Testimony to the Joint Committee on Revenue on the Single Sales Factor Apportionment Formula, How It Works, and What It Costs

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Thank you, Chairperson Cusack, Chairperson Hinds, Vice Chairs Brownsberger and Schmid, and members of the Committee. My name is Kurt Wise and I am a senior policy analyst at the Massachusetts Budget and Policy Center. I've been asked to describe what the Single Sales Factor (SSF) tax break is and how it works.

Businesses succeed and generate profits based in part on the range and quality of public investments upon which all businesses depend. These building blocks of success – things like good transportation systems, a healthy and educated workforce, well-functioning court systems and much more – are paid for with taxes. Like individuals, businesses are expected to contribute to the maintenance of these essential systems through a tax on their corporate profits. For a profitable business, with operations spread across several or many states, the question becomes: What portion of that business's profits should be taxed by each of the states in which it operates? States have a strong interest in taxing a fair portion of the business activity occurring within their borders. Businesses have a strong interest in ensuring their profits are allocated among the states such that, collectively, no more than 100 percent of their profits are subject to state tax. How to thread that needle?

In the 1950s and 1960s, most states adopted the principles underlying the Uniform Division of Income for Tax Purposes Act (UDITPA).[1] These principles provide states with a common, relatively simple formula for allocating – or "apportioning" - the profits of multi-state corporations for tax purposes.

Under UDITPA, the location of all business activity is measured by three, equally weighted "factors" - a property factor, a payroll factor and a sales factor. Each state then can determine the share of a company's total nationwide property that exists within the state, the share of the company's total nationwide payroll going to employees working in-state, and the share of the company's nationwide sales made to in-state customers.[2] Averaging these three factors, a state can tax a clearly definable portion of a company's profits – a portion directly related to the company's overall in-state business activities – leaving the remainder of the company's profit to be taxed by other states.

Single Sales Factor (SSF) apportionment – as the name implies – moves away from the UDITPA, three-factor model, instead placing all the weight on just one factor: in-state sales. For some types of companies, this approach to taxing corporate profits is highly

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beneficial. Multi-state corporations that have much or all of their property and workforce located in a given state, but which make most of their sales to customers located *outside* that state, will see significant state income tax reductions as a result of SSF apportionment. (Due to issues around "nexus," many of these companies will not be subject to taxation in the states in which their customers are located, meaning that the profits that the "production state" forgoes taxing - due to SSF apportionment - in many cases won't be taxed by *any* state.[3])

In Massachusetts, SSF apportionment is provided to three industries, all of which benefit significantly from this tax break: manufacturers, defense contractors and mutual fund companies. By ignoring the property and payroll factors when apportioning the income of these businesses, and looking only at in-state sales, the Commonwealth forgoes collection of hundreds of millions of tax dollars each year from profitable, multi-state corporations operating in Massachusetts. The Department of Revenue's current estimate is that all forms of over-weighting of the sales factor - with the SSF apportionment being the largest by far[4] - together will cost the Commonwealth some $400 million in Fiscal Year 2020.[5] It is not an inexpensive tax break.

I will close with two quick additional comments. First, the rationale for SSF apportionment is that it boosts the prospects of the industries receiving this special tax treatment, leading to a growth in jobs in these sectors. The evidence, both here in Massachusetts and throughout the country, definitively refutes this claim.[6] This approach simply does not work; too many other, much more important factors affect whether businesses add or shed jobs, remain in-state or move to a new location. In short, SSF is a costly and unsuccessful strategy for state economic development.

Secondly, beyond the obvious downsides to losing hundreds of millions of dollars in revenue that otherwise would be collected annually from profitable, multi-state companies, SSF apportionment also creates disincentives to invest and grow in Massachusetts for some companies in the affected industries. A company with significant sales *into* Massachusetts, but no property or payroll in-state, is not liable for the state's corporate income tax (i.e., the company does not have "nexus"). If this company invests even a small amount in Massachusetts property or adds even a few in-state employees, however, suddenly it *would* be taxable here, and a large portion of its income would be apportioned to and taxed by the Commonwealth. To prevent this outcome, companies may opt to avoid expanding operations into Massachusetts altogether. This is an additional, often overlooked downside to SSF apportionment.

Thank you for your time. I am happy to try to answer any questions you may have.

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[1] Institute on Taxation and Economic Policy, "Corporate Income Tax Apportionment and the 'Single Sales Factor', August 2012: https://itep.org/wp-content/uploads/pb11ssf.pdf

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[2] Institute on Taxation and Economic Policy, "Corporate Income Tax Apportionment and the 'Single Sales Factor', August 2012: https://itep.org/wp-content/uploads/pb11ssf.pdf
[3] Institute on Taxation and Economic Policy, "'Nowhere Income' and the Throwback Rule", August 2011: https://itep.org/wp-content/uploads/pb39throw.pdf
[4] Massachusetts Budget and Policy Center, "The Growing Cost of Special Business Tax Breaks", May 2017, pgs. 4-5, see Endnote #19: http://www.massbudget.org/reports/pdf/SpecialBizTaxBreaks_Update%205-10-2017%20FINAL.pdf
[5] Massachusetts Department of Revenue, 2020 Tax Expenditure Budget, pg. 57, Item 2.401: https://www.mass.gov/lists/tax-expenditure-budget
[6] Center on Budget and Policy Priorities, "Case for 'Single Sales Factor' Now Much Weaker", April 2015: https://www.cbpp.org/blog/case-for-single-sales-factor-tax-cut-now-much-weaker