

Innovative Taxes Enacted by the States

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Some states have embarked on efforts to tax businesses either as an alternative to a more traditional corporate net income or franchise tax or as a complementary tax. These efforts were undertaken at some political risk to policy makers because fiscal needs were determined to be critical. A brief description of some of these taxes follows.

Among these efforts is the **New Hampshire** Business Enterprise Tax, which has been described as a multistage consumption tax or value added tax (VAT) imposed and administered at the business level. The rate is 0.75% on the enterprise value tax base, which is the sum of all compensation paid or accrued, interest paid or accrued, and dividends paid by the business enterprise, after special adjustments and apportionment. Enterprises with more than \$150,000 of gross receipts from all their activities, or an enterprise value tax base more than \$75,000, are required to file a return. New Hampshire retained its longtime business profits tax, and adopted the BET as an alternative tax that is allowed as a credit against BPT liability. Advocates for the tax argue that it is a both economically and politically stable source of revenue and that the business community in New Hampshire is very supportive.

Michigan has replaced its Single Business Tax with the Business Income Tax (MBT). The MBT is imposed on the business income of all taxpayers (not just corporations) with business activity in Michigan, subject to the limitations of federal law. "Business income" is defined as "that part of federal taxable income derived from business activity." For a tax-exempt person, business income means only that part of federal taxable income derived from unrelated business activity. Business income is subject to a number of adjustments, including a deduction for net earnings from self-employment as defined in Internal Revenue Code (IRC) section 1402, and then apportioned using the sales factor. Any federal net operating loss carryback or carryover is added into the tax base before apportionment, and any apportioned negative business income taxable amount incurred after 2007 is deducted from the tax base after apportionment. In addition to the MBT, Michigan adopted a Modified Gross Receipts Tax. The modified gross receipts tax base is defined as gross receipts less purchases from other firms. Michigan Business Tax (MBT) uses the Single Business Tax (SBT) definition of gross receipts, with additional exclusions for a motor vehicle sales finance company, mortgage company, professional employer organization, and for invoiced items used to provide more favorable floor plan assistance. "Purchases from other firms" is defined to mean inventory acquired; other materials and supplies; depreciable property acquired; for a staffing company, the compensation of personnel supplied to their customers; and for a construction contractor not eligible for the section 417 alternate tax credit, payments to a subcontractor. Inventory is defined to include the floor plan interest expenses of new motor vehicle dealers. For the 2008 tax year, a taxpayer may deduct 65% of an SBT business loss carryforward incurred in 2006

or 2007. The tax base is apportioned using the sales factor.

The **Ohio** Commercial Activity Tax (CAT) first applies for taxable gross receipts received on and after July 1, 2005. The CAT is an annual privilege tax measured by gross receipts on business activities in this state. Ohio's CAT was one element of a tax reform package that had several parts. The CAT was intended to replace two business taxes: the tangible personal property tax and the corporate franchise tax. The tax was intended to simultaneously satisfy several goals of tax policy. First, the tax was designed satisfy the “low-rate, broad-base” criteria. The theory idea is that a tax that falls upon a very broad swath of economic activity, but at a very low tax rate, will tend to minimize the distortion of economic decisions. Second, the CAT deliberately moved away from taxing businesses on their profits. It seeks to adopt the theory that businesses should be taxed in proportion to the government benefits that they receive. Ohio's CAT attempts to incorporate this benefit principle of taxation, taking gross receipts as a proxy for the scale of the business enterprise and thus as a proxy for the extent to which the business makes use of Ohio's roadways, waterways, police and fire protections, court system, and other public services. Third, the CAT addresses the principle of state competitiveness. The CAT is explicitly a pro-exporting. Ohio-based production that is exported to other countries or to other states is not subject to the CAT, but imports into Ohio are subject to the CAT. It applies to all types of businesses: e.g., retailers, service providers (such as lawyers, accountants, and doctors), manufacturers, and other types of businesses. The CAT also applies whether the business is located in this state or is located outside of this state if the taxpayer has enough business contacts with this state. The CAT applies to all entities regardless of form, (e.g., sole proprietorships, partnerships, LLCs, and all types of corporations). A person with taxable gross receipts of more than \$150,000 per calendar year is subject to this tax, which requires such person to register with this department as a taxpayer. Certain receipts are not taxable receipts, such as interest income. The tax does have limited exclusions for certain types of businesses, such as financial institutions, dealers in intangibles, insurance companies and some public utilities if those businesses pay specific other Ohio taxes. Gross receipts subject to CAT are broadly defined to include most business types of receipts from the sale of property or realized in the performance of a service. The following are some examples of receipts that are not subject to the CAT: interest (other than from installment sales), dividends, capital gains, wages reported on a W-2, or gifts. In general, for the sale of property, such receipt is only considered a taxable gross receipt if the property is delivered to a location in this state. For services, the receipt is situated (sourced) to Ohio in the proportion that the purchaser's benefit in this state bears to the purchaser's benefit everywhere. The physical location where the purchaser ultimately uses or receives the benefit of what was purchased is paramount in making this determination, *i.e.*, receipts from sales to out-of-state purchasers or the proportion of the services where the benefit is primarily received outside of this state are not subject to the CAT.

The revised **Texas** Franchise Tax was born out of crisis. Texas had labored on

the issue of the property tax as a mechanism for financing public education for years without finding a solution that was acceptable. Only after the Texas Supreme Court declared the system unconstitutional did the popular and political will come together to find a funding solution. One major aspect of the solution was applying the tax to entities that had not before been included in the tax base. The revised Franchise Tax, known as the "Margin Tax" applies to more kinds of entities than the franchise tax it replaced. Taxable entities now include partnerships (general, limited and limited liability), corporations, LLCs, business trusts, professional associations, business associations, joint ventures and other legal entities. The revised franchise tax does not apply to sole proprietorships (except the tax does apply to single member LLCs filing as a sole proprietor for federal income tax purposes); general partnerships directly and solely owned by natural persons (except the tax does apply to all limited liability partnerships); certain exempt entities and passive entities. The revised franchise tax base is the taxable entity's margin. Margin equals the lowest of three calculations: total revenue minus cost of goods sold; total revenue minus compensation; or total revenue times 70 percent. The franchise tax rates are 1.0% for most entities, 0.5% for qualifying wholesalers and retailers or 0.575% for those entities with \$10 million or less in Total Revenue (annualized per 12 month period on which the report is based) electing the E-Z Computation. Taxable entities with total revenue (annualized per 12-month period on which the report is based) of \$300,000 or less will owe no tax. Taxable entities with tax due of less than \$1,000 will owe no tax. Exception: If the entity is a tiered partnership, the calculated amount of tax is due, even if it is less than \$1,000. A taxable entity with total revenue of \$10 million or less, annualized per 12 month period on which the tax is based, may elect to pay the franchise tax by multiplying total revenue times the apportionment factor times a tax rate of 0.575% (.00575). A taxable entity that elects to use the E-Z Computation may still qualify for the discount from tax liability; however, the taxable entity may not claim any credits.