

**ILLINOIS CHAMBER OF COMMERCE**  
**Gross Receipts Tax Policy Position**  
**Adopted December 8, 2006**

Policy Position: The Illinois Chamber believes that gross receipts taxes violate principles of transparency, fairness, economic neutrality and competitiveness and that the imposition of a gross receipts tax in Illinois would negatively impact job creation and business prosperity. The Illinois Chamber is opposed to any such tax that violates these principles of fair taxation. Regardless of whether the State needs funding for education, healthcare, pensions, infrastructure or some other program, a gross receipts tax is not a viable source of revenue.

The Illinois Chamber Board of Directors, at its December 8, 2006 meeting, voted to adopt the above-stated policy position which opposes the imposition of a gross receipts tax in Illinois. This paper will explain the reason for that decision and the many reasons why such a tax is widely recognized as violating the tax policy principles of transparency, fairness, economic neutrality and competitiveness.

**What is Gross Receipts Tax?**

The concept of a gross receipts tax (GRT) is deceptively simple. A GRT is a tax on *all income received by a business* without any deductions for costs of doing business, such as a deduction for wages or costs of goods sold. Accordingly, GRT's are not based on a company's profit or loss for the tax year, but are owed whether or not a business is profitable. In the few states that have a gross receipts tax, the rate is typically lower than a corporate income tax rate due to the much larger tax base.

**A GRT is not considered a "fair" tax.**

Proponents of GRT's argue that a broad-based, low rate gross receipts tax imposed on the gross income of all business taxpayers is good tax policy and would require all businesses to pay their "fair share" of tax. While tax scholars do typically advocate low rate, broad-based income and sales taxes they acknowledge that gross receipts taxes are bad tax policy and are not, in fact, *fair* because GRT's do not treat all taxpayers equally.

For example, since gross receipts taxes are owed whether or not a business is profitable, marginal and start-up businesses pay a higher effective tax rate than more profitable businesses. That is, a higher percentage of their available cash would go to paying taxes and less would be available to grow their business through investment in equipment or new hires. Businesses operating at a loss will still owe the full amount of GRT and the loss cannot be offset against income in a future year.

The impact of a GRT will also depend, in part, on the profit margin of a particular industry. Industries with lower profit margins will experience a higher effective tax rate and will be more adversely affected by a GRT. In Washington State, one of the few states to have a GRT, more than 15 different rates have been adopted over time in order to minimize the negative economic impact of the tax on different industries.

A fair tax should treat all taxpayers and industries equally. A GRT clearly does not.

**A GRT "pyramids" and will make Illinois products and services less competitive.**

The production process provides the best example of how a GRT "pyramids." In a production process that involves six steps from the procurement of raw materials to the final sale to the consumer, if each step were performed by a separate legal entity in a state with a gross receipts tax, the final product would be subjected to six levels of gross receipts tax.

Here is a simple example pyramiding:

- 1) "basic industry" sells \$100 worth of raw materials to a manufacturer: \$1 tax (assume a statutory 1% rate based on gross receipts)
- 2) "manufacturer" adds value and sells \$200 product to an "integrator": \$2 tax
- 3) "integrator" adds value and sells \$250 product to a "wholesaler": \$2.50 tax
- 4) "wholesaler" adds value and sells \$300 product to a "retailer": \$3 tax
- 5) "retailer" adds value and sells \$400 product to "consumer": \$4 tax

In this example, \$12.50 in tax was paid on a single product that was sold to the final consumer for \$400. Thus, the effective tax rate, as applied to the actual good, was 3.125%, or more than 300% higher than the 1% statutory rate.

This example *excludes* pyramiding resulting from the sales tax also being imposed on many of these transactions resulting in a "tax on a tax." According to a Washington state study of their gross receipts tax, the "B&O" (business and occupation gross receipts tax) pyramids an average of 2.5 times" and can be as high as 5 or 6 times.

Good tax policy dictates that taxes should not affect the competitiveness of businesses or affect the economically neutrality of business decisions. However, a GRT does just that as a result of pyramiding.

A GRT will make Illinois goods and services more costly as a result of pyramiding and would create an in-state/out-of-state cost differential that will directly affect business purchasing decisions. A GRT would give Illinois retailers and manufacturers an economic incentive to purchase less costly goods from out-of-state suppliers. A GRT would also place Illinois businesses that export product at a competitive disadvantage by increasing the cost of goods produced in Illinois.

If the added costs of the GRT are not passed on to consumers, Illinois businesses will be less profitable and Illinois will become a less desirable place to do business compared to other states.

**A GRT will increase the cost of goods and services for Illinois consumers.**

A GRT will make Illinois products more expensive for Illinois consumers. A GRT operates as a *stealth tax* or hidden tax since the effect of pyramiding is to tax each level of production (unlike the sales tax which exempts goods purchased for resale) thus raising the cost of goods sold at each production level and ultimately raising the retail selling price of the product. Additional pyramiding is caused for consumers by the imposition of the Illinois sales tax on the increased product price.

Consumers will also experience an increase in the price of services. Unlike the Illinois sales tax which does not apply to services (just the sale of tangible goods), all Illinois service providers will owe a GRT on gross income earned from their services, some or all of which will be passed on to consumers in the form of increased prices.

**GRT's have been discarded in other states and countries.**

Through the years, only a handful of other states have imposed a GRT. West Virginia was the first to adopt a GRT in 1922. The states of Washington and Indiana followed in 1933. *Until recently, and since 1933, no other state adopted a general gross receipts tax.*

West Virginia repealed their gross receipts tax in 1987 because they felt it was having a negative impact on economic development. Indiana repealed their GRT in 2002 in order to make their state more business friendly and went to an income tax based on ability to pay.

Washington State's GRT is still in effect. It is widely criticized and Washington has been forced to adopt over 15 different tax rates to alleviate the economic impact of their GRT on various industries. A 2002 report by the Washington State Tax Structure Committee found that Washington's GRT:

- Pyramided an average of 2.5 times (e.g., the effective tax rate is 250% higher than the statutory tax rate);
- Imposed a competitive disadvantage on new and expanding businesses;
- Is not transparent to consumers;
- Creates an unnatural division of business activity; and
- Dramatically violates the principle of neutrality.

The states of Delaware, New Mexico, and Hawaii have taxes labeled "gross receipts taxes" but they are generally considered more like a sales and use tax.

According to a recent article by the Committee on State Taxation (COST), GRT's in other countries have been discarded in favor of value added taxes and no highly industrialized country now has a broad-based gross receipts tax on businesses.

#### **Why is the Illinois Chamber concerned about GRT's?**

Other states have begun to consider GRT's as a way to increase revenues from the business community in order to fund increased government spending needs. By design, GRT's bring in significantly more money than a corporate income tax, even at lower rates.

Recently, Ohio adopted a GRT called the "CAT" tax (commercial activity tax) which is a form of gross receipts tax. The CAT replaced two equally onerous taxes--one on business machinery and equipment and the other an Ohio corporate franchise tax. Ohio manufacturers supported the CAT tax primarily because it was preferable to the more burdensome tax on capital investment. The CAT tax is still being phased in and the impact on economic development is still unknown.

Texas recently adopted a GRT in a slightly different form called a "gross margins" tax. Unlike a true GRT, it allows taxpayers to choose between deducting "cost of goods sold" or "compensation." It goes into effect this year and the impact on economic development is also still unknown.

In both states, businesses were accused of not paying their "fair share" of taxes and state deficits and education funding needs were spiraling out of control-- much like in Illinois. Closing perceived business "loopholes" had not adequately addressed the ever increasing need for state revenue to fund governmental services and local politicians were not willing to increase individual income or sales taxes.

The Illinois Chamber is concerned that ever-increasing fiscal pressures in Illinois could result in similar ill-advised tax policy.

