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A Gross Receipts Tax: Is It a Possibility in Georgia?

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Introduction

State gross receipts taxes have waxed and waned over the years. After nearly becoming extinct by the beginning of the 21st century, there has been a renewed general interest in adopting state-level gross receipts taxes. And, specifically, there appears to be some interest in Georgia in considering a gross receipts tax. The purpose of this report is to inform the discussion of the possible adoption of a gross receipts tax in Georgia. The report first provides some background on state gross receipts taxes, including a description of the structure of existing gross receipts taxes in the U.S. Second, it provides a description of the revenues generated from gross receipts taxes. Third, the important pros and cons of gross receipts taxes are examined in some detail. The report concludes with a summary of the main issues.

As its name suggests, a gross receipts tax is a tax on the gross revenues of businesses, i.e., revenues but with no deduction for expenses. In its purest form the tax is levied on all revenue or receipts of all firms, with no deduction for labor, cost of goods sold, interest expense, etc. However, in practice the tax is much more complicated than that.

Gross Receipts Taxes Post-2000

While the gross receipts tax has a long and interesting history (see Mikesell 2007 and Watson 2019), we consider only the post-2000 period. There are six states that currently impose state-level gross receipts:[1]

- Delaware (adopted in 1913)
- Washington (adopted in 1933)
- Ohio (adopted in 2005)
- Texas (adopted in 2008)
- Nevada (adopted in 2015)
- Oregon (adopted in 2019, effective in 2020)

Since 2000, three other states adopted a gross receipts tax, but each of them subsequently repealed the tax:

- New Jersey (adopted in 2002, repealed in 2006)
- Kentucky (adopted in 2005, repealed in 2006)
- Michigan (adopted in 2008, repealed in 2011)

In addition, Indiana, which had a gross receipts tax since 1933, repealed it in 2002.[2] Since 2000, Illinois, Maine, Montana Louisiana, West Virginia, Oklahoma, and Missouri gave serious consideration of adopting a gross receipts tax, but did not.

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[1] Most states have gross receipts taxes that are imposed on firms in particular industries. For example, the tax base for the premium tax levied on insurance firms is the firm's gross receipts (i.e., premiums). Some people suggest that New Mexico has a gross receipts tax, while other argue that the tax is essentially part of the state's sales tax.

[2] Kaeding and Wilt (2016) discuss the repeal of the gross receipts tax in Indiana, New Jersey, Michigan, and Kentucky.

It should be noted that Texas, Washington, and Nevada do not levy an income tax, Ohio does not have a corporate income tax, and Delaware and Oregon do not levy a sales tax. Gross receipts taxes are seen as a substitute for these taxes. Many states state that the gross receipts tax is a tax on the privilege of doing business in the state.

Structure of Current State-level Gross Receipts Taxes

This section provides an overview of existing state-level gross receipts taxes, highlighting the major features and noting the similarities and differences across states. The section starts with identifying the major features that are common across states and then describing state-specific features. This is not a comprehensive survey of the gross receipts taxes in the six states that currently have a state-level gross receipts tax, and several legal nuances of some of the tax code provisions in these states may have been left out.

A gross receipts levy taxes all gross receipts generated within the state by all entities doing business in the state with no exemption or consideration for production costs. Delaware, for example, defines general gross receipts to include receipts of a taxpayer from goods sold or delivered or services rendered in the state, with no deduction for the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, federal or state taxes or any other expense whatsoever paid or accrued or losses.

While receipts from sales within a state by out-of-state firms that have nexus in the state are taxed, there are differences across states in how nexus is determined.[3] Typically, out-of-state sales by in-state firms are not taxed. Generally, the tax applies to all types of businesses (e.g., manufacturers, wholesalers, retailers, service providers, and other types of businesses) and to all entities regardless of form, (e.g., sole proprietorships, partnerships, LLCs, and all types of corporations).

States exempt some minimum amount of receipts, but there are large differences across states in the minimum. There are specific receipts that are not taxed, and these generally include: receipts of non-profits; receipts of firms, such as insurance companies, that pay a product— or industry—specific tax on gross receipts; sales of goods and services that federal law or the U.S. Constitution prohibits from being taxed, for example, purchases using food stamps. States do not impose a gross receipts tax on sales between firms that are part of an eligible groups of firms, although rules differ between states in what constitutes an eligible group. Earnings of employees, generally those whose earnings are reported on W-2 forms, are not taxed on their "receipts". However, receipts of business proprietors, such as self-employed attorneys, doctors, beauticians, etc., are taxed. Most states have tax credits that can be taken against the gross receipts tax.

With the exception of Ohio, states have multiple tax rates that vary by industry. This can be seen as a way of accounting for differences across industries in the relative cost of goods sold and to make tax liability more closely associated with profitability.

[3] Prior to the South Dakota v. Wayfair case, a firm without a physical presence in a state could not be required to collect sales taxes. Wayfair made is much easier for a state to require that out-of-state firms collect and pay sales taxes. Since the Supreme Court ruling in South Dakota v. Wayfair, states have been changing how nexus is determined. Discussion of nexus is beyond the scope of this report.

The following summarizes the main features of the gross receipts taxes for each of the six states that impose state-level gross receipts taxes:

DELAWARE

Delaware's gross receipts tax, referred to as the Commerce Tax, is part of the business license tax that includes a flat annual fee plus a variable rate gross receipts tax. There are several broad categories of businesses licenses, including Occupational License Tax, Contractors' License Tax, Manufactures' License Tax, and Retail and Wholesale Merchants' License Tax. There are significant differences by category in the tax provisions, which requires that the state code define each category in very specific terms.

Tax rates, which vary by industry, range from 0.0945 percent and 0.7468 percent; Watson (2019) reports that there are 54 separate tax rates. Examples of the industry specific tax rates include: 0.1260 percent for manufacturers; 0.3983 percent for wholesalers; 0.7468 percent for retailers; 0.6472 percent for restaurants; 0.3983 percent for general services. Businesses are entitled to an exclusion, which is generally $100,000 per month, but the monthly exemption for manufacturers $1,250,000.

With some exceptions, the tax is imposed on any business, including in-state and out-of-state firms, that sells goods or provides services in the state. Wholesale and retail sales made out of state are not taxed, although receipts of out-of-state sales by manufacturers are taxed. Wholesale and retail sales of motor vehicles are exempt. Construction firms can deduct the payments to subcontractors, while real estate developers can also deduct the cost of land and improvements thereon, and certain miscellaneous expenses. Portfolio income, i.e., dividends, interest, royalties, etc., of non-financial firms are not taxed. Banks are taxed based on net income.

Transactions between entities of a general business are exempt, but only if owned by the same five or fewer individuals or one family; this is a much more restrictive exemption than in other states, which rely on the federal definition of an affiliated group.

WASHINGTON

Washington's gross receipts tax is called the Business & Occupation (B&O) tax. Tax rates vary between 0.471 percent and 3.3 percent and depend on the firm's industrial classification. Watson (2019) reports that there are 35 separate tax rates, many of which apply to specific products or narrowly defined industry categories. The major industries and the associated tax rates are: 0.471 percent for retailing; 0.484 percent for wholesaling; 0.484 percent for manufacturing. Some of the receipts that are exempt are: rental income from real estate; real estate sales; investment income of nonfinancial firms, and; interest income earned by firms located in 10 states or less on loans primarily secured by first mortgages or trust deeds. Unlike other states, receipts from out-of-state sales are taxed in Washington. There are some 190 specific special treatments, including different tax rates, exemptions, and tax credits. There is a tax credit for small businesses that effectively exempts many small businesses from paying any B&O tax.

OHIO

Ohio's gross receipts tax is called the Commercial Activities Tax. The tax rate is 0.260 percent for all firms, although a flat tax amount is imposed on smaller firms. Entities with less than $150,000 in annual receipts are exempt. A flat tax of $150 is imposed if gross receipts are between $150,000 and $1 million. For gross receipts greater than $1 million, the tax is 0.26% of taxable gross receipts in excess of

$1 million plus a flat $800 if gross receipts are between $1 million and $2 million, $2,100 if gross receipts are between $2 million and $4 million, and $2,600 if gross receipts are more than $4 million.

There are no significant features or exemptions that are unique to Ohio other than the exclusion of sales between subsidiaries. Note first that when an entity owns 50 percent or more of each of a group of companies, the entity must elect to be treated as either a combined taxpayer or a consolidated taxpayer. For a combined taxpayer, each subsidiary is treated as a separate firm, so each subsidiary has its own financial statements. For a consolidated taxpayer, all of the entities are combined, and thus there is just one financial statement. For gross receipts tax purposes, for a combined taxpayer, payments between members are subject to the gross receipts tax, as long as the entity that makes the "sale" has nexus in Ohio. For a consolidated taxpayer, payments between subsidiaries are excluded from the gross receipts tax, but the receipts from outside the firm for all entities, regardless of whether they have nexus in Ohio, are taxed.

TEXAS

Texas levies a franchise tax, commonly called the Margin Tax, which has the features of a gross receipts tax. The franchise tax is imposed on a taxable entity's margin, which is computed in one of the following four ways:

- total revenue minus cost of goods sold;
- total revenue minus compensation;
- total revenue times 70 percent; or
- total revenue minus $1 million.

The firm chooses the margin that minimizes its tax liability.

A firm's total revenue is derived from revenue reported for federal income tax purposes, minus some exclusions that include dividends and interest from federal obligations and Schedule C dividends. Cost of goods sold generally includes costs related to the acquisition and production of tangible personal property and real property. There are other allowances to the costs of goods sold for certain industries. Taxable entities that only sell services will not generally have a cost of goods sold deduction. The compensation deduction includes: wages reported on W-2 forms and cash compensation paid to officers, directors, owners, partners and employees, and fringe benefits such as workers' compensation, health care, and retirement benefits.

The tax rate is 0.75 percent, although wholesalers and retailers are taxed at 0.375 percent. Note that taxing only 70 percent of gross receipts in the 3rd option is equivalent to taxing total gross receipts at a tax rate that is only 70 percent of the statutory tax rate. Entities with $20 million or less in annualized total revenue may choose to file using the EZ Computation, in which case the tax rate is 0.331 percent. Certain entities are exempted, including sole proprietors and general partnerships, and businesses with less than $1,130,000 in gross receipts. For the two options for which the firm deducts cost of goods sold or compensation, the margin is apportioned to Texas using a single-factor apportionment formula based on gross receipts. This is similar to how taxable income is apportioned for many of the states with a state corporate income tax.

Since the Texas constitution prohibits the state from levying an income tax, Texas cannot have a tax that is based on revenue minus cost of goods sold and compensation, since that would be considered a

measure of income. The gross receipts tax is a way of taxing businesses based on something that approximates profitability without actually using income. The four margin taxes are forms of gross receipt taxes, but the option of deducting the cost of goods sold or compensation is not in keeping with spirit of a gross receipts tax. The result of such provisions is to make the tax look more similar to a net income tax.

NEVADA

Nevada's gross receipts tax is called the Commerce Tax. It is imposed on businesses with revenue greater than $4 million. The tax rates vary by industrial category; Watson (2019) reports that there are 27 separate tax rates, with tax rates varying from 0.051 percent to 0.331 percent. When a firm has gross receipts from several different industrial categories, its sales are taxed at the rate that applies to the industry in which the firm is primarily engaged; in other states, an industry specific tax rate is applied to each category of product sold.

OREGON

Oregon's gross receipts tax is called the Corporate Activity Tax. Despite its name the tax, once implemented in 2020, will be imposed on all companies, not just corporations. This tax is in addition to the state's personal income and corporate net income taxes. The tax equal $250 plus 0.57 percent of taxable commercial activity (i.e., a firm's Oregon-sourced gross receipts) minus 35% of the greater of their "cost inputs" or "labor costs." Total cost is apportioned to Oregon based on the sales factor, i.e., sales in Oregon divided by total sales. Labor cost deduction for any given employee is capped at $500,000. Companies with less than $1 million in revenues are not subject to the tax.

The tax applies to businesses in every industry, including insurance companies and financial institutions, unless they are "excluded persons," a term that covers governmental entities as well as certain nonprofits, hospitals, and long-term care facilities. There are 43 types of excludible gross receipts, including special exclusions for many specific industries such as gas and fuel sellers, grocery stores, utilities, telecommunications service providers, heavy equipment providers, vehicle dealers, and agricultural cooperatives.

Revenue from Gross Receipts Taxes

Table 1 presents FY 2018 revenue from state gross receipts taxes for the five states that had active gross receipts taxes in that year. Oregon's tax becomes operational in 2020, so there was no revenue for FY 2018. Table 1 also includes gross receipts tax revenue as a percentage of state gross domestic product (GDP). As can be seen, these percentages differ across the five states, from 0.12 percent to 0.74 percent. While some of the differences in total gross receipts as a percentage of gross domestic product is due to differences in state industrial composition and in tax treatment of certain industries, we suspect that much of it reflects variations in tax rates and the values of the general exemption.

Table 1. Revenue for Gross Receipts Taxes, FY 2018

State	[1] GRT REVENUE, FY 2018	[2] GRT/GDP	[3] "ESTIMATED" GEORGIA TAX REVENUE
Delaware	$258,000,000		$2,078,634,251
Nevada	$201,926,512	0.35%	$707,449,653
Texas	$3,685,940,398	0.12%	$1,209,532,352
Ohio	$1,963,768,818	0.21%	$1,716,536,546
Washington	$4,156,327,000	0.29%	$4,343,867,062
		0.74%	

Column 3 shows the product of the percentages in column 2 times Georgia's gross domestic product. The values in column 3 can be taken to be crude estimates of the tax revenues that Georgia might expect if it adopted a gross receipts tax similar in design to one of the five states. The differences in these estimates obviously reflect the differences in tax rates, the basic exemptions, and other features of the tax across states. But the estimates do provide a first order estimate of magnitude of the revenue that Georgia might expect if it adopted a gross receipts tax.

Important Pros and Cons of Gross Receipts Taxes

There are several issues that should be considered in any debate over adopting a gross receipts tax. Many of the states that have adopted a gross receipts tax view the tax as a substitute for a corporate income tax. For example, Ohio dropped its corporate income tax when it adopted its gross receipts tax. And, it appears that the consideration of a gross receipts tax in Georgia is as a replacement for the corporate income tax. Thus, where appropriate we contrast the gross receipts tax to the corporate income tax.

STATUTORY TAX RATE

The principal feature of gross receipts taxes that supporters point to is its low statutory tax rate, while still generating substantial revenue. As noted above, statutory tax rates are less than 1 percent, but revenues are very substantial. For example, Washington's gross receipts tax rates are generally less than 0.5 percent but the tax accounts for 19.7 percent of the state's total tax revenue.

Compared to corporate income tax rates, gross receipts tax rates are much smaller. However, this difference in tax rates is obviously due to the difference in tax base, revenue versus profit. Federal corporate income tax data from the IRS suggests that, on average, profits are about 6 percent of revenue. (Note that this is an average across all firms, and the percent likely differs significantly across industries and types of businesses.) Using this 6 percent figure, it follows that a corporate income tax rate of 5.75 percent would yield the same tax revenue as a gross receipts tax with a 0.345 percent tax rate and no exemptions. The IRS data also suggests that exempting the first $1 million in receipts would reduce gross receipts by about 8 percent and increase the required gross receipts tax rate to about 0.375 percent. A couple of notes of caution. First, the IRS data are for just corporations, while the gross

receipts tax would apply to non-corporate firms as well. Second, reported receipts from the IRS do not account for the expected reductions in reported taxable receipts caused by changes in firms' behavior aimed at reducing its gross receipt tax liability (see "Incentive to Reduce Turnover" subsection below).

STABLE REVENUE

There is wide variation across products and services in how sales vary due to changing economic conditions. If annual changes in tax revenue are similar to changes in economic conditions, we say the tax is relatively stable. The tax bases for both gross receipts taxes and sales taxes include a large share of total sales of goods and services, and thus one should expect that both taxes would be relatively stable. Mikesell (2007) compared revenue over a 10-year period for Washington's sales tax and gross receipts tax and found that the gross receipts tax revenues were somewhat less stable than sales tax revenues. On the other hand, corporate income tax revenues are notoriously cyclical as compared to economic conditions, and thus relatively unstable and also rather unpredictable.

PYRAMIDING

The principal problem with the gross receipts tax that opponents point to is the pyramiding of the tax and the incentives that this leads to. A gross receipts tax is levied at each step in the production process, while a sales tax is levied largely on purchases by the final consumer.

Pyramiding of the tax occurs when different firms are responsible for each stage of the production process. With a gross receipts tax, the raw materials are taxed when they are sold to the first manufacturer. The resulting intermediate product is then taxed when that manufacturer sells to the next firm in the production chain. This continues through the sales by the wholesaler and the retailer. The result is that when the good or service is sold to the final consumer, total taxes paid will be the accumulation of the gross receipts taxes paid at each and every production stage. And, obviously, the total taxes paid will vary considerably with the level of integration of the production process.

The Table 2 provides a simple example to illustrate tax pyramiding. For simplicity we assume the tax rate is 1 percent and that there are no exemptions. Suppose that Firm A sells $100 of goods to Firm B and pays the 1 percent tax on the $100, or $1. Assume that Firm B adds $100 in value to the immediate good and sells the resulting product to Firm C for $200. Firm B thus pays a tax $2, i.e., 1 percent of $200. Firm C, in turn, adds $200 in value and sells the resulting product to Firm D for $400. Firms C pays $4 in taxes, i.e., 1 percent of $400. Assume that Firm D adds $100 to the product and sells the product to a final consumer for $500, and thus pays tax of $5. Total taxes paid on the product is $12, which is 2.4 percent of the $500 value of the final product. In contrast, in the case of a fully integrated business, the total tax paid would be $5, or 1.0 percent of the value of the final product.

Table 2. A Hypothetical Example of Tax Pyramiding

FIRM	SALES VALUE	TAX PAID AT 1% RATE	CUMULATIVE TAXES	CUMULATIVE TAXES WITH INTEGRATED BUSINESS
A	$100	$1	$1	$0
B	$200	$2	$3	$0
C	$400	$4	$7	$0
D	$500	$5	$12	$5

Pyramiding results in an effective tax rate on the final product that is larger than the statutory rate. How much larger depends on the number of stages in the production process. There is little published research regarding the effect of pyramiding on the effective tax rate, but a study was conducted by the Washington State Tax Structure Study Committee (2002). This study found that on average pyramiding in Washington resulted in a tax on the final good or service that is 2.5 times the statutory rate, which happens to be the case in our hypothetical example. In other words, the effective tax rate on the final product is much larger on average than the statutory tax rate. Since the number of stages a product goes through varies by product, the study found that the effective tax rate on the final sale varies. For some manufacturers the rate of pyramiding is 5 or 6 times.

INCENTIVE TO REDUCE TURNOVER

As with any tax, gross receipts taxes create incentives for a firm to change behavior in an effort to reduce its tax liability. In particular, firms have an incentive to reduce the number of times the product is subject to the gross receipts tax. There are many actions firms can and do take to reduce tax burden. The following are some examples.

- Firms could merge vertically, so that there are fewer stages in the production process. For example, a manufacturer could merge with a wholesaler. In our example in Table 2, if Firms C and D merged, the cumulative tax would be reduced by $4. We are unaware of any empirical study of that measures the effect of gross receipts taxes on vertical integration.
- If producers include the tax in their price, firms further up the production chain will look to out-of-state suppliers whose price does not include the tax.
- In construction, subcontractor purchase materials from a wholesaler, who pays the gross receipts tax. The prime contractor then pays the subcontractor an amount that includes the cost of the materials, so the subcontractor pays gross receipts tax on the material sold to the contractor. The prime contractor then charges the client for the materials and thus pays a gross receipts tax. The tax liability on the materials can be reduced by a third if the prime contractor, rather than the subcontractor, purchases the materials from the wholesaler.
- The report of the Washington State Tax Structure Study Committee (2002) identified various steps that firms have taken to reduce their gross receipts tax liability. For example, a wholesaler can establish itself as the purchasing agent in dealing with its retail customers. The agent arranges for goods to be purchased from a manufacturer and transferred to the retailer in exchange for a commission. The manufacturers pay a gross receipts tax on its sales. However, the wholesaler (purchasing agent) owes tax only on the commission it receives, but not on the

value of the goods the retailer receives since the wholesaler never purchased the goods, and thus did not sell them to the retailer.

COMPLEXITY OF GROSS RECEIPTS TAXES

One of the advantages that proponents of gross receipts taxes claim is that the tax is simple, and thus easy to comply with and to administer. However, in practice, existing gross receipts taxes are not the simple tax that imposes one tax rate and has limited exemptions or special provisions. In practice, gross receipts taxes are complex, and the complexity seem to increase the longer the state employs a gross receipts tax.

As noted above, in states other than Ohio, there are multiple tax rates. Delaware has 54 separate tax rates, Washington has 35, and Nevada has 27, which provide special treatment for certain industries or firms. In addition, these states have exemptions that reduce the tax for certain industries or firms. The result is a complex tax that makes compliance and enforcement difficult. For example, when a firm sell products subject to different tax rates it is difficult to audit the firms to ensure that it has correctly assigned sales to the proper tax categories.

Of course, the corporate income tax is also complex. We know of no study that attempts to compare the complexity of the two taxes. However, firms that are domiciled in states with gross receipts taxes also have to file corporate income tax returns to the federal government and possibility in states with corporate income taxes in which the firms conduct business. Thus, there is not likely to be a lot of saving in tax complexity from eliminating the state corporate income tax.

INCIDENCE AND EQUITY

There is not much that is known about the incidence of gross receipts taxes, that is, who bears the burden of the tax. It is assumed that the consumers bear the burden of the sales tax, that is, that pre-tax prices do no change in response to the imposition of the sales tax. Given this assumption, numerous studies find that sales taxes are regressive, i.e., consumption of sales-taxable goods and services are a larger percentage of annual income for low-income households than high-income households.

We were unable to find an empirical study of the incidence of gross receipts taxes. Even assuming that the burden of the gross receipts tax is on consumers, as is assumed with the sales tax, the equity impact could be much different. First, unlike the sales tax, nearly all products and service are subject to the gross receipts tax. Thus, the incidence of the gross receipts tax relative to the sales tax depends on how the consumption of the goods and services exempted from the sales tax varies by income. Second, with a gross receipts tax, the effective tax rate on the final product or service will differ across products and services. Thus, to measure the regressivity of a gross receipts tax it is necessary to identify the relationship between the effective tax rate on the final product or service and how consumption of these products and services differ by household income level. Despite the lack of empirical evidence, most tax policy experts believe that the gross receipts tax is regressive.

A gross receipts tax is a tax imposed on the firm that is selling a product, while a sales tax is a tax imposed on the buyer of a product. Economic theory generally implies that the effect of a tax is the same whether the tax is levied on the seller or on the buyer. This implies that who bears the burden of a tax imposed on the seller should be the same as a tax imposed on the buyer.

APPROPRIATE BASE FOR TAXING BUSINESS

The tax base of the gross receipts tax is essentially a firm's revenue, while the tax base for a corporate income tax is profit. What might be the more appropriate basis for taxing a firm?

One choice is some measure of ability to pay, for example, profits. That makes some intuitive sense because we generally base taxes on individuals on some measure of ability to pay. However, corporations are not individuals, but are entities that organize resources to produce some product or service. Thus, businesses do not actually bear the burden of business taxes. Rather, the tax is borne by consumers in the form of higher prices, by workers in the form of lower wages, or by the owners in the form of lower returns on capital.

Another possible basis for taxes on businesses is as a payment for the privilege of conducting business in the state. Many of the states with gross receipts taxes state that this is the purpose of their gross receipts tax. But using total receipts as a measure of that privilege suggests that it is not just the privilege, but rather the volume of business being done that is the basis for the tax. Of course, receipts are not the only measure of the volume of business. One alternative is the firm's value added, which is the value that a firm adds to the material it purchases. Value added is calculated as sales less the cost of materials, or alternatively, the sum of wages, profits, and rents paid.

A third possible basis for a business tax is something related to the benefits the firm receives from government services. The idea is that government services, such as roads and public safety, are inputs into the firm's production process, and thus it would be appropriate for a firm to pay for these inputs the same way the firm pays for its other inputs. To the extent that these benefits are correlated with a firm's economic activity, then sales or value added would be an appropriate basis for a tax on business, although it is generally argued that value added is the more appropriate basis.

FIRM PROFITABILITY

The gross receipts tax is imposed on gross revenues, and thus firms with negative net revenue, i.e., losses, still have to pay the gross receipts tax. New firms are generally not profitable in the first few years that they are in business, and thus the gross receipts tax is seen as imposing a special burden on such firms. This burden can be reduced or eliminated by exempting receipts below some amount. The gross receipts tax also adds financial stress to firm profits during downturns. This is in contrast to the corporate income tax, which is imposed on a firm only when it has positive profits.

ECONOMY EFFICIENCY EFFECTS

Taxes cause distortions in the allocation of resources; that is, taxes provide incentives for taxpayers to change behavior. For example, taxes can affect the amount of physical capital a firm employs, the amount of output it produces, and the organizational structure of businesses. Both gross receipts taxes and corporate income taxes will distort firms' decisions; we noted above that gross receipts taxes provide an incentive for vertical integration of firms. While there are studies of the distortion effects caused by corporate income taxes, we are unaware of any such studies on the extent of distortions caused by gross receipts taxes.

MISCELLANEOUS ISSUES

The sales tax exempts a substantial fraction of purchases by consumers, mainly services and food for home consumption. A gross receipts tax would include all of the goods and services that consumers buy or use. Some see this as an advantage of a gross receipts tax.

Assuming there is no minimum receipt exemption, all firms would pay a gross receipts tax. If the gross receipts tax was a substitute for the Georgia corporate income tax, there would be a substantial increase in the number of corporations that pay a state tax. In 2018, 91.2 percent of corporate income tax returns had zero net taxable income, and thus paid no state corporate income tax.[4] We do not know what size, in terms of gross sales, these firms are. Providing a minimum receipt exemption, or a tax credit, the state could reduce the number of corporations that would have a gross receipts tax liability. Using IRS data on corporate tax returns, we calculated that a gross revenue exemption of $1 million would exclude 80.7 percent of corporations from paying a gross receipts tax; this drops to 56.5 percent if the exemption is $250,000. The firms excluded from the gross receipts tax are obviously smaller firms.

It would have been desirable to include an estimate of the expected revenue that the state might collect from a gross receipts tax. However, no specific gross receipts tax proposal has been put forward that can be analyzed. Furthermore, estimating potential revenue from a gross receipts tax is very challenging given the lack of data on the size of gross receipts and given the need to estimate how gross receipts will decrease as firms change behavior in response to the tax.

Summary

On its surface, a gross receipts tax is seen as a simple tax in which a small tax rate generates substantial and relatively stable revenue. In practice however, the tax is not simple and has two undesirable features from a tax policy perspective. In particular, the effective tax rate on the final sale is generally higher than the statutory tax rate due to tax pyramiding and these tax rates vary across products and service. On the other hand, there are also concerns with the state corporate income tax. In this report, we have tried to highlight some of the issues that should be considered in any debate regarding substituting a gross receipts tax for the state corporate income tax.

[4] State of Georgia, Department of Revenue, *2018 Annual Statistical Report*.

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