Corporate Income Tax: Estimates And Considerations

February 11, 2020

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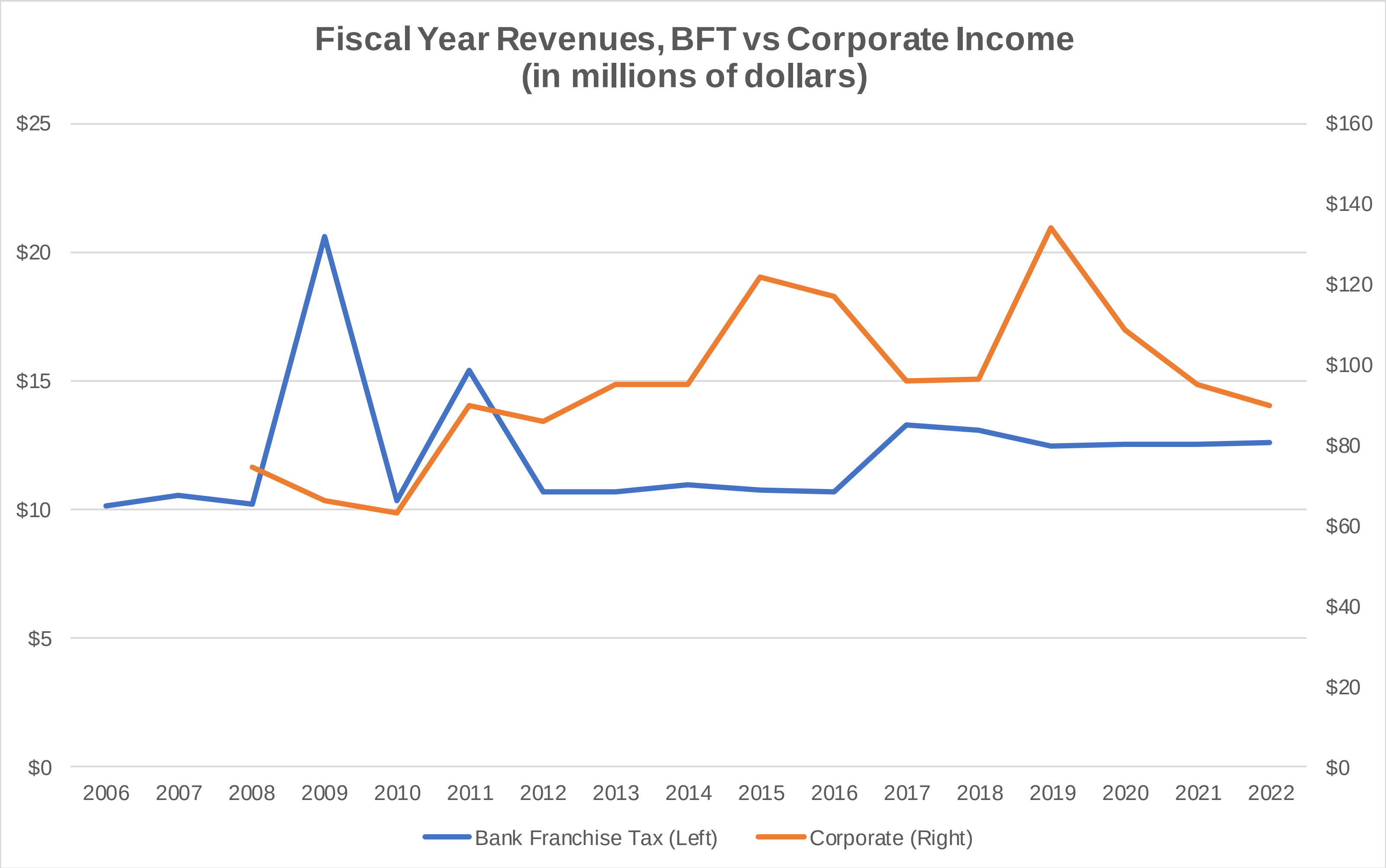
Repeal of the Bank Franchise Tax

- Under this change, all Vermont depository institutions would pay the Corporate Income Tax (CIT)
- <u>Estimate: revenue loss of $4.5 million in FY21</u>
  - Risk to this estimate is to the downside
    - Bank income is very volatile. Over the past 2-3 years, bank net income has been relatively strong, particularly in the wake of Federal Tax reform.
    - In the event of a financial downturn, revenue loss could be significant.
  - In general, a tax on bank assets is likely to be less volatile because the base is less volatile.
- Based upon FDIC data for 2017 and 2018, most Vermont depository institutions would pay less in tax
- This revenue loss is unlikely to be offset by other financial institutions paying Corporate Income Tax for the first time
  - In 2018, 113 financial institutions filed a corporate income tax return, paying $1.7 million in CIT.

Bank Franchise Tax vs Corporate Tax



Considerations for Bank Franchise Tax Repeal

- Market-based sourcing (MBS) prevents this from being an even larger revenue loss.
  - Most out-of-state financial institutions sell intangibles into the state.
  - MBS focus on delivery location for sales factor means that these institutions will have a greater presence in Vermont for CIT purposes.
  - That positive revenue impact is not reflected here because it was reflected in the estimate for MBS last year.
- JFO research found that only 4 states had a similar tax on bank assets (like the Bank Franchise Tax), rather than income.
  - 8 had special taxes for financial institutions, although usually, it was on some measure of net income.

State Taxation of Banks/Financial Institutions

States with Specific Taxes on Financial Institutions/Banks	
State	**Notes:**
States with Tax on Assets of Banks (capital, deposits, etc)	
Vermont	0.0096% on average monthly deposits.
Kentucky	Repealed in 2019. 1.1% of net capital. Beginning 2021, all banks will pay corporate tax
Ohio	Financial institutions tax, in lieu of corporate activity tax. Based upon the amount of equity capital. 0.008 on the first $200 million, 0.004 on up to $1.3 billion, 0.00025 on above $1.3 billion. Minimum tax of $1,000.
Virginia	State tax is 1% of net capital, with a cap of $20 million in tax liability. Different cities have different franchise tax rates.
Michigan	Financial institutions tax. 0.29% of net capital, paid in lieu of the corporate income tax.
States with Tax on Net Income (similar to business/corporate but with adjustments)	
Indiana	Financial Institutions Tax, on net income, declining rates over time. For tax years between 2016 and 2019, 6.5%. For tax years beginning 2022, 4.9%
Delaware	Marginal rate structure based upon net income of the bank, not deposits. Rates range from 8.7% down to 1.7%
New York	Previously a banking corporate tax but was repealed and folded into the corporate income tax. Their current corporate tax is the highest of net income, capital base or minimum tax. The corporate rate is 6.5% on net income, 0.1% on capital.
Missouri	7% on the net income of banks, trust companies, credit institutions, savings and loans banks, credit unions.
Alabama	Financial institutions tax. 6.5% of net income
Hawaii	Financial institutions pay a 7.92% tax on net income in lieu of the corporate income tax.
Wisconsin	Effective Jan 2020, financial institutions will be an additional 1.2% tax on the business and occupation tax, which is 7.9%. Financial institution is determined as an entity with over $1 billion in net income
Kansas	Privilege tax. Tax on the net earnings of financial institutions. Tax rate is 2.25% on most banks, plus another 2.125% on banks with income above $25,000

Pros and Cons to repealing/changing BFT

Pros

- Not very many states still have a franchise tax or any tax on bank assets
- BFT tax base (deposits) not necessarily a reflection of a bank's ability to pay
- Deposits are not necessarily a reflection of modern financial institutions business lines.
- Number of Vermont depository institutions not likely to increase.
- Easier administration for the Department of Taxes

Cons

- Taxing assets is generally less volatile than a tax on income.
  - Small banks are particularly prone to volatile swings in income.
- Corporate income tax easier to shift or deduct income away.
- BFT is less prone to Federal tax changes.

Switching to Triple-Weighted Sales

- Current Vermont apportionment formula is property, payroll and double-weighted sales
- Proposal would put greater emphasis on sales, such that it accounts for 60% of the apportionment formula.
- **Estimate: decrease in corporate tax revenues, TBA pending Dept. of Taxes information.**
  - Two states have had triple-weighted sales factors
    - Maryland: VT-equivalent revenue loss estimate of $300,000
    - Delaware: VT-equivalent revenue loss estimate of $4 million.
  - Data availability issues
    - Department of Taxes only has sales information using Cost of Performance methodology. Beginning 2020, Vermont sales factors are based upon Market Based Sourcing (MBS) methodology.
      - In theory, MBS would exacerbate revenue impacts of triple-weighting sales for firms selling intangibles.

Considerations for Triple Sales Weighting

- Corporations who could see a tax decrease:
  - Corporations with significant payroll and property in the state
  - Capital or labor intensive industries based in Vermont
    - Manufacturing, Transportation, Utilities, Construction
- Corporations who could see a tax increase:
  - Out-of-state businesses whose nexus in Vermont is mostly sales
  - Businesses focused more on sales of services or intangibles
    - Financial services, professional services, entertainment, information technology
- Note: many corporations do not have corporate tax liability. If taxable income is zero, making changes to the apportionment formula do not matter.

Repeal of 80/20 language

- Would require corporations with subsidiaries with more than 80% of their income based outside the U.S. to file as part of the unitary group.
  - Currently, if 80% or more of the businesses is conducted outside the U.S., then the entity is excluded from the income of the unitary return.
- **Estimate: indeterminate revenue increase**
  - Data is not available to make an estimate
    - Montana estimated repeal of this provision would lead to a 5% increase in corporate tax revenues.
      - Differences in corporate taxpayers between the two states, as well as Montana's election of worldwide or waters-edge reporting makes this estimate unreliable for Vermont purposes.