COST
COUNCIL ON STATE TAXATION

Gross Receipts Taxes

Policy Position

Position: *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.*

Explanation: The average voter's eyes begin to glaze over when economists discuss "tax policy principles." This reaction is understandable, but it is also unfortunate, because a tax that violates fundamental principles of tax policy, like gross receipts taxes, directly impacts average people by frustrating job creation and economic development. Gross receipts taxes implicate several tax policy principles:

- A *transparent* tax, like the sales tax on consumer purchases, is obvious to the taxpayer, and its economic effects are easily understood. Gross receipts taxes, on the other hand, are stealth taxes that affect individuals in several unseen ways: 1) as sellers, by taxing their receipts while not taxing receipts of some competitors and thus making their products less competitive; 2) as purchasers, by imposing hidden taxes and thus making the products they purchase more expensive; and 3) as workers, by depressing investment and thus reducing wages and employment opportunities.
- A *fair* tax treats similarly situated taxpayers similarly. Gross receipts taxes are unfair in that they impose a significant tax burden on start-up businesses, low margin enterprises and unprofitable firms. Businesses are already subject to myriad taxes that are not based on ability to pay—property tax, sales tax, unemployment insurance tax, etc.—another tax should not be added to that list. Gross receipts taxes also punish firms that buy from in-state suppliers by imposing at least one additional layer of tax on business inputs. Employers are generally unable to pass gross receipts taxes along to consumers in other jurisdictions which results in lower wages and fewer employment opportunities.
- An *economically neutral* tax does not influence business choices (of location, of operational entity, of suppliers, etc.). Gross receipts taxes are among the least neutral of all taxes. Because a gross receipts tax is imposed every time a product is sold, it discriminates against producers that are not vertically-integrated. If each step in a production process is performed by a different business, the final product would have been subjected to multiple levels of tax. This is called "pyramiding", and it results in an effective tax rate that can be more than three times higher than the actual statutory tax rate.
- The impact of a tax on *competitiveness* is closely related to the principle of economic neutrality discussed above. The essential question is: Does a gross receipts tax make businesses more or less competitive when compared with businesses that are not subject to a gross receipts tax? Clearly, the answer is "less competitive." Because a gross receipts tax is imposed at every stage of the production process, exporters who are not vertically integrated will have a significant level of tax built into their exports.

Gross receipts taxes are widely understood to represent poor tax policy, and thus they are frequently given "new" names, such as "Commercial Activity Tax", "Alternative Minimum Assessment" or "Margins Tax". Washington calls its gross receipts tax the "Business and Occupations" (B&O) tax. Washington was one of the first states to adopt a broad-based gross receipts tax, and it is the only state to have maintained such a tax for more than a few years and not subsequently repealed it. The Washington Tax Structure Study Committee recently found that the B&O tax: 1) pyramided an average of 2.5 times (e.g., the effective tax rate is 250% higher than the statutory tax rate); 2) imposed a competitive disadvantage on new and expanding businesses; 3) is not transparent to consumers; 4) creates an unnatural division of business activity; and 5) dramatically violates the principle of neutrality.[1]

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[1] Washington State Tax Structure Study Committee, "Tax Alternatives for Washington State: A Report to the Legislature," Chapter, 4, November, 2002.

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