NEED TO KNOW

AMERICANS FOR PROSPERITY FOUNDATION

GROSS RECEIPTS TAXES

A HISTORY OF THE GRT

At the turn of the century, gross receipts taxes (GRT's) seemed like a dying relic of the Great Depression (2). At the time, the state of Washington was the last state with such a tax on business transactions, as every other state with a GRT had repealed the emergency revenue measure passed after the Second World War. But as states started to look for creative ways to raise revenue, the GRT made a comeback in the 21st century. Today, eight states levy some sort of GRT and even more are looking to enact one, burdening businesses with a complicated charge whose negative consequences ripple throughout the economy (3).

THE TOLL OF TAXING GROSS RECEIPTS

GRT's are distinct from income taxes in that they tax all the money a business receives from a sale rather than purely its profit. Whereas corporate income taxes deduct a company's business costs, GRT's tax all the money that comes in the door. For example, while a restaurant should be able to deduct its employees' wages and costs of maintaining its facilities, it could not do so under the GRT. As a result, it becomes more expensive for the restaurant to invest in upkeep or to hire new employees. Indeed, the restaurant could even make no profit and still be subject to the GRT – discouraging entrepreneurs from even trying to enter the market.

QUICK FACTS

- Instead of taxing a company's profits like an income tax, GRT's charge all the money a business makes regardless of their gain.
- GRT's are also known as "margin taxes" in many states.

NOTABLE & QUOTABLE

"Gross receipts taxes suffer from severe from severe flaws that are well documented in the economic literature, and rank among the most economically harmful tax structures available to lawmakers."

- **Andrew Chamberlain & Patrick Fleenor**, the Tax Foundation (1)

This toll of taxing gross receipts is even higher on businesses with slim profit margins. To illustrate this point using a helpful example from the Tax Foundation, imagine two companies (4). One is a small grocery store with a profit margin of 5%, and the other is a big software developer with a profit margin of 50%. If both companies make $1 million in sales and their state's GRT is 1%, they would both owe $10,000. While that tax may not be a major burden for the big software developer since $10,000 is only 2% of its total profit, it is a whopping 20% of the small grocer's gain. Such a giant charge can easily sink businesses big and small, leaving workers unemployed and weakening a state's overall economy.

TAX PYRAMIDING

Whereas other taxes (such as a sales tax) exempt business-to-business transactions, GRT's charge each transaction since they are included in a company's gross receipts. Thus, if a product undergoes multiple stages of production, it is charged every time it changes hands. As a result, goods are effectively taxed much more than services businesses – an economic phenomenon known as "tax pyramiding." For example, a pencil would be taxed at least five times throughout its stages of production – first for its wood shaft, a second time for its rubber eraser, a third time for its metal tip, a fourth time for lead individually, and a fifth time for the pencil as a whole.
On the other hand, services like therapy would be taxed only once for labor. As proof, the chart to the right displays the effective tax rates of certain goods in services in Washington State as a result of its GRT.5 Such unequal taxation increases the price of goods and discourages companies from engaging in business with each other since it would add another cost to its product.

CRONYISM

Effective Tax Rates of Washington State's Business & Occupation Tax	
Industry	*Effective Rate*
Electricity	3.2%
Petroleum	3.1%
Food	2.0%
Lumber	1.9%
Auto Repair	1.0%
Retail	0.8%

Since GRT's are so burdensome, rent-seeking businesses in many states have successfully lobbied for exemptions to their industry. New Mexico's GRT, for example, is littered with exemptions and deductions for stadium owners, filmmakers, and car salesmen (6). It's logical for these industries to seek relief from the hefty tax, but it's unfair and economically damaging to shift the tax burden onto the small businesses that drive the economy but lack the political connections to get a special deal. Instead, states would prosper by eliminating burdensome taxes like the GRT and looking to less damaging alternatives like sales taxes for revenue.

CONCLUSION

During these tough economic times, it can be tempting for state and local governments to levy a GRT to make up for lost revenue. Such an impulse is not only fiscally unsound, fueling government spending, but is economically destructive as well, increasing the costs of starting and maintaining a business. Worst of all, these increased costs are ultimately shifted onto us as consumers, raising the cost of living in all of the goods and services we purchase in our everyday lives.

Endnotes:
1. Andrew Chamberlain and Patrick Fleenor, "Tax Pyramiding: The Economic Consequence of Gross Receipt Taxes," Tax Foundation (December 2006), http://taxfoundation.org/sites.taxfoundation.org/files/docs/sr147.pdf.
2. Ibid.
3. Jean Murray, "Gross Receipts Tax," About.com US Business Law / Taxes, http://biztaxlaw.about.com/od/glossaryg/g/grossreceipttax.htm.
4. Supra note 1.
5. Ibid
6. "Gross Receipts & Compensating Taxes: An Overview," New Mexico Taxation and Revenue Department (July 2012), http://www.tax.newmexico.gov/SiteCollectionDocuments/Publications/FYI-Publications/FYI-105__GROSS%20RECEIPTS%20and%20COMPENSATING%20TAXES%20-%20AN%20OVERVIEW%202009.pdf.