D.C. Tax Revision Commission Policy Options

Policy Option #31: Replace Business Taxes with a Gross Receipts Tax

MEMORANDUM

Proposal: Replace business taxes with a gross receipts tax
Tax Type: Business
Origin: Norton Francis
Commission Goal: Broaden the tax base and simplify

Current Law

D.C. taxes business income via the business franchise tax (BFT) and unincorporated business franchise tax (UBFT). Both of these business taxes have a rate of 9.975%.

Businesses also pay personal property taxes. (D.C. residents are excluded from this tax.) A business pays $3.40 per $100 of assessed property value; the first $225,000 of taxable value is excluded from the tax.

If a business has more than $5,000,000 in gross receipts in D.C. then it also pays the Ballpark Fee. Revenue from the ballpark fee is dedicated to paying off the bonds issued to build the ballpark. Businesses pay according to the following schedule:

D.C. Gross Receipts	Ballpark Fee	Gross Receipts Tax Rate Paid
Less than $5,000,000	$0	0%
$5,000,000 to $8,000,000	$5,500	0.11% to 0.069%
$8,000,0001 to 12,000,000	$10,800	0.135% to 0.09%
$12,000,001 to $16,000,000	$14,000	0.117% to 0.088%
$16,000,001 and above	$16,500	0.103% or less

In fiscal year (FY) 2012, D.C. collected $302,924,000 from the BFT, $162,972,000 from the UBFT and $55,734,000 from the personal property tax for a total of $521,648,000 in tax revenue from these business taxes.

D.C. also collected $31,910,000 from the Ballpark Fee in FY 2012.

Proposed Change

Replace the BFT, UBFT and personal property tax with a gross receipts tax. The Ballpark Fee would continue under this proposal because its revenue is dedicated to paying off bonds.

Please see "Revenue and Rate Estimates" below for a detailed description of possible rates for this tax.

Reason for Change

D.C. could trade a set of highly complex business taxes for a more simple and broad-based tax. More businesses would pay the tax but at a lower tax rate and with lower compliance costs.

Pros

- Would simplify how D.C. taxes business—which could benefit both taxpayers and tax administrators. For example, Ohio's gross receipts tax form is only one page. D.C. could use the federal definition of gross sales which would ease compliance burdens.
- "Tax planning" might be reduced with a gross receipts tax.
- A gross receipts tax does not tax income, so the tax could potentially be extended to non-resident professionals.
- Revenue from gross receipts taxes could be more stable than business income tax revenue.
- A gross receipts tax could collect money from non-D.C. based businesses that conduct business in the city.

Cons

- A gross receipts tax may be "pyramided," meaning that the tax could apply at more than one stage of production. Pyramiding creates different effective tax rates for different industries.
- Law firms, and other businesses, that are currently exempt from business income taxes might try to avoid this tax by moving to Maryland or Virginia if they become taxable. (Although Northern Virginia already has a small gross receipts tax.)
- Businesses and residents might purchase from non-D.C. suppliers to avoid the tax.
- Because a gross receipts tax is based on sales and not profit, the tax is not sensitive to a business's ability to pay. This is particularly important for start-up companies that take time to generate profit.

Revenue and Rate Estimates

Replacing D.C.'s business franchise taxes and personal property tax with a gross receipts tax is intended to be a revenue-neutral reform. As such, the Office of Revenue Analysis (ORA) has not produced a revenue estimate for this policy option. Instead, ORA has estimated what tax rates D.C. would have to impose to maintain revenue neutrality. The multiple tax rates correspond with different tax bases—a tax base would also have to be defined as a part of this policy change.

ORA estimates that in the first year of implementation of a gross receipts tax (FY 2014), the BFT, UBFT and personal property tax would raise $550 million in tax revenue. This is the revenue hole that a gross receipts tax would need to fill.

D.C.'s current tax base for the BFT and UBFT is roughly $34 billion. Notably, this tax base excludes lawyers, accountants and other professionals exempt from the UBFT as well as non-profit organizations such as universities and hospitals. **If the gross receipts tax were imposed on this tax base the gross receipts tax rate would need to be 1.6% for the tax to maintain current revenues**.

But the objective of this proposal is to spread a gross receipts tax to all businesses, including those currently exempt from the UBFT. This broader tax base is more difficult to calculate, however, and ORA currently does not have an estimate. But in 2007 the U.S. Census Bureau estimated that D.C.'s total tax base was roughly $77 billion. **If the gross receipts tax were imposed on this tax base the gross receipts tax rate would need to be 0.71% for the tax to maintain current revenues.**

Defining the tax base is critical to establishing the tax rate for a gross receipts tax. And exemptions for certain professions and employers are not the only consideration. For example, in Ohio a business must have at least $150,000 in taxable gross receipts in a calendar year to be subject to the tax.

Below is a chart produced by ORA to show the tax rate required to maintain revenue neutrality with various tax bases. For comparison, Ohio's 2012 gross receipts tax rate was 0.26%.

D.C. Gross Receipts Tax		
Tax Revenue	**Tax Base**	**Tax Rate**
$550 million	$34 billion	1.6%
$550 million	$73 billion	0.75%
$550 million	$110 billion	0.5%