

Gross Receipts Tax

In recent years, concern over declining corporate tax collections, aggressive tax planning and state revenue needs have led a few states to consider and even enact a gross receipts tax (GRT) on companies that do businesses within its borders. On the surface, a GRT is simple since it allows no deductions. The broad base allows for a very low rate that can make the tax more palatable. Further, all businesses are typically subject to the GRT, with the result that all businesses contribute something to state coffers.

Yet, many oppose the GRT because of its inherent flaws, one being that it is not tied to a business's ability to pay. Below, we'll look at reasons why some state tax reform discussions include the GRT and how the GRT stacks up against the principles of good tax policy. For more information see [Gross Receipts Taxes \(April 2008\)](#).

Rationale

The Multistate Tax Commission reports that in 1962 and 1980, corporate income taxes represented 6.4 percent and 9.7 percent of state tax receipts, respectively. In 2002, that percentage dropped to 4.9 percent ([Federalism at Risk \(PDF\)](#), 2003).

States have also seen corporations increasingly using a mix of tax provisions to optimize planning through the use of "nowhere income," holding companies, beneficial apportionment factors and state tax incentives. Budget deficits have led many states to reconsider their tax systems. The Center on Budget and Policy Priorities reports that a majority of states face budget problems for fiscal year 2009.

These concerns led to GRTs in Ohio (2006) and Michigan (2007). Ohio's GRT was part of a reform measure that also reduced the top personal income and sales tax rates and eliminated the corporate franchise and tangible personal property tax. Michigan's GRT arose from budget concerns and a desire to improve the business climate by encouraging jobs, investment and R&D ([Michigan Dept. of Treasury and Governor's statement \(PDF\)](#)).

These concerns also led Illinois Governor Blagojevich to propose a GRT in March 2007. He noted ([PDF](#)) that the average Illinois taxpayer paid \$1,500 of state income taxes. However, an average of only \$151 of corporate income tax was paid by 12,521 of the largest corporations in the state. He proposed ([PDF](#)) a "historic Tax Fairness Plan" to "replace the loophole riddled corporate income

tax with a simple, fair" GRT.

However, his proposal had strong opposition. The Illinois Association of Realtors issued a report noting that the GRT would increase housing costs and result in a loss of about 14,000 construction jobs due to pyramiding (where tax is paid on a tax). In May 2007, the Illinois General Assembly voted unanimously to oppose the GRT (HR 402, May 2007).

An understanding of the pros and cons of a GRT helps explain how it can be so loved and hated.

Advantages and Disadvantages

Evaluation of a GRT within the context of the principles of good tax policy (PDF) follows.

Equity: A GRT is not based on a taxpayer's ability to pay and does not tie well to benefits received by the state. Profit margins vary by business and industry. A GRT is more favorable to a high-margin business than a low-margin one. A GRT can tend to favor a larger business that is (or can become) vertically integrated relative to a small business that must buy from other companies with GRT included in the prices.

A GRT often applies to all forms of businesses that can improve equity compared to having different tax systems for sole proprietors and corporations. A GRT can also be viewed as equitable in that every business pays something.

Certainty: While a GRT may be certain for an in-state business, it can be less certain for multistate businesses. For example, the guidance and protection of P.L. 86-272 does not apply since a GRT is not a net income tax, leaving taxpayers with less certainty as to where they may be subject to GRT. **Simplicity:** Lack of deductions makes a GRT simpler to compute and audit relative to an income tax. However, GRTs tend to vary among jurisdictions as to the base, sourcing, nexus and apportionment rules, which increases complexity. Some states also address GRT problems, such as pyramiding, by allowing certain deductions or having different tax rates for different industries, which can also create complexities.

Neutrality: With no deductions or credits, a GRT is less likely to affect business decisions than a typical income tax. However, some GRTs do include deductions and credits.

The significant neutrality concern is pyramiding in which tax is paid on a tax. Because GRT is owed by each company providing services or goods along a production and distribution chain, it is built into prices charged, with GRT again paid by the purchaser. A 2002 study of Washington's Business & Occupation tax (a GRT) found that it pyramided an average of 2.5 times ranging from about 1.5 times for service businesses and over six times for some manufacturers. Pyramiding can affect business operational decisions such as encouraging provision of goods and services in-house or purchasing from firms not subject to the GRT (that might be out-of-state firms).

Michigan partially addresses pyramiding by allowing companies to deduct purchases from other firms from the GRT base. Some states use multiple rates. However, pyramiding is inherent in a GRT. States eager to reduce pyramiding should consider a value-added tax since it is structured to

eliminate pyramiding.

Economic growth: A GRT can be harmful to start-ups that tend to operate at a loss. The pyramiding effect and any unintended consequence of a GRT encouraging firms to purchase from out-of-state firms can also harm economic growth.

Transparency: A GRT is not visible because typically businesses may not separately state it on sales invoices. Also, it is not obvious how much GRT is included in prices due to pyramiding.

Appropriate government revenues: A state may find that a GRT helps it achieve its revenue and economic development goals. However, if that result is achieved with a modified GRT with multiple rates and special deductions and credits, a net income tax could probably have been used instead. A GRT may increase sales tax revenues because the GRT is factored into prices charged. A state may prefer a GRT over an income tax because there is no need to consider whether it should conform to federal income tax changes. Finally, states may find that a tax based on gross receipts rather than net income is more stable.

Is It Worthwhile?

Despite the strong negative reaction to a GRT in Illinois, Ohio, Michigan and Texas enacted GRTs in the same time frame.

As states consider tax reform, they should start first by looking at their income taxes, since such levies can be modified to have a broader base and lower rates. States must also consider whether a GRT comports with their economic development goals and is consistent with what comparable states are doing.

If a GRT is created, it will certainly be more acceptable if it replaces other business taxes and addresses some of the concerns we discussed earlier in this article. States have a tremendous opportunity to learn from the states that recently enacted GRTs.

As states struggle to deal with budget problems, we are likely to see more consideration of GRTs despite the criticism against them. However, the exercise might lead states to more effectively consider how existing taxes can be improved.

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