

## Shifting to “Single Sales Factor” Taxation of Corporations (AB 380)

Although some of the reputed benefits of the proposed change in the income apportionment formula for corporations have been widely touted, a number of significant concerns have received very little attention:

### **1. The single sales factor apportionment formula has not proven to be a particularly effective economic development tool in other states.**

A September 2001 analysis of single sales factor apportionment by the Center on Budget and Policy Priorities (CBPP) indicates that switching to this formula for taxing multi-state corporations “is a weak economic development incentive that is unlikely to be cost-effective.” That report looks at the five states that have had a single sales factor (SSF) formula for manufacturers since at least 1995. The CBPP study found:

- Two of the five states with SSF had declines in manufacturing jobs between 1995 and 2000 and lagged the national average.
- Only one of those five states was among the 10 corporate income tax states with the fastest rate of growth in manufacturing employment between 1995 and 2000. (Nebraska was 7<sup>th</sup> out of the top 10.)

### **2. Adoption of this tax break forecloses more cost-effective options for helping Wisconsin have a strong economy and a skilled workforce.**

Unless the change to SSF apportionment is coupled with “combined reporting” (as Governor Thompson proposed in 1999), it will cost at least \$80 million per year when it is fully phased in. Whatever economic benefits there might arguably be from the change, they will be offset by reducing revenue available for other investments to maintain and improve Wisconsin’s education system and infrastructure to keep our economy strong. Especially in a time when the state has a very serious structural deficit and an even more imminent budget shortfall, the state can ill afford to increase that structural deficit and undermine our ability over the long-haul to have an educated, competitive workforce.

### **3. Corporations are not accountable for using the tax break to create jobs.**

This type of tax break for multi-state corporations does not require or ensure that they create a single job in Wisconsin. The SSF formula was enacted in Massachusetts in 1995 in response to a threat by Raytheon to close plants in the state unless it was granted tax relief. Since then, Raytheon closed or sold several facilities and reduced its workforce in Massachusetts by 3,000 people. In the words of Massachusetts Senator Susan Fargo, the bill amounted to “payoffs for layoffs.”

### **4. Less than 2 percent of corporations doing business in Wisconsin will benefit from this tax break. Almost 4 percent will pay more taxes.**

A recent analysis by the Department of Revenue found that the single-sales factor apportionment formula would benefit less than two percent of all corporations doing business in the state.

Those corporations would receive a \$115 million tax cut (about \$53,800 each). That reduction would be partially offset by increased taxes paid by a larger number of corporations, about 4 percent of the businesses in the state, who would face a tax increase of about \$11,000 per business. The other 94 percent of corporations doing business in Wisconsin would not be affected – unless, of course, the lost tax revenue is made up by across-the-board tax increases (e.g., by cutting local aids and increasing property taxes).

**5. Adoption of AB 380 will accelerate the steady decline in the proportion of state taxes paid by corporations.**

The share of state taxes paid by corporations has dropped very substantially over the past decade several decades. In 1968 corporate income taxes constituted 12.1 percent of total state general fund revenue. That dropped to 8.8 percent in 1988 and to just 5.3 percent of GPR in fiscal year 2001. That percentage will continue to fall under current law, but it will drop much further if the states phases in an \$80 million per year corporate income tax cut.

**6. The single sales factor formula is likely to cause some corporations not to locate jobs in Wisconsin.**

Proponents of the single sales factor formula argue that it could promote the creation of jobs in Wisconsin because it removes the factors in the apportionment factor for multi-state corporations that potentially discourage them from locating employees and facilities in Wisconsin. What has not been noted is that the formula will also discourage the creation of jobs here. For many multi-state corporations it would increase their state taxes.

The DOR analysis referred to above found that the number of corporations adversely affected by this tax change would be twice the number benefited. Specifically, when a corporation’s percentage of sales in Wisconsin is greater than the sum of its percentage of employees and property in our state, it would be better off under the current double-weighted formula than under a formula that looks only at its percentage of sales in the state.

Take the hypothetical example of a very large drug company that is considering setting up a biotech research facility at the UW-Madison research park or near a campus in another state. The company currently has substantial sales in Wisconsin, but pays no taxes here because it does not have any physical presence (“nexus”) in our state. If you accept the premise that taxes are a significant factor in a corporation’s business location decisions, the drug company would be better off locating its new facility in a state that uses the current three-factor formula, rather than a single-sales-factor formula.

**7. Some corporations may eliminate jobs in Wisconsin to avoid the adverse impact of the new formula.**

For reasons similar to those noted above, some corporations may actually reduce or eliminate their Wisconsin-based employees. A large multi-state corporation that has a larger percentage of its sales in Wisconsin than its combined percentage of employees and property in the state will face a higher corporate income tax here if the proposed formula change is adopted. However, as

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the CBPP report explains, federal law precludes a state from taxing corporations that do not have a physical presence within the state. Some of the more than 4,000 businesses that would face about \$47 million in tax increases because of the formula change would probably eliminate employees or restructure their operations to take advantage of the federal law, and thereby totally eliminate the ability of Wisconsin to subject them to a corporate income tax.

### **8. The fiscal impact of the SSF tax cut could grow to be substantially more than \$80 million annually.**

Because the proposal would adversely affect some large multi-state corporations (as explained above), they would have an increased incentive to restructure their operations to avoid taxation in Wisconsin. This could significantly increase the \$80 million price tax loss that has been projected to occur when the change is fully implemented. The CBPP paper explains this issue more thoroughly, as well as why these considerations made it very sensible for Governor Thompson to propose coupling the single sales factor change with the adoption of a combined reporting system. While it is often pointed out that Minnesota uses the single-sales-factor formula (or something very close to it), it should be noted that Minnesota also uses combined reporting, which helps avoid an increased loss of tax revenue as corporations exploit the new tax system by shifting profits to out-of-state subsidiaries.

### **9. AB 380 would substantially worsen the state's very large structural deficit.**

The state's fiscal problems in the current biennium were caused to a large degree by the structural deficit caused by the previous budget. Unfortunately, the formidable challenge of balancing this budget has led to a number of budget maneuvers that lead to an extremely large structural deficit again in the next biennium. A phased-in \$80 million per year corporate tax cut will substantially exacerbate that problem.

The question often arises whether a tax cut such as this will result in a shift in tax burden to other taxpayers. There is not a clear-cut answer to that question. However, the magnitude of the state's structural deficit will make it difficult to phase-in a substantial tax cut in the 2003-05 biennium without either making deep spending cuts or shifting the tax burden to another group of taxpayers.

Alternatively, Wisconsin could take its cues from Minnesota, where SSF apportionment is almost in place (sales have a 90% weighting in the apportionment formula) and where combined reporting is also used.

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