Corporate Franchise and Income Taxes

Apportionment of Business Income in Utah

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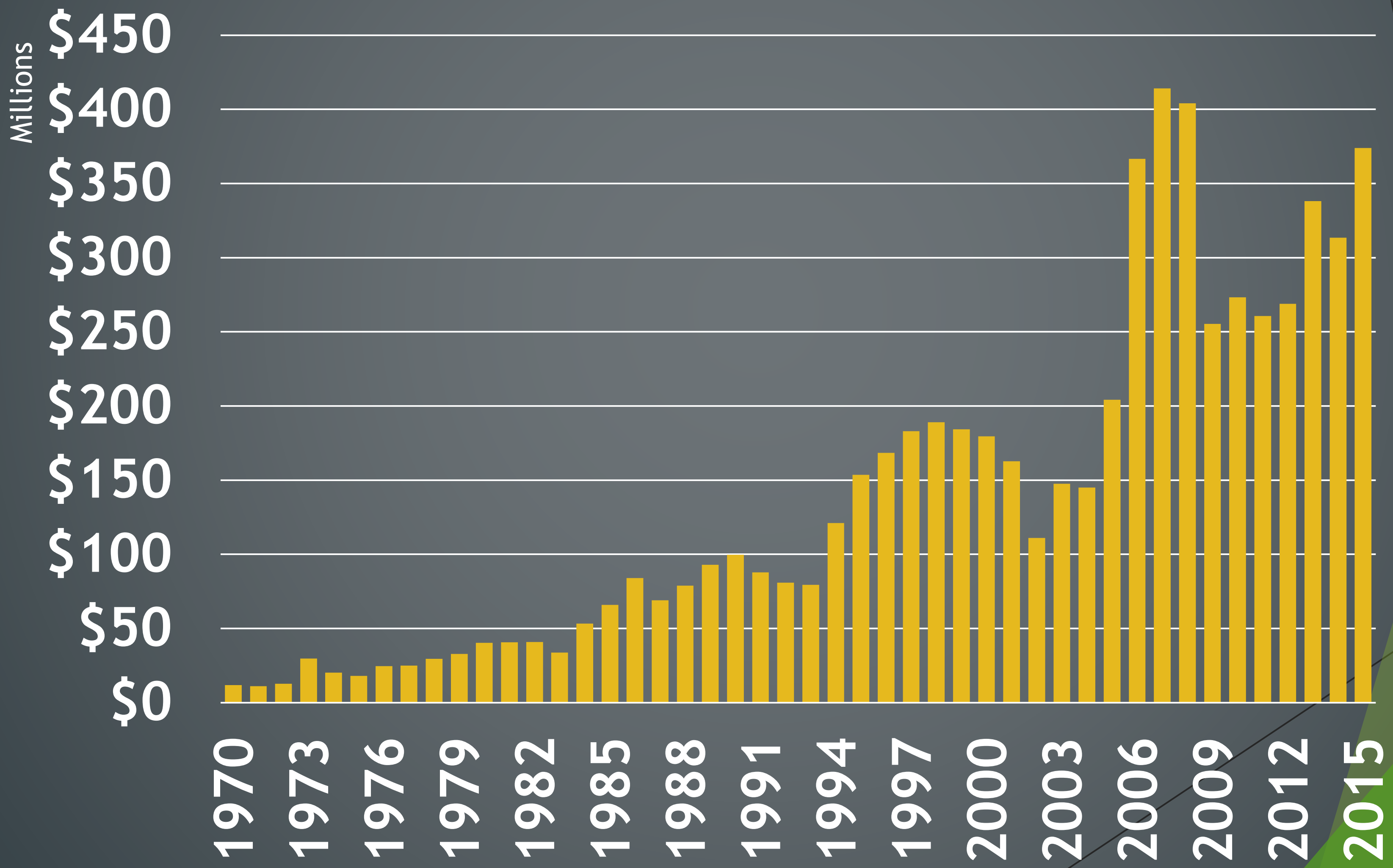
Office of Legislative Research and General Counsel

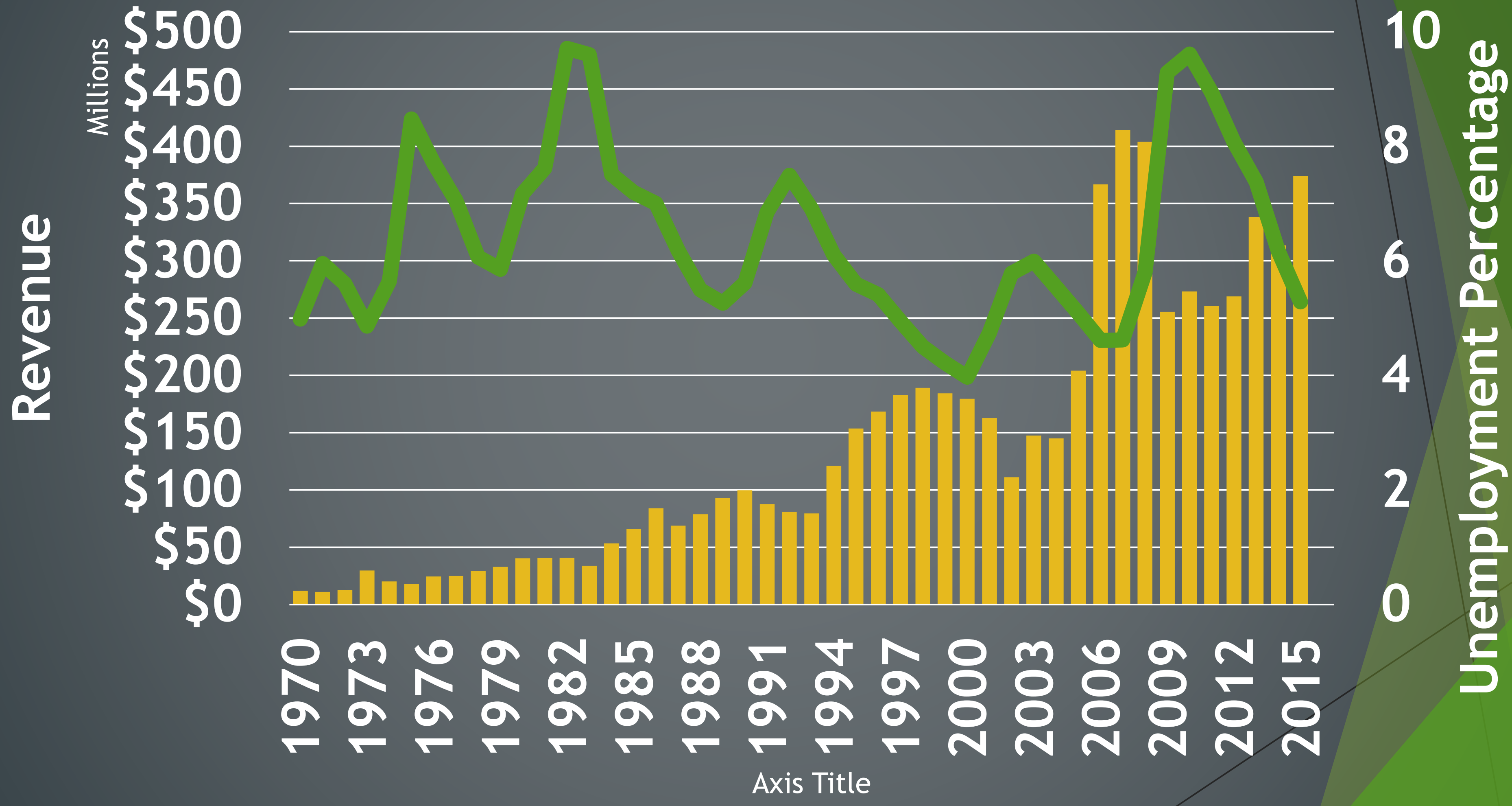
-- April 2016

Corporate Franchise & Income Tax Revenue
FY 1970 to FY 2015



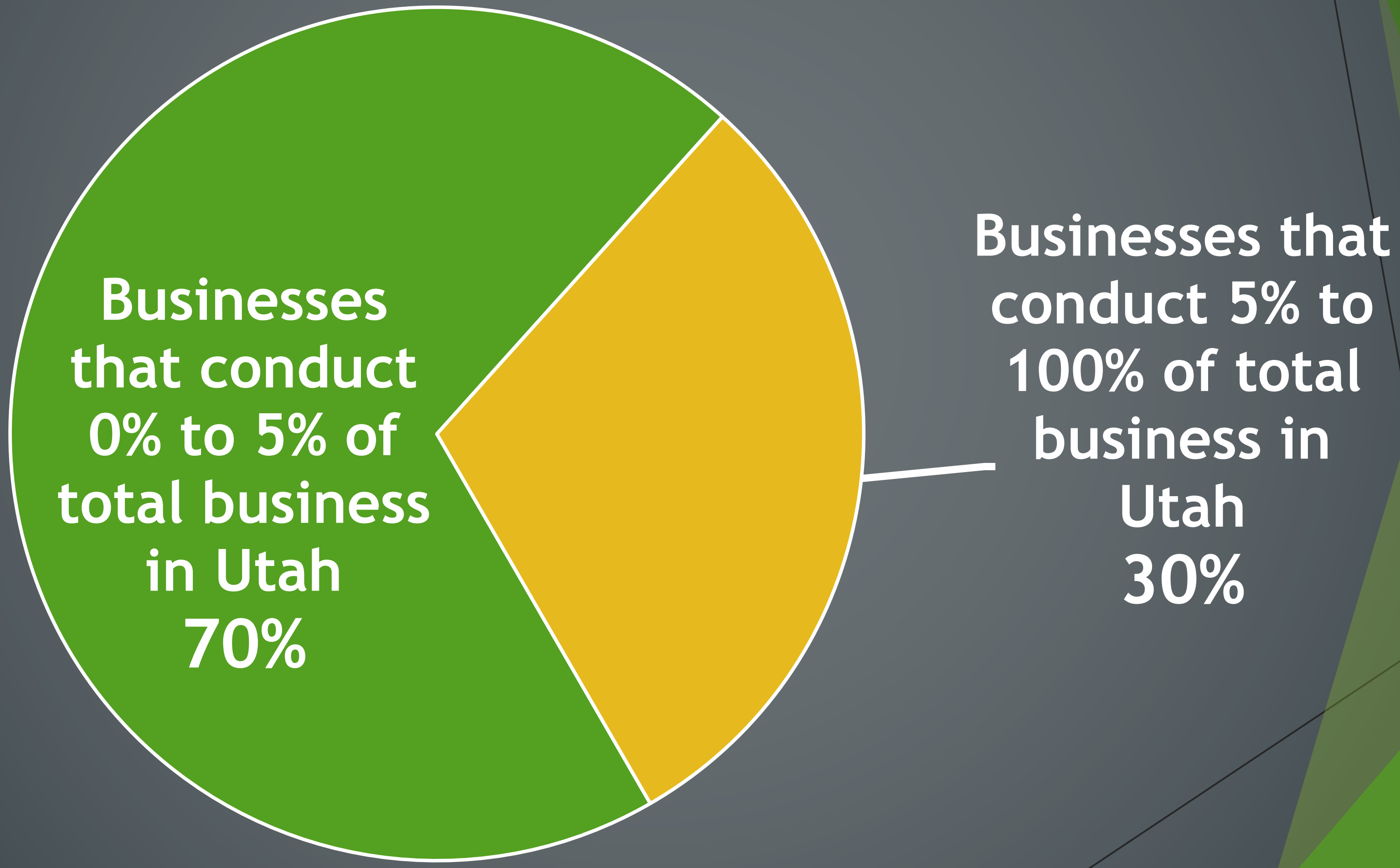
Source: Utah State Tax Commission

Corporate Franchise & Income Tax Revenue
FY 1970 to FY 2015



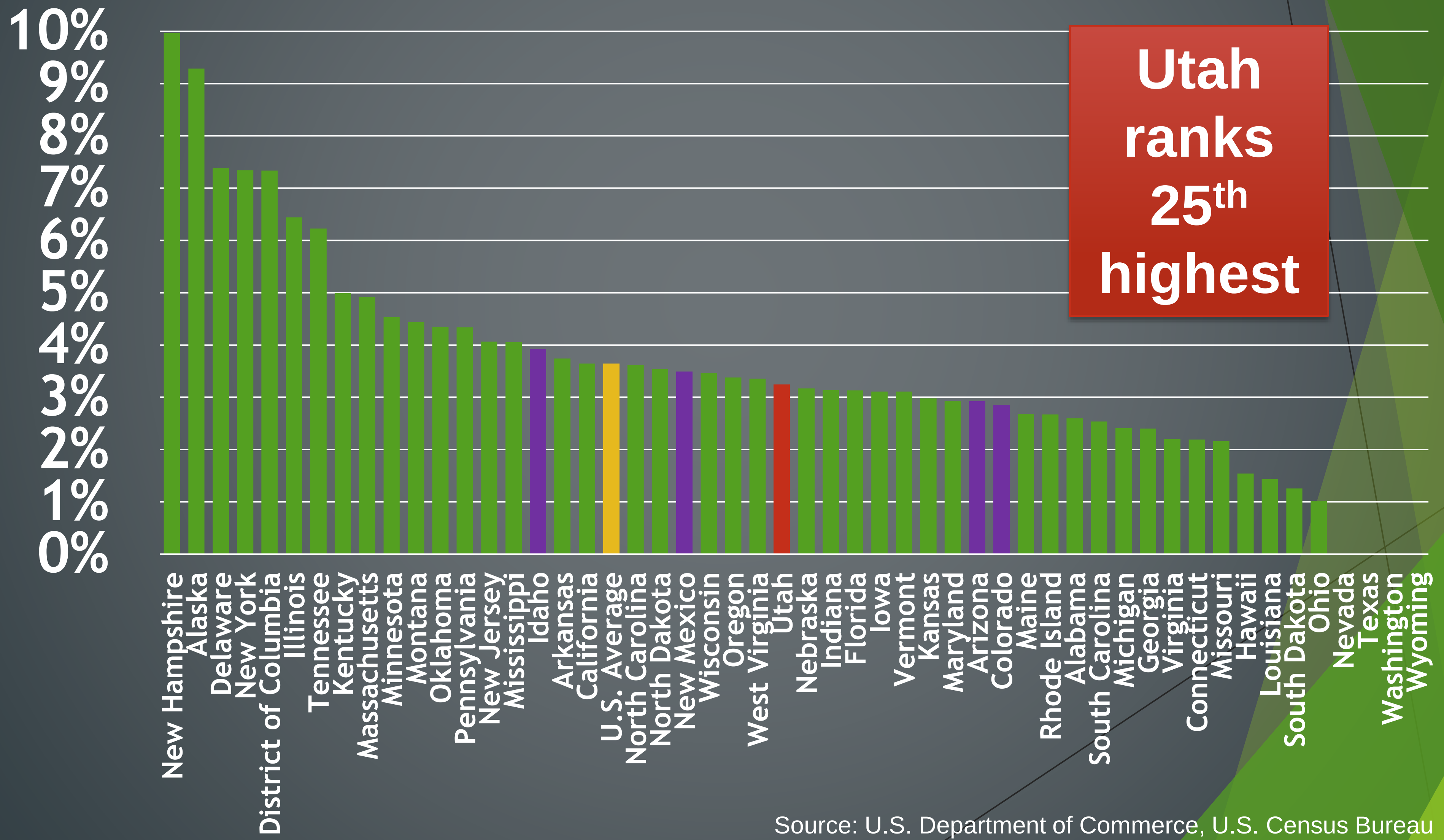
Source: Utah State Tax Commission and Bureau of Labor Statistics

Corporate Franchise & Income Tax Revenue by % of Business in Utah Tax Year 2013



Source: Utah State Tax Commission

Corporate Income Tax as a Percent of State and Local Taxes
FY 2013



Source: U.S. Department of Commerce, U.S. Census Bureau

Why Does the Corporate Franchise & Income Tax Matter?

Earmarked for public and higher education

Volatile revenues

Tax on income (generally C-corporations)

Businesses don't pay taxes – people do

- Employer wages
- Investor rates of return
- Prices for goods and services
- Tax shift can occur across states and countries

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Principles behind Apportionment

- A state may only collect taxes on a business's income that is earned within that state's borders.

  Apportionment => tax burden aligns with income generation

- "Business income": income arising from transactions and activity in the regular course of a taxpayer's trade or business, including income from tangible and intangible property if the acquisition, management, and disposition of that property is part of the business's regular trade or operations.

History of Utah Code § 59-7-311 - Method of Apportionment of Business Income

(1967 to Present)

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Original Statute - 1967 through 2005

- Three-factor formula: property, payroll, and sales
  - Fraction calculated for each factor to compare taxpayer's property, payroll, and sales in the state to taxpayer's property, payroll, and sales everywhere

    Example:

    $$\frac{\text{Property in Utah}}{\text{Total Property}} + \frac{\text{Payroll in Utah}}{\text{Total Payroll}} + \frac{\text{Sales in Utah}}{\text{Total Sales}}$$

  - Each factor **weighted equally**, so the factor fractions are added together and divided by **three**
  - **To calculate tax, total income** is **multiplied by** the **resulting fraction**

HB0078 - 2005 (effective 2006)

- Created an **electable sales factor-weighted** formula
  - Taxpayer could choose to double the sales factor fraction
  - Election had to be maintained for five years

    Example:

    $$\frac{\text{Property in Utah}}{\text{Total Property}} + \frac{\text{Payroll in Utah}}{\text{Total Payroll}} + 2 \times \left(\frac{\text{Sales in Utah}}{\text{Total Sales}} \right)$$

  - Sum of three fractions divided by **four**
  - **To calculate tax, total income** is **multiplied by** the **resulting fraction**

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SB0059 - 2009 (Proposed: did not pass)

- Proposed legislation would have phased in a sales factor weighted formula, culminating in a **mandatory single sales factor** formula for all taxpayers beginning in 2012

  Example:

  $$\frac{\text{Sales in Utah}}{\text{Total Sales}}$$

- To calculate tax, total income is multiplied by the sales factor fraction

SB0165 - 2010

- Maintained a choice between equally weighted and double sales factor-weighted for taxpayers that are not “sales factor weighted taxpayers”
- Phased in a sales-factor weighted formula that eventually became a **mandatory single sales factor** formula for “sales factor weighted taxpayers”

Sales-Factor Weighted Taxpayers

"Sales Factor Weighted Taxpayer": a taxpayer having more than 50% of taxpayer's total sales everywhere generated by economic activities:

- Performed by the taxpayer; and
- Classified in a NAICS code except the following:
  - Mining (Sector 21)
  - Natural Gas Distribution (Industry Group 2212)
  - Manufacturing (Sector 31-33)
  - Transportation and Warehousing (Sector 48-49)
  - Information except Other Information Services (Sector 51)
  - Finance and Insurance (Sector 52)

SB 15 and HB 61 - 2016

S.B. 15

- Eliminated obsolete phase-in language from 2010 SB0165

H.B. 61, as enacted

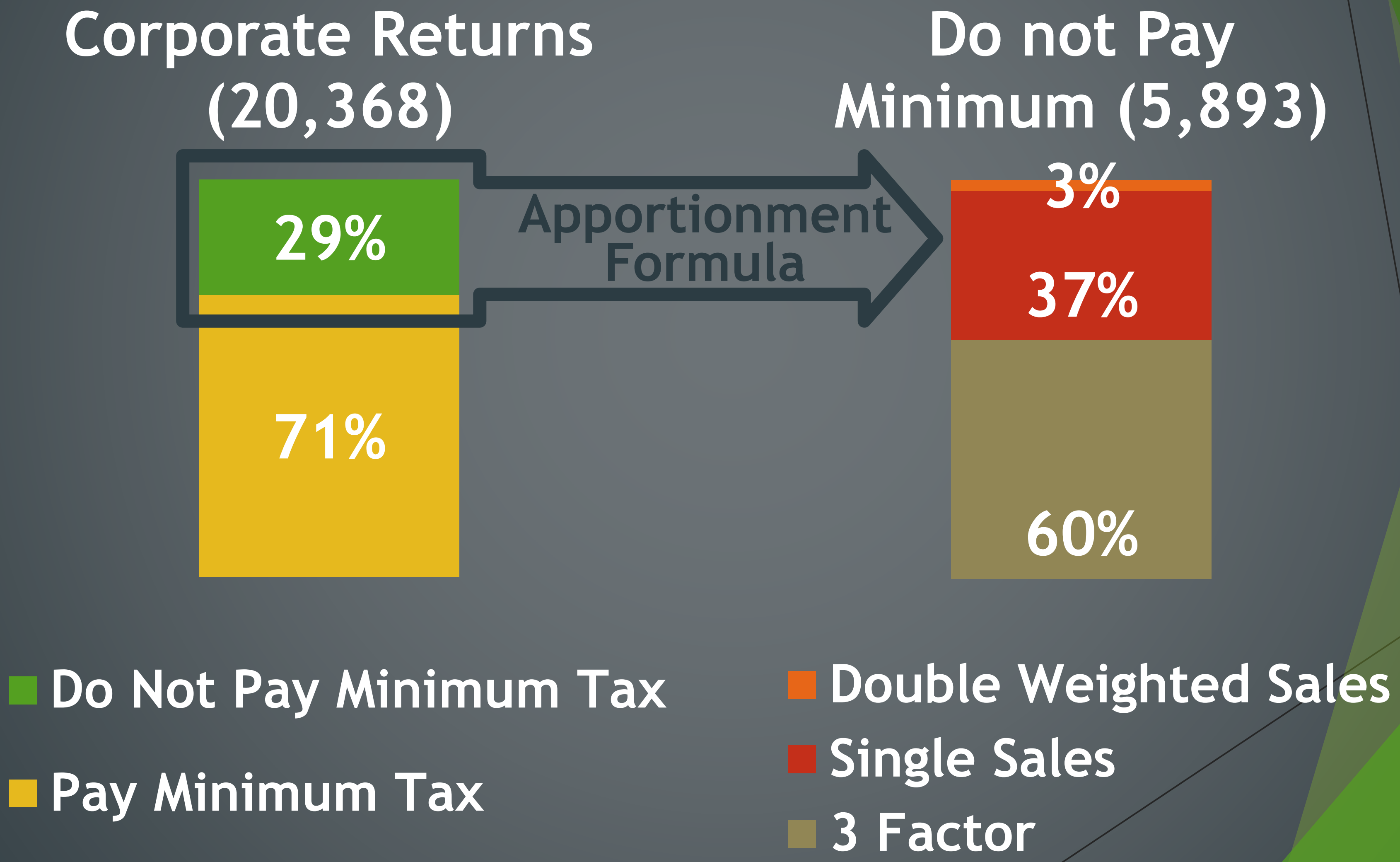
- Created a category of "**optional sales factor weighted taxpayers**" that can choose between equal weight, double weight, and single sales
- "Optional sales factor weighted taxpayer": a taxpayer having more than 50% of the taxpayer's total sales everywhere generated by economic activities classified as Computer and Electronic Product Manufacturing (NAICS Subsector 334)

HB 61 (cont'd)

H.B. 61 as originally introduced

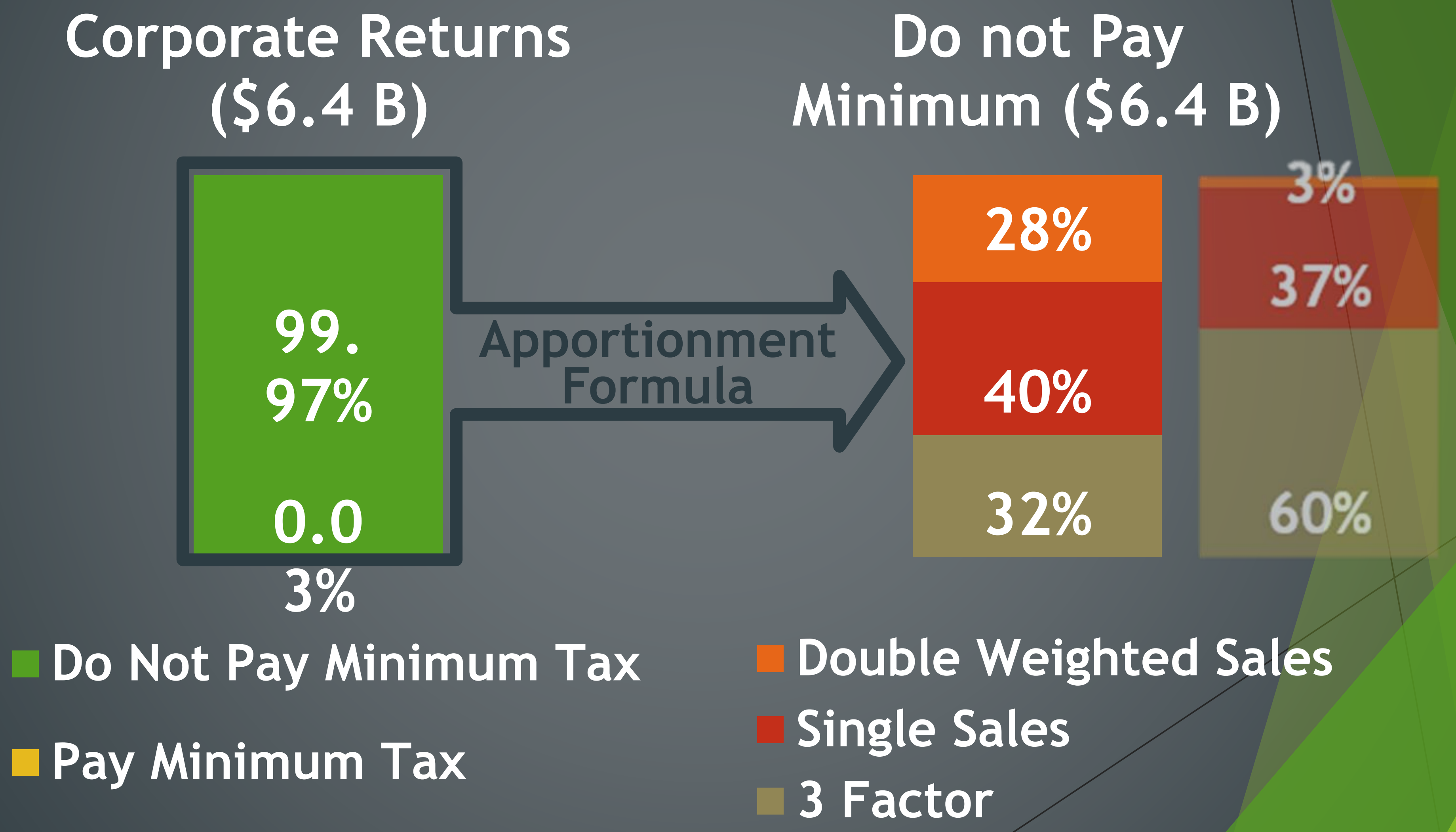
- Authorized all taxpayers to choose between equally weighted three-factor apportionment, double weighted sales factor apportionment, and single sales factor apportionment.
- Projected fiscal note: Ongoing loss to Education Fund (approx. $132M in FY 2017)

Corporate Franchise & Income Tax Returns (number of returns)
Tax Year 2013



Source: Utah State Tax Commission

Corporate Franchise & Income Tax Returns
(net taxable income)
Tax Year 2013



Source: Utah State Tax Commission

Tax Review Commission Tasks

- Study the economic benefits of allowing the election of a single sales factor formula to apportion business income to:
  1. <u>all taxpayers</u>; or
  2. <u>additional taxpayers</u>.
     - Which additional NAICS industries should receive the option?
     - Would allowing particular industries to elect single sales factor remove barriers to economic development and investment in the state?
- Make recommendations to the Revenue and Taxation Interim Committee