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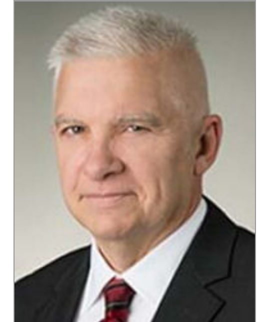
# Digital Services And Asphalt Production: SALT In Review

By **David Brunori** (August 25, 2023, 10:49 AM EDT)

I regularly scour the latest state and local tax news to bring you only the interesting — and sometimes absurd — parts. Here are the recent developments that earned my praise, gripes and other thoughts, from Massachusetts' proposed gross receipts tax on digital providers to a dispute over equipment used to make asphalt in North Carolina.


David Brunori

**Worst Tax Policy Proposal of the Year – I Know It's Only August**

A bill in Massachusetts, H. 74, seeks to impose a 5% gross receipts tax on revenue that digital streaming service providers collect from Massachusetts customers. I hate gross receipts taxes, and you should, too. Taxing revenue without regard to profits is unsound. And as everyone who has ever studied the issue knows, gross receipts taxes are ultimately paid by customers. This is particularly true with streaming services, which as I understand are inelastic.

So while Hulu will nominally pay the tax, it will pass the burden on to its customers as higher prices. Many politicians, and even some tax scholars, think saliency, transparency and open government are overrated. You should not be one of those people. Gross receipts taxes are a hidden, cowardly, dastardly way to collect revenue. They are money grabs by people who do not want you to know they are grabbing your money.

The bill's sponsors want to use some of the revenue to fund community media programming. I think that means government-operated television channels where you can spend your evenings watching township council meetings. If you are lucky, you may catch a local mosquito control board hearing. If you want to enjoy those essential government services in the commonwealth, though, you will have to pay more for your Netflix subscription. I wonder how many people would pay more to watch "Ted Lasso" on Apple TV so that the government can fund a local access station featuring politicians discussing sewage treatment plans.

I must confess my bias. I love Netflix. My favorite shows have been "Peaky Blinders," "Squid Game" and "Beef." I like Hulu, too — highly recommend "The Bear" — and Amazon Prime; watch "The Marvelous Mrs. Maisel"! I just wouldn't want to pay more. And whether politicians admit it or not, the people of Massachusetts will pay more.

Besides the money grab, what is the rationale for this tax? Unlike cable companies, the streaming business does not use public rights of way. We have seen cities across the country try to tax streaming companies because they are like cable companies. The courts have universally rejected that idea.

Now, don't get me wrong. I think streaming services should be subject to the Massachusetts sales tax. The customer would pay the tax. At least the customer would be aware of that. And while I detest the corporate tax, the streaming companies should be taxed on their profits earned in the commonwealth. Why do we need more taxes than that?

I just turned on my local public access channel and saw a looping advertisement noting where the

farmers' markets are on Saturday mornings. I am not sure I would pay more to watch "The Pope's Exorcist" on Netflix for that.

**No Coincidences**

Many people have opinions about why people move to low-tax states. The policy debate largely boils down to whether lowering taxes, particularly on income, will lead to more people and businesses moving in.

My liberal friends say migration is not about taxes. Some of my conservative friends say it's all about taxes. I realize that this is an important question for policymakers. I believe taxes matter way more than liberals think. But I recognize that taxes are not the whole story. If they were, there would be a line of U-Hauls entering Wyoming every day.

The progressive Center on Budget and Policy Priorities released a report, "State Taxes Have a Minimal Impact on People's Interstate Moves," that concludes, well, taxes don't matter in determining where people live and work. "State tax levels," the report says, "have little effect on whether and where people move — certainly not to a degree that should lead state policymakers to enact unaffordable tax cuts to attract people or avoid enacting productive increases focused on the wealthy."

The study's author, Michael Mazerov, is a smart guy who has led the fight for more progressive state taxation for decades. He concludes that people leave states for reasons other than lower taxes such as jobs, family, weather and cost of living. He points out that many people move into high-tax states. He also criticizes studies conducted by conservative organizations that find that people do leave states because of taxes. The report is long and, because I think you should be exposed to all sides of arguments, worth reading.

Again, I will admit that taxes are not the only reason people move. But it can't be a coincidence that in the past several years, many more people left high-tax states and moved to low-tax states. They can't all be wanting to play golf or sit on the beach. And the people who move take their money with them. UBS Wealth Management released a report this year showing that the average incoming migration rate for states with no income tax is 2%, while that for states with 10% and higher top marginal tax rates is minus 1.7%.

It can't be a coincidence that Internal Revenue Service and census data shows that from 2019 to 2020, 28 states realized a net gain in income tax filers from migration. The top five were Florida, Texas, Arizona, North Carolina and South Carolina. But 22 states and the District of Columbia realized a net loss of income tax filers. The five most affected were New York, California, Illinois, Massachusetts and New Jersey. The data — the science — shows that people move from high-tax states to low-tax states. By the way, Katherine Loughead of the Tax Foundation did an excellent report on this data late last year.

Now, you will always be able to find people who move for reasons other than taxes. But the one common thread in our migration story is that people are moving from high-tax states to low-tax states. Liberal think tanks and professors do a lot of studying of this issue; somehow they all conclude that few people move for taxes. I note that those who argue that taxes do not matter are also the people who want higher taxes. And the people who want higher taxes really want higher taxes on other people. They want others to pay their fair share.

Most readers, though, know that wealthy folks can and do move. This is especially so in the post-pandemic, remote worker economy. There is a whole industry devoted to assisting them move. I know; I am part of it. Hundreds of accountants, tax lawyers and consultants help rich folks move from high- to low-tax climates. They have checklists to ensure you will meet the residency requirements. Why do you care whether you changed your driver's license or voter registration? It's because you don't want to be considered a resident of a high-tax state. Geez, Louise. Everybody knows this. Well, apparently not everybody.

**But Maybe It's Not About Migration at All ...**

Richard Auxier at the Tax Policy Center, also a very smart guy, released an interesting paper late last month, "Reviewing Three Years of Tax Cuts." No one would accuse Auxier or the Tax Policy Center of being conservative. The paper tells the story of almost continual tax cuts since 2021. The only two states not to cut taxes since then are Alaska and Nevada. Every other state and the District of Columbia have reduced tax burdens in some fashion.

As the report notes and others have opined, states had large surpluses over those years. The economy spiked after COVID-19 and the federal dollars rolled in. Even in liberal states, being flush usually leads to tax cuts or tax rebates.

The states primarily cut income taxes: 11 states in 2021, 12 states in 2022 and nine states in 2023. And some states, like Iowa, cut personal income tax more than once. Many states enacted or expanded earned income tax credits: 13 states and D.C. in 2021, nine states and D.C. in 2022 and 12 states in 2023. States cut other taxes during that time, including 18 that reduced property taxes.

The big surpluses played a big role in spurring the tax cuts. And certainly interstate competition factored in. I am starting to think, though, that something else is going on. I have been writing about the politics of anti-taxation for decades. It has been difficult to raise taxes at every level of government. Rather than concerns about migration, maybe we are seeing politics truly play out.

Sure, Americans want some level of government. But maybe they don't want quite as much government as they have been getting. Maybe they are looking to keep more of their money in their pockets. And maybe, just maybe, their elected officials are listening.

**... And Then There Is This**

A recently released study in the Journal of Economic Policy Reform — "Do Revenue Neutral Tax Swaps Boost Growth?" — found that some taxes are worse than others. I know. I have been saying that since '96. But it's nice to hear other people say it. The study looked at revenue systems in nine countries of the Organization for Economic Cooperation and Development.

The study found that the most growth-damaging tax is the corporate income tax. I have long said the state corporate income tax should be repealed. The study provides proof not only that the corporate income tax is difficult to enforce but that its very existence hurts the economy. Interestingly, the second-most-damaging tax from an economic growth perspective is the personal income tax. These findings reiterate that taxing mobile capital and investment is unsound.

As many state legislators have long known, the study found that shifting from income taxes to consumption taxes leads to greater growth. The study found that revenue-neutral tax reforms focusing on a shift from income taxation to consumption and property taxation would promote growth. So true.

**The Real Lesson From Tractor Supply**

A South Carolina administrative law judge recently decided the Tractor Supply case. It drew a lot of attention, including **excellent coverage** by Law360's Maria Koklanaris. In short, Tractor Supply had two affiliates with which it conducted transactions. Tractor Supply commissioned a transfer pricing study, generally a very smart move. Companies should seek transfer pricing studies, especially if they have significant intercompany transactions.

Usually, a transfer pricing study from a reputable firm will ward off transfer pricing adjustments. I say usually because in this case it didn't. The South Carolina Department of Revenue audited the companies and determined that the transactions improperly shifted income from South Carolina to other states. The **ALJ agreed**.

According to the opinion, both the taxpayer's and department's expert witnesses said that the transfer pricing study was wrong. You don't see that very often. Indeed, the ALJ asked the parties to submit accurate pricing information — which they could not do. Tractor Supply was represented by very good lawyers from Nelson Mullins, including Bryson Geer, John von Lehe Jr. and Robert

Streisel. But I am not sure how you can win a transfer pricing case when everyone admits the transfer pricing study is flawed. I guess the lesson is to make sure your transfer pricing study is not flawed.

The other interesting point about this case is that the department asserted that Tractor Supply and its affiliates must file on a combined basis. Last I checked, South Carolina is a separate-accounting state. The law allows the department to use alternative apportionment if it leads to equitable results. States usually adjust pricing to accomplish that goal in transfer pricing cases. They rarely require combined reporting. To be sure, no one could be sure what the "correct" pricing should be in this case. And perhaps the lack of pricing alternatives left the department and the ALJ no choice.

The taxpayer challenged the authority of the department to require combined reporting, but the ALJ held that it was authorized under these circumstances. I find that troubling. There are several cases pending in South Carolina on transfer pricing issues. And while the ALJ said this decision was limited to the facts and circumstances, I can't help thinking it will be far too convenient to require combined reporting when the department disagrees with the transfer pricing decision.

**Reason 1,001 Why All Business Inputs Should Be Exempt**

A case before the North Carolina Supreme Court involves sales tax exemptions for manufacturing equipment. Many states have such exemptions, which are good. Yet this case, North Carolina Department of Revenue v. FSC II LLC, illustrates once again why businesses should not pay sales tax on their purchases.

The taxpayer made asphalt products. It purchased equipment to make said asphalt products. The statute says there is an exemption for manufacturing equipment. But the Department of Revenue said that you can get an exemption only if you sell at least 50% of the product. Two lower courts held for the taxpayer, noting that this 50% requirement is not in the statute. The department appealed to the state high court.

Like many American businesses, the case is complicated. The taxpayer retains more than 50% of its asphalt to use in its own business, and it sells the rest. The **taxpayer argued** that the rule was made outside the administrative process and is contrary to the plain meaning of the statute. Whether the department can conjure up this requirement is what the state Supreme Court will decide. But wouldn't it be easier to just say all equipment purchased by a business is exempt from sales tax? The answer is yes.

**Fare Thee Well**

As most know already, George Isaacson **died Aug. 19**. Isaacson was a giant in our business. His influence was too great and accomplishments too numerous to discuss here. But he had a profound effect on state tax policy for decades. And of course he represented the Direct Marketing Association and then Wayfair, Overstock and Newegg before the U.S. Supreme Court.

He understood the virtues of uniformity and the vices of taxing people and transactions outside a state's borders. He built a small law firm into a national practice representing e-commerce companies across the country. The lawyers at Brann & Isaacson are among the best in the business.

While I know his work, I did not know him personally very well. And I regret that. He was a mentor, teacher, intellectual and gentleman. His was a life too short but well lived.

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