

Gross Receipts Taxes

A Closer View¹

Overview

The Multistate Tax Compact defines a GRT as "a tax, other than a sales tax, which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which no deduction is allowed which would constitute the tax an income tax".

In 2005, Ohio enacted a GRT called the Commercial Activity Tax (CAT) that is now imposed on all types of business entities. The legislature described the CAT as a tax on the "privilege" of doing business in Ohio - not specifically a sales tax. The rate is 0.26 percent of the business's annual receipts over \$1 million. Businesses with receipts of \$1 million or less pay a flat fee of \$150 and business with receipts of \$150,000 or less owe no tax at all. The rate can be adjusted based on tax collections. The Ohio CAT replaced the state's corporate franchise tax.

In contrast, the recently enacted Michigan GRT is a modified GRT imposed at a rate of 0.8 percent of gross receipts less purchases from other firms. Some jurisdictions with a GRT apply different rates to different industries.

Design and Legal Constraints

The Ohio CAT cannot be passed directly through to customers or shown separately on a customer invoice. Per a Q&A from Ohio's Department of Revenue, the CAT is not considered a sales tax, but is instead a tax on business activity. However, the CAT can be included in the overall costs of doing business and factored into the prices the business can charge.

Generally, the "true economic impact of a tax is what ultimately determines its nature" (In re: Advisory Opinion To The Governor, 509 So. 2d 292 (S. Ct. Fl 1987)). If a business has all of its sales subject to sales tax and is subject to a GRT on those sales receipts, its sales tax and GRT base would be the same. However, the GRT operates differently from a sales tax. Generally, a sales tax

exempts sales made for resale while a GRT does not. Also, a sales tax is separately shown on sales invoices, while typically a GRT is not. In addition, when, for example, Taxpayer in State Y purchases from an out-of-state vendor, Taxpayer owes use tax to State Y. However, State Y won't necessarily collect GRT on the transaction.

The nature of a GRT is relevant in at least three situations.

1. State law prohibits or requires special treatment of a particular type of tax.

In *Ohio Grocers Association v. Wilkins* (06CVH02-2278 (PDF), 8/24/07), the Ohio CAT was challenged as unconstitutionally imposed on food sales. The CAT was upheld as an excise tax on the privilege of doing business in Ohio rather than imposed on food sale transactions. In *Volusia County Kennel Club v. Haggard*, 73 So.2d 884 (S Ct. Fl 1954), cert denied 348 US 865 (1954), the court held that a GRT on gambling was a privilege tax rather than an income tax and therefore was not prohibited under Florida law.

2. Treatment of the tax by other states. For example, Wisconsin law does not allow a deduction for a GRT, but GRT paid might generate a credit for income taxes paid to another state.

3. Determining the appropriate nexus standard. Nexus guidance under P.L. 86-272 only applies to net income taxes and so does not apply to a GRT. Thus, businesses with customers, employees or property in a GRT state must review the state's law to determine if they owe GRT. Such laws pose constitutional issues if too broad in their reach.

Controversial Features

Some GRT features have generated or likely will generate legal challenges for some taxpayers and jurisdictions.

Nexus: The CAT nexus standard is modeled on the Multistate Tax Commission's factor presence standard (PDF). An out-of-state business is treated as having substantial nexus in Ohio and thus subject to the CAT if it meets any of the following criteria: (1) at least \$500,000 in taxable gross receipts in Ohio, (2) at least \$50,000 of property in Ohio, (3) at least \$50,000 of payroll for work done in Ohio, or (4) at least 25 percent of its total property, payroll or sales in Ohio. This standard is different from what Ohio uses for its sales and franchise taxes.

In contrast, a business has nexus in Michigan if it has a physical presence there for more than one day during the tax year or it "actively solicits" (PDF) sales in Michigan and has unapportioned gross receipts of \$350,000 or more sourced there.

Challenges are likely with new nexus standards and issues as to the nature of a GRT.

Sourcing: Determining whether a business is subject to tax and if so, how much of its receipts are taxable, can raise apportionment issues and commerce clause issues.

Differences in sourcing rules stem from varying purposes that states have for their GRTs. Ohio does not tax export sales, indicating that the state is encouraging businesses to locate in state and have customers out of state. In contrast, Washington's GRT (called the Business & Occupations (B&O) tax) is imposed on businesses for engaging in commercial activities within the state (RCW

82.04.220). This design ties the tax to benefits received in the state (for doing business there). For a contrast of sourcing and apportionment approaches, compare Ohio (PDF) and Washington.

Conclusion

No question, Gross Receipts Taxes are getting a great deal of attention today as policy makers wrestle with exactly what kind of a tax a GRT is - or should be. In addition, issues exist for each individual state as lawmakers debate whether or not a GRT is a desirable way to tax businesses that operate within their jurisdictions.

Source: AICPA

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