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June 13, 2017

Oregon State Legislature
Joint Committee on Tax Reform

Via E-mail

Re: COST's Opposition to -2 Amendment to H.B. 2830, "Commercial Activity Tax"

Dear Chairman Hass, Chairman Barnhart, Vice Chair Boquist, Vice Chair Bent, Vice Chair Smith Warner, and Members of the Committee:

On behalf of the Council On State Taxation (COST), I am writing in opposition to provisions in the -2 amendment to House Bill 2830 that would impose a gross receipts tax. Specifically, sections 4 through 31 would impose a Commercial Activity Tax on all business entities, including partnerships and S corporations, that are doing business in Oregon at various rates ranging from 0.15 percent to 0.75 percent. A leading professor of public finance and policy, Dr. John Mikesell, has concluded, "There is no sensible case for gross receipts taxation… They do not belong in any program of tax reform."[1] For the reasons described below, COST urges the Committee to reject gross receipts taxation provisions in the -2 amendment to House Bill 2830.

About COST

COST is a nonprofit trade association consisting of approximately 600 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

Policy Against Gross Receipts Taxes

The COST Board of Directors has adopted a formal policy position regarding gross receipts taxes.[2] That policy position states:

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[1] "Gross Receipts Taxes in State Government Finances: A Review of Their History and Performance," by Dr. John L. Mikesell, Indiana University School of Public and Environmental Affairs, January 2007, p. 2, available on the COST website at: http://cost.org/WorkArea/DownloadAsset.aspx?id=67458.
[2] COST's policy position and explanation are available on the COST website at: http://cost.org/uploadedFiles/About_COST/Policy_Statement/GrossReceiptsTaxes.pdf.

Gross receipts taxes are widely acknowledged to violate the tax policy principles of transparency, fairness, economic neutrality and competitiveness; generally, such taxes should not be imposed on business.

Asserted Benefits of Gross Receipts Taxes Are Not What They Seem

Proponents of gross receipts taxes often state that such taxes have a broad base, which allows their imposition at a low rate while providing a stable revenue source. It is true that a gross receipts tax base can be broad, in fact even broader than the total value of production of the economy. However, such taxes lack any link either to capacity to bear the cost of government services or to the amount of government services used—the normal standards for assigning tax burdens.

Further, whether a gross receipts tax has a low rate depends on how much revenue the government intends to raise from it. Unlike most taxes, the effective rate of a gross receipts tax is higher than the statutory (or advertised) rate. A broad-base, low-rate gross receipts tax is unlikely to contribute a major share of tax revenue to state government.

Ohio, for example, adopted a relatively low-rate Commercial Activity Tax (0.26%) as part of a net tax *decrease* for businesses, including the elimination of the State's corporate franchise tax (tax imposed on net income or net worth, whichever was greater), a complete phaseout of its personal property tax on general businesses, and a significant reduction in personal income tax rates (which helped mitigate the impact of the CAT on pass-through entities). In contrast, Oregon is simply not in a fiscal position to impose a gross receipts tax at a low rate while eliminating other anti-competitive taxes and mitigating the harmful effects of the new tax.

Finally, research demonstrates that gross receipts taxes appear to be roughly as stable as a retail sales tax.[3] Gross receipts taxes do not contribute to the overall stability of total state revenue because their fluctuations follow generally the same pattern as other major taxes. Simply put, a gross receipts tax is as stable as a sales tax, but with the harmful effects described below.

Lack of Economic Neutrality

Gross receipts taxes interfere with private market decisions. Their pyramiding creates a haphazard pattern of incentives and disincentives for business operations. Most significantly, they establish artificial incentives for vertical integration and discriminate against contracting work with independent suppliers and the advantages of scale and specialization that production by independent firms can bring. In this way, **gross receipts taxes particularly harm small and medium-sized businesses.** Even with the $3 million threshold, these problems still exist.

Anticompetitive

Gross receipts taxes interfere with the capacity of individuals and businesses to compete with those in other states and other parts of the world. The tax embedded in prices grows as the share of a production chain within the state increases, so there is incentive to purchase business inputs

[3] *See* Mikesell, *infra*, pp. 8-9.

from outside the state. It discourages capital investment by adding to the cost of factories, machinery, and equipment, and the disincentive increases as more of those capital goods are produced in the taxing state. **This tax structure inhibits growth and development of the economy of an adopting state.**

Unfair

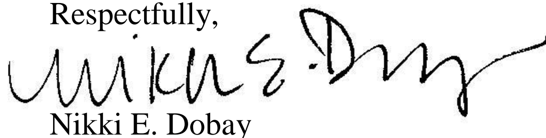
Gross receipts taxes do not treat similarly situated businesses the same. Firms with the same net income will face radically different effective tax rates on that income, depending on their profit margins. Low-margin firms will be at great disadvantage relative to higher-margin firms, regardless of their overall profitability. Many new and expanding firms have low margins (or even are initially unprofitable). As a result, **a gross receipts tax reduces the chance that new and expanding businesses, or low-margin businesses in general, will survive.**

Lacks Transparency

A gross receipts tax is a stealth tax with its true burden hidden from taxpayers. The public does not see the tax because it is imposed on businesses, and the public has no way of seeing the pyramiding that converts a low legal rate into a much higher effective rate. Hiding the cost of government is inconsistent with the efficient and responsive provision of government services and is contrary to the fundamentals of democratic government.

For the reasons described above, I urge the Committee to reject the Commercial Activity Tax in the -2 amendment to House Bill 2830 and any other proposals that would tax a business's gross receipts. Please contact me with any questions regarding this testimony or COST's research in this area, or if I may in any other way be of assistance.

Respectfully,



Nikki E. Dobay

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director