HJR 177/SJR 101 - Joint Subcommittee studying Benefits of Adopting a Single Sales Factor for Corporate Income Tax Purposes

(http://dls.state.va.us/ssf.htm)

October 21, 2008

Opening Remarks

The joint subcommittee studying the benefits of adopting a single sales factor for corporate income tax purposes held its third meeting in Richmond. Co-chair Delegate Kathy Byron stated that it is her intention to study the possibility of the Commonwealth adopting an optional single sales factor. A mandatory single sales factor will not be considered as it would result in some corporations paying less income tax and other corporations paying more income tax.

Staff presentations

Staff to the joint subcommittee reviewed some major studies that analyzed the potential economic impact from adopting a single sales factor. Professor Austan Goolsbee of the Graduate School of Business of the University of Chicago and Professor Edward L. Maydew of the Kenan-Flagler Business School of the University of North Carolina completed a study in November 2000 of the economic impact of implementing a single sales factor in the state of New York. The study concluded that implementation of a single sales factor should increase the number of manufacturing jobs in New York by about 3.5 percent or 32,000 jobs and should increase non-manufacturing jobs by about 1.3 percent or 101,000 jobs. Personal income tax revenue from these new jobs was estimated at $184 million to $247 million per year. Any long-run increases in employment would occur gradually over a period of three years or more. These estimates were based on a statistical examination of the experiences of states that changed their apportionment formula for corporate income taxation during the 1980's and 1990's. Any decrease in corporate income tax revenues from adoption of a single sales factor would need to be weighed against the anticipated increase in personal income tax revenue. The study took into consideration other factors that can affect employment such as tax rates, state trends, national unemployment rates, and actions of other states regarding their apportionment formula for corporate income taxation.

Professor Kelly D. Edmiston of the Fiscal Research Center and Department of Economics of the Andrew Young School of Policy Studies, Georgia State University, analyzed the potential economic impact from implementing a single sales factor in Georgia. The study concluded that there would be a decline in Georgia corporate income tax revenues of $101.7 million in 2004 growing to $133.7 million in 2008. However, because a single sales factor apportionment formula eliminates that portion of the corporation income tax that is generated by a corporation's payroll and property, Professor Edmiston estimated that there would be a 6.9 percent increase in Georgia's multistate corporate payroll over a three-year period, which would level off at the end of the three years. The study projected that the increase in payroll paid by multistate corporations would increase Georgia's personal income tax collections by $32.4 million to $65.9 million in 2004 and by $118 million to $239.8 million in 2008. Thus, the increase in personal income tax collections would more than offset any decrease in corporation income tax revenues. The study was based upon actual Georgia corporation income tax returns filed from 1992 through 2000.

Michael Mazerov, a Senior Fellow with the Center on Budget and Policy Priorities, studied manufacturing employment in the United States between 1995 and 2004. He concluded that every state except North Dakota suffered a loss in manufacturing jobs. During the 2001 - 2004 period, five of the eight states that adopted a single sales factor had manufacturing job losses worse than the median average loss (-8.2 percent in Louisiana) for the period. The manufacturing job loss in Connecticut was -9.6 percent; in Texas -9.8 percent; in Illinois -10.2 percent; in Maryland -13.3 percent; and in Massachusetts -14.8 percent. With regard to the remaining single sales factor states, Iowa (-3.0 percent), Missouri (-5.3 percent), and Nebraska (-7.0 percent) had manufacturing job losses that were better than the median. During the 1995 - 2004 period, the top three states (North Dakota, Kansas, and Utah) and seven of the top 15 states with manufacturing job losses that were better than the median used equally weighted payroll, property, and sales factors in apportioning the income of multistate corporations.

Mr. Mazerov also studied facility or plant investments made between 1995 and 2004. Citing data from *Site Selection Magazine*, he determined that 71 facility or plant investments of at least $700 million were made during this period. Seven of the ten single sales factor states did not land any of these investments after adoption of the single sales factor.

Mr. Mazerov concluded that the empirical evidence does not support the single sales factor as an effective incentive for job creation or job retention. The labor pool, transportation infrastructure, quality of education, and public safety have a greater impact than tax policy in attracting business investment, and reducing corporate income tax revenues could mean that less is spent on these items. He stated that even if a single sales factor attracts business investment, it would not be cost effective because reductions in corporate income taxes are not tied to job creation or capital investment.

Michael Mazerov

Mr. Mazerov provided testimony on the single sales factor. He stated that the single sales factor apportionment formula does not reflect where corporations receive state services or where they earn income because it excludes the payroll and property factors that were endorsed under the Uniform Division of Income for Tax Purposes Act. Under an optional or election to use a single sales factor, there will no additional corporate income tax paid by out-of-state multistate corporations to make up for any decrease in corporate income tax revenues. A single sales factor apportionment formula that can be elected by manufacturers is estimated to decrease corporate income tax revenues by $64.7 million annually, or 7.4 percent of 2007 corporate income tax revenues.

Mr. Mazerov stated that the single sales factor automatically reduces corporate income tax liability for corporations with a greater percentage of their sales outside of the Commonwealth, regardless of whether the corporation creates new jobs or makes a new capital investment. Under a single sales factor, corporations may reduce jobs and still receive tax savings. Mr. Mazerov testified that the fundamentals of business dictate where a business locates its operations. Using a single sales factor to influence location decisions is an inefficient use of state financial resources. Because Virginia does not have a throwback rule, sales to customers in states in which the corporation is not taxable will not be taxed by any state.

Mr. Mazerov told the joint subcommittee that there is no correlation between the single sales factor and manufacturing jobs or capital investment. He stated that the vast majority of corporations are not taxable in other states and would not benefit from implementation of a single sales factor, therefore, there would be little incentive to invest. According to the Virginia Department of Taxation, two-thirds of all Virginia corporations are taxable only in Virginia.

Mr. Mazerov testified that combined state and local taxes are about 2 percent of a business' total expenses, with corporate income taxes accounting for less than 10 percent of this 2 percent total. Reducing this minor expense by implementing a single sales factor does not have a major impact on a corporation's profitability and will not have a major impact on location decisions. He stated that the absence of a single sales factor could be the tipping point in a business deciding not to invest in Virginia, but that the single sales factor is inefficient. Under California's dynamic revenue model, every $1 billion decrease in corporate income tax revenue would recoup $180 million in dynamic revenue gains after five years.

Mr. Mazerov stated that the Goolsbee/Maydew and Edmiston studies were predictions and not descriptive of actual results. Successive studies by Goolsbee and Maydew resulted in lower estimates for new jobs created under a single sales factor. Mr. Mazerov concluded that (i) the single sales factor is unlikely to be effective or cost-effective in bringing about job creation or investment, (ii) a single sales factor should not be enacted while Virginia is confronting a fiscal crisis, and (iii) there are better ways to fund economic development.

Dr. Fletcher Mangum, Mangum Economic Consulting, LLC

Dr. Mangum stated that manufacturing has a large economic impact in Virginia, $172 billion. In 2007 manufacturing provided 286,579 jobs in Virginia, which was 8 percent of total employment. Virginia manufacturing jobs on average paid $48,516 per year in 2007, which was 5 percent above the statewide average. Manufacturing has a larger impact in the Shenandoah Valley, Western Virginia, New River/Mount Rogers, Region 2000, West Piedmont, South Central, and the Crater Area regions of the Commonwealth. A 2005 Ernst & Young study found that the effective state and local tax rate in Virginia on manufacturing is 2.2 times higher than on professional services; 1.9 times higher than on information, data, and computer services; 1.5 times higher than on agriculture and forestry; and 1.4 times higher than on retail. Between 1990 and 2007 Virginia manufacturing employment fell 32 percent, while between 2000 and 2007 Virginia manufacturing employment fell 22 percent.

Dr. Mangum testified that the single sales factor removes the current disincentive on increasing Virginia employment and capital investment, encourages companies that have a disproportionately high economic impact on Virginia to locate in the Commonwealth, shifts some of the tax burden to businesses located outside the Commonwealth, and keeps Virginia competitive with other states. Dr. Mangum stated that between 2007 and 2008 ten states increased their sales factor weight and the number of states offering at least an optional single sales factor increased from eleven to fifteen.

Dr. Mangum concluded that the Goolsbee\Maydew single sales factor study in 2000 is the most comprehensive study to date of the single sales factor. It employed a fifty state analysis based on twenty years of data and used a multivariate regression analysis to control for the effect of other factors on employment. The study found that moving from a 50 percent to a 100 percent sales factor in New York increased manufacturing employment by 3.5 percent and non-manufacturing employment by 1.3 percent within three years.

Based on current trends, Virginia manufacturing employment could decline from 286,579 jobs in 2007 to 241,173 jobs in 2012, or 45,406 jobs. A loss of these 45, 406 jobs would result in a loss of $396 million in state tax revenue ($70 million in business taxes, $160 million in individual taxes, and $166 million in sales and use taxes). Applying the Goolsbee/Maydew estimate of a 3.5 percent increase in manufacturing jobs from the implementation of a single sales factor means that 8,441 of the 45,406 manufacturing jobs otherwise projected to be lost could be retained if the single sales factor were implemented in Virginia. Saving these 8,441 jobs would result in a positive revenue impact of $75 million annually ($13 million in business taxes, $30 million in individual taxes, and $32 million in sales and use taxes).

Mr. Brett A. Vassey, President & CEO, Virginia Manufacturers Association

Mr. Vassey stated that the General Assembly has by statute found the economic vitality of the Commonwealth would be enhanced if manufacturing facilities were established in Virginia. See Section 58.1-439 of the Code of Virginia. Mr. Vassey stated that in 2006 the Joint Legislative Audit and Review Commission (JLARC) found that the state and local tax burden on Virginia manufacturing is "higher than its proportional percentage of the State's economy in terms of employment, the number of firms, and total gross state product."

Mr. Vassey stated that Virginia manufacturing supports 1,015,971 jobs (303,829 direct and 712,142 indirect jobs) and is responsible for $172 billion in annual economic output ($85.8 billion in direct output and $86.2 billion in additional output). Based on calendar year 2005 data, Virginia's manufacturing sector, its supporting industries, and its employees generate $6.3 billion in tax revenue each year ($3.5 billion in state tax revenue and $2.8 billion in local tax revenue). Manufacturing accounted for 9.3 percent or $34.2 billion of Virginia's $369.7 billion in gross domestic product in 2006.

Between 1990 and 2007, manufacturing jobs decreased by 118,944. Conversely, between 1990 and 2006, manufacturing wages increased by 82.1 percent. A JLARC survey in 2006 of Virginia manufacturers determined that workforce quality and availability followed by workforce costs and taxes were the most important determinants for investment decisions.

Since 2005, Virginia manufacturing job announcements are down 44 percent and capital investment announcements are down 49 percent. In a 2008 evaluation by the Ball State University School, Virginia ranked fiftieth in growth in value-added manufacturing. Among competing Southern states, Virginia has the highest effective tax rate on manufacturers at 11.6 percent (Alabama, 8.5 percent; Georgia, 7.5 percent; Kentucky, 6.2 percent; North Carolina, 8.8 percent; and South Carolina, 10.4 percent). Each year manufacturing tax compliance costs in Virginia are $113 million to $201 million. Manufacturers pay 27 percent of local business taxes and 35 percent of total corporate income taxes.

Mr. Vassey told the joint subcommittee that nineteen states have already adopted a single sales factor. Mr. Vassey concluded that (i) doing nothing may cost $396 million in state and local revenue by 2012, (ii) manufacturing overall performance has declined in the last seven years, (iii) analysis of the single sales factor requires the consideration of the substantial impact that manufacturers have on both their suppliers and the Commonwealth, (iv) manufacturers have demonstrated that they have invested in their workforce, and (v) capital investment is slowing.

Mr. Rob Shinn, Partner, Capital Results

Mr. Shinn stated that the trend in many states is toward adoption of a single sales factor for the apportionment of multistate corporation income. He stated that the single sales factor rewards corporations for making investments in Virginia. Mr. Shinn testified that the Goolsbee/Maydew studies were the most comprehensive and reliable because they controlled for many different variables that can impact employment. He concluded by mentioning that the single, biggest issue for the business of Barr Laboratories is the single sales factor.

Next Meeting

The fourth meeting of the joint subcommittee is scheduled for November 17 at 10:00 a.m. The meeting agenda will be posted on the study's website *(http://dls.state.va.us/ssf.htm)* prior to that meeting.