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# Wisconsin Briefs

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## SINGLE SALES FACTOR FOR CORPORATE INCOME TAXES

Taxing businesses that derive all of their income within Wisconsin is relatively straightforward. Taxing those that earn income from operations in other states and countries in addition to Wisconsin is a more complicated issue. The 1999 Legislature considered several approaches to taxing multistate and multinational corporations, including switching from the state's current three-factor formula to a "single sales factor apportionment". Although none of the proposals passed, strong support for the single sales factor from major business leaders makes it likely the issue will resurface in the next legislative session.

### THE CURRENT THREE-FACTOR APPORTIONMENT

Corporations that do business both inside and outside Wisconsin are taxed on the basis of the Wisconsin portion of three factors in their operations: 1) sales, 2) payroll, and 3) property value. Generally, the statutory formula requires that the sales factor be doubled and the sum of all the percentages is then divided by four.

For example, if ABC Corporation has 40% of its companywide payroll and 50% of its property within Wisconsin and makes 30% of its total sales in this state, then 37.5% of ABC's nationwide profit is taxable in Wisconsin, as illustrated below:

$$(\% \text{ of payroll} + \% \text{ of property value} + 2 (\% \text{ of sales})) \div 4 = \% \text{ income taxed}$$

$$\text{ABC Corporation: } (40\% + 50\% + 2 (30\%)) \div 4 = 37.5\%$$

Special apportionment formulas are required for certain industries. Income taxes for insurance companies are based on the portion of policy premiums and payroll related to Wisconsin. For financial organizations, taxable income is apportioned under rules established by the Wisconsin Department of Revenue (DOR).

### 1999 LEGISLATION

1999 Assembly Bill 735, which passed the assembly (76-22) but was not taken up by the senate, proposed to base a corporation's taxable income solely on its sales in this state. Similarly, the premium factor would be the only one used in computing taxes for insurance companies operating in Wisconsin and other states. Income of financial organizations would be based on a sales factor determined by DOR rules. Governor Tommy Thompson had previously proposed the single sales factor in his 1999 biennial budget, but he coupled the concept with a requirement that multistate corporations with subsidiaries in the same line of business in other states would have to develop combined reporting to account for profits by their out-of-state subsidiaries. The legislature did not adopt these proposals in its version of the budget.

DOR estimates that, when fully implemented, adoption of the single sales factor would reduce state revenues by \$79.3 million annually. Not all multistate businesses would gain from using the factor. Businesses whose sales are less than the average of their property and

payroll factors would benefit, but those whose sales factors are greater would pay more. In the ABC Corporation example above, that fictional company would have paid 30% instead of 37.5% of taxable income. Based on 1996 corporate statistics, DOR reports 2,426 firms would have had a total tax decrease of \$113.5 million, and 3,997 firms would have had a total increase of \$42.6 million.

## **ARGUMENTS FOR AND AGAINST SINGLE SALES FACTOR**

**Proponents.** Proponents of the single sales factor believe it would spur job growth. Firms that require large investments in property and payroll might locate or expand facilities in Wisconsin instead of other states. A 1999 study, conducted for the Wisconsin Manufacturers and Commerce by economists at the University of Chicago and the University of Wisconsin-Milwaukee, estimated that, over the long run, changing to a single sales factor would increase the number of manufacturing jobs by 2.9% (about 18,000 jobs) and nonmanufacturing employment by 2.4% (about 49,000 jobs). The new employment could potentially provide an additional \$51 million in personal income tax revenue.

Proponents also argue that the change is necessary to keep Wisconsin competitive with neighboring states. Iowa, Missouri, and Nebraska all have single sales apportionment, and Illinois and Michigan are phasing in a 100% sales formula. Minnesota has adopted a 75% sales factor, and Ohio and Pennsylvania adopted a triple-weighted sales factor in 1999.

**Opponents.** Opponents claim that adopting the proposal would increase the share of state taxes paid by individuals. Corporate income taxes equaled 19.9% of Wisconsin's 1988 income tax collections but only 11.8% of the 1999 total. Adopting the single sales factor would drop the corporate share to about 10%. Opponents question how the state would balance that decrease. The individual income tax already makes up more than 50% of the state's total tax collections, and sales tax collections show signs of leveling off because of the rapid growth of Internet sales.

Opponents emphasize that using the single sales factor would benefit only 2% of all corporations doing business in Wisconsin. They contend that, while the measure might encourage multistate corporations to build facilities here, it could discourage job creation by other firms and that companies with high sales factors might move out of state in order to benefit from federal legislation that precludes a state from taxing a corporation if it has no physical presence in that state. Companies that might have located research facilities or sales offices in Wisconsin may prefer states that use a three-factor formula.

## **EXPERIENCE IN OTHER STATES**

**Massachusetts' Experience.** Massachusetts adopted a single sales factor law that allowed defense contractors to use a 100% factor in 1996. Other manufacturers were phased in over a 5-year period. Under a provision that expired January 1, 2000, defense contractors were required to maintain 90% of their 1995 Massachusetts employment level as measured by payroll.

Results have been mixed. Raytheon Corporation, which had lobbied vigorously for the law, has laid off over 3,000 employees – mostly production workers – since the law took effect. An attempt to restore the 90% provision, based on a head count of employees, rather than payroll dollars, has not passed. Raytheon defenders claim cuts in defense spending and declining profits forced the company into layoffs. Meanwhile, other manufacturers claim that the law has favorably influenced their decisions to open new operations or keep older plants going.

The Massachusetts Commissioner of Revenue estimates a loss of more than \$300 million in tax monies since the law took effect. Critics note that Massachusetts has lost manufacturing employment since 1995, but the governor's office responds that the single sales factor law has helped minimize those losses.

**National Research Findings.** Economists and location consultants argue that state tax provisions play a minor role in business decisions to build or locate. Current economic conditions, transportation, markets, and labor force factors are considered more important. It is also noted that, on a nationwide basis, states are depending less on corporate income taxes as a major source of revenue. Yet, other things being equal, changes in tax calculations may have an impact.

Two University of Chicago economists, Austan Goldsbee and Edward Maydew, who participated in the WMC study, also produced a study, titled "Coveting Thy Neighbor's Manufacturing: The Dilemma of State Income Tax Apportionment", in which they concluded states that reduced the payroll factor in apportioning corporate income tax have experienced statistically significant growth in manufacturing employment. After surveying 20 states that reduced the payroll factor from one-third to one-quarter of apportionment (similar to Wisconsin's current apportionment) between 1978 and 1994, they found these states increased manufacturing employment by about 1.1%, mostly in durable goods. They noted, however, that this did not result in overall growth in employment nationwide. The major portion of the increase came at the expense of other states. According to the study, a state may experience as much as 2.8% growth in its manufacturing employment over the long run. Realizing these benefits may, however, depend on actions taken by other states.

An article on the single sales factor in *State Policy Reports* points out the benefits from this type of competitive tax policy may be short-lived as neighboring states respond with incentives of their own.

## FOR MORE INFORMATION

Copies of 1999 Assembly Bill 735 may be downloaded from <http://www.legis.state.wi.us> or obtained by calling the Legislative Reference Bureau at (608) 266-0342. Further information is available from the Dr. H. Rupert Theobald Legislative Library under the subject Corporations - Taxation (call number: 336.291).