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Single Sales Factor Apportionment

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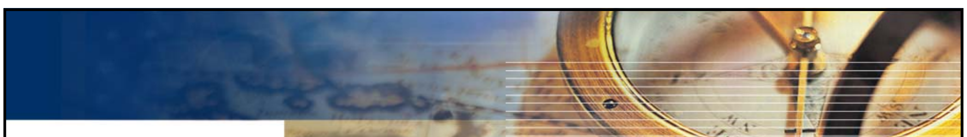

VSCPA Efforts and Role

Emily Walker | VSCPA Government Affairs Director

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VSCPA Efforts and Role

VSCPA formed a coalition task force that:

- Comprised members from various industries and organizations, including:
  - > VSCPA
  - > Virginia Manufacturers Association (VMA)
  - > Virginia Bar Association (VBA)
  - > Virginia Chamber of Commerce
- Strongly supported legislation that provided the basis for this study
- Served as an independent resource to the Study Committee

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VSCPA Efforts and Role

Recommendations for study methodology:

- Who should this apply to?
- How would it be implemented?
- What are some additional legislative changes that should be considered in this process (i.e. throwback, market-based sourcing, etc.)?

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VSCPA Efforts and Role

VSCPA position:

- Neutral
- The VSCPA believes that it is important to study the impact of adopting a single sales factor apportionment formula in Virginia and that the study be well-balanced.

Overview of Technical Terms

Damon L. DeSue, CPA | VSCPA Board of Directors Executive Committee

Overview of Technical Terms

A. Nexus/Doing Business

1. Standards

a. Nexus — sales of goods

i. Although it varies by state, nexus is the standard by which a state considers a company to be “doing business” and, thus, subject to the state income taxing regime.

ii. States are prohibited from taxing income derived from the sale of tangible personal property if the business activities fall within the protected scope of Public Law 86-272 (mere “solicitation of orders” exception).

Overview of Technical Terms

A. Nexus/Doing Business

1. Standards

b. Nexus — sales of services

i. Activities related to the sale of services are not protected by Public Law 86-272; however, a “bright-line physical presence” test must be met in order for a state to tax business income earned in the state.

Overview of Technical Terms

A. Nexus/Doing Business

1. Standards

   c. Economic nexus

      i. Rejects the "bright-line physical presence" test

      ii. Requires a business to file if the business conducts continuous and systematic business activities in a state producing significant gross receipts attributable to that states' customer base

      iii. Limited application for certain industries

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Overview of Technical Terms

A. Nexus/Doing Business

2. Apportionment issues are considered <u>after</u> nexus has been established with the taxing state.

   a. Change in the apportionment methodology by itself does not create more Virginia taxpayers.

   b. Changes in the apportionment methodology may increase or decrease taxes for Virginia taxpayers already subject to Virginia taxes.

   c. Changes may shift tax collections from corporate income taxes to personal income taxes.

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Overview of Technical Terms

B. Sales Factor

1. Sourcing methodologies
   a. Sales of Tangible Personal Property (TPP)
      i. Destination rules
         a) Gross receipts are sourced to the state where goods are received or delivered to the customer.
      ii. Throwback
         a) Gross receipts are sourced to the originating state if the taxpayer is not taxed in the delivery or destination state.
         b) Virginia currently does not apply the throwback provision.

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Overview of Technical Terms

B. Sales Factor

1. Sourcing methodologies
   b. Sales of services
      i. Income-producing activity/Cost of performance
         a) Gross receipts are sourced where the greater proportionate share of income-producing activity occurs.
      ii. Market-based sourcing
         a) Gross receipts are sourced where the customer received benefit of the services.

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Overview of Technical Terms

B. Sales Factor

2. Sourcing receipts for service businesses

   a. Various state sourcing rules

      i. Virginia: Income-producing/Cost of performance
      ii. Georgia: Market-based
      iii. Illinois: Market-based
      iv. Maryland: Market-based

Overview of Technical Terms

Example: Impact of Georgia Change on Virginia Taxpayer

Scenario:

A corporation from North Carolina contracts with a computer software company from Virginia to develop and install computer software for one of its business offices, which is located in Georgia. The software will only be used by the business office in Georgia. All of the development and installation services occur in Virginia. The computer software company has nexus in both Georgia and Virginia.

Overview of Technical Terms

Example: Impact of Georgia Change on Virginia Taxpayer

Conclusion:

All of the gross receipts from the software development and installation services are attributable to Georgia and are included in the numerator of the apportionment factor because the North Carolina corporation received all of the benefit of the service in Georgia. In addition, the same gross receipts would be attributable to Virginia because all of the computer software company's income-producing activities were located in Virginia. ***Based on the double inclusion in the numerator of both states, the computer software company's tax burden has increased by 100% on the same income earned on the contract.***

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Overview of Technical Terms

B. Sales Factor

3. Sourcing issues are considered <u>after</u> nexus has been established with the taxing state.
   a. Change in the sourcing methodology by itself does not create more Virginia taxpayers.
   b. Changes in the sourcing methodology may increase or decrease taxes for Virginia taxpayers already subject to Virginia taxes.
   c. Changes may create equal footing for Virginia-based businesses.

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Study Considerations

Art Auerbach, CPA | VSCPA Board of Directors

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Study Considerations

A. Study Considerations
   1. Economic development incentives
      a. Impact on investment
      b. Impact on employment
   2. Fiscal Impacts on tax collections
      a. Net losses and gains
      b. Tax collection shift from corporate to personal, sales/use taxes, and other taxes

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Study Considerations

B. Transitioning State References
1. Sample studies
   a. Georgia
      i. Economics professor from Georgia State University
      ii. Statistical examination
      iii. Projected long-term increase in revenue (i.e. net personal income tax collection and jobs)
   b. New York
      i. Collaboration of economics professors from University of Chicago and the University of North Carolina
      ii. Statistical examination
      iii. Projected long-term increase in revenue (i.e. net personal income tax collection and jobs)

Implementation Approaches

Teresa Jordan, CPA | VSCPA Tax Advisory Task Force

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Implementation Approaches

Single Sales Factor States

- Colorado
- Georgia
- Iowa
- Maine
- Michigan
- Nebraska
- Oregon
- Texas
- Connecticut
- Illinois
- Kentucky
- Maryland
- Minnesota
- New York
- Pennsylvania
- Wisconsin
- Florida
- Indiana
- Louisiana
- Massachusetts
- Missouri
- North Carolina
- South Carolina

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Implementation Approaches

All Industries vs. Targeted Industries

All	Targeted
• Colorado	• Connecticut
• Georgia	• Florida
• Illinois	• Kentucky
• Indiana	• Louisiana
• Iowa	• Maryland
• Maine	• Massachusetts
• Michigan	• North Carolina
• Minnesota	• Pennsylvania
• Missouri	
• Nebraska	
• New York	
• Oregon	
• South Carolina	
• Texas	
• Wisconsin	

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Implementation Approaches

Phased-In vs. Immediate Implementation

Phased-In	Immediate
• Georgia	• Colorado
• Illinois	• Connecticut
• Indiana	• Florida
• Massachusetts	• Iowa
• Michigan	• Kentucky
• Minnesota	• Louisiana
• Nebraska	• Maine
• New York	• Maryland
• Oregon	• Missouri
• South Carolina	• North Carolina
• Wisconsin	• Pennsylvania
	• Texas

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Implementation Approaches

Optional v. Mandatory

Optional	Mandatory
• Florida	• All other states
• Kentucky	
• Missouri	

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Fiscal Impact on Taxpayers: Examples of Winners and Losers

Damon L. DeSue, CPA | VSCPA Board of Directors Executive Committee

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Fiscal Impact on Taxpayers: Examples of Winners and Losers

General Characteristics of a Winner or Loser

1. Winners — Sales Factor
   a. Business with minimal sales volume in Virginia but a higher concentration of property and payroll in Virginia
   b. Business relocating or expanding operations in Virginia
   c. Business with a projected future sales factor less than the current three-factor formula
2. Losers — Sales Factor
   a. Business with minimal property and payroll but a higher sales volume in Virginia
   b. Business relocating or expanding operations outside Virginia
   c. Business with a projected future sales factor greater than current three-factor formula

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Fiscal Impact on Taxpayers: Examples of Winners and Losers

General Characteristics of a Winner or Loser

1. Winners — Market-Based Sourcing
   a. In-state service business with cost inputs both inside and outside Virginia (i.e. only taxed once on income earned outside Virginia)
2. Losers — Market-Based Sourcing
   a. Out-of-state service business with cost inputs both inside and outside Virginia (i.e. more income taxed in Virginia)

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Fiscal Impact on Taxpayers: Examples of Winners and Losers

Tax Increase (Loser) Example

- $13,000 increase in Virginia taxes

Apportionment Method	Sales % (2x)	Payroll %	Property %	Apportionment %	Federal Taxable Income	Virginia Taxable Income	Virginia Tax
Three-Factor	8.3800%	0.9700%	0.9757%	2.5814%	$13,500,000	$348,492	$20,910
Single-Factor	4.1900%			4.1900%	$13,500,000	$565,650	$33,939
			Increases	**1.6086%**		**$217,158**	**$13,029**

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Fiscal Impact on Taxpayers: Examples of Winners and Losers

Tax Decrease (Winner) Example

- $14,000 decrease in Virginia taxes

Apportionment Method	Sales % (2x)	Payroll %	Property %	Apportionment %	Federal Taxable Income	Virginia Taxable Income	Virginia Tax
Three-Factor	10.0000%	5.1000%	7.3000%	5.6000%	$39,000,000	$2,184,000	$131,040
Single-Factor	5.0000%			5.0000%	$39,000,000	$1,950,000	$117,000
			Decreases	**(0.6000%)**		**($234,000)**	**($14,040)**

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Questions?

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