



State Business Tax Developments

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Presentation to Maryland Business Tax Reform
Commission

July 9, 2009

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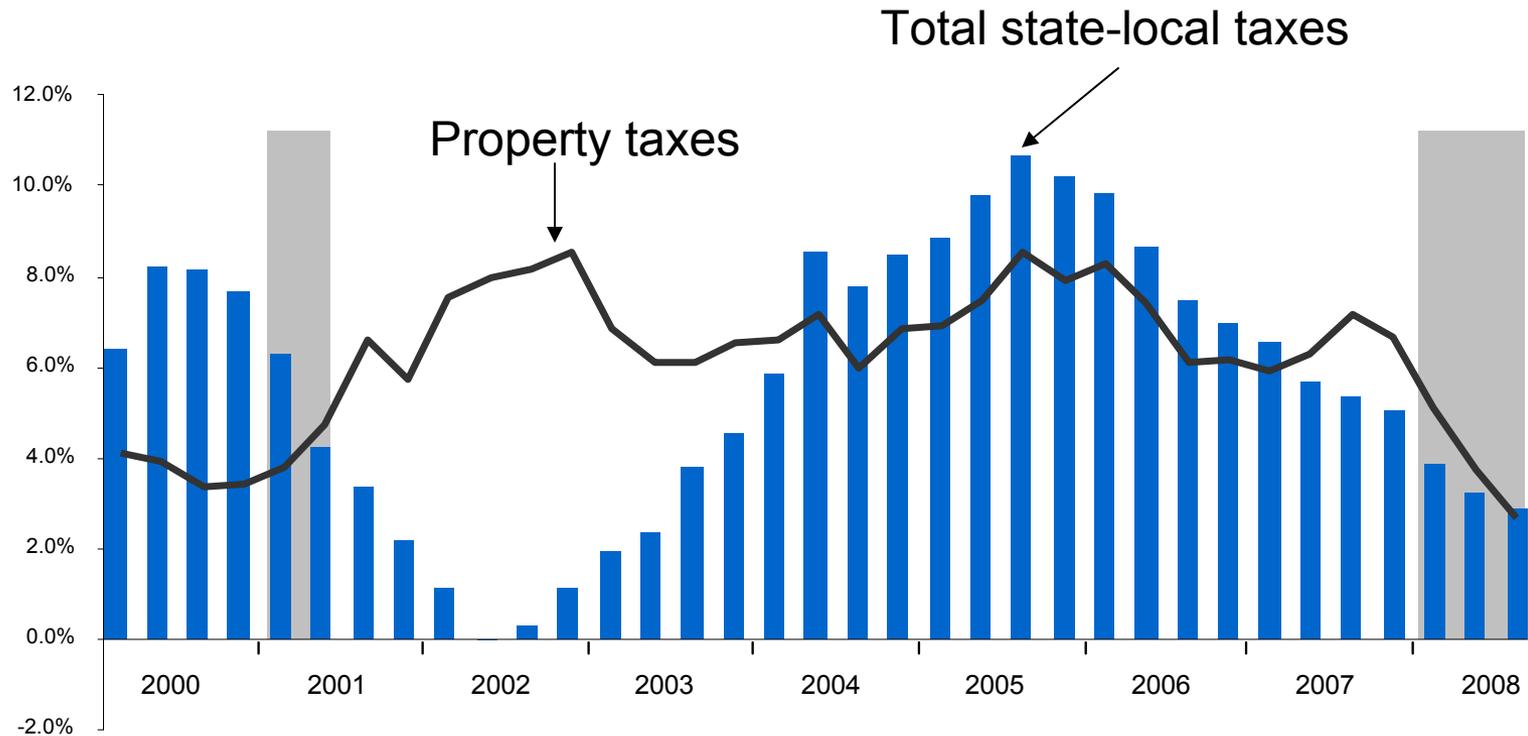
State and local business tax system

- ▶ FY 2008 annual 50-state study done in conjunction with COST
- ▶ E&Y estimates of state-local taxes that are the legal liabilities of business: includes corporate and pass-thru business income, net worth, sales tax on business purchases, property taxes
- ▶ \$590 billion of state-local taxes -- 44% of total taxes
- ▶ Business taxes increased faster than non-bus. taxes prior 5 yrs.
- ▶ Property tax accounts for 36% of business taxes; 22% share for sales tax paid on business input purchases
- ▶ Corporate income tax share is 9.6% and falling
- ▶ Study compares business taxes to state-local spending on programs that directly benefit business -- benefits received rationale for bus. taxes. In 2008, business taxes exceeded estimated benefits by 83%; in MD the excess is 47%

FY2008 state and local business taxes

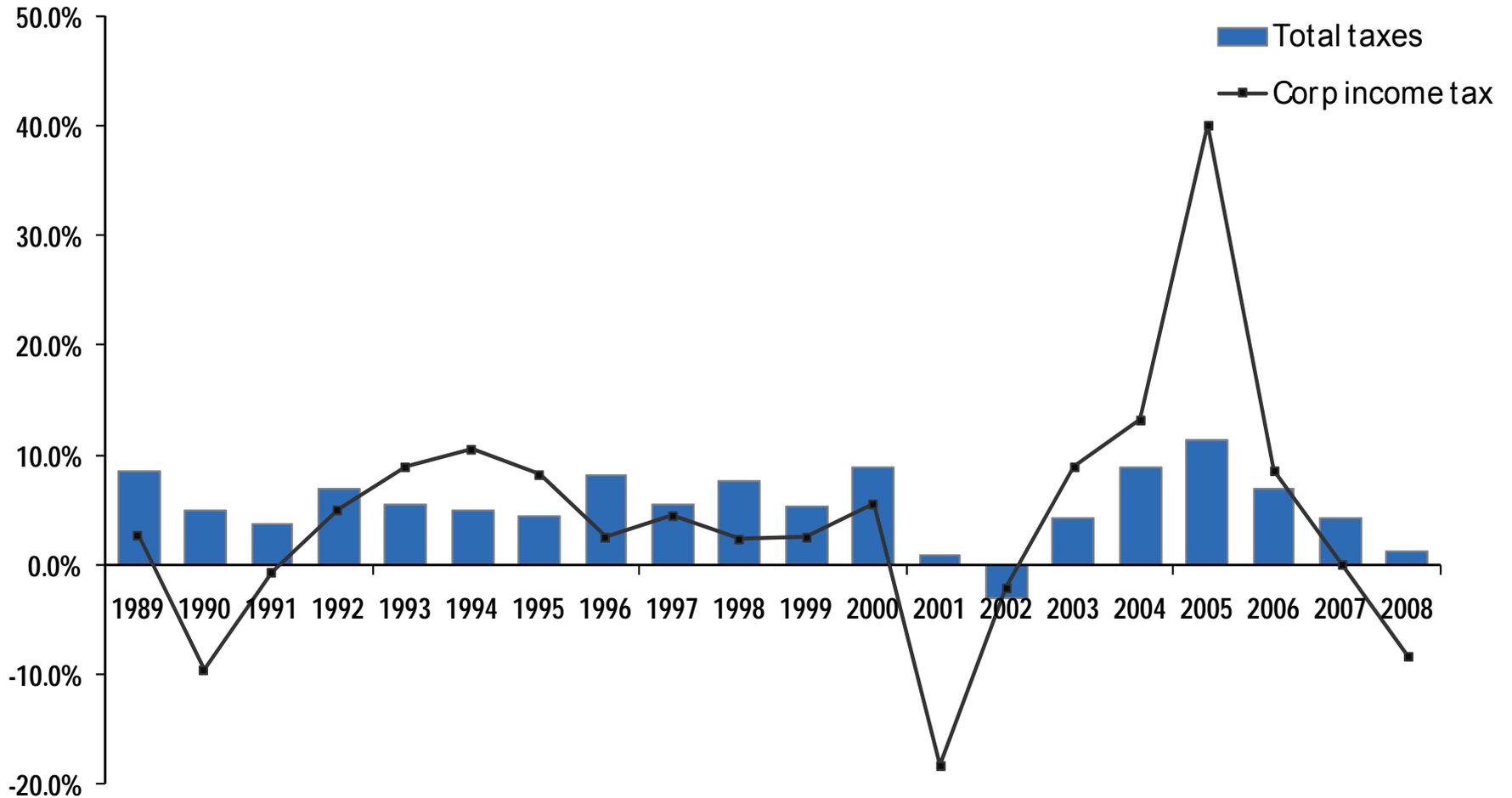
Business Tax	2008 (\$billions)	% Total Taxes	One-Year Growth
Property taxes on business property	\$209.3	35.5%	4.9%
General sales taxes on business inputs	130.8	22.2%	1.3%
Corporate income tax	56.9	9.6%	-7.1%
Unemployment insurance	32.5	5.5%	-9.2%
Business and corporate license	36.8	6.2%	7.1%
Public utility taxes	26.6	4.5%	12.1%
Individual income tax on business income	27.2	4.6%	5.4%
Excise taxes	26.0	4.4%	-6.0%
Insurance premiums taxes	15.6	2.6%	0.7%
Other bus. taxes (includes severance tax)	28.4	4.8%	28.8%
Total Business Taxes	\$590.0	100.0%	2.7%

Property taxes will not prop up state and local total taxes in this recession



4-quarter moving average of percent changes in taxes

State corporate income tax vs. total state taxes, % change (fiscal years, 1989- 2007)

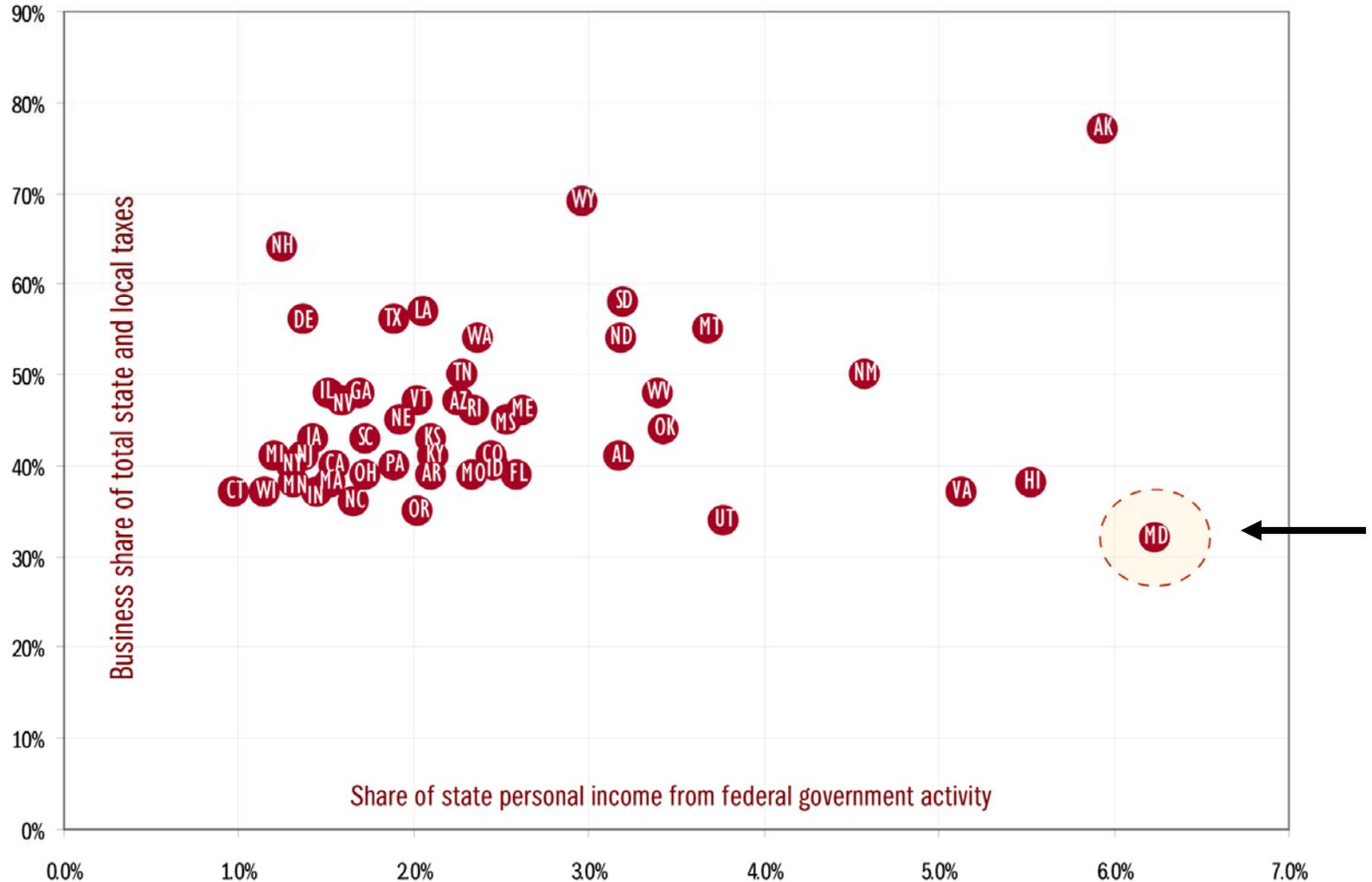


Maryland state and local business taxes

FY 2008 (billions of dollars)

<u>Business Tax</u>	<u>Amount</u>	<u>1-yr growth</u>
Property tax on bus. prop.	\$2.3	5%
Sales tax on bus. inputs	1.5	9%
Corporation income tax	0.7	-6%
Business license tax	0.4	-3%
Unemployment insurance	0.4	-22%
Excise taxes	0.7	-1%
Individual income tax	0.9	17%
Public utility tax	0.5	4%
Insurance premiums tax	0.4	8%
Other business taxes	1.3	4%
<u>Total business taxes</u>	<u>\$9.2</u>	<u>3%</u>

Importance of non-taxable federal government activity in Maryland



Short-Run business tax developments

- ▶ Shoring up existing taxes – changes in rates and bases
- ▶ Continued efforts to increase taxes on “out-of-state” firms: economic and affiliate nexus, market sourcing, combined reporting, expense addbacks, single sale factor apportionment.
- ▶ Combined reporting: adopted in WI, being considered in CT, NC and PA – more than “loophole closing”
- ▶ Property tax increases on business: rising rates, including effects of homestead exemptions, increased share of assessed values, classified property tax systems
- ▶ Shift to non-income tax bases: large filing fees, alternative minimum taxes based on gross receipts as a backstop to the corporate income tax
- ▶ Significant unemployment tax increases

Longer-run perspective: tax changes to improve competitiveness

- ▶ Single sales factor apportionment
 - CA election
 - VA election for manufacturers
 - New York City phase in
- ▶ NJ throws out throwout
- ▶ Proposals to eliminate CIT: RI, MN, GA, SC, CA
- ▶ Opportunities to expand targeted credits and incentives
- ▶ More attention is being focused on the longer-run competitiveness impacts of tax policy changes
- ▶ Analysis of the positive or negative economic impacts of business tax changes – focuses on the private-sector impacts

What are states trying to accomplish with longer-run business tax reform?

- ▶ Improve business tax *system* competitiveness
 - Reduce taxes on mobile capital, including property taxes
 - Shift taxes to “out-of-state” taxpayers – move from origin to destination-based taxes; relax P.L. 86-272 constraint
- ▶ Find a more stable source of business tax revenue
 - Corporate income taxes fell 24% in last recession, increased 115% in 5 years, and have fallen more than 20% in this recession
- ▶ Tax all forms of doing business, not just corporations, to broaden the base, lower tax rates, reduce market distortions
- ▶ Find an effective way to tax services and cross-border sales – issues of taxing business inputs and protection of *Quill*
- ▶ Changing perspective from ability-to-pay to benefits-received rationale for business taxes -- issue of low-profit/loss firms)

Taxonomy of new state business taxes

Tax Base	Examples	Description of Tax Base
General gross receipts tax (GRT)	OH CAT, WA B&O	Gross receipts (GR) with few, if any, deductions
	TX tax base option	70% of GR
Modified GRT	1 of 2 new MI bases	GR minus purchases of goods from other firms
Value-added tax (VAT)	MI SBT (1975), earlier BAT (1953) NH BET (1993)	GR minus purchases from other firms Minimum tax based on modified VA (credit against corporate income tax)
Gross margin tax	TX tax base option; NJ AMA	Gross receipts minus cost of goods sold (COGS)
Labor-adjust. GRT	TX tax base option	Gross receipts minus labor costs
Business income tax	1 of 2 new MI bases	GR minus labor costs, depreciation, interest paid, all purchases from other firms
Corporate inc. tax	Current CA tax	Same as bus. inc., but limited to corporations

Business tax rate comparisons

*Tax rates needed to raise \$50 billion a year nationally
in state and local business taxes*

Corporate income tax	5.8%
Business income tax	3.3%
Valued added tax	1.1%
Gross receipts tax	0.3%

Recent state business tax reforms

► Ohio Reform (2005)

- New commercial activity tax (CAT): 0.26% times gross receipts in excess of \$1m (\$150 minimum tax); minimum filing threshold of \$150,000
- Applies to all forms of doing business and most industries; economic nexus adopted
- Eliminated local business tangible property tax, corporate income tax & net worth tax; cut business taxes \$1.4b (-9%)
- Destination sales; P.L. 86-272 not applicable; combined filing or elective consolidation with deduct. for intercompany sales
- Phased in over five years
- Revenue in first few years came in 10% above original est.

Recent business tax reforms (cont.)

► Texas (2006)

- Taxable margin tax: 1.0% general rate (0.5% for whole. & retail) times selected base (70% of GR, GR – COGS, or GR – compensation); taxes most forms of doing business
- \$3.4b increase in business entity taxes; 18% cut in business personal property tax; no net change in total business taxes
- Destination sales apportionment; P.L. 86-272 not applicable; mandatory combined reporting
- No phase in of new tax
- First-yr. collections came in 20% short of estimate
- New law increases the minimum filing threshold from \$300,000 to \$600,000 permanently and to \$1m for two years

Recent business tax reforms (cont.)

▶ Michigan (2007)

- SBT (\$1.8b) replaced with new system: business income tax (4.95%) plus 0.8% times modified GRT
- GRT provides 2/3 of taxes; minimum filing threshold of \$350,000
- Applies to most bus.; destination taxes; economic nexus
- GRT pyramiding reduced by subtract. purchases of tangible property
- New entity taxes of \$3.5b with \$1.6b of new, targeted credits
- Significant property tax reductions
- Overall package shifts taxes from manufacturing to services

▶ Reform studies in CA, RI, NC, MN

Information needed to make informed business tax policy decisions

- ▶ Understanding of the nature of retail sales taxes
 - Current sales tax taxes too many business inputs and too few household purchases
 - Debate over taxing services is a debate about business taxes
- ▶ Accurate estimates of revenue impacts of adopting combined reporting
 - Challenges in estimating revenue impacts for a new system
 - Large numbers of winners and losers
- ▶ Analysis of the “dynamic” impacts of state tax policy changes on the private sector (jobs and income), including ranking tax changes in terms of economic impacts
- ▶ Unintended consequences of tax policy changes: impacts on competitiveness, economic distortions (GRT pyramiding), redistributions of taxes (tax incidence analysis)

Lessons learned from other states

- ▶ Business tax reform packages have included multiple taxes
 - focus on the system of state-local business taxes
- ▶ Not requiring a revenue neutral package of business tax changes provides flexibility to mitigate tax redistributions
- ▶ Importance of identifying winners and losers due to the significant shifts in tax liabilities among firms & households
- ▶ Important to involve the business community in the policy debate and the design of alternative business taxes
- ▶ Pay attention to the transition issues: phase-ins, impacts on balance sheet tax items
- ▶ Focus on the long-run economic benefits of a more competitive state-local business tax system; expect targeted tax credits to be continued in new systems