UTAH TAX REVIEW COMMISSION

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September 28, 2009

Senator Wayne A. Niederhauser, Senate Chair
Representative Todd E. Kiser, House Chair
Revenue and Taxation Interim Committee
Utah State Capitol Complex
Salt Lake City, Utah 84114

Gentlemen:

You asked the Utah Tax Review Commission (TRC) to respond to several questions regarding the apportionment of business income under the state corporate and franchise income taxes. This letter contains our response to the questions you asked.

Introduction

Utah imposes tax of five percent of a corporation's Utah taxable income. Because some corporations have income from business activity that is both in and out of Utah, a corporation's business income is currently apportioned between the states in which it does business based on its sales, payroll, and property.

A corporation subject to the Utah state corporate income tax may choose between two different methods to apportion its taxable income. Under the first method, the corporation's sales, payroll, and property are all equally weighted (33.3%). Under the second method, a corporation may make a five year non-revokable election to use an apportionment formula that weights its sales factor at twice the amount (50%) of its payroll (25%) and property factors (25%).

These apportionment formulas are also used by businesses that are not corporations (such as partnerships, limited liability companies, and sole proprietorships) that have business income from more than one state.

The state collected just over $264 million in state corporate franchise and income tax revenue in FY 2009. This represents a 38% reduction over FY 2008 collections of $418 million. The state corporate income tax is a volatile source of revenue, with year-over percentage change in collections in the last 35 years ranging from increases as high as 80% and decreases as low as 40%.

What issues should the Legislature consider related to the apportionment of business income for multi-state businesses?

The TRC believes that a high quality revenue system is responsive to interstate and international economic competition. The Utah economy does not exist in a vacuum. We compete with other states for capital investment and job creation.

How do other states apportion business income?

Table 1 below shows how the states apportion business income.

Table 1
Apportionment of Business Income

Apportionment Method	2000 Tax Year Number of States	2008 Tax Year Number of States
Single Sales Factor	3	11
Sales Factor Greater Than 50% But Less Than 100%	5	5
Double Weighted Sales	19	13
Equally Weighted Three Factors	12	8
Election Between Different Methods	7	9
No State Corporate Income Tax	3	4

As shown above, between tax year 2000 and 2008, more states have adopted a single sales factor apportionment formula. California will adopt an electable single sales factor apportionment formula beginning in 2011. The map in Appendix 1 shows the apportionment formula for all states in effect for the 2008 tax year.

If the state were to move to a non-electable single sales factor apportionment formula, what are the likely impacts to taxpayers in different industry types?

Taxpayers with a large property and payroll presence in Utah, relative to other states in which they also have payroll and property, would likely pay less in state corporate income taxes under a single sales factor apportionment formula. These industries include those engaged in utilities, mining, and manufacturing. Taxpayers with a relatively small payroll and property presence in Utah but a large sales presence would likely pay more in state corporate income taxes. Taxpayers in this category include those in the retail sales and financial services industries.

What are the estimated fiscal impacts of a non-electable single sales factor apportionment formula?

During its 2009 General Session, the Legislature considered, but did not adopt, S.B. 59 "Allocation and Apportionment of Income and Deduction of a Net Loss." This bill changed the formula for apportioning business income by providing for a non-electable single sales factor apportionment formula beginning with a taxable year that begins on or after January 1, 2012. The Office of the Legislative Fiscal Analyst (LFA) estimated that this legislation would have resulted in a reduction of $12 million in Education Fund revenue in Fiscal Year 2011.

The LFA explained to the TRC how it developed this estimate. The LFA maintains a database of tax return information for each state corporate income taxpayer including information on the taxpayer's payroll, property, and sales factors. The estimate was determined by recalculating each taxpayer's tax liability using a non-electable single sales factor apportionment formula and comparing that tax liability to the taxpayer's liability under current law.

The TRC was also told by the LFA that under a non-electable single sales factor apportionment formula, there would be more taxpayers who experience an increase in state corporate income tax liability than those who would experience a decrease in state corporate income tax liability. However, the amount of the decrease in state corporate income tax liability (for those taxpayers with a decrease) is more than the amount of the increase in tax liability for those taxpayers with an increase.

Another factor in the loss of revenue is that under federal law (P.L. 86-272), a state may not impose a state corporate income tax on a corporation if its only economic presence in the state consists of the solicitation of sales. Because of this law, there are many corporations that are not subject to state corporate franchise or income taxes even though they make sales in Utah.

Approximately what increase in business investment in the state would be required to achieve revenue neutrality?

The Office of the Legislative Fiscal Analyst estimates that it would require an increase of approximately $700 million in direct business investment in the state to achieve revenue neutrality for the state corporate income tax.

Overview of Public Testimony Regarding a Single Sales Factor Apportionment Formula

The TRC received testimony from the Utah Taxpayer's Association (UTA) that a single sales factor apportionment formula would be attractive to companies who sell most of their product to out of state customers. The UTA noted a retail business is not likely to bring new employees to Utah from other states. In contrast, a company that has a small proportion of sales in Utah but has a sizable investment in plant and equipment is more likely to need employees with specialized skills that cannot be met solely from within the state. These companies are likely to create jobs that will be at least partially filled with employees relocating from other states. The UTA also testified that most large multi-state retail firms would not benefit from a single sales factor apportionment formula.

The TRC received testimony from Voices for Utah Children that the corporations that pay most of the Utah state corporate income tax are very large, multi-national companies. The state corporate income tax paid by these companies represent less than one percent of their total profits. This organization told the TRC that the state tax code has little effect on the investment and employment decisions of these companies and that adoption of a single sales factor apportionment formula would result in a reduction in revenue for public and higher education.

Conclusion

We hope that this information is helpful to you and other members of the Legislature as you make decisions regarding the state corporate franchise and income tax.

Sincerely,

M. Keith Prescott
Chair
Utah Tax Review Commission

David Crapo
Vice Chair
Utah Tax Review Commission