses, trademarks, franchises, patents and copyrights; performance of services, including contracting; and leasing property used in the state.

**New Mexico.** New Mexico uses a gross receipts tax on corporations for the privilege of doing business in the state. The gross receipts tax takes the place of a sales tax, but it is imposed on the business rather than on the consumer. There is nothing preventing the business from passing the tax along to the consumer. Activities taxed include manufacturing, production, wholesaling, retailing, leasing, providing services, and construction. There are provisions of the tax code to exempt sales to and sales by tax-exempt organizations. Administration of the tax is complicated because non-taxable transaction certificates are required for many deductions and exemptions.

**Basis.** The basis for the tax is the gross receipts of the business from business activity within the state.

**Rate.** A basic five percent state gross receipts tax is supplemented by local options available to all counties and municipalities. Recently, the tax has ranged from 5.125 percent to 7.25 percent depending on location.

**Adjustments.** The law presumes all transactions are taxable unless statute provides a specific exemption or deduction. Statutes allow deductions for: personal property that becomes an ingredient or component part of a manufactured or constructed product; services or property purchased for resale; sub-lease of property; certain out-of-state purchases and services; certain sales to farmers and ranchers; sale of tangible property to qualified non-profits, government, or Indian tribes; bad debts; and other miscellaneous deductions.

Gross receipts from items taxed by other statutes (i.e. fuel, oil and gas production, motor vehicle sales, boats, and insurance premiums) are exempt. Other statutory exemptions include: factors of production, including wages and salaries; receipts of government agencies and non-profit agencies; food stamp receipts; sale of farm products by producers and growers; receipts from feeding or pasturing livestock; interest and dividend receipts; occasional sales; gross receipts generated by items not allowed to be taxed by the U.S. Constitution; sale of tangible personal property to credit unions; and receipts from the sale of real property.

**Legal citation.** The statutory authority for the gross receipts tax in New Mexico can be found at N.M.S. §§ 7-9-1 through 7-9-91.

#### **TYPES OF BUSINESS TAXATION: THE BUSINESS AND OCCUPATION TAX**

A variant of a gross receipts tax is the Business and Occupation (B&O) tax. This is a tax on the gross receipts of all businesses operating in the state. Unlike a corporate income tax, almost all business entities within the state are subject to the tax, including corporations, partnerships, sole proprietorships and nonprofit corporations. A sale does not have to occur for a business to owe the B&O tax. Among the advantages to the B&O tax is the lack of need to apportion income among states. Finally, there is no discrimination for payment of the tax due to the structure of the business entity.

**Washington.** Although Washington's B&O tax is similar to a gross receipts tax, Washington levies the B&O tax in addition to the state's sales tax. Washington does not have a corporate income tax. Local counties and cities are allowed to add

additional taxes to the state's B&O tax. The classification and rate of the B&O tax are based on the type of business activity. The most common classifications are retailing, wholesaling, manufacturing and service activities.

**Basis.** A business must register with the Department of Revenue if its gross income is \$12,000 a year or more or if it collects or pays other taxes to the department. If a business's annual revenues are \$24,000 or less, a tax return does not have to be filed. The basis of the B&O tax is the gross receipts, gross volume of sales, other taxable amounts of a business.

**Rates.** There are thirteen different tax rates for various classifications of business activities. They are presented in table 1 below.

**Table 1. Washington B&O Tax Rates.**

| Activity                                                                                                                                                                                                       | Rate   |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|
| Wholesaling of wheat, corn, barley, canola, dry peas and beans, oats, lentils, and triticale                                                                                                                   | 0.011% |
| Wholesale processing of meat, soybeans, canola, wheat into flour, and raw seafood products                                                                                                                     | 0.138% |
| Travel agent commissions, manufacturing nuclear fuel, processing dry peas, and international investment management                                                                                             | 0.275% |
| Manufacturing fruits and vegetables                                                                                                                                                                            | 0.330% |
| Stevedoring and freight brokers                                                                                                                                                                                | 0.363% |
| Retailing                                                                                                                                                                                                      | 0.471% |
| Manufacturing, wholesaling and related activities                                                                                                                                                              | 0.484% |
| Insurance agent and insurance broker commissions                                                                                                                                                               | 0.550% |
| Public and nonprofit hospitals                                                                                                                                                                                 | 1.5%   |
| Selected business services, including clerical, computer, information, legal, accounting, engineering, business management, protective, public relations and advertising, surveying, and real estate appraisal | 1.5%   |
| Service providers, including physicians, dentists, teachers, and bureaucrats                                                                                                                                   | 1.5%   |
| Financial services, including banking, securities and investment management, and investment advising                                                                                                           | 1.5%   |
| Disposal of low-level radioactive waste                                                                                                                                                                        | 3.30%  |

**Source:** Work papers prepared by Tax Reform 2000 staff and verified by LSO, ultimately found in R.C.W. §§ 82.04.230 through 82.04.298.

**Adjustments.** There is no deduction from the tax base for labor, materials, taxes or other costs of doing business; however, a business may qualify for exemptions, deductions or credits.

Exemptions are allowed for certain business activities including certain agricultural activities, certain activities of nonprofit and social service organizations, government activities, certain financial activities, and for out-of-state firms, which sell consumer products in the state through representatives and not retail outlets.

Amounts that are deductions must first be included in gross income and then identified and deducted from gross income. Deductions are allowed for certain agricultural activities, certain activities of nonprofit and social service organizations, government charges of services among political subdivisions, certain activities of financial institutions, and a number of other activities.

Credits are subtracted from the B&O tax due on the tax return. Examples include a credit for small businesses; a bad debt tax credit; a distressed area credit; a multiple activities credit; a credit for overpayment of taxes; and a high technology tax credit.

**Legal citation.** The statutory authority for the B&O tax in Washington can be found at R.C.W. §§ 82.04.010 through 82.04.900.

#### **TYPES OF BUSINESS TAXATION: OTHER BUSINESS TAXES**

There are a few other business taxes that merit mention. They include the corporate license fee (or franchise tax) and the business enterprise and business profits taxes.

**Corporate license fee.** While sometimes not called a tax, many states impose a corporate license fee on business entities doing business within the state. The annual fee may be uniform for all corporations or may vary depending on the income or assets of the corporation. Several states require payment of the annual licensing fee at the same time corporate income tax is due. Wyoming imposes an annual business-licensing fee, with a rate of \$50 or \$0.0002 on all assets located and employed in the state, whichever is greater.

In Texas, the charge imposed is known as a franchise tax. Texas, with neither a personal nor corporate income tax, imposes a franchise tax on each corporation and limited liability company doing business in the state. The rate is 0.25 percent of net taxable capital or 4.5 percent of net taxable earned surplus, whichever is greater. Taxable capital is a corporation's stated capital (capital stock) plus surplus. Surplus means the net assets of a corporation minus its stated capital. Earned surplus basically includes the corporation's federal net taxable income, plus compensation paid to officers and directors of a corporation.

#### **Business enterprise and business profits taxes.**

New Hampshire has a unique system that is essentially a variant of a value-added tax. The business profits tax imposes an 8.5 percent tax on income from conducting business activity within the state for businesses with more than \$50,000 in gross receipts. In addition, the business enterprise tax levies a 0.75 percent tax on businesses with gross receipts are over \$150,000, or whose value tax (the sum of compensation, interest, and dividends) is more than \$75,000. Thus, 9.25 percent is the highest rate paid by any corporation.

#### **REVENUE AND ADMINISTRATIVE COST ESTIMATES OF BUSINESS TAX SYSTEMS**

The Department of Administration and Information's Economic Analysis Division (EAD) prepared general revenue estimates related to the discussed state business tax systems, where data was available. The Department of Revenue (DOR) provided similar estimates regarding the anticipated administrative costs of imposing sample state business taxes.

**Revenue Estimates.** According EAD, a one percent corporate income tax in Wyoming would yield between \$5 and \$10 million, before constitutional offsets. Based on a particular analysis of Colorado's 4.63 percent corporate income tax, \$30 million in tax liability might be expected from a similar scheme in Wyoming, prior to constitutional offsets. A proportional analysis of gross state product between New Mexico and Wyoming was used to estimate that each percent of the gross receipts tax in Wyoming might be expected to generate roughly \$100 million, according to EAD. Finally, according to the Secretary of State's Office, the current

corporate license fee imposed in Wyoming generated \$4.7 million in FY03.

Comprehensive fiscal analysis of all presented tax schemes is hindered by data limitations and time constraints. The above examples are intended to be illustrative estimates based on *extremely broad* assumptions. Despite significant limitations, EAD prepared estimates of two different classes of business taxes: corporate income taxes and gross receipts taxes. The method employed to estimate the likely revenue generation in Wyoming proportionally compared the gross state product (GSP) of Wyoming to identified states' business tax collections. One benefit of this methodology is that using actual tax liability and collections data, each state's entire business system should be represented.

Among the significant constraints of this analysis are the assumptions that the two state's economies are relatively similar and that GSP is a reasonable indicator of the basis of the tax. Further, Wyoming's Constitutional provision regarding income taxes would likely significantly reduce the previous estimates, particularly for any corporate income tax imposed on the mining sector. In the event one business tax alternative is selected and adequately defined, LSO, EAD, and the Department of Revenue could potentially narrow and improve the expected revenue estimates, despite continued data limitations.

**Expected Administrative Costs.** The Department of Revenue prepared rough estimates for administering both a corporate income tax and a gross receipts tax in Wyoming. Clearly, more refined estimates would be dependent upon a number of factors such as the tax structure; tax basis; number and types of deductions, credits, and exemptions; as well as array of other factors.

The DOR estimates that a corporate income tax in Wyoming would require an additional \$1.5 to \$2 million annual appropriation. In addition, several million dollars would be required in up-front costs for expenses such as computer programming and office space. A gross receipts tax would likely cost roughly half as much to administer – approximately \$750,000 annually. Upfront costs, particularly for program development, are initially estimated at \$2 to \$3 million in a one-time

appropriation. The reduced costs of a gross receipts tax (as compared to a corporate income tax) are based on its similarity to the existing sales and use tax structure. While DOR staffing requirements would need to be enhanced, existing processing equipment and resources might be shared.

### **ISSUES FOR CONSIDERATION: A POTENTIAL FRAMEWORK FOR FUTURE DELIBERATIONS**

To conclude, there are numerous policy as well as technical considerations the Legislature may wish to review with respect to any business tax issues. A brief summary of the scope of potential issues, although admittedly not a comprehensive list, is presented below.

#### **Policy considerations.**

- ✓ **Structure and form:** What structure and form of a business tax, if any, would be most appropriate in Wyoming? For example, this report has identified and summarized a broad range of taxes including a corporate income tax, gross receipts tax, value-added tax, and franchise tax. Many hybrids also exist.
- ✓ **Incidence:** What potential differences are there in the economic incidence and distributional impacts of various business taxes?
- ✓ **Relation to other taxes:** How would the imposition of a business tax relate to existing taxes and state revenue needs? Would a business tax be intended to supplement existing state or local taxes or supplant one or more existing taxes?
- ✓ **Behavioral response:** What consumer, labor, and business investment behaviors would likely be impacted by a business tax? Moreover, is it the Legislature's intent to induce a set of behaviors, and can a particular business tax be expected to achieve that outcome?
- ✓ **Constitutional considerations:** What, if any, constitutional impediments exist to the imposition or administration of a selected business tax?

**Technical considerations.**

- ✓ **Basis:** What is the basis, or subject, of a potential business tax? Examples of potential bases include net income, gross receipts, assets, corporate license, occupation, etc.
- ✓ **Administration:** How will a business tax be structured and administered, and what information will be required of filers?
- ✓ **Level and characteristic of the tax rate:** Should there be a graduated tax rate or a flat rate? Should there be a floor, or threshold up to which the basis is free from taxation?
- ✓ **Credits/exclusions:** What types of exemptions, deductions, exclusions, and credits, if any, should be considered? This technical consideration also applies to the policy consideration of influencing behaviors. That is, some states allow for credits or deductions to encourage expenditures on research and development, equipment purchases, or business development in designated enterprise zones. Further, some credits for taxes paid are constitutionally required for any future income tax.
- ✓ **Apportionment:** What factors will Wyoming include to apportion the taxable basis of a business or corporation engaged in business in multiple states?

**ADDITIONAL READING**

Consensus Revenue Estimating Group (CREG), *Wyoming State Government Revenue Forecast: Fiscal Year 2004-2008* (Cheyenne, WY: October 2003).

Hellerstein, Jerome R. and Walter Hellerstein, *State Taxation: Constitutional Limitations and Corporate Income and Franchise Taxes*, 3<sup>rd</sup> Ed. (2001), for a discussion of state and federal constitutional provisions and case law interpretations relating to business taxation.

National Conference of State Legislatures, *Tax Policy Handbook for State Legislators*, 2<sup>nd</sup> Ed. (Denver, CO: April 2003).

Tax Reform 2000 Committee, *Building Wyoming's Tax Structure for the 21<sup>st</sup> Century* (Cheyenne, WY: June 1999).

**CONTACTS FOR FURTHER INFORMATION**

The following, along with their staffs, provided invaluable insights and contributions during the preparation of this report:

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### Attachment A: State and Local Revenue by Industry (FY2002)

| INDUSTRY<br>(1)                           | TAXES       |                          |                            |                    |              | TOTAL<br>MAJOR<br>REVENUE<br>(4) | CORPORATE<br>PROFITS |
|-------------------------------------------|-------------|--------------------------|----------------------------|--------------------|--------------|----------------------------------|----------------------|
|                                           | SEVERANCE   | AD VALOREM<br>(assessed) | AD VALOREM<br>(taxes paid) | SALES & USE<br>(2) | OTHER<br>(3) |                                  |                      |
| Agriculture, Forestry, Fishing, & Hunting | 0           | 142,408,663              | 9,224,094                  | 1,436,753          |              | \$10,660,847                     | \$4,827,973          |
| Mining                                    | 299,433,961 | 6,891,909,146            | 446,402,739                | 60,361,511         |              | \$806,198,211                    | \$445,632,380        |
| Manufacturing                             | 0           | 826,305,326              | 53,521,449                 | 25,286,703         |              | \$78,808,152                     | \$209,593,476        |
| Utilities, Transportation & Warehousing   | 0           | 359,986,762              | 23,317,063                 | 48,334,625         |              | \$71,651,688                     | \$173,655,768        |
| Government                                | 0           | 0                        | 0                          | 62,877,493         |              | \$62,877,493                     | \$0                  |
| Commercial                                | 0           | 635,198,485              | 41,143,076                 | 385,687,839        | 31,322,472   | \$458,153,387                    | \$362,901,675        |

#### Sources:

FY02 severance taxes taken from *Wyoming State Government Revenue Forecast, FY 2004-FY2008*, Consensus Revenue Estimating Group (CREG), October 2003.

Ad valorem assessments and taxes paid based on an LSO summary of Revenue Committee handouts from it meeting on Thursday, September 25th. Sales and use taxes, and other taxes as reported in the *State of Wyoming Department of Revenue Tax Distribution Report, FY02*, Department of Revenue.

Corporate profits are taken as reported to the Revenue Committee on Thursday, September 25th by Rep. Childers based on IRS data and aggregated by LSO.

#### Notes:

(1) Industries generally reflect SIC classifications. Utilities and Transportation & Warehousing are combined for purposes of comparability. "Commercial" includes Construction, Wholesale Trade, Retail Trade, Information, Finance and Insurance, Real Estate & Rental & Leasing, Professional & Technical Services, Management of Companies & Enterprises, Administrative & Waste Services, Educational Services, Health Care & Social Assistance, Arts, Entertainment, & Recreation, Accommodation & Food Services, Other Services, except Public Administration, and Nonclassified.

(2) Sales and Use tax category includes state and local general and optional sales taxes, lodging taxes, penalties, interest, and fees. For the Agriculture, Forestry, Fishing, and Hunting industry, the total reflects the statewide taxes fitting the above definition and classified by the Department of Revenue as Agriculture, Forestry, and Fisheries SIC codes. Mining translates to the Mining SIC industry codes. Manufacturing translates to the Manufacturing SIC codes. Utilities, Transportation, and Warehousing industries total includes the combined SIC category of Transportation, Communication, and Public Utilities. Commercial includes SIC codes relating to the industries of Contract Construction, Retail, Wholesale, Finance, Insurance and Real Estate, and Services. Government relates to the SIC code designation of Government.

Some sales and use taxes are reflected in the government category; and significantly influenced by the sales and use taxes for personal property, such as vehicles, paid to county governments.

(3) Other taxes include cigarette taxes, gross receipts of the state liquor division, liquor taxes, and franchise taxes. All are entirely assumed to be applied to the Commerce industry. (Technically these taxes are not paid by the Commerce industry but by consumers generally and remitted by the retail sector.) Other taxes and fees not designated such as the estate taxes, public service commission fees, rents and royalties from state lands, Wyoming's share of abandon mine lands (AML) fees, federal mineral royalties, and government user fees are not included in any category for any industry.

(4) Fuel taxes data are generally not collected by industry classification. Further, it is impossible to determine the purpose of the purchase at the pump. Consistent with previously applied rationales in this analysis, one could apply the total taxes paid to the Commerce (or retail) industry, as the sector remitting most payments (statutory incidence). Other, more elaborate attempts could be made to make a distinction between industry categories. LSO estimates based on DOT data suggest, at minimum, the following roughly applies to total fuel tax revenues in FY2002: off-road mining (\$2.2 million), off-road agriculture (\$1.6 million), transportation (\$17.7 million), highway users and off-road construction (\$90.5 million). Readers can incorporate this information as they deem appropriate.

## Attachment B: Relative Contribution of Major State Tax Collections, by State and Source (2002)

|                | Property taxes | Sales and Gross Receipts | Individual Income Taxes | Corporation Net Income | Other |
|----------------|----------------|--------------------------|-------------------------|------------------------|-------|
| UNITED STATES  | 1.8%           | 48.9%                    | 34.7%                   | 4.9%                   | 9.8%  |
| ALABAMA        | 2.8%           | 49.2%                    | 34.9%                   | 4.7%                   | 8.4%  |
| ALASKA         | 4.6%           | 13.0%                    | 0.0%                    | 24.7%                  | 57.7% |
| ARIZONA        | 3.9%           | 63.2%                    | 24.7%                   | 4.1%                   | 4.2%  |
| ARKANSAS       | 9.7%           | 51.4%                    | 29.6%                   | 3.2%                   | 6.1%  |
| CALIFORNIA     | 2.5%           | 39.5%                    | 42.5%                   | 6.9%                   | 8.6%  |
| COLORADO       | 0.0%           | 40.9%                    | 50.2%                   | 3.0%                   | 5.9%  |
| CONNECTICUT    | 0.0%           | 50.0%                    | 40.8%                   | 1.7%                   | 7.5%  |
| DELAWARE       | 0.0%           | 14.9%                    | 33.0%                   | 11.6%                  | 40.6% |
| FLORIDA        | 1.7%           | 76.2%                    | 0.0%                    | 4.9%                   | 17.1% |
| GEORGIA        | 0.4%           | 43.7%                    | 47.1%                   | 4.1%                   | 4.7%  |
| HAWAII         | 0.0%           | 61.9%                    | 32.5%                   | 1.5%                   | 4.0%  |
| IDAHO          | 0.0%           | 49.2%                    | 37.1%                   | 3.4%                   | 10.4% |
| ILLINOIS       | 0.3%           | 49.3%                    | 30.9%                   | 9.2%                   | 10.3% |
| INDIANA        | 0.0%           | 53.4%                    | 35.4%                   | 6.7%                   | 4.4%  |
| IOWA           | 0.0%           | 50.7%                    | 35.3%                   | 1.8%                   | 12.2% |
| KANSAS         | 1.1%           | 50.6%                    | 38.6%                   | 2.5%                   | 7.2%  |
| KENTUCKY       | 5.5%           | 46.9%                    | 33.6%                   | 3.8%                   | 10.2% |
| LOUISIANA      | 0.5%           | 57.1%                    | 24.2%                   | 3.6%                   | 14.7% |
| MAINE          | 1.8%           | 47.1%                    | 40.8%                   | 2.9%                   | 7.3%  |
| MARYLAND       | 2.5%           | 43.4%                    | 43.5%                   | 3.3%                   | 7.3%  |
| MASSACHUSETTS  | 0.0%           | 35.2%                    | 53.4%                   | 5.5%                   | 6.0%  |
| MICHIGAN       | 8.6%           | 46.1%                    | 28.0%                   | 9.4%                   | 7.8%  |
| MINNESOTA      | 0.1%           | 44.6%                    | 42.1%                   | 4.2%                   | 9.1%  |
| MISSISSIPPI    | 0.0%           | 67.3%                    | 20.8%                   | 4.1%                   | 7.7%  |
| MISSOURI       | 0.2%           | 47.7%                    | 41.7%                   | 3.5%                   | 6.9%  |
| MONTANA        | 12.6%          | 25.7%                    | 35.9%                   | 4.7%                   | 21.1% |
| NEBRASKA       | 0.2%           | 50.3%                    | 38.5%                   | 3.6%                   | 7.3%  |
| NEVADA         | 2.9%           | 84.6%                    | 0.0%                    | 0.0%                   | 12.5% |
| NEW HAMPSHIRE  | 26.6%          | 32.1%                    | 3.8%                    | 20.0%                  | 17.4% |
| NEW JERSEY     | 0.0%           | 47.9%                    | 37.3%                   | 6.0%                   | 8.8%  |
| NEW MEXICO     | 1.5%           | 50.2%                    | 27.1%                   | 3.4%                   | 17.8% |
| NEW YORK       | 0.0%           | 30.3%                    | 59.1%                   | 5.2%                   | 5.3%  |
| NORTH CAROLINA | 0.0%           | 42.2%                    | 46.8%                   | 4.3%                   | 6.7%  |
| NORTH DAKOTA   | 0.1%           | 55.5%                    | 17.9%                   | 4.5%                   | 22.1% |
| OHIO           | 0.1%           | 44.9%                    | 42.5%                   | 3.9%                   | 8.6%  |
| OKLAHOMA       | 0.0%           | 37.5%                    | 37.8%                   | 2.9%                   | 21.8% |
| OREGON         | 0.0%           | 12.7%                    | 71.5%                   | 3.8%                   | 12.0% |
| PENNSYLVANIA   | 0.2%           | 49.5%                    | 30.4%                   | 5.4%                   | 14.5% |
| RHODE ISLAND   | 0.1%           | 54.6%                    | 38.7%                   | 1.3%                   | 5.4%  |
| SOUTH CAROLINA | 0.2%           | 54.9%                    | 34.0%                   | 3.8%                   | 7.1%  |
| SOUTH DAKOTA   | 0.0%           | 79.6%                    | 0.0%                    | 4.2%                   | 16.3% |
| TENNESSEE      | 0.0%           | 77.5%                    | 1.9%                    | 6.5%                   | 14.1% |
| TEXAS          | 0.0%           | 82.3%                    | 0.0%                    | 0.0%                   | 17.7% |
| UTAH           | 0.0%           | 51.5%                    | 40.9%                   | 2.8%                   | 4.7%  |
| VERMONT        | 31.6%          | 34.5%                    | 24.4%                   | 2.4%                   | 7.1%  |
| VIRGINIA       | 0.2%           | 37.4%                    | 52.5%                   | 2.4%                   | 7.5%  |
| WASHINGTON     | 11.5%          | 78.8%                    | 0.0%                    | 0.0%                   | 9.7%  |
| WEST VIRGINIA  | 0.1%           | 54.1%                    | 29.1%                   | 6.2%                   | 10.5% |
| WISCONSIN      | 0.8%           | 45.9%                    | 42.1%                   | 4.4%                   | 6.8%  |
| WYOMING        | 13.2%          | 49.7%                    | 0.0%                    | 0.0%                   | 37.2% |

Source: LSO analysis of U.S. Census Bureau data, 2002.