LR 536 Interim Study: Briefing Paper—Gross Receipts Taxes in Other States

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The purpose of this research paper is to help the Revenue Committee of the Nebraska Legislature carry out its 2010 interim study of gross receipts taxes in other states.

I. Purpose of Legislative Resolution 536

The purpose of LR 536 "is to examine gross receipts taxation in other states."[1]

II. Gross Receipts Taxes Generally

In general, a gross receipts tax is a broad-based tax based on gross receipts.[2] Few states impose a gross receipts tax.[3] "Many municipalities, however, impose general business activity taxes measured by gross receipts that resemble" a gross receipts tax.[4]

A. How is a Gross Receipts Tax *Classified*?

"The classification of taxes, like most classifications, depends largely on the purposes of the classifier."[5] State and local taxes can usually be classified as (1) property taxes; (2) excise taxes; (3) income taxes; and (4) capitation or poll taxes."[6]

"A gross receipts tax can be classified as either (1) an excise tax, when it is imposed on a taxable 'event' such as a wholesale or retail sale transaction; or (2) as an income tax, when it is imposed on business profits or the receipt of income."[7]

B. What is the *Subject* of a Gross Receipts Tax?

"A workable definition of the *subject* of a tax is (1) the property taxed in the case of a property tax; (2) the activity, event, privilege, or specific property right taxed in the case of an excise tax; and (3) the income received or accrued in the case of an income tax."[8]

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[1] Legislative Resolution 536, One Hundred First Legislature, Second Session (2010). Gross receipts taxes in the following states are examined herein: Washington, New Mexico, New Jersey, and Hawaii. West Virginia repealed its gross receipts tax in 1987. Ohio's "commercial activity tax" is also examined.

[2] Hellerstein and Hellerstein, *State and Local Taxation*, p. 234 (6th ed. 1997)(hereinafter cited as *State and Local Taxation*).

[3] *State and Local Taxation*, p. 234.

[4] *State and Local Taxation*, p. 234.

[5] *State and Local Taxation*, p. 21.

[6] *State and Local Taxation*, pp. 21-22.

[7] *State and Local Taxation*, p. 23.

[8] *State and Local Taxation*, p. 23 (emphasis in original).

C. What is the *Measure* of a Gross Receipts Tax?

"The *measure* of a tax is the yardstick or base to which the tax is applied."[9] The measure of a gross receipts tax is the dollar amount of gross receipts or income subject to taxation.[10]

D. What is the *Rate* of a Gross Receipts Tax?

The rate of a gross receipts tax can vary depending on who the taxpayer is. For example, Washington imposes a gross receipts tax (known as the "business and occupation tax") at different rates depending on the type of business (e.g., retail, wholesale, manufacturing).

E. Who is the *Taxpayer*?

The taxpayer varies depending on how the gross receipts tax is designed.

For example, New Mexico's gross receipts tax is imposed on "the selling business and can be passed on to the consumer."[11] New Mexico imposes an individual income tax and a corporate income tax, but it does *not* impose sales and use taxes.

By contrast, Washington's gross receipts tax (its "business and occupation tax") is imposed on several classes of persons, including retailers, wholesalers, manufacturers, and stevedoring companies. Washington does *not* impose an individual income tax, but it imposes a sales and use tax.[12]

F. How Are Gross Receipts Taxes Different from Sales and Use Taxes?

Gross receipts taxes and sales and use taxes can be distinguished from one another on the basis of how the tax is classified, the measure of the tax, or who the taxpayer is. With respect to sales and use taxes, the ultimate or final consumer of taxable goods and

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[9] *State and Local Taxation*, p. 23 (emphasis in original).

[10] *State and Local Taxation*, p. 23. "Measures of taxes vary widely. . . . Prevalent measures of taxes include: (1) The value of property in the case of a property tax; (2) Receipts or income in the case of gross receipts taxes, gross income taxes, and net income taxes; (3) The selling price in the cased of sales and use taxes; (4) A fixed or flat sum of money in the case of (a) gallonage taxes (such as gasoline taxes and alcoholic beverage taxes), (b) license taxes, and (c) stock transfer taxes; and (5) Miscellaneous measures, such as the (a) weight of a car or truck in the case of motor vehicle license taxes, (b) the face amount of a bond in the case of a bond issue tax, and (c) the amount of authorized capital in the case of a corporate franchise tax." *State and Local Taxation*, p. 23.

[11] Dianne Goodman, "What Is the New Mexico Gross Receipts Tax?", *Journal of State Taxation*, p. 41 CCH (May-June 2010 edition)(hereinafter cited as "What Is the New Mexico Gross Receipts Tax?"). (Copy available upon request.)

[12] *Business and occupation tax*, Washington Department of Revenue ("Washington, unlike many other states, does not have an income tax.") (http://dor.wa.gov/content/FindTaxesAndRates/BAndOTax/).

services is the taxpayer (the seller of the taxable goods or services merely functions as a tax collector), whereas a gross receipts tax is imposed on the seller rather than the buyer. Nevertheless, gross receipts taxes and sales and use taxes can have some things in common. For instance, both types of taxes can be measured by gross receipts and both can be characterized as excise taxes.

III. Washington's "Business and Occupation Tax" (B&O Tax)

A. General Explanation of Washington's B&O Tax

"The state B&O tax is a gross receipts tax."[13]

1. Statutory Jurisdiction ("Nexus") to Impose Apportioned B&O Tax

"Statutory nexus" must be distinguished from "constitutional nexus." The former is a state statute that attempts to assert jurisdiction to impose a tax by setting forth the type and/or extent of activities that are taxable. By contrast, "constitutional nexus" is a judicial doctrine determined by applying the first prong of the U.S. Supreme Court's four-prong test set forth in the *Complete Auto Transit, Inc. v. Brady*[14] case, which evaluated the constitutionality of a state tax that was challenged on grounds that it violated the Commerce Clause and Due Process Clause of the U.S. Constitution. The High Court's Commerce Clause and other constitution-based jurisprudence is examined in Part IX of this research paper.

> Under the economic nexus standard recently adopted by Washington and effective June 1, 2010, royalty income and other apportionable income received from Washington can become subject to business and occupation . . . tax on an apportioned basis. The economic nexus standard may be met without a physical presence in Washington. An out-of-state business receiving royalty/licensing income from patents has nexus under the new standard if in a tax year it has at least one of the following in Washington:
>
> - commercial domicile;
> - property with an average value exceeding $50,000 (including certain third-party costs);
> - sales exceeding $250,000; or
> - at least 25% of its worldwide property, payroll, or sales
>
> Once nexus has been established, it will continue as long as the taxpayer continues to meet at least one of the thresholds and for one year after the year in which the taxpayer no longer meets one of the thresholds.[15]

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[13] *Business and occupation tax*, Washington Department of Revenue (hereinafter cited as *Business and occupation tax*) (http://dor.wa.gov/content/FindTaxesAndRates/BAndOTax/), citing Wash. Stat. § 82-04.

[14] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

[15] "B&O Tax: Impact of Economic Nexus Standard on Businesses Receiving Royalty Income Discussed," *State Tax Review*, p. 26, CCH (July 8, 2010), citing *Special Notice*, Washington Department of Revenue (June 30, 2010).

B. Washington's B&O Tax Base

"Washington's B&O tax is calculated on the **gross** income from activities."[16] "It is measured on the value of products, gross proceeds of sale, or gross income of the business."[17]

C. Washington's B&O Tax Rates

"The B&O tax rate varies by classification."[18] The B&O tax rate for each classification is shown in the following two tables:

Major B&O Classifications [19]

B&O Classification	Rate
Retailing	.00471
Wholesaling	.00484
Manufacturing	.00484
Service & Other Activities	.018

Specialized B&O Tax Classifications [20]

B&O Classification	Rate
Extracting, Extracting for Hire	.00484
Extracting Timber, Extracting for Hire Timber	.003424
Slaughtering, Breaking and Processing Perishable Meat; Manufacturing Wheat into Flour; Soybean & Canola Processing	.00138
Travel Agent Commission; Tour Operators; International Charter Freight Brokers; Stevedoring; Licensed Boarding Homes	.00275
Insurance Agents/Insurance Brokers Commissions	.00484
Prescription Drug Warehousing; Dairy Products, Bio/Alcohol Fuel, or Splitting/Processing Dried Peas	.00138

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[16] *Business and occupation tax* (emphasis in original).

[17] *Business and occupation tax.*

[18] *Business and occupation tax.*

[19] *Business & occupation tax classifications*, Washington Department of Revenue (http://dor.wa.gov/Content/FindTaxesAndRates/BAndOTax/BandOrates.aspx).

[20] *Business & occupation tax classifications*, Washington Department of Revenue (http://dor.wa.gov/Content/FindTaxesAndRates/BAndOTax/BandOrates.aspx).

Processing for Hire; Printing and Publishing	.00484
Processing for Hire Timber Products	.003424
Sale of Standing Timber	.003424
Non-Manufacturing Aerospace Product Development	.0090
FAR Part 145 Repair Stations	.002904
Manufacturing of Timber or Wood Products	.003424
Wholesaling of Timber or Wood Products	.003424
Manufacturing of Commercial Airplanes, Components, or Aerospace Tooling	.002904
Wholesaling of Commercial Airplances, Components, or Aerospace Tooling	.002904
Royalties; Child Care	.00484
Warehousing; Radio & TV Broadcasting; Public Road Construction; Government Contracting; Chemical Dependency Center; Canned Salmon Labelers	.00484
Public or Nonprofit Hospitals	.015
Radioactive Waste Disposal	.0330
Cleanup of Radioactive Waster for US Government	.00471
Service & Other Activities; Gambling Contests or Chance (less than $50,000 a year)	.018
Gambling Contests of Chance ($50,000 a year or greater)	.0193
Parimutuel Wagering	.0013
Retailing of Interstate Transportation Equipment	.00484

D. Washington's B&O Tax Deductions and Exemptions

"[T]here are *no deductions* from the B&O tax for labor, materials, taxes, or other costs of doing business."[21] However, Washington has 58 statutory *exemptions* from its B&O tax, including exemptions for: international banking facilities; insurance business; adult family homes; employees (i.e., "any person in respect to his or her employment in the capacity of an employee or servant,"[22] except independent contractors, booth renters, and "All compensation received in any form for services rendered as a corporate director, including the reimbursement of expenses. . . ."[23]); amounts received by nonprofit organizations for fund-raising activities; certain fraternal and beneficiary organizations;

[21] *Business and occupation tax* (emphasis added).

[22] Wash. Stat. § 82.04.360.

[23] "B&) Tax: Taxability of Corporate Director Fees Discussed," *State Tax Review*, p. 27, CCH (July 8, 2010), citing *Special Notice*, Washington Department of Revenue (June 22, 2010).

operation of sheltered workshops; amounts derived from sale of real estate; mortgage brokers' third-party provider services trust accounts; credit unions; sales of agricultural products; wholesale sales to farmers of seed for planting and conditioning seed for planting owned by others; buying and selling at wholesale unprocessed milk, wheat, oats, dry peas, dry beans, lentils, triticale, canola, corn, rye, and barley; amounts received by hop growers or dealers for processed hops shipped outside the state; hatching eggs and poultry; fruit and vegetable businesses; seafood product businesses; out-of-state membership sales in discount programs; wholesale sales of motor vehicles; sales by certain out-of-state persons to or through direct seller's representatives; accommodation sales; convention and tourism promotion; semiconductor microchips; comprehensive cancer centers; investments, dividends, interest on loans; bad debts; motor vehicle fuel and special fuel taxes; compensation for patient services or attendant sales of drugs dispensed pursuant to prescription by certain nonprofit organizations; manufacturing activities completed outside the United States; reimbursement for accommodation expenditures by funeral homes; municipal sewer service fees or charges; artistic and cultural organizations (income from business activities); sales of fuel for consumption outside United States' waters by vessels in foreign commerce; tuition fees of foreign degree-granting institutions; sale or distribution of biodiesel or E85 motor fuels; amounts received from sale, lease, or rental of electrification systems; and nontaxable business (i.e., "amounts derived from business which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States").[24]

E. Washington's B&O Tax Credits

"Credits are amounts that have been paid to the Department of Revenue and are not due or are granted by the Legislature for a specific purpose. Credits are subtracted from the B&O tax due on your excise tax return."[25] Washington has 20 statutory credits against its B&O tax,[26] but the state's major B&O tax credits are:[27]

- ***Rural County B&O Credit for New Employees:***

  The Rural County Business and Occupation (B&O) Tax Credit for New Employees provides a credit against the B&O tax for each new employment position filled and maintained by qualified businesses located in a rural county or Community Empowerment Zone (CEZ). The program provides: $2,000 credit for each new qualified employment position with annual wages and benefits of $40,000 or less; or $4,000 credit for each new employment position with wages and benefits of more than $40,000 annually. To be granted the credit, the business's average qualified

[24] Wash. Stat. §§ 82.04.4271 to 82.04.4339.

[25] *Business and occupation tax.*

[26] Wash. Stat. §§ 82.04.434 to 82.04.4494.

[27] *Business and occupation tax.*

employment positions at the specific facility must increase by at least 15 percent over the following four calendar quarters from the period in which the employee was hired.[28]

- ***High Technology B&O Tax Credit:***

High technology businesses may claim a B&O tax credit for research and development activities in Washington. Businesses performing research and development in the following areas qualify for the high technology credit: advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology. Persons claiming the credit must file an annual survey due by March 31st of the year following any year in which credit is taken. Effective January 1, 2006, all returns, surveys, reports, and any other required forms or information must be filed in an electronic format as provided or approved by the Department of Revenue.[29]

- ***Small Business B&O Tax Credit:***

Businesses whose B&O tax liability is below a certain level are entitled to a credit. The credit varies depending on the amount of B&O tax due (the total of all classifications) after all other B&O tax credits have been taken. The Small Business Tax Credit is available for businesses whose total B&O tax liability is below: $71 for Monthly taxpayers; $211 for Quarterly taxpayers; $841 for Annual taxpayers.[30]

- ***Multiple Activities Tax Credit (MATC):***

When a business performs more than one taxable activity for the same product, it reports each activity under the proper classification, but takes the MATC credit so B&O tax is not paid twice on the same amount. For instance, a business that both manufactures and sells a product at wholesale in Washington does not pay both manufacturing and wholesaling B&O tax. A credit is allowed so that B&O tax is paid only once. This also applies to a business that has paid a gross receipt tax to another state. Completion of the Multiple Activities Tax Credit, Schedule C, is necessary each time credit is claimed.[31]

E. Municipal B&O Taxes in Washington

"In addition to the state B&O tax, many Washington cities also assess a local B&O tax. There is *no* connection between the state and local B&O taxes."[32]

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[28] *Rural County Business and Occupation (B&O) Tax Credit for New Employees*, Washington Department of Revenue (http://dor.wa.gov/docs/pubs/excisetax/incentprogs/employbocred.pdf).

[29] *High Technology Credit*, Washington Department of Revenue (http://dor.wa.gov/Content/FindTaxesAndRates/TaxIncentives/Def_Credits.aspx#HighTech).

[30] *Small Business B&O Tax Credit*, Washington Department of Revenue (http://dor.wa.gov/Content/FindTaxesAndRates/TaxIncentives/Def_Credits.aspx#SBC).

[31] *Multiple Activities Tax Credit (MATC)*, Washington Department of Revenue (http://dor.wa.gov/Content/FindTaxesAndRates/TaxIncentives/Def_Credits.aspx#MATC).

[32] "What about city and county B&O requirements?", Washington Department of Revenue (emphasis in original) (http://dor.wa.gov/content/QuestionsAndAnswers/article.aspx?id=10343&cNode=5K7T7O). For additional information about municipal B&O taxes in Washington, visit the web site of the Municipal Research and Services Center of Washington, which includes a link to a "model" municipal B&O tax

IV. New Mexico's Gross Receipts Tax

"Most states have what is known as a sales tax. New Mexico does not have a sales tax, but it does impose a Gross Receipts Tax."[33]

A. New Mexico's Gross Receipts Tax Base

"In general, sales and/or leases of goods are taxable."[34] "[S]ales and performance of services are taxable in New Mexico" too, including "services performed outside New Mexico for a product initially used in New Mexico."[35]

> Gross receipts are the total amount of money or value of other consideration received from: Selling property in New Mexico; Leasing or licensing property employed in New Mexico; Granting a right to use a franchise employed in New Mexico; Performing services in New Mexico, and Selling research and development services performed outside New Mexico, the product of which is initially used in New Mexico.
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> "Gross receipts" means the total amount of money or other consideration received from the above activities. Although the gross receipts tax is imposed on businesses, it is common for a business to pass the gross receipts tax on to the purchaser either by separately stating it on the invoice or by combining the tax with the selling price.[36]

B. Who Is the Gross Receipts Taxpayer under New Mexico Tax Law?

"When you engage in business in New Mexico you may be required to pay the Gross Receipts Tax. This tax is paid by the selling business and can be passed on to the consumer."[37]

C. Gross Receipts Tax Exemptions and Deductions

There are 44 statutory *exemptions* from New Mexico's gross receipts tax.[38] Examples of such exemptions "include interest and dividends and receipts of [Internal Revenue Code section] 501(c)(3) nonprofit groups."[39] Additionally, beginning "January 1, 2005, the

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ordinance and links to nine municipal ordinances (including the cities of Seattle and Tacoma) that deviate from the model ordinance: (http://www.mrsc.org/Subjects/Finance/B-Otax.aspx).

[33] "What Is the New Mexico Gross Receipts Tax?", p. 41. See NM Stat. §§ 7-9-1, et seq.

[34] "What Is the New Mexico Gross Receipts Tax?", p. 41.

[35] "What Is the New Mexico Gross Receipts Tax?", p. 41.

[36] *Gross Receipts Tax*, New Mexico Taxation and Revenue Department (July 22, 2010) (hereinafter cited as *Gross Receipts Tax*) (http://www.tax.newmexico.gov/All-Taxes/Pages/Gross-Receipts-Tax.aspx).

[37] "What Is the New Mexico Gross Receipts Tax?", p. 41.

[38] See NM Stat. §§ 7-9-12 to 7-9-41.4, and § 7-9-110.

[39] "What Is the New Mexico Gross Receipts Tax?", p. 42.

gross receipts tax was eliminated from certain food sales and certain health care services. In addition, prescription drugs are no longer subject to this tax. . . ."[40]

There are 78 statutory *deductions* from New Mexico's gross receipts tax.[41] Examples of such deductions "include sales for resale, construction material and services sold to a construction contractor for use in a construction project, and sales by suppliers of components in manufacturing processes."[42]

D. New Mexico's Gross Receipts Tax Rate

"The gross receipts tax rate varies throughout the state from 5.125% to 8.6875% depending on the location of the business. It varies because the total rate combines rates imposed by the state, counties, and, if applicable, municipalities where the businesses are located. The business pays the total gross receipts tax to the state, which then distributes the counties' and municipalities' portions to them."[43] "Changes to the tax rates may occur twice a year in January or July."[44]

The New Mexico Taxation and Revenue Department recently "revised its publication describing how to determine a business's location for the appropriate gross receipts tax rates, noting the increased gross receipts tax rate of 5.125%. The publication clarifies that if a business arranges for the lease of property it must use the rate and location code for its business location, not the leased property's location. In addition, if a taxpayer transacts business with a tribe, nation or pueblo that has not entered into a cooperative agreement with New Mexico, the proper rate and location code is the taxpayer's normal business location."[45]

E. New Mexico's Gross Receipts Tax Credits

There are 8 statutory *credits* that can be claimed against New Mexico's gross receipts tax.[46] Examples of such credits include: a credit for gross receipts (or similar) taxes paid to another state (or political subdivision of another state) on services performed on the

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[40] "What Is the New Mexico Gross Receipts Tax?", p. 41.

[41] See NM Stat. §§ 7-9-45 to 7-9-113.

[42] "What Is the New Mexico Gross Receipts Tax?", p. 42.

[43] *Gross Receipts Tax.*

[44] *Gross Receipts Tax*, New Mexico Taxation and Revenue Department (July 22, 2010) (http://www.tax.newmexico.gov/All-Taxes/Pages/Gross-Receipts-Tax.aspx).

[45] *FYI-200, Your Business Location and The Appropriate Tax Rate*, New Mexico Taxation and Revenue Department, July 2010.

[46] See NM Stat. §§ 7-9-45 to 7-9-113.

"product of the services" used in New Mexico; a biodiesel blending facility tax credit; a credit that can be claimed by certain hospitals against their New Mexico gross receipts tax liability; and a credit for tax paid to the Navajo Nation on receipts for selling coal.[47]

F. Municipal and County Gross Receipts Tax Rates in New Mexico

Municipalities and counties in New Mexico can impose their own gross receipts taxes. Currently, the highest municipal and county gross receipts tax rate in New Mexico is 8.6875 percent, which includes the state's 5.125 percent gross receipts tax rate. New Mexico's municipal and county gross receipts tax rate schedule is updated twice a year and is published on the web site of the New Mexico Taxation and Revenue Department.

V. New Jersey's Gross Receipts *Taxes*

"Although New Jersey has not enacted a general gross receipts tax, there are a number of specific New Jersey gross receipts taxes that can present a trap for the unwary new businesses or multi-state businesses conducting activity in New Jersey for the first time."[48] New Jersey imposes a petroleum products gross receipts tax, a cosmetic medical procedures gross receipts tax, a public utility gross receipts tax, and a litter control gross receipts tax.[49] The state repealed its fur clothing gross receipts tax—which was first imposed in 2006—operative January 1, 2009.[50]

A. New Jersey's Petroleum Products Gross Receipts Tax

The petroleum products gross receipts tax is imposed at a rate of 2.75 percent "on the gross receipts from the first sale of petroleum products" in the state, except that the tax is imposed at a rate of $0.04 per gallon of "fuel oils, aviation fuels, and motor fuels. . . ."[51] However, "petroleum products" exclude "numbers 2, 4, and 6 home heating oils, and kerosene and propane gas to be used exclusively for residential purposes."[52]

Also exempt are receipts from "sales of asphalt and polymer grade propylene used in the manufacture of polypropylene"; "sales to certain nonprofit entities (generally, Internal Revenue Code section 501(c)(3) organizations) and to the United States or the State of

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[47] See NM Stat. §§ 7-9-79 to 7-9-105.

[48] Peter J. Ulrich, "Gross Receipts Taxes in New Jersey: As Rare as an Uncongested Highway," *Journal of State Taxation*, pp. 29-32, 32, CCH (May-June 2010 edition) (hereinafter cited as "Gross Receipts Taxes in New Jersey"). (Copy available upon request.)

[49] "Gross Receipts Taxes in New Jersey," p. 29.

[50] "Gross Receipts Taxes in New Jersey," p. 31.

[51] "Gross Receipts Taxes in New Jersey," p. 30, citing NJ Stat. Ann. § 54:15B.

[52] "Gross Receipts Taxes in New Jersey," p. 30.

New Jersey"; and sales of "petroleum products for use by a utility, a co-generation facility, or a wholesale generation facility to generate electricity for resale. . . ."[53]

The petroleum products gross receipts tax is the state's "largest gross receipts tax," but "it raises only about $230 million annually, less than 1% of the total collections. This compares to the annual revenues raised by the Gross Income Tax of about $10 to $12 billion, the Sales Tax of about $7 to $9 billion, and the Corporation Business Tax . . . of about $3 billion."[54]

B. New Jersey's Cosmetic Medical Procedures Gross Receipts Tax

The cosmetic medical procedures gross receipts tax became operative September 1, 2004, and is imposed at a rate of 6 percent on the gross receipts from "'cosmetic medical procedures' which are defined as 'all amounts paid for services, property or occupancy required for or associated with the performance of a cosmetic medical procedure and billed to the procedure subject's account.' In turn, 'cosmetic medical procedures' mean any medical procedure performed on an individual which is directed at improving the subject's appearance and which does not meaningfully promote the proper function of the body or prevent or treat illness or disease."[55]

The tax does not apply to "reconstructive surgery or dentistry, which includes 'any surgery or dentistry performed on abnormal structures caused by or related to congenital defects, developmental abnormalities, trauma, infection, tumors or disease, including procedures to improve function or to give a more normal appearance."[56] However, the tax "is not solely on services; it also applies to the sales of foods or facility occupancies, such as hospital or clinic stay, that are required or directly associated with a taxable cosmetic medical procedure."[57]

C. New Jersey's Public Utility Gross Receipts Tax

The public utility gross receipts tax "is imposed on sewerage and water companies at a rate of 7.5% of their gross receipts for the preceding calendar year" and is a tax "in lieu of local taxes other than the real property tax."[58] However, the tax is imposed in addition to the state's public utility franchise tax.[59]

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[53] "Gross Receipts Taxes in New Jersey," p. 30.

[54] "Gross Receipts Taxes in New Jersey," p. 29.

[55] "Gross Receipts Taxes in New Jersey," pp. 30-31, citing NJ Stat. Ann. §§ 54:32E-1, et seq.

[56] "Gross Receipts Taxes in New Jersey," p. 31.

[57] "Gross Receipts Taxes in New Jersey," p. 31.

[58] "Gross Receipts Taxes in New Jersey," p. 31, citing NJ Stat. Ann. §§ 54:30A-49, et seq.

[59] "Gross Receipts Taxes in New Jersey," p. 31.

D. New Jersey's Litter Control "Fee" (A Gross Receipts Tax)

"New Jersey imposes a Litter Control Fee on gross receipts from the sales of 'litter-generating products' . . . sold within New Jersey by manufacturers, wholesalers, distributors, and retailers of such products."[60] "Litter-generating products" include items that are "produced, distributed, or purchased in disposable containers, packages or wrappings" and items "which are not usually sold in packages, containers, or wrappings but which are commonly discarded in public places . . . ," including "beer and other malt beverages, cigarettes and tobacco products, cleaning agents and toiletries, distilled spirits, food for human or pet consumption, glass containers, groceries, metal containers, motor vehicles tires newsprint and magazine paper stock, non-drug store sundry products, paper products and household paper (but not stock and wood pulp), plastic or fiber containers, soft drinks and carbonated waters, and wine."[61]

The rate of New Jersey's litter control fee is 0.03 percent of the gross receipts from sales of litter-generating products within the state made by manufacturers, wholesalers, and distributors of such products, but the rate of the "fee" for retailers is lower: "0.0225% of all gross receipts from retail sales of litter-generating products."[62]

"Retailers with less than $500,000 of annual retail sales of litter-generating products are exempt" and a "restaurant is exempt if more than 50% of its food and beverages consist of meals and food to be consumed on the premises."[63]

VI. Hawaii's "General Excise Tax" (A Gross Receipts Tax)

A. General Explanation of Hawaii's General Excise Tax

Hawaii's general excise tax is a "broad-based tax measured by gross receipts. . . ."[64] The following material summarizes the nature of the tax and distinguishes it from sales and income taxes:

> The General Excise Tax Law taxes persons (individuals, corporations, partnerships, or other entities) on the gross receipts or gross income they derive from their business activities in the State. The tax is often called a gross income tax because deductions for business expenses such as materials, labor, travel, office supplies, etc., generally are not allowed.

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60 "Gross Receipts Taxes in New Jersey," p. 29, citing NJ Stat. Ann. §§ 13:1E-213 to 13:E-1-223.

61 "Gross Receipts Taxes in New Jersey," p. 30.

62 "Gross Receipts Taxes in New Jersey," p. 30.

63 "Gross Receipts Taxes in New Jersey," pp. 29-30.

64 *State and Local Taxation*, p. 234.

This tax is also often referred to as a "sales tax." The general excise tax, however, is not a sales tax and differs from a sales tax in a number of ways. First, the general excise tax is levied on the person conducting the business; a sales tax is levied on the customer. Second, a common practice in Hawaii is to separately state and visibly pass on to the customer an amount representing the cost of the business' general excise tax liability (in a manner similar to a sales tax which is separately charged and collected from purchasers). If a business adopts this practice, the amount visibly passed on as tax must be included in the business' gross income subject to the tax. Unlike a sales tax, the amount visibly passed on as tax cannot be excluded from the gross income subject to the tax. A business is not required to separately state an amount of the sales price representing a general excise tax pass-on. Third, the general excise tax is levied on gross income at all levels of business activity unless specifically exempted by law. Sales taxes, on the other hand, usually are levied on sales of tangible personal property only at the retail level. Examples of income subject to the general excise tax include gross income derived from: sales of tangible personal property at both wholesale and retail; contracting; the rendering of services; commissions; and the rental of personal or real property.

Because the general excise tax is levied on the business rather than the customer, the gross income a business receives from transactions with tax exempt customers, such as nonprofit organizations and government agencies, is subject to the general excise tax. The customer's general excise tax status does not affect the business' general excise tax liability on the business income. For example, a business must pay general excise taxes on the gross amount it derives from contracts with a State or county government agency. There are, however, a few activities specifically exempt by law when dealing with the federal government, its agencies and instrumentalities.[65]

B. Hawaii's General Excise Tax Base

The general excise tax is levied, assessed, and collected annually as

> privilege taxes against persons on account of their business and other activities in the State measured by the application of rates against values of products, gross proceeds of sales, or gross income, whichever is specified, as follows: (1) Tax on manufacturers. . . ; (2) Tax on business of selling tangible personal property; producing. . . ; (3) Tax upon contractors. . . ; (4) Tax upon theaters, amusements, radio broadcasting stations, etc. . . ; (5) Tax upon sales representatives, etc. . . . ; (6) Tax on service business. . . ; (7) Tax on insurance producers. . . ; (8) Tax on receipts of sugar benefit payments. . . ; and (9) Tax on other business. . . .[66]

[65] Publication 1, "General Excise Tax," *Information on Hawaii State Taxes Administered by the Department of Taxation*, p. 1 (Rev. 2009). See Hawaii Stat. §§ 18-237-3 ("gross income" and "gross proceeds of sale" defined); 18-237-4 ("wholesaler" and "jobber" defined); 18-237-5 ("producer" defined to mean "any person engaged in the business of raising and producing agricultural products in their natural state, or in producing natural resource products, or engaged in the business of fishing or aquaculture, for sale, or for shipment or transportation out of the State, of the agricultural or aquaculture products in their natural or processed state, or butchered and dressed, or the natural resource products, or fish."); 18-237-6 ("contractor" defined); and 18-237-7 ("service business or "calling" defined to mean "all activities engaged in for other persons for a consideration which involve the rendering of a service, including professional and transportation services, as distinguished from the sale of tangible property or the production and sale of tangible property." However, "'service business or calling' does not include the services rendered by an employee to the employee's employer.").

[66] Hawaii Stat. § 18-237-13.

Stephen Moore, Research Analyst, Revenue Committee, Nebraska Legislature (September 23, 2010).

C. Hawaii's General Excise Tax Rates

The general excise tax rate is .5% on gross income derived from wholesaling and certain services rendered to or for an intermediary or manufacturer. Gross income from all other business activities is taxed at the rate of 4% except for a special .15% rate for insurance commissions. The City and County of Honolulu's .5% county surcharge is applied to all gross receipts in that county that are subject to the general excise tax at the 4% tax rate. Taxpayers are encouraged to contact the Department regarding their specific circumstances because certain business activities, such as wholesaling and contracting, are narrowly defined in the law and some exemptions or credits are available.[67]

D. Hawaii's General Excise Tax Exemptions

Hawaii's general excise tax law has numerous tax exemptions. Some, but not all, of the exemptions are listed below:

"**Amounts not taxable.** This chapter shall not apply to the following amounts:

(1) Amounts received under life insurance policies and contracts paid by reason of the death of the insured;

(2) Amounts received (other than amounts paid by reason of death of the insured) under life insurance, endowment, or annuity contracts, either during the term or at maturity or upon surrender of the contract;

(3) Amounts received under any accident insurance or health insurance policy or contract or under workers' compensation acts or employers' liability acts, as compensation for personal injuries, death, or sickness, including also the amount of any damages or other compensation received, whether as a result of action or by private agreement between the parties on account of the personal injuries, death, or sickness;

(4) The value of all property of every kind and sort acquired by gift, bequest, or devise, and the value of all property acquired by descent or inheritance;

(5) Amounts received by any person as compensatory damages for any tort injury to the person, or to the person's character reputation, or received as compensatory damages for any tort injury to or destruction of property, whether as the result of action or by private agreement between the parties (provided that amounts received as punitive damages for tort injury or breach of contract injury shall be included in gross income);

(6) Amounts received as salaries or wages for services rendered by an employee to an employer;

(7) Amounts received as alimony and other similar payments and settlements;

(8) Amounts collected by distributors as fuel taxes on "liquid fuel" imposed by chapter 243, and the amounts collected by such distributors as a fuel tax imposed by any Act of the Congress of the United States;

(9) Taxes on liquor imposed by chapter 244D on dealers holding permits under that chapter;

[67] Publication 1, "General Excise Tax," *Information on Hawaii State Taxes Administered by the Department of Taxation*, p. 1 (Rev. 2009).

(10) The amounts of taxes on cigarettes and tobacco products imposed by chapter 245 on wholesalers or dealers holding licenses under that chapter and selling the products at wholesale;

(11) Federal excise taxes imposed on articles sold at retail and collected from the purchasers thereof and paid to the federal government by the retailer;

(12) The amounts of federal taxes under chapter 37 of the Internal Revenue Code, or similar federal taxes, imposed on sugar manufactured in the State, paid by the manufacturer to the federal government;

(13) An amount up to, but not in excess of, $2,000 a year of gross income received by any blind, deaf, or totally disabled person engaging, or continuing, in any business, trade, activity, occupation, or calling within the State; a corporation all of whose outstanding shares are owned by an individual or individuals who are blind, deaf, or totally disabled; a general, limited, or limited liability partnership, all of whose partners are blind, deaf, or totally disabled; or a limited liability company, all of whose members are blind, deaf, or totally disabled;

(14) *[Repeal and reenactment on December 31, 2013. L 2009, c 70, §4.]* Amounts received by a producer of sugarcane from the manufacturer to whom the producer sells the sugarcane, where:

> (A) The producer is an independent cane farmer, so classed by the Secretary of Agriculture under the Sugar Act of 1948 (61 Stat. 922, Chapter 519) as the Act may be amended or supplemented;
>
> (B) The value or gross proceeds of the sale of the sugar, and other products manufactured from the sugarcane, are included in the measure of the tax levied on the manufacturer under section 237-13(1) or (2);
>
> (C) The producer's gross proceeds of sales are dependent upon the actual value of the products manufactured therefrom or the average value of all similar products manufactured by the manufacturer, and;(D) The producer's gross proceeds of sales are reduced by reason of the tax on the value or sale of the manufactured products;(15) *[Repeal and reenactment on December 31, 2013. L 2009, c 70, §4.]* Money paid by the State or eleemosynary child-placing organizations to foster parents for their care of children in foster homes;

(15) *[Repeal and reenactment on December 31, 2013. L 2009, c 70, §4.]* Money paid by the State or eleemosynary child-placing organizations to foster parents for their care of children in foster homes;

(16) *[Repeal and reenactment on December 31, 2013. L 2009, c 70, §4.]* Amounts received by a cooperative housing corporation from its shareholders in reimbursement of funds paid by the corporation for lease rental, real property taxes, and other expenses of operating and maintaining the cooperative land and improvements; provided that the cooperative corporation is a corporation:

> (A) Having one and only one class of stock outstanding;
>
> (B) Each of the stockholders of which is entitled solely by reason of the stockholder's ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building owned or leased by the corporation; and
>
> (C) No stockholder of which is entitled (either conditionally or unconditionally) to receive any distribution not out of earnings and profits of the corporation except in a complete or partial liquidation of the corporation; and

(17) *[Repeal and reenactment on December 31, 2013. L 2009, c 70, §4.]* Amounts received by a managed care support contractor of the TRICARE program that is established under Title 10 United States Code Chapter 55, as amended, for the actual cost or advancement to third party health care providers pursuant to a contract with the United States."[68]

E. Jurisdiction ("Statutory Nexus") to Impose Hawaii's General Excise Tax

The following statute exercises Hawaii's jurisdiction to impose its general excise tax.

> Gross income derived from the sale or leasing of tangible personal property, the rental of real property, or the provision of services is subject to the general excise tax if the seller has sufficient presence in the State. Presence in the State is established if your business has an office, inventory, property, employees, or other representation in the State, or if services in conjunction with the sales of property, such as training, installation, or repairs, are provided in the State. The furnishing of personal or other services in the State and the leasing of tangible personal property located in Hawaii are other examples of transactions which are taxable. You must thoroughly analyze the facts and circumstances surrounding your transaction when determining whether there is sufficient presence. Out-of-state businesses are encouraged to contact the Department of Taxation regarding their specific circumstances.[69]

F. Apportionment of Hawaii's General Excise Tax

The following statute provides for apportionment of Hawaii's general excise tax.

> **Apportionment.** If any person, other than persons liable to the tax on manufacturers as provided by section 237-13(1), is engaged in business both within and without the State or in selling goods for delivery outside the State, and if under the Constitution or laws of the United States or section 237-29.5 the entire gross income of such person cannot be included in the measure of this tax, there shall be apportioned to the State and included in the measure of the tax that portion of the gross income which is derived from activities within the State, to the extent that the apportionment is required by the Constitution or laws of the United States or section 237-29.5. In the case of a tax upon the production of property in the State the apportionment shall be determined as in the case of the tax on manufacturers. In other cases, if and to the extent that the apportionment cannot be accurately made by separate accounting methods, there shall be apportioned to the State and included in the measure of this tax that proportion of the total gross income, so requiring apportionment, which the cost of doing business within the State, applicable to the gross income, bears to the cost of doing business both within and without the State, applicable to the gross income.[70]

F. Hawaii's General Excise Tax "Non-Filer Project"

Hawaii's "General Excise Tax Non-Filer Project" resulted in "the filing of 21,721 previously unfiled tax returns and the collection of an additional $61.8 million."[71]

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[68] Hawaii Stat. § 18-237-24.

[69] Publication 1, "General Excise Tax," *Information on Hawaii State Taxes Administered by the Department of Taxation*, p. 1 (Rev. 2009).

[70] Hawaii Stat. § 18-237-21.

[71] *Annual Report 2008-2009*, p. 1, Hawaii Department of Taxation (July 6, 2010).

Stephen Moore, Research Analyst, Revenue Committee, Nebraska Legislature (September 23, 2010).

G. Hawaii Authorizes Counties to Impose a General Excise Tax

The following statute authorizes counties in Hawaii to impose a general excise tax and imposes limitations on the power of a county to enact an ordinance levying such a tax:

> **County surcharge on state tax; administration.** (a) The county surcharge on state tax, upon the adoption of county ordinances and in accordance with the requirements of section 46-16.8, shall be levied, assessed, and collected as provided in this section on all gross proceeds and gross income taxable under this chapter. No county shall set the surcharge on state tax at a rate greater than one-half per cent of all gross proceeds and gross income taxable under this chapter. All provisions of this chapter shall apply to the county surcharge on state tax. With respect to the surcharge, the director of taxation shall have all the rights and powers provided under this chapter. In addition, the director of taxation shall have the exclusive rights and power to determine the county or counties in which a person is engaged in business and, in the case of a person engaged in business in more than one county, the director shall determine, through apportionment or other means, that portion of the surcharge on state tax attributable to business conducted in each county.
>
> (b) Each county surcharge on state tax that may be adopted pursuant to section 46-16.8(a) shall be levied beginning in the taxable year after the adoption of the relevant county ordinance; provided that no surcharge on state tax may be levied prior to January 1, 2007.
>
> (c) The county surcharge on state tax, if adopted, shall be imposed on the gross proceeds or gross income of all written contracts that require the passing on of the taxes imposed under this chapter; provided that if the gross proceeds or gross income are received as payments beginning in the taxable year in which the taxes become effective, on contracts entered into before June 30 of the year prior to the taxable year in which the taxes become effective, and the written contracts do not provide for the passing on of increased rates of taxes, the county surcharge on state tax shall not be imposed on the gross proceeds or gross income covered under the written contracts. The county surcharge on state tax shall be imposed on the gross proceeds or gross income from all contracts entered into on or after June 30 of the year prior to the taxable year in which the taxes become effective, regardless of whether the contract allows for the passing on of any tax or any tax increases.
>
> (d) No county surcharge on state tax shall be established on any:
>
>> (1) Gross income or gross proceeds taxable under this chapter at the one-half per cent tax rate;
>> (2) Gross income or gross proceeds taxable under this chapter at the 0.15 per cent tax rate; or
>> (3) Transactions, amounts, persons, gross income, or gross proceeds exempt from tax under this chapter.
>
> (e) The director of taxation shall revise the general excise tax forms to provide for the clear and separate designation of the imposition and payment of the county surcharge on state tax.
>
> (f) The taxpayer shall designate the taxation district to which the county surcharge on state tax is assigned in accordance with rules adopted by the director of taxation under chapter 91. The taxpayer shall file a schedule with the taxpayer's periodic and annual general excise tax returns summarizing the amount of taxes assigned to each taxation district.
>
> (g) The penalties provided by section 231-39 for failure to file a tax return shall be imposed on the amount of surcharge due on the return being filed for the failure to file the schedule required to accompany the return. In addition, there shall be added to the tax an amount equal to ten per cent of the amount of the surcharge and tax due on the return being filed for the failure to file the

> schedule or the failure to correctly report the assignment of the general excise tax by taxation district on the schedule required under this subsection.[72]

VII. West Virginia Abandoned Its Gross Receipts Tax in 1987

West Virginia imposed a gross receipts tax "for many years, but it replaced it with a net income tax in 1987."[73]

VIII. Are Commercial Activity Taxes, Business Activity Taxes, and Margin Taxes Gross Receipts Taxes?

At least two state and local tax commentators think the answer to that question is yes:

> In recent years, three states have changed their corporate income tax structure entirely: Texas, Ohio, and Michigan. All three of those new tax regimes incorporate a gross receipts tax. Those types of sweeping changes highlight risks associated with the assumptions about the longevity of existing tax planning and also may point out a trend in state taxation favoring gross receipts taxes.[74]

Additionally, Oklahoma enacted a business activity tax in 2010 as a legislative response to the Oklahoma Supreme Court's decision in a case which "held that a telephone company was not entitled to an ad valorem tax exemption on all of its intangible personal property because property not specifically exempted by the state constitution is taxable and included in the company's unit value."[75]

However, courts of law in Ohio have expressed differing opinions about the nature of Ohio's commercial activity tax.

A. Is Ohio's "Commercial Activity Tax" a Gross Receipts Tax?

Ohio's commercial activity tax is a tax—measured by gross receipts—that is imposed for the privilege of doing business in the state.[76] When the constitutionality of the tax was challenged, Ohio's courts expressed differing opinions about the nature of the tax:

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[72] Hawaii Stat. § 18-237-8.6.

[73] *State and Local Taxation*, p. 234.

[74] J. Bragg and R. Tuinstra, Jr., "Managing State and Local Tax Risks," *State Tax Notes*, pp. 361, 365 (August 9, 2010). [The authors' state that the three states changed their "corporate income tax structure" but that is misleading with respect to Texas because the Texas "margin tax" replaced the state's *corporate franchise tax*. Texas did not impose a corporate income tax before enactment of the state's margin tax.]

[75] "Oklahoma Taxpayers Grapple With New Business Activity Tax," *State Tax Notes*, p. 278 (August 2, 2010), citing *Southwestern Bell Telephone Co. v. Oklahoma State Board of Equalization*, 231 P.3d 638 (Okla. 2009).

[76] Ohio Revised Code § 5751.02(A).

The Ohio Supreme Court reversed an Ohio Court of Appeals decision and held that the commercial activity tax (CAT) is not a tax on the sale or purchase of food and therefore does not violate Secs. 3 and 13 of Article XII of the Ohio Constitution. The high court ruled that the fact that the tax is measured by gross receipts that include proceeds from sales of food does not affect the constitutionality of the tax.

A group of taxpayers, led by the Ohio Grocers Association, had challenged the CAT on the basis that it was really an excise tax imposed on the sale of food, food ingredients, and packaging, and thus violated Secs. 3(C) and 13 of Article XII of the Ohio Constitution. The taxpayers argued that the CAT is an excise tax because it is levied on persons with taxable gross receipts for the privilege of doing business in Ohio.

Prior Decisions

The Ohio Court of Appeals (*Ohio Grocers Association v. Wilkins,* Ohio Court of Appeals, No. 07AP-813, September 2, 2008) had reversed the court of common pleas of Franklin county in determining that the CAT, when applied to gross receipts from the wholesale sale of food and from the retail sale of food for human consumption off premises where sold, operates as, and is, an excise tax levied or collected upon the sale or purchase of food, and therefore violates the Ohio Constitution.

The appellate court ruled that to find the true nature of a tax, the court must look at the operation of the tax rather than simply looking at the label of the tax. The court held that the CAT, by its very operation when applied to gross receipts derived from the sales of food, becomes a transactional tax.

Privilege Tax

The supreme court looked at the constitutional text, structure, and history of Secs. 3(C) and 13 and determined that the sections permit a tax upon the privilege of doing business that includes in its measure proceeds from the sale of food.

The court further determined that when the CAT's practical operation is considered, it is evident that the tax is a permissible tax on the privilege of doing business, not a proscribed tax upon the sale or purchase of food.

The taxpayers conceded that the CAT is nominally a tax upon the privilege of doing business but asserted that "substantively" it is "a tax on the sale or purchase of food, and suffers from the very same evils as the sales taxes" that prompted Secs. 3(C) and 13. The high court disagreed, holding that when the operation of the CAT is considered, one can only conclude that it is not a tax upon the sale or purchase of food.

The court stated that the CAT in its practical operation is neither triggered by a sale of food nor necessarily reflected in the price of food; therefore, the CAT does not look like a tax upon the sale or purchase of food. It is clear that the tax falls on food sellers, among others. It is far from clear, however, that it falls upon the sale or purchase of food. It does not do so formally, nor must it do so practically. The notion that the CAT "operates" as a sales tax which is collected from purchasers, imposed at the point of sale, and computed by multiplying the sale price by the applicable rate is factually incorrect.

Dissent

One justice dissented, arguing that it is clear beyond a reasonable doubt that the CAT is an excise tax levied or collected upon the sale or purchase of food and violates the Ohio Constitution.[77]

[77] "Ohio—Corporate Income Tax: State High Court Rules CAT Constitutional," *Newsstand*, RIA (2009), discussing *Ohio Grocers Assn. v. Levin,* 916 N.E.2d 446 (Ohio Supreme Court, September 17, 2009) (emphasis added).

Stephen Moore, Research Analyst, Revenue Committee, Nebraska Legislature (September 23, 2010).

B. Is the Texas "Margin Tax" a Gross Receipts Tax?

The Texas margin tax was first enacted in 2006 and became operative for tax years beginning on or after January 1, 2007. It was enacted to replace the Texas corporate franchise tax, in part because the state's corporate franchise tax did not apply to certain business entities, including limited liability companies. The following explanation of the Texas margin tax shows that it is a hybrid form of taxation—part gross receipts tax and part net income tax.

> In a nutshell, the calculation of the new Margin Tax is based on a taxable entity's (or unitary group's) gross receipts after deductions for either . . . compensation or . . . cost of goods sold. . . .
> For purposes of the Margin Tax, a taxable entity's total revenue is generally total income as reported on IRS Form 1120 (for corporate entities), or IRS Form 1065 (for partnerships and other pass-through entities), plus dividends, interest, gross rents and royalties, and net capital gain income, minus bad debts, certain foreign items, and income from related entities to the extent already included in the margin tax base. . . . [78]

The Texas margin tax was amended by Laws 2007, HB 3928, the provisions of which became operative January 1, 2008:

> The law includes the following additional provisions:
>
> -- a discount for small businesses with total revenue between $300,000 and $900,000 calculated by applying a sliding scale ranging from an 80% discount for taxable entities with total revenue less than $400,000, to a 20% discount for taxable entities with total revenue greater than $700,000 but less than $900,000;
>
> -- an "E-Z computation and rate," which is an optional alternative method for calculating tax for businesses with total revenue of $10 million or less whereby a qualified taxable entity calculates tax by multiplying apportioned total revenue by 0.575%;
>
> -- calculation of the temporary credit on taxable margin by (1) determining the amount of the business loss carryforwards of the taxable entity as required for taxable reports originally due before January 1, 2008, that were not exhausted on a report originally due before January 1, 2008; (2) multiplying that amount by 2.25% for reports originally due on or after January 1, 2008, and before January 1, 2018; and 7.75% for reports originally due on or after January 1, 2018, and before September 1, 2027; and (3) multiplying the amount obtained under (2) by 4.5%;
>
> -- a change in the due date for notifying the Comptroller of Public Accounts of the taxpayer's intent to utilize the temporary credit on taxable margin to the first report originally due on or after January 1, 2008 (under H.B. 3, Laws 2006, the due date was March 1, 2007; a subsequent regulation changed the date to September 1, 2007);
>
> -- an additional compensation deduction for small employers who initiate health care coverage equal to 50% of costs for the first year of coverage and 25% of costs for the second year of coverage;

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[78] B. Egan, *Choice of Entity Decision Tree After Margin Tax and Texas Business Organizations Code*, Jackson Walker, LLP (May 26, 2006) (emphasis added) (sponsored by the Texas Bar CLE and the Business Law Section of the State Bar of Texas)(http://www.jw.com/site/jsp/publicationinfo.jsp?id=580). (A digital copy of the 168-page article can be downloaded from that website.)

Stephen Moore, Research Analyst, Revenue Committee. Nebraska Legislature (September 23, 2010).

-- the inclusion of gross rental income of taxable partnerships instead of net rental income when determining total revenue;

-- reduction of the amount of control required for inclusion of a related entity in a combined group from 80% to "more than 50%";

-- the inclusion of a limited liability partnership as a taxable entity subject to the business margin tax;

-- the exclusion of nonprofit self-insurance trusts, trusts qualified under IRC §401(a), and trusts or entities exempt under IRC §501(c)(9) from the definition of "taxable entity";

-- the joint and several liability of each member of a combined group for the tax of the combined group;

-- inclusion of the net distributive income from a limited liability company treated as a sole proprietorship for federal income tax purposes as "wages and cash compensation" if the person receiving the distribution is a natural person;

-- conformity to the IRC as it existed on January 1, 2007;

-- the filing of an annual public information report by a limited liability company; and

-- the creation of a Business Tax Advisory Committee to conduct a biennial study of the effects of the business margin tax.[79]

A flurry of related tax regulations and other official tax guidance followed enactment of the Texas margin tax and amendments thereto, including regulations and guidance designed to help taxpayers transition from complying with the corporate franchise tax to complying with the new margin tax.[80]

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[79] "Texas—Corporate Income Tax: Governor Signs Business Margin Tax Law," *Tax Newsletter*, CCH (June 2007), citing H.B. 3928, Laws 2007, effective January 1, 2008.

[80] See, e.g., "Texas—Corporate Income, Franchise Taxes: Guidance Offered for Transition to Margin Calculation," *Tax Newsletter*, CCH (August 2007), citing *Tax Policy News*, Vol. XVII, Issue 8, Texas Comptroller of Public Accounts, August 2007; "Texas—Corporate Income Tax: Comptroller Posts Margin Tax Rules," *Tax Newsletter*, CCH (December 2007), citing 34 TAC 3.581 through 34 TAC 3.595, Texas Comptroller of Public Accounts, effective January 1, 2008; "Texas—Texas Franchise Tax ruling addresses cost of goods sold capitalization," *Tax Newsletter*, CCH (January 2008), citing Texas Policy Letter Ruling 200801034L, 01/11/2008; "Texas—Corporate Income Tax: Preview of New Tax Forms Available," *Tax Newsletter*, CCH (March 2008), citing *Release*, Texas Comptroller Susan Combs, March 11, 2008; "Texas—Corporate Income Tax: New Franchise Tax Forms Finalized," *Tax Newsletter*, CCH (April 2008), citing *Release,* Texas Comptroller Susan Combs, March 31, 2008; "Texas—Texas Comptroller grants 30-day extension for revised franchise tax filing," *Tax Newsletter*, CCH (April 2008), citing *Release,* Texas Comptroller Susan Combs, April 22, 2008; "Texas—Corporate Income Tax: Various Business Margin Tax Rules Amended," *Tax Newsletter*, CCH (December 2008), citing 34 TAC §3.583, through 34 TAC §3.585, 34 TAC §3.587, 34 TAC §3.589 through 34 TAC §3.590, 34 TAC §3.592, and 34 TAC §3.594, Texas Comptroller of Public Accounts, December, 2008; "Texas—Texas Comptroller adopts amendments to franchise margin tax rules," *State & Local Tax Updates*, RIA (December 24, 2008), citing 34 Tex. Admin. Code § 3.583, eff. 01/01/2009; 34 Tex. Admin. Code § 3.584, eff. 01/01/2009; 34 Tex. Admin. Code § 3.585, eff. 01/01/2009; 34 Tex. Admin. Code § 3.587, eff. 01/01/2009; 34 Tex. Admin. Code § 3.589, eff. 01/01/2009; 34 Tex. Admin. Code § 3.590, eff. 01/01/2009; 34 Tex. Admin. Code § 3.592, eff. 01/01/2009; 34 Tex. Admin. Code § 3.594, eff. 01/01/2009; and "Texas—Corporate Income Tax: Use of MTC

C. Is the "Michigan Business Tax" a Gross Receipts Tax?

The "Michigan Business Tax" (MBT) is a hybrid form of taxation that combines elements of a gross receipts tax and a net income tax. The impetus for enacting the MBT was the scheduled December 31, 2007, sunset of the state's "Single Business Tax" (SBT). A comprehensive summary of the MBT follows: [81]

> A comprehensive tax bill, S.B. 94, that replaces the single business tax (SBT) with <u>a new tax on business income and modified gross receipts</u>, was signed by Michigan Governor Jennifer Granholm on July 12, 2007. The Michigan business tax (MBT) is effective January 1, 2008, after the SBT is repealed on December 31, 2007. Highlights of changes enacted by the MBT include an addition to taxable income for related party expenses, a single sales factor apportionment formula, combined filing for unitary business groups, an increased tax rate for insurance companies, and a franchise tax for financial institutions. The bill enacts many credits, some of which include credits for compensation, investment, and research and development. . . .
>
> **<u>Nexus Standards</u>**
>
> ***Business income tax.*** The business income tax is imposed on every taxpayer with business activity in the state unless prohibited by P.L. 86-272. The definition of "business activity" under the MBT is substantially similar to the definition under the SBT. It applies to activity that is conducted with the "object of gain, benefit, or advantage to the taxpayer," including transactions involving intangibles and the performance of services, "whether in intrastate, interstate, or foreign commerce."
>
> ***Modified gross receipts tax.*** Taxpayers subject to the modified gross receipts tax have nexus if: the taxpayer has physical presence in Michigan for more than one day; or the taxpayer actively solicits sales in Michigan and has $350,000 or more of gross receipts attributable to state sources.
>
> **<u>Tax Rates</u>**
>
> ***Business income tax.*** The income tax portion of the MBT is imposed at a rate of 4.95%.
>
> ***Modified gross receipts tax.*** The modified gross receipts tax portion of the MBT is imposed at a rate of 0.8%.
>
> **<u>Income Tax Computation</u>**
>
> The business income tax base is federal taxable income subject to the following addition and subtraction adjustments: interest and dividends from other states' obligations are added back; taxes measured by net income are added back; net operating loss carrybacks or carryovers are added back; dividends and royalties received from persons other than U.S. persons and foreign operating entities may be deducted; losses attributable to another entity subject to the business income tax

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Apportionment Formula Prohibited," *Tax Newsletter*, CCH (July 2010), citing *Tax Policy News*, Texas Comptroller of Public Accounts, July 2010.

[81] "Michigan—Multiple Taxes: New Tax on Business Income and Gross Receipts Enacted," *Tax Newsletter*, CCH (July 2007), citing Act 36 (S.B. 94), Laws 2007, applicable to all business activity occurring after December 31, 2007 (<u>underscored</u> emphasis added).

must be added back or may be subtracted; interest income from U.S. obligations may be subtracted; net earnings from self-employment or a partner or a limited liability company member may be subtracted, except to the extent that those net earnings represent a reasonable return on capital; and royalty, interest, or other expenses paid to a related person for use of an intangible asset if the person is not included in the taxpayer's unitary business group are added back.

The royalty and interest addback is not required if the taxpayer can show that the transaction has a nontax business purpose (other than tax avoidance), is conducted at arm's-length, and (1) is a pass through of another transaction between a third party and the related person with comparable rates and terms; (2) results in double taxation; or (3) is unreasonable as determined by the Department of Treasury.

After apportionment, the business income tax base may be adjusted by deducting any business loss incurred after December 31, 2007.

Gross Receipts Computation

The modified gross receipts tax is based on gross receipts less purchases from other firms. Purchases from other firms include inventory, assets, materials, and supplies. Gross receipts includes the entire amount received by the taxpayer from any activity in intrastate, interstate, or foreign commerce for the gain, benefit, or advantage to the taxpayer. There are numerous exceptions to gross receipts, including: proceeds from the taxpayer's transfer of an account receivable if the sale that generated the account receivable was included in gross receipts for federal income tax purposes; proceeds from the original issue of stock or debt instruments; refunds from returned merchandise; trade discounts; federal, state, or local tax refunds; payment of the principal portion of loans; and the value of property received in a like-kind exchange.

Apportionment

All tax bases are apportioned using a 100% sales factor. The following are deemed to be Michigan sales: sales of tangible personal property if the property is shipped to a purchaser in the state; receipts from the sale or lease of real property if the property is located in Michigan; receipts from the lease or rental of tangible personal property to the extent that the property is used in Michigan; receipts from the performance of services if the recipient of the services receives all of the benefit in Michigan; receipts from the origination of a loan secured by residential real property if the real property is in Michigan, or more than 50% of the fair market value of the property is in Michigan, or the borrower is located in Michigan; interest from a loan not secured by real property if the borrower is located in Michigan; receipts from credit card receivables if the billing address of the card holder is in Michigan; and loan servicing fees derived from loans of another person that are secured by real property if the real property is in Michigan, or more than 50% of the fair market value of the property is in Michigan, or the borrower is located in Michigan.

All other receipts are sourced depending on where the benefit to the customer is received or, if this cannot be determined, to the customer's location.

Combined Returns

Unitary business groups are required to file combined tax returns. All transactions between taxpayers in a unitary business group must be eliminated from the business income tax base, the modified gross receipts tax base, and the apportionment formula. A unitary business group is a group of U.S. persons, other than a foreign operating entity, one of which owns or controls more than 50% of the ownership interest of the other U.S. persons and has business activities which result in a flow of value between the persons in the group. The business activities may also be integrated with, dependent upon, or contribute to the other persons in the group.

Stephen Moore, Research Analyst, Revenue Committee, Nebraska Legislature (September 23, 2010).

Other Tax Changes

Insurance companies. Insurance companies are subject to a tax at the rate of 1.25% on gross direct premiums. Direct premiums do not include premiums on policies not taken, returned premiums on canceled policies, and receipts from the sale of annuities.

Financial institutions.-Financial institutions are subject to a franchise tax at a 0.235% rate. This is in lieu of the business income tax and the modified gross receipts tax. The tax base is the financial institution's net capital, which is equity capital as computed in accordance with generally accepted accounting principles.

D. Is Oklahoma's "Business Activity Tax" a Gross Receipts Tax?

No, because Oklahoma's business activity tax is imposed: (1) as a flat dollar amount ($25) for all noncorporate entities doing business in Oklahoma; and (2) on a corporation's "net revenue," derived from business activity allocated to Oklahoma, at a rate of one percent.

> Under SJR 61, which Gov. Brad Henry (D) signed into law June 20, the franchise tax will be suspended for two years and a business activity tax will be adopted instead. The tax will be "in lieu of" ad valorem taxes on intangible personal property of locally assessed business entities. . . . The tax is effective August 27 [2010].
>
> The legislative change was the result of an Oklahoma Supreme Court ruling on September 29, 2009, that held a telephone company was not entitled to an ad valorem tax exemption on all of its intangible personal property because property not specifically exempted by the state constitution is taxable and included in the company's unit value. . . .
>
> The *Southwestern Bell Telephone* ruling made big waves. The Oklahoma Chamber of Commerce warned its members that it could mean businesses would pay property taxes on previously untaxed items such as customer lists, signage, trademarks, and contracts.
>
> This could mean a significant tax increase for businesses, the chamber and other groups warned.
>
> SJR 61 was drafted to comply with the court ruling and to be revenue neutral. It calls for a $25 tax per year on all noncorporate entities doing business in the state. It levies an additional tax of 1 percent of the net revenue derived from business activity allocated to Oklahoma. For tax years 2010, 2011, and 2012, corporate entities will pay business activity tax equal to the franchise tax paid in 2010.
>
> The $25 would be offset by an income tax credit equal to the $25 business activity tax paid. . . .
>
> The measure also calls for the creation of a 21-member commission to study the effects of the business activity tax, which sunsets in tax year 2013. The commission will send a report to the Legislature by January 1, 2012. The commission's members have not yet been appointed. . . .
>
> The [Oklahoma Tax Commission] has not yet issued guidance on the measure.
>
> "We're still kind of delving into it, figuring out all the implications for the agency," spokeswoman Joanne Kurjan said. "It is still so new." [82]

IX. Tests Used by Courts to Evaluate the Constitutionality of State and Local Taxes

The constitutionality of state gross receipts taxes has been upheld by the U.S. Supreme Court.[83] Gross receipts taxes imposed by municipalities "raise issues identical to those

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[82] "Oklahoma Taxpayers Grapple With New Business Activity Tax," *State Tax Notes*, p. 278 (August 2, 2010), citing *Southwestern Bell Telephone Co. v. Oklahoma State Board of Equalization*, 231 P.3d 638 (Okla. 2009).

[83] E.g., *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232 (1987).

raised by . . . [state] gross receipts taxes when they apply to activities carried on across state lines."[84]

A. Federal Commerce Clause and Due Process Jurisprudence

The U.S. Supreme Court clarified its Commerce Clause and Due Process jurisprudence with respect to state and local taxation in *Complete Auto Transit, Inc. v. Brady*,[85] which set forth a four-prong test to evaluate the constitutionality of state and local taxes under the Commerce Clause and Due Process Clauses of the U.S. Constitution.

- The **first prong** of the *Complete Auto* test provides that "a state tax will withstand scrutiny under the Commerce Clause if 'the tax is applied to an activity with a ***substantial nexus with the taxing State***' . . . ."[86]

- The "central purpose" of **second prong** of the *Complete Auto* test, the ***apportionment*** requirement, "is to ensure that each State taxes only its fair share of an interstate transaction."[87] There are two parts to the second prong of the *Complete Auto* test: Courts will analyze a state tax scheme to see if it is both internally and externally consistent.

    - To be externally consistent, a tax can lawfully reach "only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed."[88]

    - "To be internally consistent, a tax must be structured so that if every state were to impose an identical tax, no multiple taxation would result."[89] The "internal consistency test focuses on the text of the challenged statute and hypothesizes a situation where other States have passed an identical statute."[90]

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[84] *State and Local Taxation*, p. 234, citing *City of Winchester v. American Woodmark Corp.*, 471 S.E.2d 495 (Virginia 1996)("invalidating municipal gross receipts tax applied to 100 percent of the revenues of corporations with headquarters in the city because it violated the Commerce Clause's fair apportionment requirement").

[85] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)(hereinafter cited as *Complete Auto*).

[86] *Goldberg v. Sweet* and *GTE Sprint Communications Corporation v. Sweet*, 488 U.S. 252, 257 (1989)(hereinafter cited as *Goldberg*), quoting *Complete Auto*, 430 U.S. at 279.

[87] *Goldberg*, 488 U.S. at 260-61.

[88] *Goldberg*, 488 U.S. at 262.

[89] *Goldberg*, 488 U.S. at 261.

[90] *Goldberg*, 488 U.S. at 261.

Stephen Moore, Research Analyst, Revenue Committee, Nebraska Legislature (September 23, 2010).

The U.S. Supreme Court has said that "'the Constitution imposes no single [apportionment] formula on the states'" and it has consistently "declined to undertake the essentially legislative task of establishing a 'single constitutionally mandated method of taxation.'"[91]

- The **third prong** of the *Complete Auto* test asks if the State is "imposing a ***discriminatory tax on interstate commerce***."[92] In recent times, the Court has taken a pragmatic approach to this problem by focusing more on the practical realities of modern-day commercial transactions and less on measurable quantitative factors.[93]

- The **fourth prong** of the *Complete Auto* test asks whether the "tax is fairly related to the presence and activities of the taxpayer within the State. . . . ***The purpose of this test is to ensure that a State's tax burden is not placed upon persons who do not benefit from services provided by the State.*** . . . [It] focuses on the wide range of benefits provided to the taxpayer, not just the precise activity connected to the interstate activity at issue."[94]

B. Equal Protection Clause Jurisprudence

"The Equal Protection Clause does not mean that a State may not draw lines that treat one class of individuals or entities differently from the others. Where taxation is concerned and no specific federal right, apart from equal protection is concerned, the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation."[95]

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[91] *Goldberg*, 488 U.S. at 261, quoting *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 164, 171 (1983).

[92] *Goldberg*, 488 U.S. at 265.

[93] See, e.g., *Goldberg*, 488 U.S. at 252 (footnote 2 omitted): "This case comes to us against a backdrop of massive technological and legal changes in the telecommunications industry. Years ago, all interstate telephone calls were relayed through electric wires and transferred by human operators working switchboards. Those days are past. Today, a computerized network of electronic paths transmit thousands of electronic signals per minute through a complex system of microwave radios, fiber optics, satellites and cables. When fully connected, this network offers billions of paths from one point to another. When a direct path is full or not working efficiently, the computer instantly activates another path. Signals may even change paths in the middle of a telephone call without perceptible interruption. Thus, the path taken by the electronic signals is often indirect and typically bears no relation to state boundaries. The number of possible paths, the nature of the electronic signals, and the system of computerized switching make it virtually impossible to trace and record the actual paths taken by the electronic signals which create an individual telephone call."

[94] *Goldberg*, 488 U.S. at 266-67, citing *Commonwealth Edison v. Montana*, 453 US 609, 627 (1981).

[95] *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 357 (1973) (emphasis added) (case challenging the constitutionality of Illinois' personal property tax under the Equal Protection Clause of the 14th Amendment of the United States Constitution).

Stephen Moore, Research Analyst, Revenue Committee, Nebraska Legislature (September 23, 2010).

"[S]tate tax classifications require only a ***rational basis*** to satisfy the Equal Protection Clause.[96]" "States are, of course, bound by Supreme Court precedent when they construe the *federal* Equal Protection Clause. When construing equal protection clauses of state constitutions, however, the state courts are free to depart from the Supreme Court's view of equal protection."[97]

C. Jurisprudence Involving "Instrumentalities of Interstate Commerce"

"The states have long employed gross receipts taxes directed specifically at interstate transportation and communication and at other public utilities. . . . *Complete Auto*, which involved a transportation company engaged in 'exclusively interstate commerce,' may be read as the Court's coup de grace to 60 years of decisions striking down nondiscriminatory gross receipts taxes on the instrumentalities of interstate commerce."[98]

"During the era when the Court invalidated even nondiscriminatory gross receipts taxes on the instrumentalities of interstate commerce, the Court nevertheless sustained a number of gross receipts taxes aimed expressly at railroads and other instrumentalities of interstate commerce as taxes in lieu of property taxes. . . . The rationale of these cases was that the levies were imposed not on interstate commerce or receipts from such commerce, but rather on the taxpayers' in-state property, and that the gross receipts apportioned to the states were a reasonable measure of the value of the taxpayers' in-state property, including its franchises. Where, however, the Court found the levies on interstate transportation or communication companies were in fact imposed on 'gross receipts' or on 'the interstate business' and not in truth on 'a just equivalent for the ordinary tax,' the Court struck them down."[99]

X. Do Gross Receipts Taxes Meet the Requirements of a Good Tax System?

The six principles of a good tax system are set forth below.[100] (No opinion is expressed herein as to whether gross receipts taxes meet the requirements of a good tax system.)

A. Reliability.

Reliability has three primary components: stability, certainty, and sufficiency. Stability implies that revenues are relatively constant over time and not subject to

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[96] *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997).

[97] *State and Local Taxation*, p. 60 (emphasis in original).

[98] *State and Local Taxation*, pp. 237-238.

[99] *State and Local Taxation*, pp. 238-239.

[100] *Tax Policy Handbook for State Legislators*, pp. 7-9, National Conference of State Legislatures (2nd ed. Apr. 2003)(hereinafter cited as *Tax Policy Handbook for State Legislators*).

unpredictable fluctuations. Certainty means that the number and type of tax changes are kept at a minimum to allow businesses and individual to plan for the future. Sufficiency requires that revenue sources provide the revenue growth necessary to finance the desired rate of growth of spending. The reliability of different types of tax sources varies greatly, depending on the type of activity being taxed. States can improve the reliability of their tax systems by imposing a balanced mix of taxes.[101]

B. Equity.

"Equity" includes horizontal and vertical equity. Horizontal equity means that taxpayers with similar economic circumstances have similar tax burdens. Vertical equity refers to the distribution of tax burdens among taxpayers with different economic circumstances.[102]

C. Compliance and Ease of Administration.

The tax system should facilitate "taxpayer compliance by minimizing the time and effort necessary to comply with the law" and it should minimize "the cost of the state administrative apparatus necessary to collect revenue, enforce the law, and audit to ensure compliance."[103]

D. Responsiveness to Interstate and International Competition.

"A state tax system does not operate in a vacuum—lawmakers must recognize that the tax policies of surrounding states can limit the revenue potential of some taxes. Businesses that sell in a national or global marketplace can relocate if state business taxes are too burdensome. Individuals may choose to shop in neighboring states if specific state consumption tax differentials are high."[104]

E. Economic Neutrality.

"Taxes by their very nature are not economically neutral. . . . A quality tax system tries to minimize the effect of the tax system on the allocation of resources in the economy. . . . Taxes with broad bases and low rates, spread across a wide range of sources and economic activities, reduce the effect of taxation on economic decisions."[105]

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[101] *Tax Policy Handbook for State Legislators*, p. 7.

[102] *Tax Policy Handbook for State Legislators*, p. 7-8.

[103] *Tax Policy Handbook for State Legislators*, p. 8.

[104] *Tax Policy Handbook for State Legislators*, p. 8.

[105] *Tax Policy Handbook for State Legislators*, p. 8.

F. Accountability.

"[T]ax burdens should be explicit, not hidden. This principle can be applied in two ways. First, credits and exemptions in the tax code should be minimized and reviewed frequently to determine their cost (in lost revenue) and to determine whether they are unfairly benefiting some taxpayers at the expense of others. Second, taxes that are designed to be 'passed through' to consumers provide less accountability than taxes that are paid directly and openly by taxpayers."[106]

XI. Summary

This interim study research paper has:

(1) Identified the purpose of LR 536;

(2) Identified the five basic elements of any tax;

(3) Distinguished gross receipts taxes from sales and use taxes;

(4) Examined the gross receipts taxes imposed by Washington, New Mexico, New Jersey, and Hawaii;

(5) Discovered that West Virginia repealed its gross receipts tax in 1987 in favor of imposing an income tax;

(6) Discovered that Ohio's "Commercial Activity Tax" is a hybrid tax combining elements of a gross receipts tax and a privilege-of-doing-business tax;

(7) Discovered that the "Texas Margin Tax" is a hybrid tax combining elements of a gross receipts tax and a net income tax;

(8) Discovered that the "Michigan Business Tax" is a hybrid tax combining elements of a gross receipts tax and a net income tax;

(6) Discovered that Oklahoma's "Business Activity Tax" is <u>not</u> a gross receipts tax;

(10) Summarized the various tests used by courts of law to evaluate the constitutionality of state and local taxes under the U.S. Constitution; and

(11) Summarized the six generally accepted principles for evaluating the quality of state and local taxes.

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[106] *Tax Policy Handbook for State Legislators*, p. 8-9.