Wyoming Gross Receipts Tax

Critical Analysis

April 30, 2017

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"Analysis of gross receipts taxation needs to be done within the policy context of efficient, equitable, and transparent transfer of resources from private to public use, not in a context of determining the proper share of total taxes a business ought to pay." Professor John L. Mikesell, Indiana University.

The State of Wyoming is facing budgetary challenges. As Wyoming currently has no form of personal or entity/corporate income tax, the State relies upon mineral excise, sales, property taxes and user fees to fund most programs.

The Wyoming Legislature's Joint Revenue Committee has been tasked with examining ways in which the revenue streams may be diversified and stabilized. As part of that effort, the committee will be studying a form of taxation called the Gross Receipts Tax.

Only a very small number of states use gross receipts taxes. Five states currently have statewide gross receipts taxes (see map below), but more and more, including Wyoming, are examining this type of tax as an additional revenue source.

What Is a Gross Receipts Tax?

Economist Justin Ross defines a gross receipts tax as one in which there is "… a tax levied against the receipts of a sale that results in a change of ownership.[1]" Beyond this, however, it can be a tax levied against receipts of a sale of services as well.

This type of tax is calculated allowing few, if any, deductions against the gross receipt from the transaction and applies a percentage rate to the gross receipt. As an example, if an attorney charges a $500 fee for drafting a letter on behalf of a client in Wyoming, and there is a 5% gross receipts tax, then the attorney will be required to remit a $25 tax to the State of Wyoming. If the law firm generates $300,000 in fees on an annual basis, then that law firm would have to remit $15,000 to the State.

How Is a Gross Receipts Tax Different From a Sales Tax?

A sales tax is traditionally applied to the end-consumer of the good or service and is collected by the seller on behalf of the taxing authority[2] while a gross receipts tax is applied at all levels of production, whenever a taxable transaction occurs.

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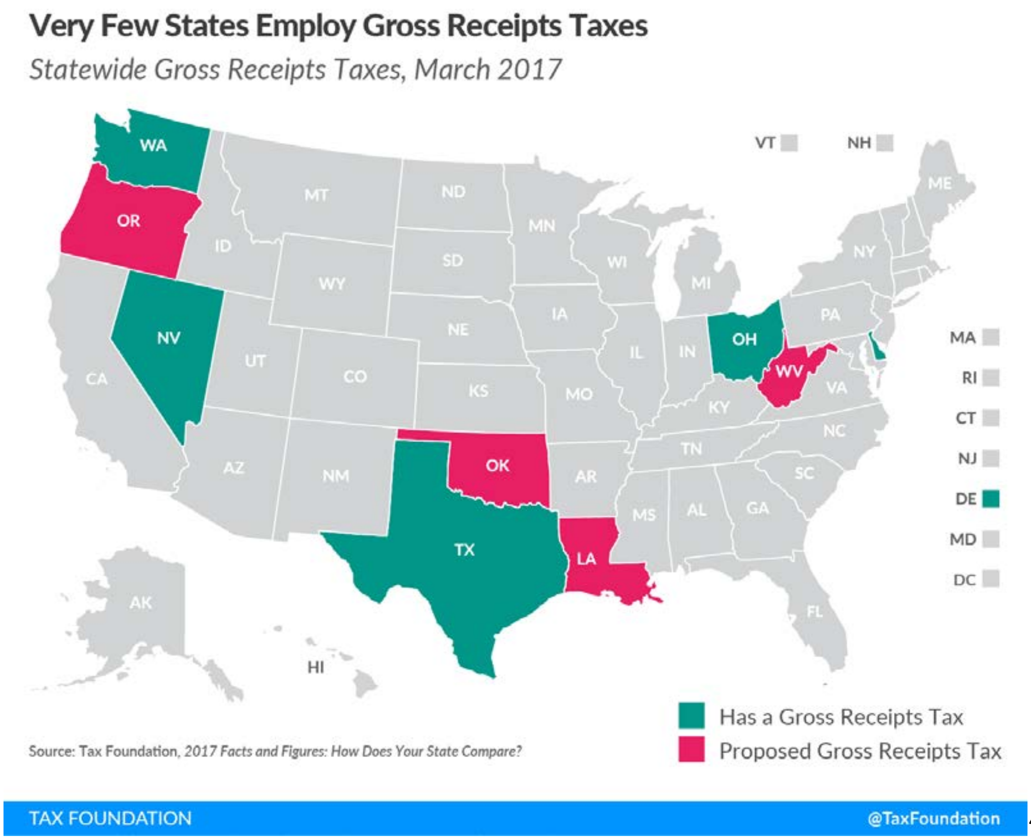
[1] "Gross Receipts Taxes: Theory and Recent Evidence". *Justin Ross.* Oct. 2016.
[2] Wyoming currently exempts most services from the collection of sales tax.

History

"Each time gross receipts taxes are enacted, they create economic problems that cripple growth, conceal true tax burdens, and breed inefficiency." Tax Foundation economist Nicole Kaeding.

This history of the gross receipts tax is long and (figuratively) bloody. The majority of states repealed their gross receipts taxes in the 1920s and 1930s and replaced them with retail sales taxes, but in the last two years, states have begun to be reinvigorated with the possibility of this "new" type of tax that could feed an ever-expanding role of government and create the illusion that certain businesses are "paying their fair share". In 2015, Nevada created its Commerce Tax. In 2016, Oregon voters considered Measure 97, which would have established a gross receipts tax of 2.5 percent on all sales in excess of $25 million. Measure 97 was defeated soundly. And now this pace is accelerating. Four states, Louisiana, Oklahoma, Oregon, and West Virginia, and Louisiana so far in 2017 have considered gross receipts tax proposals. Wyoming is now on this list as well.[3]



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Detriments of a Gross Receipts Tax

General Problems

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[3] *Tax Foundation, 2017 Facts and Figures: How does Your State Compare?*

[4] Courtesy Tax Foundation, 2017.

A gross receipts tax creates various problems for taxing authorities. Economists who have studied the implementation and maintenance of the gross receipts tax have found several problems with this type of tax, including pyramiding, vertical integration, unequal effect on businesses in different stages, unforeseen effects on economic diversification and growth, and a lack of transparency.

1. Pyramiding

   A gross receipts tax is leveled on all business income. This causes a ramping, or pyramiding effect on products or services that move through the production cycle. As a product is manufactured or produced, there is a tax on the gross receipts of the vendors that sell the raw materials to the manufacturer. That vendor adjusts its prices to reflect the tax. Then, the manufacturer is charged a tax on the gross receipts of each sale to a wholesaler, who then is charged a tax on each sale to a retailer, who then is charged the tax on each sale to the public. At each level, the tax is built into the price paid. In the end, the consumer is paying a significantly higher price than if there were a simple sales tax added to the sale.

   As an example, in looking at a simple gallon of milk. In Wyoming right now, groceries are exempt from sales tax. However, under a gross receipts tax regime, the tax would be paid by the businesses and then, indirectly by the consumers at a far higher rate than the sales tax rate. For ease of calculation, let's say the gross receipts tax is 5% and the dairy farmer sells the milk to the dairy normally for $1 per gallon. The dairy farmer is now taxed 5 cents on that sale. Because the dairy farmer is now making 5 cents less, he or she now has to either charge more to cover the tax, pay their employees or laborers less, or accept a lower profit.

   Then, the dairy finishes production, packages the gallon of milk and sells it to the wholesaler for $2. Another 10 cent tax is paid on this sale. So instead of the milk being sold to the wholesaler for $2, the gallon of milk needs to be sold for roughly $2.15 (tax that the farmer built into their price plus the tax that the wholesaler builds into theirs).

   In the next step, the wholesaler sells to the retailer normally for $3, but now has to add the extra 15 cents plus another 17 cents, which is the increase that he or she will have to add in order to pay the tax on the sale.

   In the final sale to the consumer (which may normally be $4), the tax is levied again to the retailer, who again builds the tax into their price and charges $4.54. At that point, instead of a mere 5% effect on the price (which would normally be the case with a sales tax), it becomes an 11.89% effective tax.

   Not all businesses will either choose or be able to build the tax into their pricing. Agricultural businesses are heavily dependent on commodity pricing and as such cannot adjust prices easily. These and other businesses in heavily price-sensitive industries will either choose to lower wages, lose competitiveness or lower return for their shareholders. None of these options are good.

2. Vertical Integration
   Larger businesses will buy or create their own captive suppliers, wholesalers and retailers to avoid the tax. This results in less ability for smaller businesses to compete.
3. Effect on Start-Ups and Economically Impacted Businesses
   The tax has a disproportionate impact on startup businesses and businesses that are suffering from economic downturns. The tax is paid on gross sales. Even if a company is losing money, they will still owe tax. This could potentially break the back of companies that are teetering. It also suppresses startups, who are more likely to lose money in their first few years. A startup will choose a taxing locality that will tax based on net income as opposed to gross receipts.
4. Effect on Economic Diversification and Growth
   The negative effects on startups (discussed in item 3) can combine with pyramiding (discussed in item 1) and lower the attractiveness of a state or region for creation or relocation of a business. This is because the real after-tax dollars available to a business are lower and limit the ability of the owners or investors to reinvest their dollars into business growth.
5. Lack of Transparency
   This is an issue that some legislators feel is a benefit. However, it is almost always bad. If the legislature wants to hide the truth of the real effect that taxes have on consumer prices, it may seem that this is would be a great tax to use. However, it is nearly impossible to hide that truth forever. For example – In Wyoming, groceries are exempt from sales tax. The gross receipts tax would be a means by which the legislature could still tax groceries without the consumer seeing the addition of a sales tax. Wyoming also does not apply a sales tax to services (such as legal and accounting services). The gross receipts tax would be a means by which to circumvent that exemption as well.

Benefits of a Gross Receipts Tax

Gross receipts taxes provide revenue. Regardless of the detrimental effects of the tax, they do provide revenue to the state.

Considerations Specific to Wyoming

Strategic Considerations

On April 14, 2017, Governor Matt Mead recently signed legislation in Wyoming to create the ENDOW initiative (Economically Needed Diversity Options for Wyoming). This bill provides a framework for expanding the economic base in the state. It relies heavily on studying ways in which the state can support new and economically diverse businesses with the goal of increasing employment and standard of living for the citizens of Wyoming.[5] Any tax, especially one such as a gross receipts tax will have to be studied as to the impact on this critical legislation.

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[5]" Mead Takes Long Economic Path With ENDOW Initiative", WBR Staff, 11/11/16, Wyoming Business Report

Operational Considerations

Wyoming has no income tax and therefore no bureaucratic structure to administer an income tax. The Wyoming Department of Revenue would presumably be tasked with the development of regulations and collection of the tax. At a minimum, this would require the following new subdivisions to be created within the Department of Revenue itself:

a. Taxpayer Services: Tasked with providing assistance and customer service to businesses who need help with complying,
b. Processing: The area tasked with processing all of the forms submitted by the businesses
c. Collection: Tasked with collecting money from taxpayers that have filed, yet not paid
d. Enforcement: Tasked with enforcing the statutes and regulations – this would include the audit function and the investigation function.

Prior to creating this tax, the cost of administration of the tax will need to be studied so as to both properly administer the tax and to properly set the tax rate (with the goal of collecting sufficient tax exceed the cost of administration).

State-Level Experiences

Indiana, New Jersey, Kentucky, and Michigan have repealed their gross receipts taxes within the last twenty years. As noted above, Washington, Nevada, Texas, Ohio and Delaware currently levy a gross receipts tax.

Indiana 1933-2002
Indiana's gross receipts tax was instituted in 1933 and repealed in 2002. Following is a quote from Indiana Senator Glen Howard:

> We are also the only Midwestern state with a tax on gross receipts. We need to eliminate these outdated taxes and send a clear signal that we are serious about continuing to bring new jobs to Indiana and helping our existing companies.[6]

New Jersey 2002-2006
New Jersey's gross receipts tax lasted from 2002 to 2006. In instituting the tax (Known as he Alternative Minimum Tax Assessment), New Jersey was looking for a stable, economically neutral means of generating revenue. Instead, New Jersey concluded in 2006 that its gross receipts tax reduced equity, transparency and stability.

Kentucky 2005-2006
In one of the shortest lived major taxes, Kentucky passed its gross receipts tax in 2005 and repealed it in 2006. The following quote explains why:

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[6] Glenn Howard, "Tax Restructuring Is Good For Jobs And Good For Business," Indianapolis Recorder, Feb. 1, 2002, 11.

> "This taxing regime means that even unprofitable businesses, or start-up ventures which typically have losses in early years, may be subject to taxation. The alternative minimum tax may also cause entity level taxes to increase for businesses with high volumes of receipts and low margins."[7]

Michigan 2008-2011

In signing the repeal of the Michigan Business Tax in 2011, Michigan's Governor called it the "dumbest tax in the United States," and it "simply had to go away" because it killed Michigan jobs.[8]

Washington 1933

> "Nobody likes taxes, but people really, really hate the levy Washington imposes on businesses. Called the Business & Occupation Tax, the "B&O" is loathed with the intensity usually reserved for your college football team's archrival. Think the Apple Cup, but with lots more money at stake. The B&O is a tax on gross receipts. Sounds simple, right? Not at all, say business owners. First enacted as a temporary funding mechanism in 1933, it has been amended, tweaked and updated to include hundreds of exemptions, exceptions and classifications. And 39 cities in the state—including Seattle—have gotten in on the action, imposing their own versions of the B&O on top of the state tax."[9]

Nevada 2015

> "Nevada, once viewed as a "tax-friendly" state, implemented a $1.5 billion tax plan to fund its education system. As part of the plan, the state created a business entity tax called the "commerce tax." [10]

Ohio

> "Since the CAT (Commercial Activity Tax) is a tax imposed on businesses based on gross receipts, those businesses with large revenue and low gross profit margin have been hit the hardest by this type of tax."[11]

Texas 2006

Texas does not have a true gross receipts tax. Texas allows a deduction for cost of goods sold, payroll or 30% of gross income.[12] As such, it is better described as a margin tax.

> "With the Texas margin tax collecting far less in revenue than expected, causing significant confusion and compliance costs, resulting in significant litigation and controversy over "cost of

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[7] Kentucky Overhauls its Tax Code," Frost Brown Todd LLC, March 23, 2005.
[8] Snyder Signs Tax Reform Bills to Fuel State's Turnaround," May 25, 2011. http://www.michigan.gov/snyder/0,1607,7-277-57577-256823--,00.html.
[9] "The Infamous B&O Tax" Chris Ghrygiel, Seattle Business Magazine, February, 2012
[10] "Are You Ready For The Nevada Commerce Tax" Prentice Barbee, The Tax Advisor, 1/17/16
[11] "What Is The Ohio Commercial Activity Tax?" Paul Pahoresky, The News-Harold, 8/17/14
[12] "Understanding the Texas Franchise, - or 'Margin'- Tax", Texas Taxpayers and Research Association, Oct. 2011

goods sold" definitions, and facing calls for substantial overhaul and even repeal, it should not be used as a model tax reform for any other state."[13]

Opinion and Conclusion

Wyoming should not implement a gross receipts tax. There are myriad problems associated with that type of tax. Pyramiding, transparency, economic impact and a detrimental effect on both existing businesses and startups are just a few of the issues that are experienced with this type of tax and Wyoming should not participate.

[13] "Texas Margin Tax Experiment Failing Due to Collection Shortfalls, Perceived Unfairness for Taxing Unprofitable and Small Businesses, and Confusing Rules", Joseph Henchman, Tax Foundation, 8/17/11