Corporate Income Tax Reform

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Corporate Income Tax Reform

- S.53 Summary:
- Single sales factor (Section 5)
- Joyce to Finnigan (Section 6)
- Repeal exemption for 80/20 companies (Section 3)
- Repeal throwback rule (Section 5)

Additional Provisions in S.53

- ~~Increase minimum corporate income tax (Section 4)~~
- ~~Cloud tax (Sections 9-12)~~
- ~~Mutual fund fee increase~~

- Not what I'm talking about today

- Exempting menstrual products from sales tax – became law in Act 73
- Exempting $10,000 in military retirement pay

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Who is Impacted?

- C-Corporations, NOT pass-through entities (S-Corp, partnership)
- Big C-Corps that do business in multiple states or countries
- These 4 main elements of corporate reform **do not** generally affect small businesses in Vermont

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Why Care About this Reform?

- Better structure for corporate *income* tax to reflect where companies avail themselves of the market
  - This is really a restructuring, not a tax cut or increase
- Remove potential barriers to expansion/relocation of workforce/property footprints in Vermont
- Impacts generally reduce taxes for companies with Vermont workforces and Vermont property while enhancing revenues from companies who sell to Vermonters without a Vermont workforce or property
- Protect Vermont companies from “losing” twice to our neighboring states who already enacted these reforms!

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What are Other States Doing?

- All New England states and New York use single sales factor
- Massachusetts has enacted single sales factor for favored domestic industries (manufacturing, defense contractors, financial services)
- In the past 10 years, 18 states have moved to single sales factor
- Not aware of any who moved from single sales factor to 3 factor
- There are 18 Finnigan states, 13 Joyce states
- In the past 10 years, 7 states have moved from Joyce to Finnigan
- Not aware of states moving from Finnigan to Joyce

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Key Concepts

Apportionment: The methodology by which states determine how much of a company’s income should be reported to a state for income taxation, when a company operates in more than one state.

Unitary Reporting: Current law in Vermont since tax year 2006, which requires related businesses with common ownership to file as a unitary group. The income of the group is apportioned in one tax return.

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Single Sales Factor

- Vermont currently uses three factors to determine the share of total income apportioned to Vermont:

  Sales into Vermont
  Payroll in Vermont
  Property in Vermont

- Single sales factor looks at only sales

- Who wins? Companies with more payroll/property in the state than sales

- Who loses? Companies selling into Vermont with no/lower payroll or property

- Full Vermont company? No impact

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Joyce to Finnigan

Joyce and Finnigan are names of court cases that led to two different methodologies for determining sales apportionment factors for unitary groups.

- Joyce → Tax jurisdiction for each company is evaluated individually within the group
- Finnigan → Tax jurisdiction for the group is evaluated as a whole
- Note: Both of these methodologies still require unitary filing
- Why does this matter? Public law 86-272
- Finnigan is a natural pairing with SSF, if you rely on sales for apportionment, you want to ensure that those with sales into the state are paying tax.

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Throwback Rule

Companies must report sales of tangible personal property made to the Federal government, or in states where they are not taxable (or claim PL 86-272), back to Vermont (IE the “throwback” to the home state).

- There is a natural tension between the policy goals of the throwback rule and single sales factor.
- If we believe the best reflection of income is where you’re availing yourself of the market, why should companies be required to throwback sales when they were not Vermont sales?
- For complicated reasons, the change from Joyce to Finnigan makes the impact small

80/20 Companies

An 80/20 company is a US company that has more than 80% of its property and payroll overseas.

- The original vision for these companies were legitimate overseas subsidiaries of US companies. Consider a soft drink company with a European distribution network.
- Companies may have one employee for an entire subsidiary, stationed in Europe, where the entirety of a company's intellectual property revenue comes into, thereby avoiding state taxation.
- Because of this potential for abuse, the United States repealed their recognition of 80/20 companies in 2010.
- Only 1/3 of states that have unitary reporting allowance an 80/20 exclusion
- This is **not** opening Vermont up to worldwide reporting because these are US companies

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