# VERMONT DEPARTMENT OF TAXES

## ACT 51 VERMONT CORPORATE INCOME TAX REPORT

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# Executive Summary

Act 51 of 2019 tasked the Vermont Department of Taxes to provide the General Assembly with a report that analyzes several aspects of Vermont's corporate income tax. The Act laid out four specific tasks:

(I) Identify and analyze any fiscal, legal, distributional, and administrative issues related to moving Vermont from its current apportionment formula under 32 V.S.A. §5833 to a single sales factor;

(II) Evaluate the impact of the current exclusion of overseas business organizations from an affiliated group, and identify and analyze any fiscal, legal, distributional, and administrative issues related to eliminating that exclusion;

(III) In consultation with the Vermont Bankers Association, compare the impact of the current bank franchise tax to the impact of a taxing regime where there is no bank franchise tax, and financial institutions pay the Vermont's current apportionment factors with the market-based sourcing changes made in this act; and

(IV) Examine alternatives to Vermont's corporate income tax which could more accurately capture corporate economic activity within Vermont, focusing particularly on corporations who conduct business in the State, but who have little or no taxable income.

This report explores each element and seeks to provide information to make informed legislative decisions about the future of Vermont corporate income tax revenues. Each of these issues on their own has the potential to change the landscape of Vermont corporate income and require delicate consideration. Like all matters of taxation adjusting, the impacts of changing regulations and statutes cannot be considered in a vacuum as the effects of a change can extend over several tax types and taxpayers. The Department acknowledges that pertinent information required to adequately analyze any change to the current Corporate filing structure is needed before concrete recommendations can be made. However, the Department is confident that this report contains useful information for policymakers to utilize when considering changes to Vermont's corporate income tax structure.

# Background

Like many states, Vermont taxes C-corporations (C-corps), S-corporations (S-corps), partnerships, and limited liability corporations (LLCs) differently[1]. C-corps must file a Vermont corporate income tax return, whether they are incorporated under the laws of the state of Vermont or receive income allocable or apportionable to Vermont. Tax is levied at the entity level for C-corps. Vermont's corporate income tax is forecasted to generate $108.4M in FY2020[2].

C-corps are taxed in 45 states and the District of Columbia. However, there is considerable variation amongst the states as to what income is taxable. States primarily differ on:

- How to apportion corporate income to that state
- Treatment of parent and subsidiary corporations. States that treat a parent corporation and subsidiaries as a single entity are known as combined reporting states.
    - Vermont mandated combined reporting beginning in 2006 for any corporations with a unity of ownership, operation, and use (unitary combined).

Even among combined reporting states, the expansiveness of the unitary group of companies is a consideration. For groups that include only U.S. companies, the structure is known as "water's edge," while those that include international corporations are a "worldwide." By regulation, Vermont is a water's edge state. However, some water's edge states like Vermont exclude U.S. corporations that primarily operate overseas ("80/20" companies) with differing definitions of an 80/20 company.

There are two primary state apportionment formulas for capturing the state-level economic activities of a corporation. States either use a combination of sales, property, and payroll to apportion corporate income or use only the sales factor. Since 2006, Vermont has used all three factors with double weight on sales. However, Act 51 of 2019 substantially changed how sales factors are calculated. Act 51 redefined the sales factor for services and other intangible property from being based on where the income-producing activity of the sale took place **("cost-of-performance")** to where the customer receives and will use the benefit **("market-based sourcing")**. This new method for calculating the sales factor will take effect starting with tax year 2020.

1 For Partnerships, S-corps, and most LLCs, income is "passed through" to its owners and is taxed at that level.

2 About 7% of all forecasted general fund revenue

# I. Single Sales Factor

## a. Vermont

Vermont apportions corporate income based on three different factors: sales, payroll, and property. Vermont double weights the sales factor, resulting in apportionment of 50% sales, 25% payroll, and 25% property. Vermont's current double-weighted sales apportionment structure began in 2006—the same year as the transition to unitary combined reporting. Vermont's double-weighted approach to apportionment is no longer consistent with the majority of states. By 2019, roughly half the states have come to rely on the sales factor exclusively to determine apportionment. Of those states that employ the single-sales-factor approach, more than three-quarters use market-based sourcing to source the sales of services and intellectual/intangible personal property.

It is difficult to pinpoint the fiscal impact of switching to a single-sales factor for apportionment because the current sales factors reported by taxpayers and therefore current Department data sets reflect sales based on the cost-of-performance method. Tangible personal property was already subject to market-based sourcing; however, the sales of services and intangible property may change drastically under the new structure. The Department will not have a complete tax year data set for market-based sourcing until sometime in 2022[3]. That data is critical to precisely estimate the fiscal impact of switching to single-sales-factor apportionment.

Given the lack of necessary data available to accurately forecast corporate tax revenue for Vermont, it is necessary to study other states who made the switch to single-sales-factor apportionment. The Department concedes that switching to single-sales-factor apportionment will have an impact on tax compliance. Sales factors tend to be areas most ripe for taxpayer manipulation, whereas property and payroll tend to be easier to verify. However, any burden imposed on the compliance staff is collateral when considering Vermont's need to remain a competitive marketplace for corporate activity as a majority of states in New England and throughout the country are switching to single-sales-factor apportionment.

## b. Other State Experiences

In 2014, Rhode Island simultaneously switched from cost-of-performance to market-based sourcing and went from three-factor apportionment to a single sales factor. Using pro-forma returns filed by corporate taxpayers, the Rhode Island Division of Taxation separately analyzed the impact of each new provision based on the 2015 tax year[4]. Overall, net corporate tax revenues dropped by 30%. While the shift to market-based sourcing resulted in 2% corporate tax growth, the change from three-factor apportionment to a single sales factor resulted in a decrease of 53% corporate tax revenue. Both in-state and out-of-state corporations benefited from the change, resulting in a reduction in corporate taxes paid of 74% for in-state corporations and 19% for out-of-state corporations.

According to a study from the Center on Budget and Policy Priorities, 11 states that analyzed the impact of switching from a three-factor formula with double-weighted sales to a sales-only formula, saw a reduction in corporate revenue anywhere from 1.1% to 16.7%[5]. Two states actually categorize single sales factor as a tax

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3 Calendar year filers can extend until November 2021; however, fiscal-year filers extend well beyond that.

4 http://www.tax.ri.gov/combinedreporting/Report_on_corporate_tax_changes_03_15_18.pdf

5 https://www.cbpp.org/archiveSite/3-27-01sfp.pdf

expenditure and estimate the cost of that approach in their expenditure reports: Pennsylvania and Oregon. Pennsylvania estimates a loss of $632.2M versus a base of $3,511.2M for a relative loss of 18% in fiscal year 2018[6]. Oregon estimates a loss of $77.6M versus a base of $932.6M.

In 2005, Minnesota enacted a provision that increased its sales factor from 75% to 100%, gradually phased in from 2007 to 2014. In its tax expenditure budget[7], Minnesota calculates the cost of single-sales-factor apportionment versus an equal-weight formula. Estimates range from $357.9M in FY18 to $379M in FY20, or approximately 9% of the total revenue baseline under an equally weighted structure.

Delaware is presently transitioning from three-factor apportionment to single-sales-factor apportionment. Delaware's transition has been gradual, increasing from 33% to 50% in tax year 2017, then 60% in 2018, 75% in 2019, and 100% by tax year 2020. Delaware Department of Finance analysts estimate increasing revenue loss in each year of the transition and, by the time it is at 100%, a total decrease of corporate tax revenue of 14.4%. However, Delaware analysts concede that forecasting changes of this nature have proven difficult given the relatively small corporate income tax baseline (~$210M per year) in that state and the inherent volatility associated with a small population of larger taxpayers—characteristics that also exist in Vermont.

Even though no state has yet to forecast or experience an increase in revenue from single-sales-factor apportionment, states continue to make this transition in order to remain competitive. Relying entirely on sales tends to shift tax burden from in-state corporations with significant sales out-of-state to out-of-state corporations because the property and payroll factors (which are significantly more prevalent among the in-state corporations) no longer impact the apportionment. Furthermore, because corporate tax revenue constitutes a relatively small portion of a state's general fund[8], budgetary impacts are not insurmountable.

One possible benefit, however, is that the reduction in corporate revenue may be partially or fully offset by revenue from other tax types. For example, if a corporation moves its domicile to Vermont based on a favorable corporate tax structure, it will contribute to the property tax base and its employees to the personal income tax base. Considering the unavailability of data needed to forecast revenue changes, Department analysts are comfortable estimating a decrease in revenue of no more than 20%.

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6 https://www.budget.pa.gov/PublicationsAndReports/CommonwealthBudget/Documents/2019-20%20Proposed%20 Budget/2019-20_Budget_Document_Web.pdf#page=192

7 https://www.revenue.state.mn.us/sites/default/files/2018-03/2018_tax_expenditure_links.pdf#page=103

8 Roughly 7% in Vermont's case

## II. Exclusion of Overseas Business from Affiliated Group

In some "water's edge" states, income from overseas business organizations is not included in the affiliated group. These companies are commonly known as "80/20" companies; however, the definition of what makes up an 80/20 company varies by state. In Vermont regulation, an 80/20 company, or an overseas business organization, is defined as "a business entity that ordinarily has 80% or more of its payroll and property located outside the United States," and an affiliated group is defined as "a group of two or more corporations in which more than 50 percent of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, either corporate or noncorporate, or by one or more of the member corporation." Currently, Vermont is one of 10 water's edge states that exclude income of overseas business organizations from affiliated groups.

Through sophisticated tax planning strategies, some corporations attribute a disproportionate share of their taxable income to overseas business organizations in low or no tax jurisdictions. Two states have taken measures to combat this behavior: Montana and Oregon. Montana requires corporations that have elected to be taxed as water's edge to include the income of unitary subsidiaries incorporated in countries that have been identified as tax havens by the Multistate Tax Commission[9]. That provision is estimated to generate about $9M[10]for Montana or about 5% of its FY17 total. Oregon enacted a similar reform in 2013, but it was repealed in 2018.

According to the Multistate Tax Commission, roughly 20 of the 30 states that have combined reporting include the income (and apportionment) from any foreign affiliates of any U.S. incorporated companies, no matter the balance of payroll and property. These states often define the water's edge group in statute by saying, "all U.S. corporations are included in the water's edge return." In other words, only 10 states allow a domestic corporation to exclude that income if they qualify as an overseas business organization. Eliminating the Vermont exclusion for overseas business organizations and including the income from 80/20 companies in the water's edge group would expand the amount of taxable income subject to Vermont corporate income taxes but would reduce apportionment percentages for some taxpayers. Based on limited data available to the Department of Taxes, we estimate a fiscal impact of up to 5% increase in revenue from this change.

9 https://leg.mt.gov/content/Publications/Services/2019-agency-reports/dor-tax-haven-update.pdf

10 https://leg.mt.gov/bills/2013/FNPDF/HB0578.pdf

# III. Bank Franchise Tax to Corporate

Vermont taxes banks and some other types of financial institutions with Vermont deposits under the Bank Franchise Tax. A financial institution's liability is based on the average monthly deposit for the previous 12 months. Because financial institutions which are subject to Bank Franchise Tax are not subject to Corporate Income Tax, the Department does not have the data necessary to perform an internal analysis. Presently the Vermont Bankers Association is studying the impact of its members transitioning from filing the Bank Franchise Tax to Corporate Income Tax. That information will be presented to this committee as soon as the Vermont Bankers Association has it available, but presumed to be by Dec. 31, 2019. While the Department is not comfortable making a firm recommendation without understanding the fiscal impact, there are several reasons to consider repealing the Bank Franchise Tax:

- Simplifying and streamlining the tax filing process. Consolidating miscellaneous tax types that only impact a handful of entities allows the Department tof Taxes to conserve limited resources and focus on areas that better serve Vermont taxpayers.
- Compliance programs for tax types with large numbers of filers are both more efficient and more effective at closing the tax gap. This is because they lend themselves to data driven approaches that compare submissions made by many companies and identify trends through automation.
- Creation of two separate taxation structures creates boundaries where misinterpretation could lead to an underreporting of taxable income. Removal of the alternative taxation structure can, by itself, remove risk of non-compliance

Additionally, the trend of eliminating the Bank Franchise Tax in favor of Corporate Income tax is popular among states that that have also made the switch to single-sales-factor apportionment. Generally, conformity among states is frequently cited as a tax competitive trait; therefore, it could be argued that abolishing the Bank Franchise Tax in favor of corporate income tax is in Vermont's best interest from a tax competitive standpoint. If not repealed, Vermont runs the risk of losing economic activity from banks who would take their business to neighboring states due to more favorable corporate tax treatment. Some states have also seen revenue increases from the change; for instance, Kentucky saw a slight revenue increase when it repealed Bank Franchise Tax in favor of Corporate Income tax

## IV. Alternatives to Corporate Taxation

States that do not have corporate income tax tend to have gross receipts taxes. Historically, gross receipts taxes were the preferred choice in the United States until court cases and a changing economic landscape inspired states to replace them with corporate income taxes[11]. Gross receipts taxes have seen a renewed interest in the past two decades and are discussed below. Value added taxes may also be substitutes for corporate income taxes but tend to be politically undesirable in the United States[12].

A gross receipts tax exists in seven states under a variety of names. A gross receipts tax is a tax imposed on "the dollar value of receipts from the sale of goods and services,"[13] including sales made between businesses. Gross receipts taxes ideally apply a single tax rate to all business types, including passthrough businesses, and all goods, including services and tangible personal property. States often dilute this base by levying different tax rates for different industries, including exemptions for categories of receipts, and excluding certain types of business such as nonprofits.

**Table 1** provides a brief overview of gross receipts taxes relative to corporate income taxes. Features and drawbacks of gross receipts taxes are detailed below.

### Positive Features of Gross Receipts Taxes

Gross receipts taxes are appealing because, when implemented with a single rate and no exceptions or deductions, their broad base allows for a simple structure, lower statutory rate, and low costs for a stable revenue source. The literature discusses the following favorable characteristics of gross receipts taxes:

- As gross receipts taxes are imposed on the dollar value of receipts from goods and services, they have a broad base that may include services, tangible personal property, and intermediate transactions between businesses[14].
- Because gross receipts taxes are imposed on receipts rather than income, PL 86-272 does not apply[15].
- This broad base allows gross receipts taxes to be revenue neutral with their predecessors using a low statutory rate[16].
- Gross receipts taxes tend to be stable revenue generators that are relatively immune to the business cycle[17] because the tax is paid on receipts rather than income—profitability is not a prerequisite for taxation.

11 Kaeding and Wilt 2016, Watson 2019

12 Pogue 2007

13 Pogue 2007 p. 799

14 Walczak 2017, Kaeding and Wilt 2016, Fox 2010

15 Fox 2010, Coffill and Allen 2017

16 ITEP 2007, Walczak 2017, Kaeding and Wilt 2016, Fox 2010, Watson 2019, Pogue 2007

17 Walczak 2017, Kaeding and Wilt 2016, Fox 2010, Watson 2019, ITEP 2007, Pogue 2007

- Gross receipts taxes are levied on all entity forms, including C-corporations, S-corporations, partnerships, LLCs, and sole proprietorships[18].
    - The tax becomes more difficult to avoid because the only lever available to companies is shifting where items are sold[19].
- Compliance and administrative costs are lower (provided that the gross receipts tax does not include exemptions and deductions)[20].
    - Inclusion of intermediate transactions in the gross receipts tax incentivizes filing as a consolidated group, which is administratively easier and less costly for the Department of Taxes[21].
    - Firms need only calculate receipts, not profits[22].

**Table 1. Overview of Gross Receipts Taxes vs. Corporate Income Taxes**

| | Gross Receipts Tax | Corporate Income Tax |
|---|---|---|
| **Size of base** | Broad | Narrow: corporate profits |
| **Applicable business entities** | C-corp, S-corp, LLC, LLP, Partnerships | C-corp |
| **Statutory tax rate** | Low | High |
| **Effective tax rate** | Higher because taxes must be paid multiple times on a single product or service | Can be lower if company engages in tax planning |
| **Stability** | Stable, less sensitive to business cycle because based on total sales | Very sensitive to business cycle because based on corporate profits |
| **Administrative and compliance costs** | Low if single rate | High |
| **Business decision inefficiencies** | Companies may choose to vertically integrate to avoid intermediate taxes. May choose not to sell goods in a state to avoid tax in that state. | Companies may choose corporate structure (e.g. partnership vs. corporation) for tax planning reasons. |
| **Interacts with PL 86-272** | No | Yes |
| **Ways to avoid tax** | Alter where goods are sold | Alter profits: change corporate structure, move production, avoid nexus |
| **Progressivity** | Regressive: 1) must pay regardless of ability to pay, 2) taxing intermediate production makes final goods more expensive | Tends to be progressive |
| **Transparency** | Low – intermediate level taxation not clear to end consumer | Moderate |

18 Hicks 2018, Fox 2010

19 Fox 2010, Pogue 2007

20 Pogue 2007

21 Hicks 2018, Kaeding and Wilt 2016, Fox 2010

22 Fox 2010, Kaeding and Wilt 2016, Watson 2019

### Negative Features of Gross Receipts Taxes

States largely eliminated their gross receipts taxes in the middle of the last century after finding that those taxes could be inequitable, disadvantage some businesses (including manufacturing, retail, startups, and businesses with low margins[23]), and frequently end up being more complex than initially assumed. The literature discusses the following unfavorable characteristics of gross receipts taxes:

- Gross receipts taxes have an unclear policy justification because the taxes are not related to use of government services or infrastructure[24], especially if they are designed to heavily capture revenue from out-of-state businesses.
- Gross receipts taxes are paid at intermediate stages of production as well as on the final product; this is called "tax pyramiding"[25].
  - Each tax payment gets folded into downstream transactions upon which subsequent taxes are assessed at the statutory rate, magnifying the effective tax rate[26].
  - Tax pyramiding obscures tax incidence—no one can easily see how much of the cumulative tax burden is absorbed by the business and how much is passed on to consumers[27].
- These taxes are insensitive to ability to pay because they are levied on receipts rather than profits, net income, or final consumption[28].
  - Start-ups are frequently unprofitable for the first several years, making gross receipts taxes particularly burdensome during their most vulnerable period[29].
  - Different businesses, even within the same industry, have different business models. Gross receipts taxes are more favorable to businesses that are vertically integrated (because they have fewer intermediate transactions on which to pay tax) and businesses that have high profit margins[30].
- Gross receipts taxes avoid the corporate income tax problem of businesses making business entity formation choices solely for tax planning purposes. However, gross receipts taxes promote inefficient economic decision making in their own right by changing relative prices and altering production and consumption incentives[31]:

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23 Watson 2019

24 Kaeding and Wilt 2016, Coffill and Allen 2017, Pogue 2007

25 Coffill and Allen 2017, ITEP 2007, Pogue 2007

26 Watson 2019

27 ITEP 2007, Coffill and Allen 2017, Watson 2019

28 ITEP 2007, Kaeding and Wilt 2016, Walczak 2017, ITEP 2007

29 Watson 2019

30 Walczak 2017, Fox 2010, Coffill and Allen 2017

31 Walczak 2017, Fox 2010, Watson 2019, ITEP 2007, Pogue 2007

- As discussed above, businesses have an incentive to vertically integrate for tax planning reasons rather than for business merit that creates an efficiency loss for society overall[32].
- If one state has a gross receipts tax and the neighboring state does not, such a tax may lead to discrimination against in-state suppliers because the out-of-state supplier will not be taxed on intermediate transactions that happen out of state and may therefore have lower prices[33].
- Similarly, the gross receipts tax may create incentives to shift activity to downstream states that tax differently; this will be particularly harmful for states with economies that rely on manufacturing or other input creation[34].

32 Walczak 2017, ITEP 2007, Coffill and Allen 2017, Watson 2019

33 ITEP 2007, Pogue 2007

34 Fox 2010

## States with Gross Receipts Taxes

As mentioned above, gross receipts taxes have experienced another popularity surge in the 2000s. **Table 2** presents information on states that have gross receipts taxes. This table illustrates how, in practice, states have tried to mitigate negative characteristics of a gross receipts tax such as tax pyramiding by introducing exemptions, exclusions, deductions and credits. This increased complexity, in turn, erodes the positive characteristics of broad tax bases and low administrative and compliance costs. The relative popularity of Ohio's Commercial Activity Tax (CAT) inspired many states to examine this tax type. However, it is important to note that the CAT was popular largely because the taxes it replaced were particularly burdensome[35].

**Table 2. Existing and New Gross Receipts Taxes**

| State and Title | Adopted | Thresholds & Rates | Exemptions and Exclusions | Deductible Expenses | Consolidated, Combined, or Unitary Filing | Credits | % Total FY18 Revenue | State 2018 GDP (millions) | Other Corporate Taxes |
|---|---|---|---|---|---|---|---|---|---|
| **Delaware** Business & Occupational Gross Receipts Tax | 1975 | 0.0945% to 0.7468% on total gross revenues | Vary by business activity type | None | File separately, allow one deduction for related entities | -- | 5.6% | $ 63,855 | 8.7% Corporation Income Tax |
| **Nevada** Commerce Tax | 2015 | 0.051% to 0.331% on gross revenue above $4 million | Vary by business activity type | Payroll, interest and dividends, other taxes | Each entity must file separately | Partial credit of this tax against MBT | 2.9% | $ 146,225 | 1.475% Modified Business Tax |
| **New Hampshire** Business Enterprise Tax | 1993 | 0.60% on gross receipts > $217,000 or enterprise value tax base > $180,000 | Federal requirements such as 501(c)(3) organizations | Intercompany dividends | -- | R&D, job creation, education, economic revitalization | 12.5% | $ 75,615 | 7.7% Business Profits Tax |
| **Ohio** Commercial Activity Tax | 2005 | $150 - $2600 AMT plus 0.26% tax on gross receipts > $1 mil. | Vary by business activity, consolidated or combined | -- | Combined Can elect consolidated for 8 quarters | Job creation & retention, R&D, NOLs | 6.4% | $ 601,496 | no |
| **Oregon** Corporate Activity Tax | 2019 | $250 AMT plus 0.57% on commercial activity > $1 million | Unitary group transactions, some interest income, dividends, more | 35% of greater of input costs or labor costs | Unitary combined with > 50% common ownership | -- | n/a | $ 213,708 | $150 minimum excise tax or 6.6 to 7.6% corporate net income tax |
| **Texas** Franchise (Margin) Tax | 2008 | 0.375% on margin > $1.18 million for retail or wholesale or 0.75% on margin > $1.18 million for other industries | Several types of dividends, industry-specific exclusions | Costs of goods sold or compensation, depending margin calculation | Combined report required for affiliated group or unitary business | Economic development, R&D, historic preservation, clean energy | 3.1% | $ 1,676,679 | no |
| **Washington** Business and Occupation Tax | 1935 | 0.138% to 3.3% on gross receipts One business may pay under multiple classifications. | Vary by business activity type | None | -- | Multiple Activities Credit | 19.7% | $ 506,706 | no |

Source: State departments of revenue or taxation, state statutes

35 Walczak 2017

Four states have recently switched away from gross receipts taxes; **Table 3** presents those states. Notice that three of them swiftly had negative experiences with gross receipts taxes that led them to discard the tax type within five years.

**Table 3. Overview of Recently Repealed Gross Receipts Taxes**

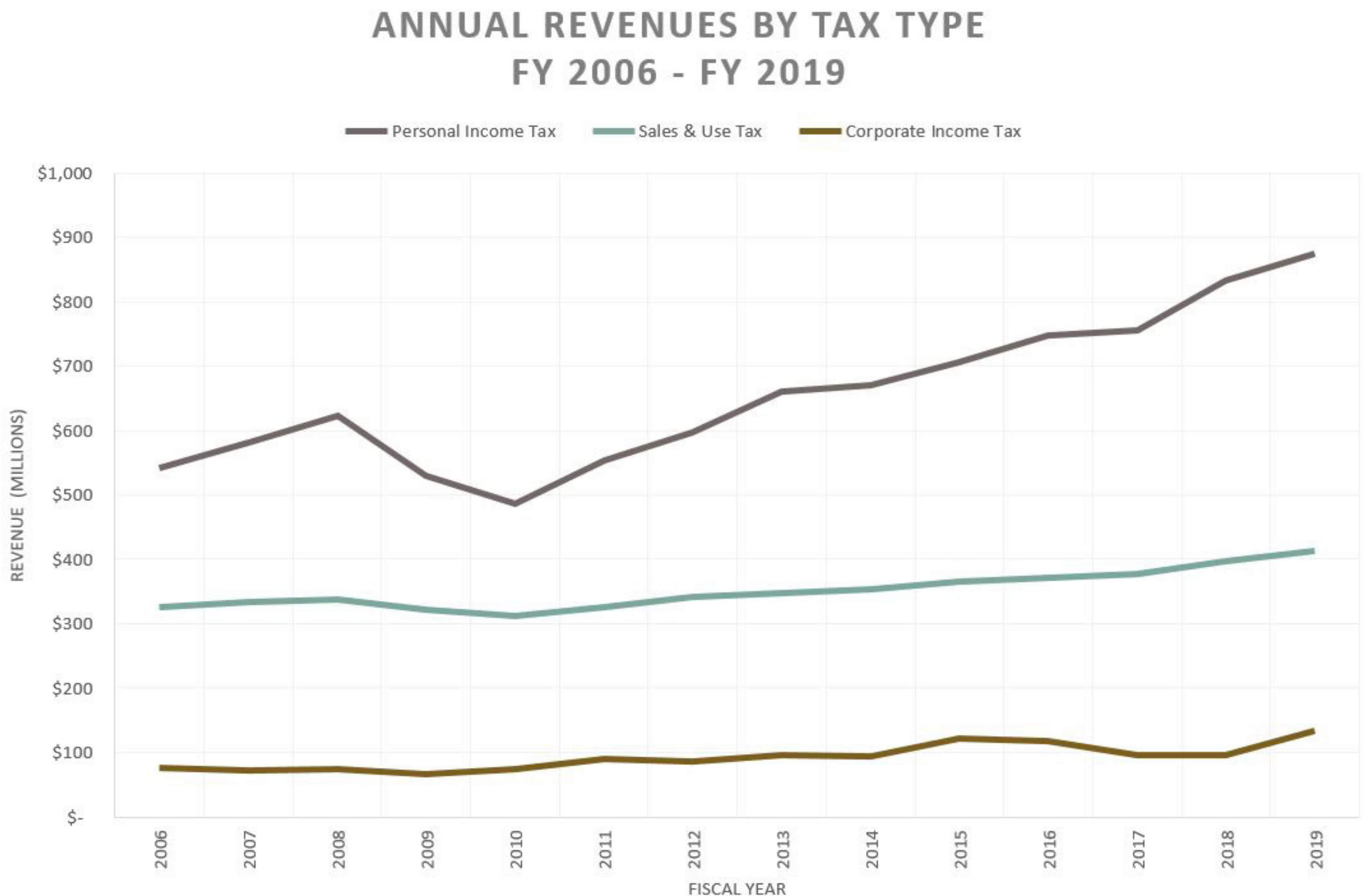
| State | Description | Adopted | Repealed | Repeal Reason |
|---|---|---|---|---|
| Indiana | 1933 to 1963, 0.25 percent tax on wholesaling, manufacturing, and agriculture and a 1.0 percent tax on other business and individual gross receipts. 1963 to 1985, levied against corporations only with rates varying from 0.3125 to 2.0 percent. 1986 to 2002, high rate of 1.2 percent and a low rate of 0.3 percent. | 1933 | 2002 | Industry-specific rates were complex; tax pyramiding; perception that tax dissuaded businesses |
| New Jersey | Alternative minimum assessment for business taxes. Rates ranged from 0.125 percent to 0.4 percent. Levied on companies with more than $2 million in gross receipts. | 2002 | 2006 | Perception of unfairness; applied disproportionately to different businesses; unprofitable businesses still required to pay tax |
| Kentucky | Alternative minimum calculation for corporate income of 9.5 cents per $100 in gross receipts or 75 cents per $100 in gross profits. | 2005 | 2006 | State Budget Director's Office forecaster found that tax reduced investment and hurt small businesses |
| Michigan | Michigan Business Tax (MBT) levied against gross receipts less purchases from other firms at a 0.9 percent rate. MBT replaced the Single Business Tax, which was in effect from1976 to 2007 and contained features of gross receipts taxes and value-added taxes. | 2008 | 2011 | Complex industry-specific credits were still inequitable; not competitive |

Source: Table 1 from Kaeding and Wilt 2016. Fifth column has been added using information from that publication and Watson 2019.

## Vermont's Present Corporate Tax Landscape

In order to better understand how changes might affect Vermont, it is necessary to have context about Vermont's current economy and corporate income tax. **Figure 1** presents Vermont's receipts from personal income tax (PIT), sales and use tax (SUT), and corporate income tax (CIT) from fiscal year 2006 to fiscal year 2019. Notice that CIT is the smallest of the three major revenue sources; SUT brings in approximately three times as much revenue; and PIT brings in six to eight times as much revenue. Revenues from CIT and SUT remain relatively steady, unlike increasing PIT revenue.

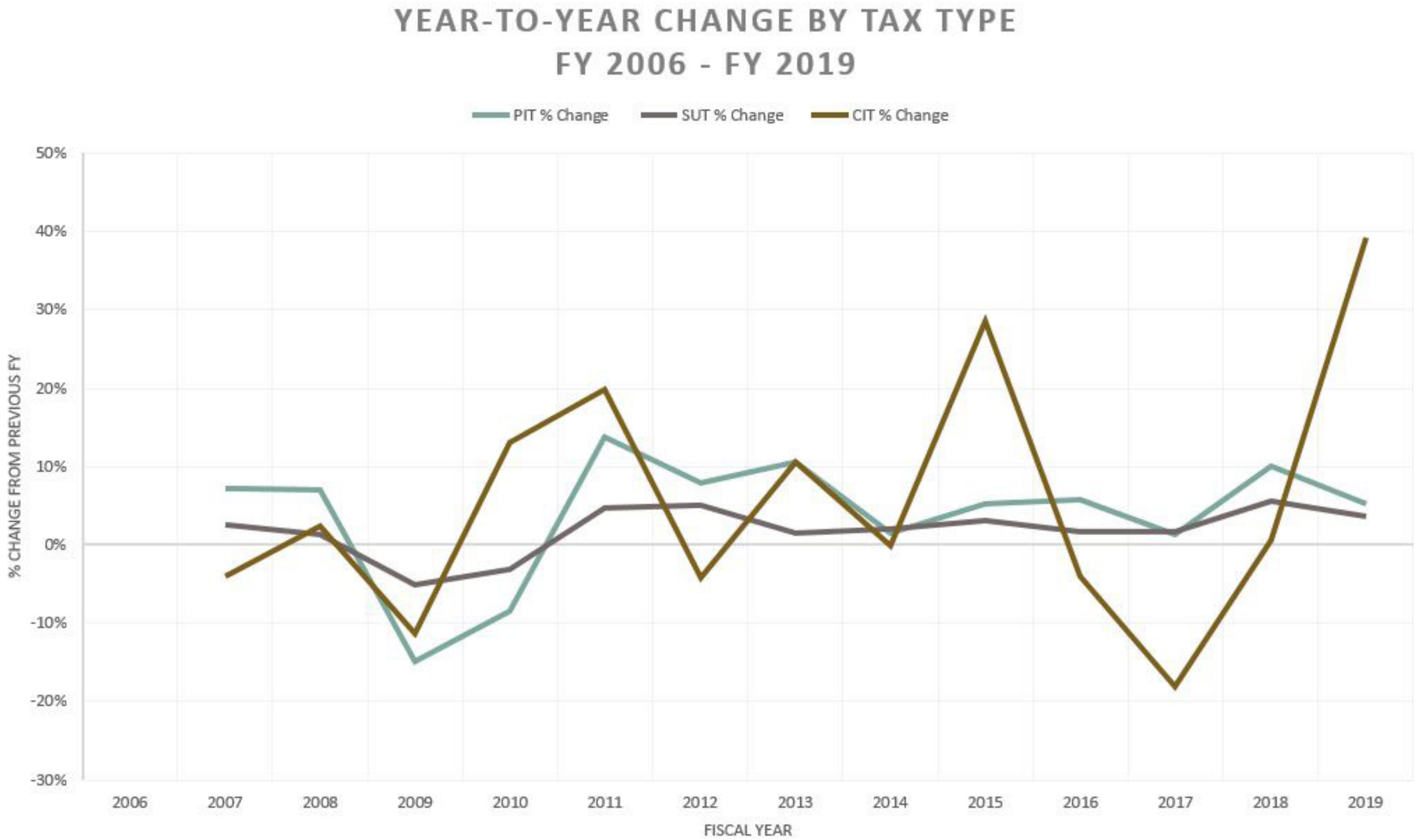
**Figure 1. Annual Revenues by Tax Type FY 2006 - FY2019**




**Source: Vermont Department of Taxes monthly revenue receipts as provided to State Economists**

The volatility (or year-to-year change) in those same revenues constitutes **Figure 2**. CIT receipts fluctuate more from one year to the next than either PIT or SUT. This volatility is one of the main drawbacks of corporate income taxes.

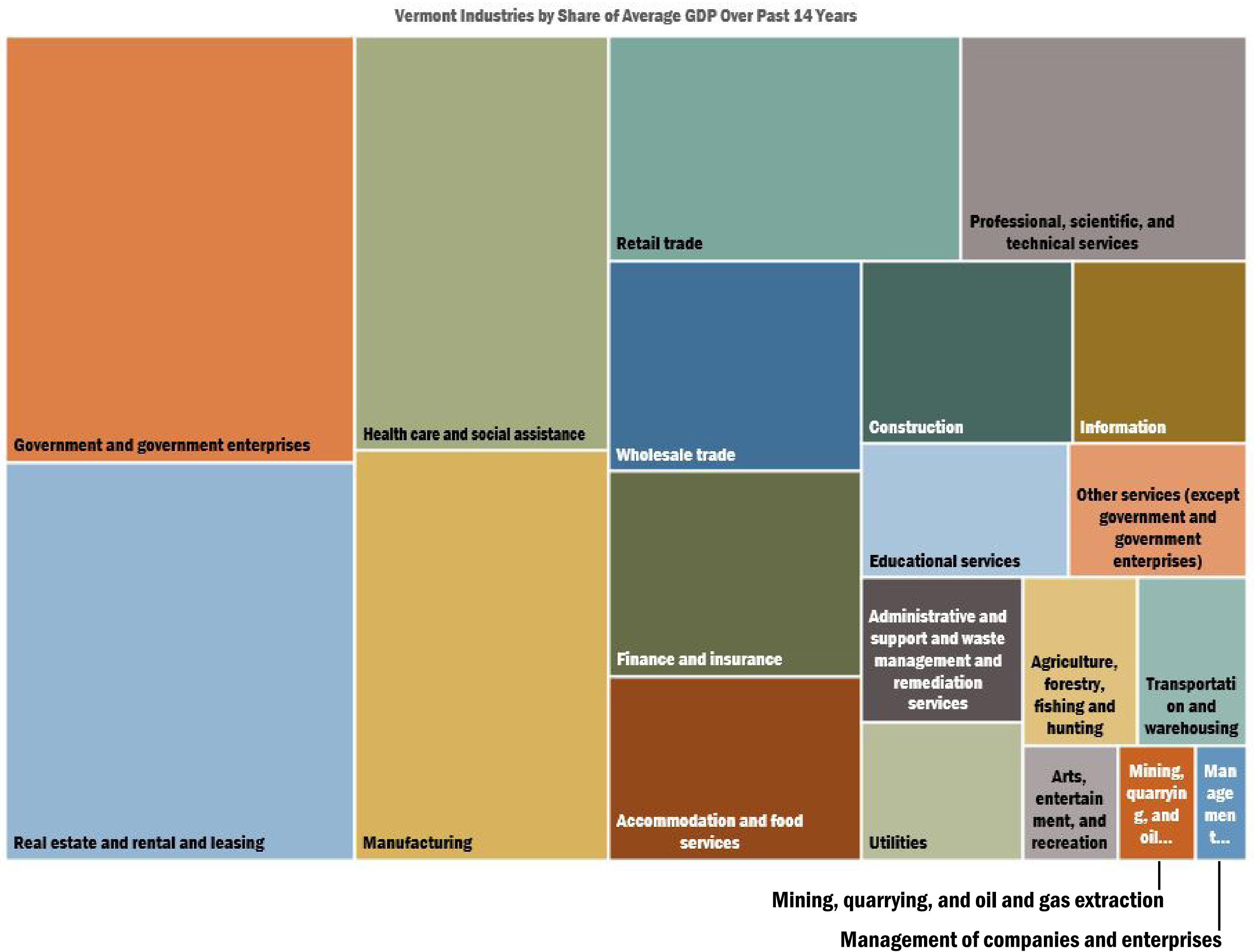
**Figure 2. Year-to-Year Change by Tax Type FY2006-FY2019**




**Source: Vermont Department of Taxes monthly revenue receipts as provided to State Economists**

The next figure provides an overview of Vermont's major industries[36]. **Figure 3** provides an idea of the relative contribution of each industry to Vermont's GDP as a share of average GDP from 2005-2018. More than half of Vermont's GDP comes from six industries: government; real estate; health care and social assistance; manufacturing; retail trade; and professional, scientific, and technical services. **Figure 4** shows how those six industries have changed over time.

**Figure 3. Vermont Industries by Share of Average GDP Over Past 14 Years**

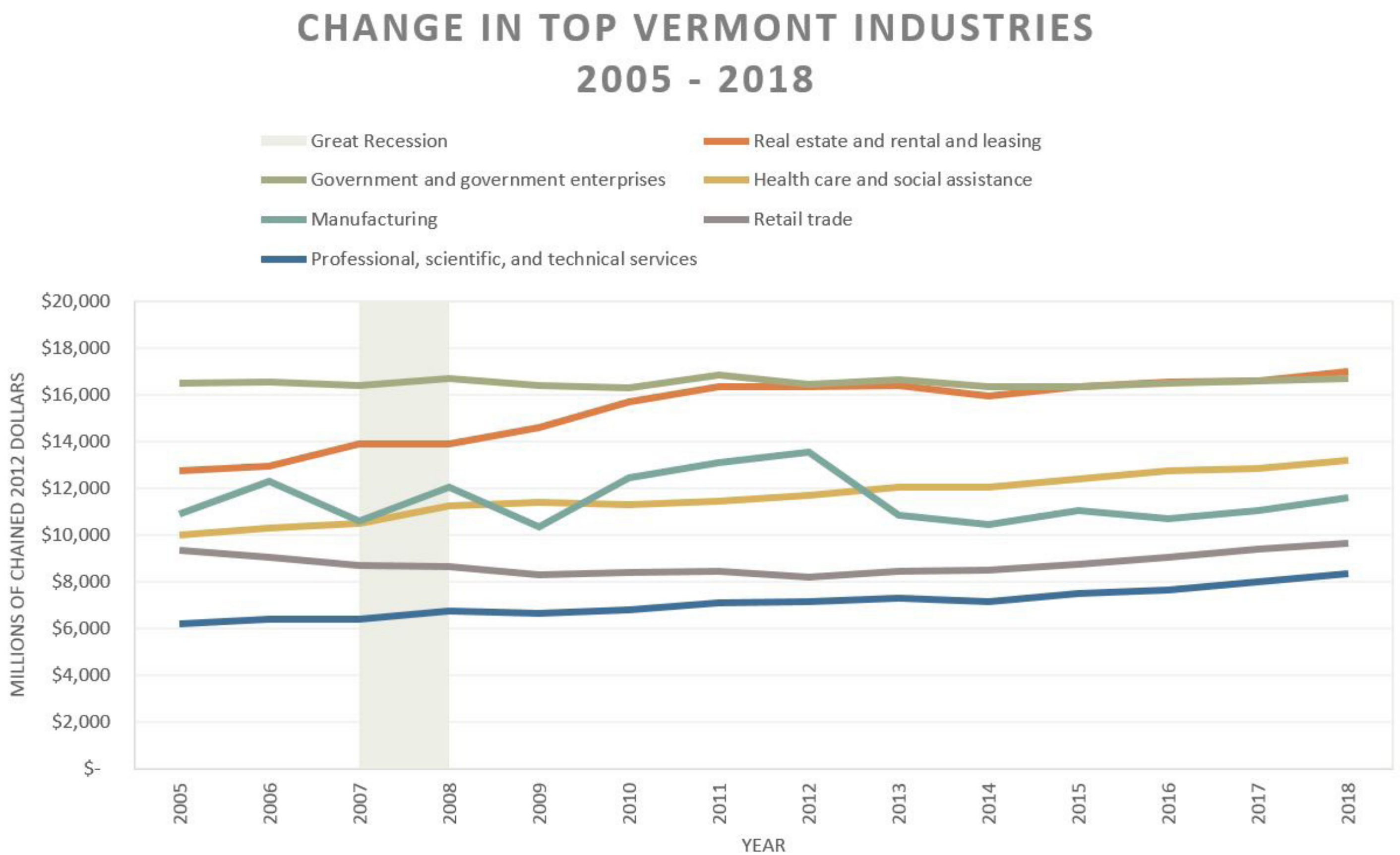



**Source: Bureau of Economic Analysis Real GDP by state series SQGDP9**

36 Industry definitions come from the North American Industry Classification System (NAICS).

Of those main industries, manufacturing has been the most volatile. Real estate, rental, and leasing experienced the most growth over the period, changing $3.6 billion between 2005 and 2011 and then increasing more slowly through 2018. Health care and social assistance and professional, scientific, and technical services have both seen more moderate but steady increase over the period, while retail trade decreased until 2012 before increasing again. Keep in mind that this graph is scaled in millions, so visually small changes in GDP can have large impacts for Vermont.

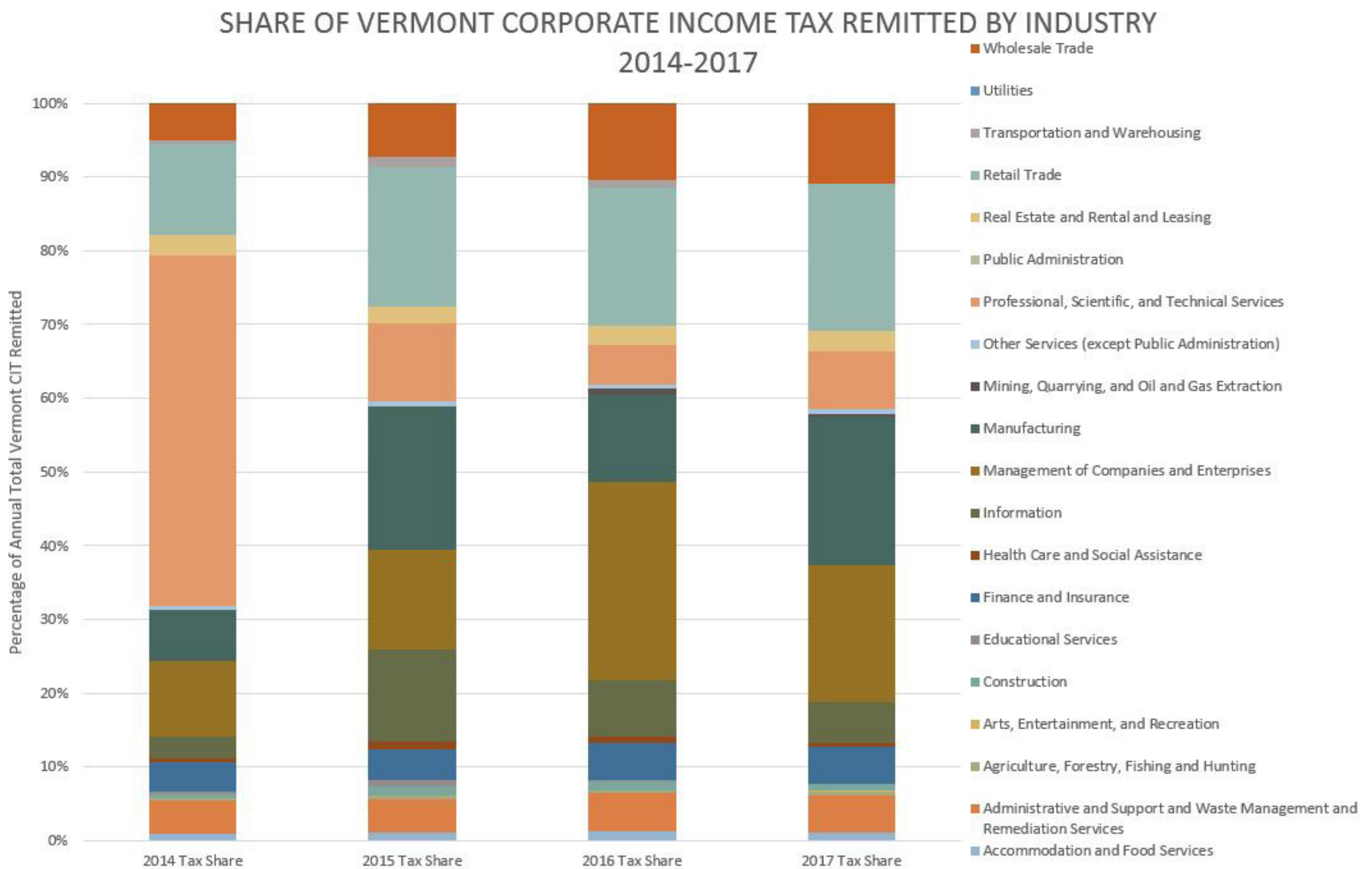
**Figure 4. Change in Top Vermont Industries 2005-2018**




**Source: Bureau of Economic Analysis Real GDP by state series SQGDP9**

How does the industry breakdown in Vermont's economy overall compare with the industry breakdown of Vermont corporate taxpayers? **Figure 5** shows Vermont's industries by share of corporate income tax paid for the most recent four years of available data. Corporate income tax is paid by C-corporations only; the effects of this difference are obvious in, for example, government/public administration that accounts for a large percentage of Vermont GDP but pays very little in corporate income tax. Averaged over the most recent four years of available data, the top industries for corporate income tax in Vermont are: professional, scientific, and technical services; retail trade; management of companies and enterprises; manufacturing; and wholesale trade. Professional, scientific, and technical services had a particularly big year in 2014 but usually accounts for closer to 9% of corporate taxes paid.

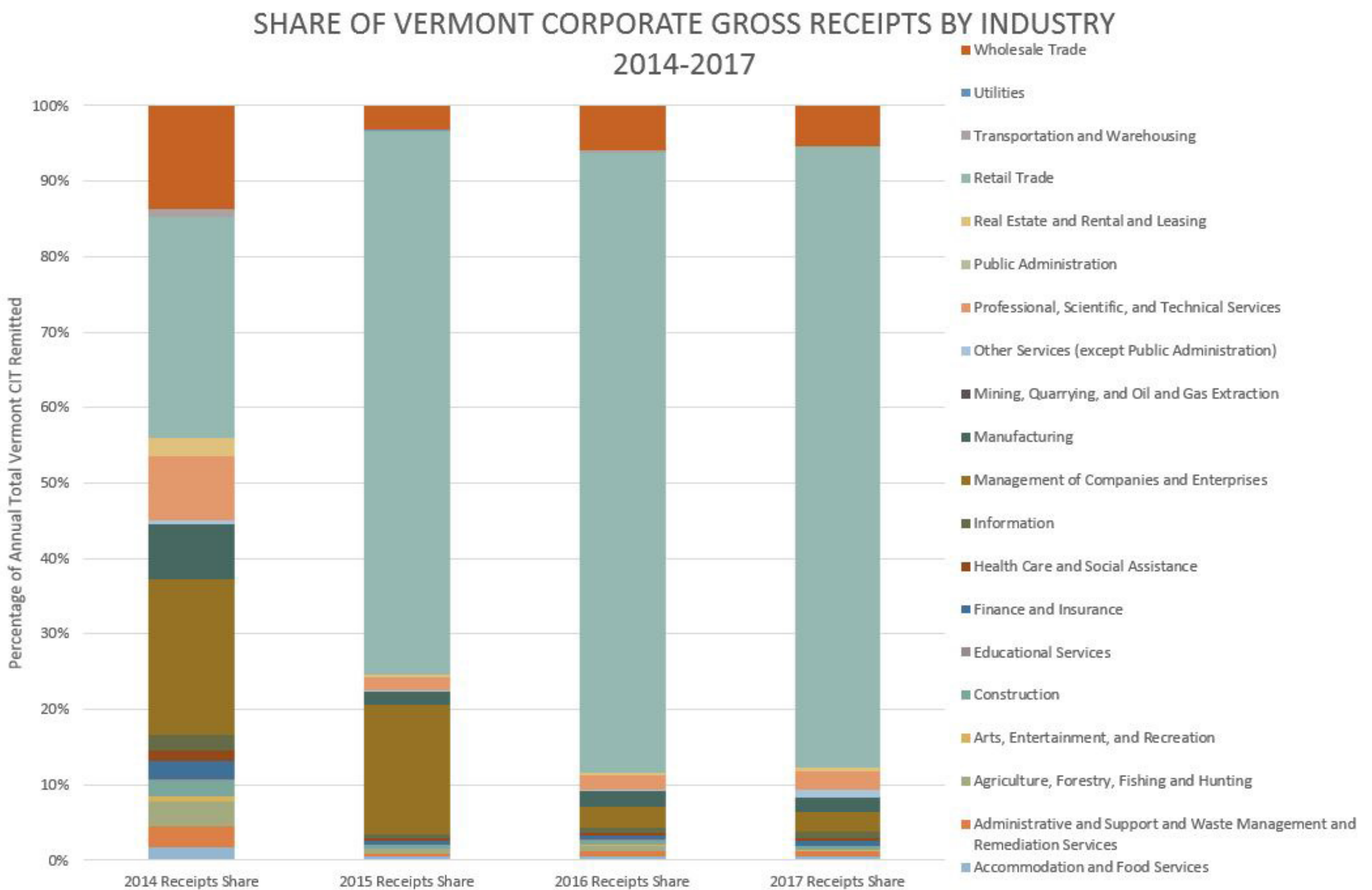
**Figure 5. Share of Vermont Corporate Income Tax Remitted by Industry 2014-2017**




**Source: Bureau of Economic Analysis Real GDP by state series SQGDP9**

It is informative to compare the corporate income taxes remitted to the gross receipts attributable to Vermont as reported on the same corporate income tax forms. **Figure 6** shows gross receipts by industry for Vermont corporate income taxpayers. For this purpose, gross receipts are defined as "the total amounts the organization received from all Vermont sources during its annual accounting period, without subtracting any costs or expenses."[37]

**Figure 6. Share of Vermont Corporate Gross Receipts by Industry 2014-2017**




**Source: Bureau of Economic Analysis Real GDP by state series SQGDP9**

37 Vermont Form CO-411 Instructions Rev 10/17 p. 10

# V. Conclusion

This report tasked the Vermont Department of Taxes with four objectives in determining how/to what extent changes to Vermont law would have on corporate income tax in the state. In this report, the Department did the following:

1. Identified issues related to a shift to single-sales-factor apportionment
2. Evaluated the impact of 80/20 companies and their relation to corporate income
3. Examined the effects in a shift from entities who file the bank franchise tax to corporate income tax
4. Explored alternatives to Vermont's current corporate income tax

Each of these changes on its own will alter the landscape of Vermont corporate income and requires delicate consideration before abrupt delineations are made. Further, adjustments to tax regulations and/or statutes cannot be viewed in isolation as the impacts can spread over several tax types and taxpayers.

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