Lessons to Be Learned

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One of the most dangerous developments in state efforts to increase tax revenue in the face of budgetary shortfalls is the enactment of gross receipts taxes (GRT) — an annual tax imposed on the privilege of doing business, measured by the gross receipts from most business activities. While only a handful of states currently have such a tax, the idea appears to be growing in popularity among some state legislatures as a quick solution for closing the gap between increasing state expenditures and flat tax revenue. In 2005 Ohio enacted its commercial activity tax and Nevada adopted a commerce tax in 2015. But the pace may be accelerating. Four states — Louisiana, Oklahoma, Oregon, and West Virginia — have considered GRT proposals in 2017. There could be more.

The lure of a GRT can be enticing to state legislatures. The tax produces substantial — and relatively predictable — revenue, due to the scope and depth of its reach into the state's economy. It yields a high level of revenue, in large part by pyramiding, as the same product can be taxed multiple times as it moves through progressive stages of production and distribution. Since GRTs are computed based on a company's sales and not on its income, the state's tax revenue is less affected by up-and-down business cycles. A company's income is likely to vary from year-to-year, so under a corporate income tax, businesses do not pay income tax if they do not make a profit — even though they may have substantial sales volume. The same is not true of a GRT.

The apparent, and seductive, solution presented by a GRT belies the fact that it is bad tax policy and even worse economic policy. A tax on a company's gross receipts, which permits no or limited deductions for the expenses a firm incurs in generating sales, imposes a burden unrelated to the company's ability to pay. A business with high sales volume but little or no profit will be saddled with high taxes. In this regard, a GRT is blatantly discriminatory due to its disproportionate impact on high-volume, low-margin businesses.

Aside from being unfair, the impact of a GRT is to discourage investment, with a resulting loss of jobs and an overall dampening of economic growth. Start-up ventures, which typically sustain losses in their early years, may nonetheless be subject to a substantial tax burden. Indeed, a GRT is a deterrent to attracting innovative enterprises, and it may precipitate the exodus of corporations that believe the tax places them at a competitive disadvantage. To add to the pain, unlike a VAT, a GRT is imposed on the *full* value at each stage of taxation. Moreover, GRTs present complex sourcing issues and are also notoriously difficult to administer.

In the mid-2000s, several states explored adopting GRTs. Michigan, New Jersey, and Kentucky enacted such taxes, but quickly repealed them due to their adverse economic impact. In 2002 Indiana repealed its GRT, which was adopted in 1933. The lesson to be learned is that GRTs are convoluted and unfair, suppress investment, and impede economic growth. States would be wise to avoid falling prey to the sweet siren call of a GRT.