Corporate Income Taxes

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Who pays corporate income tax?

US Resident C Corporations

“Pass-through” entities do NOT pay corporate income tax

Who pays corporate income tax?

- US Resident C Corporations
  - Incorporated entities (ending in names like: Inc., Corp., etc.)
  - Creation of separate legal person, which provides shareholders protection from personal liability.
  - “C” corporation” refers to the subchapter of the Internal Revenue Code.
  - Corporate income tax is imposed on the entity; not on individual shareholders.
  - Shareholders then pay personal income taxes on dividends and capital gains on the appreciation of shares.
  - Advantage: ability to raise money on public markets.

Who does not pay corporate income tax?

- "Pass-through" entities and individuals do not pay corporate income tax.
  - Business structure: partnerships, limited liability companies, S Corporations, sole proprietors.
  - Income tax is not imposed on pass-throughs at the entity level. Instead, income passes through directly to the members (or partners, owners, sole proprietor, etc.), who are then taxed under the personal income tax.
  - Unincorporated pass-through entities are not used to raise money on public markets.

What corporate income is taxed?

- Taxable income is calculated at the federal level.
  - Taxable income is a corporation’s receipts minus allowable deductions, including the cost of goods sold, wages and other employee compensation expenses, interest, nonfederal taxes, depreciation, and advertising.
  - Federal corporate tax rate is a flat 21%.
    - This rate was lowered in 2018 by the TCJA from the top rate of 35%.
    - TCJA also eliminated tiered corporate income tax rates and 20% corporate alternative minimum tax.

What corporate income is taxed?

- Vermont taxes “net income,” which is federal taxable income with certain adjustments:
  - No deductions allowed for bonus depreciation, non-VT bond interest, or federal operating losses.
  - Deductions allowed for certain income added at the federal level related to foreign credits and job-creating credits. Starting in TY2022, cannabis establishments may deduct business expenses in Vermont.

Vermont corporate income tax rates

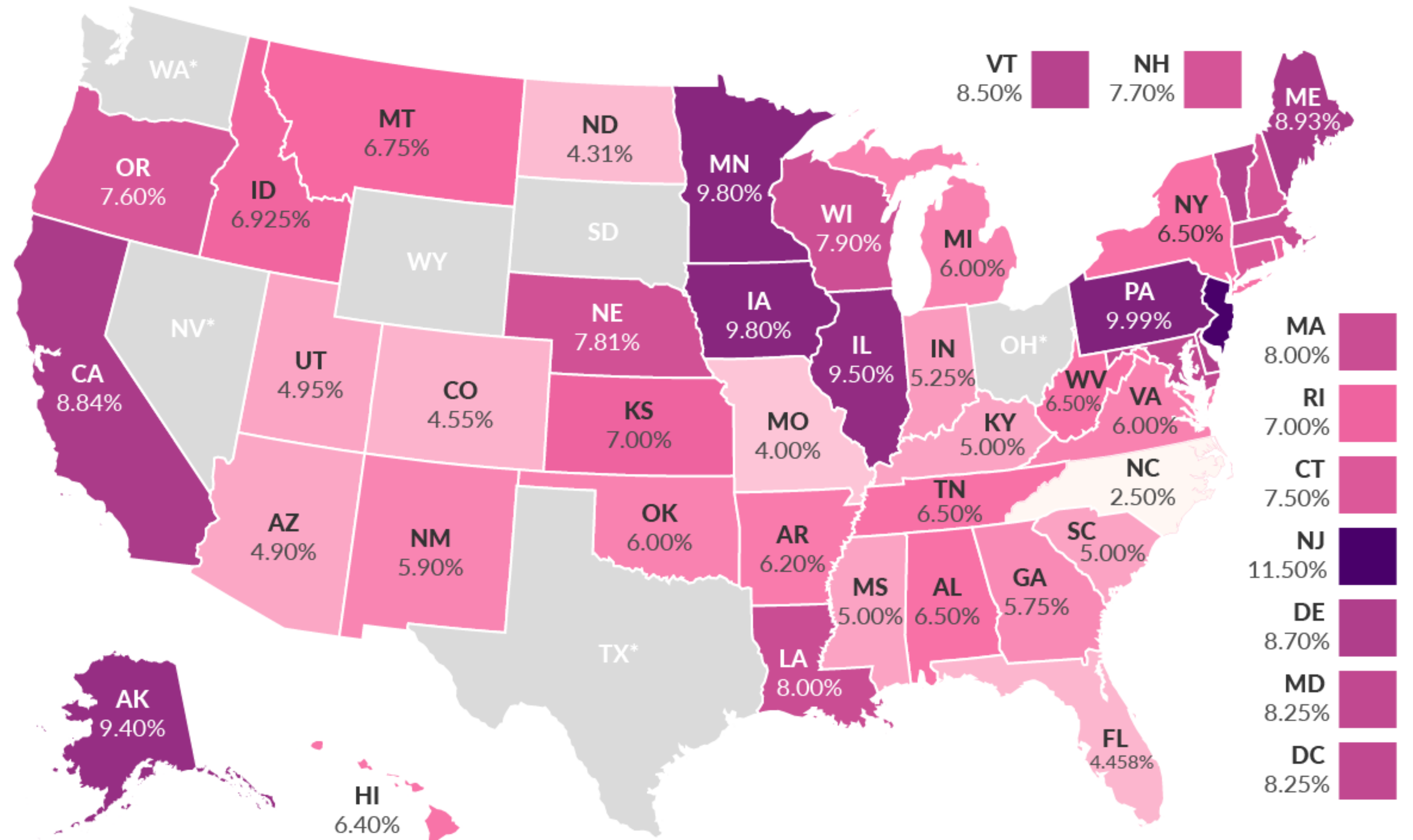
- Vermont’s corporate tax rate is tiered. The top marginal rate is 8.5%.

VT Net Income Allocated and Apportioned to VT	Base tax	Plus	of Amount Over:
$0-$10,000		6%	$0
$10,001-$25,000	$600	7%	$10,000
$25,001 and over	$1,650	8.5%	$25,000

- A minimum tax applies to all active corporations (including LLCs electing to be taxed as C corporation). The minimum tax is based on the amount of the corporation’s Vermont gross receipts.

VT Gross Receipts	Minimum Annual Tax
$0-$2,000,000	$300
$2,000,001-$5,000,000	$500
$5,000,001 and over	$750
Small farm corporations	$75

Top Marginal Corporate Income Tax Rates as of January 1, 2021



Top State Marginal Corporate Income Tax Rates as of January 1, 2021

Note: (*) Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Delaware, Tennessee, and Oregon have gross receipts taxes in addition to corporate income taxes, as do several states like Pennsylvania, Virginia, and West Virginia, which permit gross receipts taxes at the local (but not state) level.

Illinois' rate includes two separate corporate income taxes, one at a 7% rate and one at a 2.5% rate. Indiana's rate will change to 4.9% on July 1, 2021. In New Jersey, the rates indicated apply to a corporation's entire net income rather than just income over the threshold. A temporary and retroactive surcharge is in effect from 2020 to 2023, bringing the rate to 11.5% for businesses with income over $1 million. In addition to regular income taxes, many states impose other taxes on corporations such as gross receipts taxes and capital stock taxes. Some states also impose an alternative minimum tax and special rates on financial institutions.

Sources: Tax Foundation; state tax statutes, forms, and instructions; Bloomberg Tax.

How do states identify the income of a corporation?

- What is the income of the taxpayer?

  Unitary combined reporting v. separate reporting

- How is income is apportioned to the State?

  Apportionment Factors

What is the income?

- Most large multistate corporations have complex organizational structures composed of a “parent” corporation and a number of “subsidiary” corporations owned by the parent.
- Separate reporting treats transactions between affiliated companies as though they were unrelated entities, so each entity files its own return. As a result, intercompany transactions may be deductible expenses (e.g., as cost of goods sold). This enables corporations to shift income between affiliated companies to reduce tax liability.
- Combined reporting treats affiliated companies that are part of a “unitary group” as one entity for tax purposes, so the group only files one return.

Unitary Combined Reporting

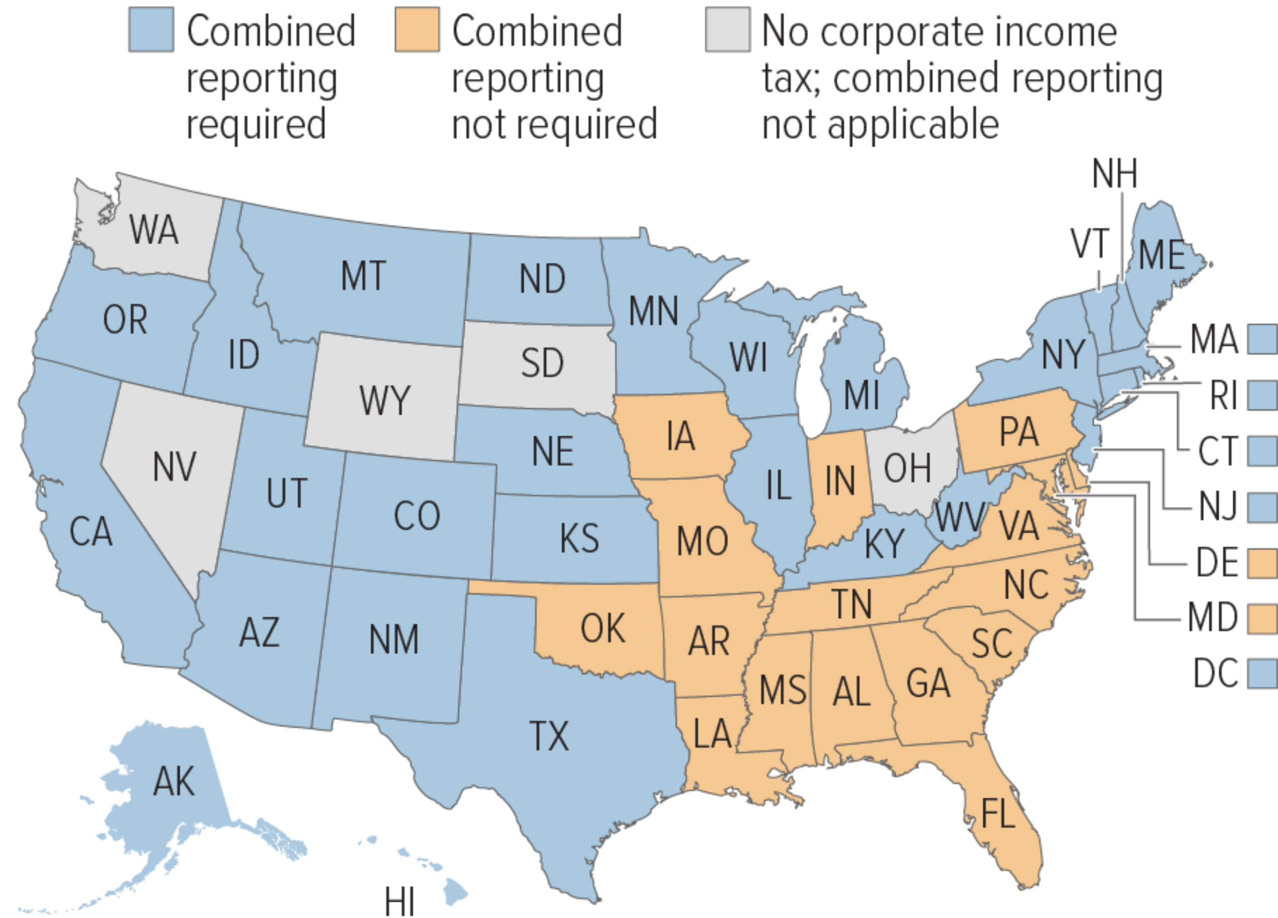
““Unitary business” means one or more related business organizations engaged in business both within and outside the State among which there exists a unity of ownership, operation, and use; or an interdependence in their functions.” 32 V.S.A. § 5811(23); Vt. Reg. § 1.5862(d) – 6.

““Affiliated group” means 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 corporations, but shall exclude overseas business organizations or corporations taxable under 8 V.S.A. § 6014 [captive insurance companies].” 32 V.S.A. § 5811(22); Vt. Reg. § 1.5862(d) – 4.

Unitary Combined Reporting

- Applies to:
  - Multi-state businesses that are part of a unitary group; and
  - The portion of the unitary business that occurs within the US borders.
- Does not apply to:
  - Overseas businesses with 80% or more of payroll and property located outside the US (i.e., “water’s edge” group test);
  - S corporations; or
  - Captive insurance companies.

28 States Plus D.C. Require Combined Reporting for the State Corporate Income Tax



Note: Combined reporting treats a parent company and its subsidiaries as one entity for state income tax purposes, thereby helping prevent income shifting.

Source: John C. Healy and Michael S. Schadewald, “2019 Multistate Corporate Tax Guide, Vol. 1,” Kentucky HB 487 (2018), effective January 1, 2019; New Jersey AB 4262 (2018), effective July 1, 2019, New Mexico, HB 6 (2019), effective January 1, 2020

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Apportionment

- Vermont taxes a corporation's "net income" that is allocated or apportioned to the State.
  - If a taxable corporation's income is derived from any trade, business, or activity conducted entirely within this State, then the corporation's Vermont net income will be allocated to this State in full.
  - If the income of a taxable corporation is derived from any trade, business, or activity conducted both within and outside this State, then the corporation's Vermont net income that will be apportioned to this State, so as to allocate to this State a fair and equitable portion of that income, is determined by using the apportionment formula. 32 V.S.A. § 5833(a).

Apportionment

- Historically, most states have used an equally weighted, three-factor formula based on property, payroll, and sales. In the last two decades, most states have moved to a double-weighted sales factor formula and increasingly to a single sales factor.
- When Vermont enacted unitary combined reporting in 2004 (effective TY 2006), the apportionment factors were also changed from three equally weighted factors to a double-weighted sales factor.
- Vermont currently uses a double-weighted sales factor, so a corporation's apportionment percentage is the average of:
  - Vermont real and tangible **property** / total property
  - Vermont **wages** paid / total wages paid
  - Vermont **sales** of tangible and intangible property / total sales (x2)

Apportionment: Joyce or Finnigan

- "Joyce" and "Finnigan" methods are approaches to determining state jurisdiction over a corporation's income. The names refer to several California Board of Equalization appeal cases on apportionment.
- *Appeal of Joyce, Inc.*, Cal. State Bd. Of Equal., No.66-SBE-069 (Nov. 23, 1966)
  - Prohibited California from apportioning all of the unitary group's California-source income to the corporation taxable in California, when some of that income came from activities carried on by an affiliate exempted from California's tax.
  - Joyce method looks at each entity of the unitary group as a separate taxpayer and whether each entity has nexus with the State. Only entities with nexus will have their property, payroll, and sales factors included in the apportionment formula.
- *Appeal of Finnigan Corp.*, 1990 WL 15164
  - Board construed "taxpayer" to include all members of the unitary group.
  - Finnigan method: once one entity within the unitary group has nexus with the State, then the entire group has nexus. All entities in a unitary group, even entities who do not have nexus with the State, will have their property, payroll, and sales factors included in the apportionment formula.

STATE APPORTIONMENT OF CORPORATE INCOME

(Formulas for tax year 2021 -- as of January 1, 2021)

State	Formula	State	Formula
ALABAMA *	Double wtd Sales	MONTANA *	3 Factor
ALASKA*	3 Factor	NEBRASKA	Sales
ARIZONA *	Sales/Double wtd Sales	NEVADA	No State Income Tax
ARKANSAS *	Sales	NEW HAMPSHIRE	Double wtd Sales
CALIFORNIA *	Sales	NEW JERSEY	Sales
COLORADO *	Sales	NEW MEXICO *	3 Factor/Sales
CONNECTICUT	Sales	NEW YORK	Sales
DELAWARE	Sales	NORTH CAROLINA *	Sales
FLORIDA	Double wtd Sales	NORTH DAKOTA *	3 Factor/Sales
GEORGIA	Sales	OHIO	N/A (2)
HAWAII *	3 Factor	OKLAHOMA	3 Factor
IDAHO *	Double wtd Sales	OREGON	Sales
ILLINOIS *	Sales	PENNSYLVANIA	Sales
INDIANA	Sales	RHODE ISLAND	Sales
IOWA	Sales	SOUTH CAROLINA	Sales
KANSAS *	3 Factor	SOUTH DAKOTA	No State Income Tax
KENTUCKY *	Sales	TENNESSEE	Triple wtd Sales
LOUISIANA	Sales	TEXAS	Sales
MAINE *	Sales	UTAH	Sales
MARYLAND (3)	75.0% Sales, 12.5% Property & Payroll	VERMONT	Double wtd Sales
		VIRGINIA	Double wtd Sales/Sales
MASSACHUSETTS	Sales/Double wtd Sales	WASHINGTON	No State Income Tax
MICHIGAN	Sales	WEST VIRGINIA *	Double wtd Sales
MINNESOTA	Sales	WISCONSIN *	Sales
MISSISSIPPI	Sales/Other (1)	WYOMING	No State Income Tax
MISSOURI *	Sales	DIST. OF COLUMBIA	Sales

Source: Compiled by FTA from state sources.

Notes:

The formulas listed are for general manufacturing businesses. Some industries have a special formula different from the one shown.

* State has adopted substantial portions of the UDITPA (Uniform Division of Income Tax Purposes Act).

Slash (/) separating two formulas indicates taxpayer option or specified by state rules.

3 Factor = sales, property, and payroll equally weighted.

Double wtd Sales = 3 factors with sales double-weighted

Sales = single sales factor

(1) Mississippi provides different apportionment formulas based on specific type of business. A single sales factor formula is required if no specific business formula is specified.

required if no specific business formula is specified.

(2) Ohio Tax Department publishes specific rules for situs of receipts under the CAT tax.

(3) Maryland is phasing in a single sales factor for tax years after 2022.

Proposals in S.53

(note, revenue estimates are from early 2021 and are likely to be updated with new information)

Changes to Apportionment/Single Sales

- Vermont is currently a three factor apportionment state
  - Payroll, property, and double weighted sales
- S.53 proposes to make apportionment factor only dependent upon sales.
- Revenue estimate:
  - -$4.98 million in FY2022, -$19.31 million in FY23, -$20 million in FY24

Single Sales Example

- Company A has net income of $10 million.
- Company A has $2 million worth of payroll
  - $1.5 million in based in Vermont
- Company A has $20 million worth of property
  - $15 million in based in Vermont
- Company A has $50 million worth of sales
  - $1 million of those sales were in Vermont

Single Sales Example

- What percentage of Company A's net income is taxable in VT?
- Under current law:
  - $VT\ Payroll = \frac{\$1.5\ million\ in\ VT}{\$2\ million\ in\ US} = 75\%$
  - $VT\ Property = \frac{\$15\ million\ in\ VT}{\$20\ million\ in\ US} = 75\%$
  - $VT\ Sales = \frac{\$1\ million\ in\ VT}{\$50\ million\ in\ US} = 2\%$
  - $\boldsymbol{VT\ Apportionment = \frac{Property\ (75\%) + Payroll\ (75\%) + Sales\ (2\%) + Sales\ (2\%)}{4} = 38.5\%}$
  - **VT Net Income: 38.5% x $10 million = $3.85 million**
- Under S.53 single sales:
  - VT Apportionment is sales only=2%
  - VT Net Income: 2% x $10 million = $200,000

Why change to single sales factor?

- In theory, putting more emphasis on sales factor encourages businesses to set up operations in your state since there is no payroll and property in the apportionment percentage.
  - In this way, it is advantageous for businesses who have a lot of payroll and property in the state.
  - Provides a benefit to higher payroll, property businesses like manufacturing
- It is a way to “export” your corporate tax revenues.
  - Multi-state corporations who operate in your state with little physical presence will pay a greater tax burden.
- May be a better reflection of how the economy works
  - In small states, much business activity is coming from out-of-state companies that often don’t have much physical presence in the state.
- Trend in states is moving towards single sales factor over the years
  - Neighboring states: Maine, Connecticut, Rhode Island, New York.
  - Massachusetts is double weighted sales like Vermont
  - New Hampshire was moving to single sales but has since pushed back implementation.

Why not change to single sales?

- Academic literature has shown little economic development or jobs impact to switching to single sales factor (see Tom Kavet memo)
  - Department of Taxes simulations show tax cuts for high VT apportionment firms, but they make up a very small share of overall corporate tax revenues.
- Apportionment and definitions of sales are more “squishy” than payroll and property.
- Obscures the benefit principle of taxation:
  - A corporation with large numbers of employees and property in a state uses more state resources than those who do not, and therefore, they should be paying more in taxes.
- Switching to single sales does not impact corporations with no taxable income (~80% of corporate tax returns).
- Revenue losses

Joyce and Finnegan

- Vermont taxes corporations based upon the profits of the unitary group
- When a state has unitary reporting, it has to decide whether a member of a unitary group triggers nexus in the state
- **Joyce method:** a corporation is considered to be taxable if only the corporation itself has taxable nexus in the state.
  - Vermont is currently a Joyce state
- **Finnegan method:** a corporation is taxable if any member of the unitary group is taxable.
- **Example:** three companies, all part of a unitary group, each with a $1 million in sales.
  - Company A has nexus in Vermont whereas Companies B and C do not and have operations elsewhere.
  - Under Joyce: only $1 million from Company A are apportioned in the sales factor to Vermont.
  - Under Finnegan: all $3 million of the group's sales are apportioned in the sales factor to Vermont
- About half of states with unitary combined reporting are Joyce and half are Finnegan.
- **Revenue Impact: Approximately $6.5 million per year once fully implemented**

Throwback and Throwout

- Public Law 86-272 says that a state cannot subject a corporation to its income tax if the corporation is only soliciting sales in the state but otherwise does not have "nexus."
  - If a company owns a kiosk, warehouse, employee in a state, it has nexus.
  - However, if a company solicits an order from a Vermonter, the order is fulfilled in another state, and delivered to the Vermonter using a common carrier, the company does not have nexus and has 86-272 protection.
- This creates "nowhere" income for corporations that operate across many states
  - Example: A company with $10 million in net income in 10 states, split $1 million per state, of which Maine and Vermont are included.
  - In Maine, where it solicits orders, it does not have sufficient nexus and has 86-727 protection so Maine cannot apply its CIT to the $1 million sold in Maine.
  - Assuming the company has nexus in the other 9 states, then in effect, only $9 million net income is subject to state corporate income taxes. $1 million becomes nowhere income.

Throwback and Throwout

- **Throwback Rule: Requires the company to "throwback" nowhere income into its numerator for sales apportionment purposes.**
  - In the example, Vermont would "throwback" the $1 million in Maine nowhere income into the apportionment so Vermont's sales factor would be: $1 million (VT) + $1 million (nowhere income) divided by $10 million, so 20%.

$$\frac{\$1\ million\ in\ Vermont\ income + \$1\ million\ in\ Maine\ \text{"}nowhere\ income\text{"}}{\$10\ million\ in\ nationwide\ income} = 20\%$$

- **Throwout Rule: Requires the company to "throwout" nowhere income from its numerator for sales apportionment purposes.**
  - In the example, Vermont would "throwout" the $1 million in Maine nowhere from the numerator so Vermont's sales factor would be $1 million (VT) divided by $9 million

$$\frac{\$1\ million\ in\ Vermont\ income}{\$10\ million\ in\ nationwide\ income\ - \$1\ million\ in\ Maine\ \text{"}nowhere\ income\text{"}} = 11.1\%$$

- Vermont has a throwback rule for most income, but a throwout for intangibles

Pros and Cons of Throwback Rule

- Pros
  - Throwback rules are in place to prevent corporations from structuring themselves in a way to avoid nexus in states.
  - Was included in the original MTC document for greater tax cooperation among states.
- Cons
  - States are attributing sales of a corporation to themselves even though they bear no relation to actual business activity.
  - If a corporation has nowhere income, the tax costs of doing business in a throwback rule are much higher than just a pure reflection of their business activity in the state
  - Businesses can structure themselves to avoid nexus in throwback states.
  - Runs counter to theory of single sales: that taxation should be destination-based, not origin-based.
- Revenue Impact: -$850,000 per year once fully implemented

80/20 Rules

- Vermont taxes the income of a unitary group, rather than individual separate entities.
- What about members of the group that operate primarily outside the US?
- **80/20 rule:** excludes from the apportionment calculation the member of the group if more than 80% of the business comes from sales outside the US.
  - Vermont says that an 80/20 company (overseas business operation) does not need to be counted for apportionment.
- Committee considered repealing Vermont’s 80/20 rule, which would mean any overseas business operations would need to be added to the apportionment factors for the unitary group.

Corporate Minimum Tax

- Corporations with zero or negative taxable net income are required to pay Vermont's corporate minimum tax
- Current law:
  - For corporations with Vermont gross receipts less than $2 million, $300
  - For corporations with Vermont gross receipts greater than $2 million but less than $5 million, $500.
  - For corporations with Vermont gross receipts greater than $5 million, $750.
- S.53 Proposal: Raises approximately $4.23 million per year once fully implemented

S.53 CMT Proposal	
Vermont Gross Receipts	**Minimum Rate**
Under $100k	$250
$100k-$1 million	$500
$1 million to $5 million	$2,000
$5 million to $300 million	$6,000
$300 million+	$100,000

Corporate Minimum Tax

Minimum Tax Payers by Gross Receipts

Gross Receipts Range	# Minimum Tax Payers 2018	# Minimum Tax Payers 2019	% of All Payers Who Pay Min Tax 2018	% of All Payers Who Pay Min Tax 2019
Less than $100,000	7,246	7,345	91.3%	90.4%
$100,000-$200,000	654	621	73.3%	70.6%
$200,000-$500,000	778	718	64.6%	59.6%
$500,000-$1 million	468	457	55.3%	53.1%
$1 million-$1.5 million	181	182	47.6%	45.7%
$1.5 million to $3 million	314	283	49.4%	46.5%
$3 million to $5 million	154	150	43.1%	41.8%
$5 million+	309	288	42.3%	40.6%
TOTAL	10,104	10,044	77.8%	76.4%

Source: VT Department of Taxes

Corporate Minimum Tax-Other States

Survey of State Corporate Minimum Taxes	
State	**Minimum Tax**
Massachusetts	$456. 2019 House proposal to increase this to up to $150,000 for businesses with annual sales of over $1 billion
Maine	5.4% of alternative taxable income. Repealed for 2018
New Hampshire	Repealed in 2018.
New York	Differing amounts based upon gross receipts. Starts at $75 for under $100,000 in NY receipts and goes to $200,000 for those with over $1 billion
Connecticut	$250 for all corporations
Rhode Island	$400 for all corporations
New Jersey	Varied depending on gross receipts. Less than $100,000 is $500. More than $1 million, is $2,000
West Virginia	$50 for all corporations on corporate franchise tax
Minnesota	Varies depending on total minnesota payroll, property and sales. Ranges from $0 for less than $1.04 million to $10,380 for over $41.5 million
Kentucky	$175 for all corporations and limited liability companies
Delaware	$175 plus a $50 filing fee
Oregon	Minimum based upon Oregon gross receipts. Ranges from $150 for under $500,000 to $100,000 for sales of greater than $100 million
Iowa	AMT based upon Federal AMT. 7.2% rate

For a corporation with New York State receipts of:	Tax
Not more than $100,000	$25
More than $100,000 but not over $250,000	$75
More than $250,000 but not over $500,000	$175
More than $500,000 but not over $1,000,000	$500
More than $1,000,000 but not over $5,000,000	$1,500
More than $5,000,000 but not over $25,000,000	$3,500
More than $25,000,000 but not over $50,000,000	$5,000
More than $50,000,000 but not over $100,000,000	$10,000
More than $100,000,000 but not over $250,000,000	$20,000
More than $250,000,000 but not over $500,000,000	$50,000
More than $500,000,000 but not over $1,000,000,000	$100,000
Over $1,000,000,000	$200,000