

Back to the BAT Cave

Elliott Dubin, Director of Policy Research, Multistate Tax Commission



I. Introduction

Former MTC Policy Research Intern Cameron Snow and MTC Director of Policy Research Elliott Dubin wrote an article "Musings from the BAT Cave" which appeared in the summer 2008 issue of the *Multistate Tax Commission Review*.¹ In light of the introduction of H.R. 1439, *Business Activity Tax Simplification Act of 2011*, the previous article is updated.

The great American philosopher, inventor, publisher, and public servant, Benjamin Franklin noted:

"In this world nothing is certain but death and taxes."²

Furthermore, in his canons of taxation, Adam Smith stated:

"The tax which each individual is bound to pay ought to be certain, and not arbitrary."³

Thus, good tax policy requires that taxpayers should be aware that their actions can result in tax liability; and, if they incur a tax liability, the amount of tax owed should be known with a reasonable degree of certainty.

Given the complexity of state nexus laws regarding Business Activities Taxes (BATS), the canon that taxes should be certain are frequently violated. Companies that wish to expand their operations across State lines are often uncertain as to how these BATS will be applied to them. Furthermore, this uncertainty, it is claimed, and not the taxes themselves

is what is inhibiting new business investment and threatening to cripple the economy. In the opinion of the Coalition to Protect Interstate Commerce, overly aggressive state attempts to expand taxing authority have:

- led to unfairness and uncertainty;
- increased compliance costs (inevitably, such increased costs will be passed on to consumers in the form of higher prices);
- hindered business expansion;
- put companies at the risk of duplicative over-taxation;
- threatened the continued development of electronic commerce;
- threatened the revenue collections of states that fully comply with constitutional nexus requirements;
- stymied the intent of accounting reporting rules for publicly traded companies; and
- negatively affected international competitiveness.

Left unchecked, this unwarranted expansion of the states' power to impose business activity taxes on companies that do business across state lines will have a chilling effect on the entire economy as tax burdens, compliance costs, litigation and uncertainty escalate.⁴

In order to address these concerns, various corporate groups and Members of Congress

have cosponsored H.R. 1439, the Business Activity Simplification Act of 2011 (BATSA). This bill was introduced by Bob Goodlatte (R-VA), Bobby Scott (D-VA), Jeff Duncan (R-C), and Sheila Jackson-Lee (D-TX). According to Congressman Goodlatte:

“This legislation will ensure that businesses are not subject to double taxation at the state level, which will ultimately facilitate the continued growth of e-commerce, job creation and the overall strength of the American economy.”⁵

Unfortunately, the proponents of federal legislation to change state nexus standards for imposing state business activity taxes do not provide evidence that admittedly complex and sometimes confusing state BATS nexus laws have actually contributed to the perpetration of the perverse actions listed previously. Nor have they provided sufficient evidence to show that passage of H.R. 1439 will have a utopian effect on businesses — all business will be well managed, profitable, and able to grow unhindered by state taxes.

Furthermore, the proponents of H.R. 1439 provide no measures of the relative importance of BATS to either state government fiscs or to the business sector. Nor do they provide any empirical evidence on how the uncertainty of state business activity tax liability affects investment. As Thomas Lord Kelvin reminds us:

“...when you can measure what you are speaking about, and express it in numbers, you know something about it; but when you cannot measure it, when you cannot express it in numbers, your knowledge is of a meagre and unsatisfactory kind; it may be the beginning of knowledge, but you have scarcely in your thoughts advanced to the state of Science, whatever the matter may be.”⁶

The purpose of this article is quite limited. We shall define and measure the magnitude

of BATS and relate the magnitude of BATS to all state and local taxes and to all state and local taxes initially imposed on business, (SLTIIB). We use the acronym SLTIIB because businesses, *per se*, do not “pay” taxes. The ultimate incidence of taxes could result in lower profits for the owners of the business, lower payments for business inputs such as labor, or higher prices for sales to the ultimate consumers.⁷ Despite the fact that the burden of SLTIIB is not borne by the business, it is well known that taxes can have a negative impact on business investment. Taxes lower the profit potential of entering new markets and are, therefore, factored into the cost-benefit analysis of potential investors.

Then we will compare BATS to measures of the size of the business sector — Gross Domestic Product of Private Business and “business income”⁸ We will then discuss the possible effects of federal legislation to change state nexus standards on new business investment. We will then discuss the possible effects of changing BATS nexus standards on new business investment. We find that BATS is small relative to measures of the size of the business sector and that uncertainty regarding BATS nexus standards should have little effect on new business investment.

II. State and Local taxes Initially Imposed on Business

A. *All State and Local Taxes Initially Imposed On Business*

Before we examine BATS, it is useful to examine all SLTIIB, over time, and relative to all state and local taxes, and in relation to the overall size of the business sector. A study released by Ernst & Young and COST in April 2010 defines SLTIIB as:

1. Property taxes on business property
2. General sales tax on business inputs
3. Corporate income tax
4. Unemployment insurance
5. Business and corporate licenses
6. Excise and gross receipts taxes
7. Individual income tax on business income

- 8. Public utility taxes
- 9. Insurance premiums taxes
- 10. Other business taxes

Table 1 below shows the magnitude and the composition of SLTIIB for selected years 1980 to 2009. Property taxes were the largest state and local tax imposed on business representing 36 percent of total SLTIIB. These were followed by sales taxes which accounted for 23 percent of total SLTIIB.⁹ Property taxes on business property and general sales tax on purchases of business inputs combined have averaged about

fifty nine (59) percent of all SLTIIB during this period. Corporate income taxes were about 12.8 percent of SLTIIB in 1980 but declined in relative importance to about 7.1 percent in 2002. Since 2002, corporate income taxes, as a proportion of all SLTIIB, have risen to a maximum of about 10.6 percent in 2007 but have declined since then as a result of the recession. Business license taxes and individual income taxes on business income were 1.3 percent and 1.62 percent of all SLTIIB in 1980. These taxes have grown in relative importance to where they account for 6.5 percent and 5.5 percent of all SLTIIB in 2009 respectively.

Table 1: State and Local Taxes Initially Imposed on Business by Type: Total and as Percent of All State and Local Taxes Initially Imposed on Business: Selected Years 1980 to 2009

Year	All State & Local Taxes Initially Imposed on Business	Property Tax on Business Property	General Sales Tax on Business Inputs	Unemployment Insurance	Insurance Premiums Tax	Corporate Income Tax	Public Utility Taxes	Excise Taxes	Business License Taxes	Individual Income Tax on Business Income	Other Taxes Initially Imposed on Businesses
(Billions)											
1980	\$104.9	\$38.0	\$22.6	\$5.5	\$3.1	\$13.4	\$5.9	\$4.6	\$1.4	\$1.7	\$7.2
1985	164.1	57.6	37.1	9.1	4.5	19.3	10.0	7.2	2.8	2.2	11.8
1990	229.4	84.7	53.4	12.4	7.4	23.7	11.4	10.6	7.3	6.7	11.8
1995	303.2	110.7	70.2	15.8	8.6	31.7	15.0	16.0	11.4	9.7	14.1
2000	382.4	136.8	94.4	20.9	9.8	36.4	17.7	20.1	14.8	15.0	16.5
2001	395.3	142.6	97.6	20.8	10.3	35.8	17.9	20.2	15.0	16.2	18.9
2002	401.8	152.9	97.9	21.0	11.2	28.5	20.3	20.8	17.0	14.8	17.4
2003	424.2	160.9	100.9	23.9	12.6	31.9	21.2	21.9	16.8	14.6	19.5
2004	459.9	169.7	107.3	31.9	14.0	34.1	21.3	23.4	18.9	17.5	21.8
2005	502.0	176.6	115.2	35.5	14.9	43.5	22.6	23.9	29.5	21.5	18.8
2006	546.5	187.9	123.8	36.4	15.6	53.3	23.6	25.1	38.0	21.2	21.6
2007	577.4	199.9	131.5	35.8	16.1	60.9	26.8	28.3	32.9	23.6	21.6
2008	611.1	209.6	133.2	32.5	16.4	58.1	28.0	29.2	37.5	37.5	29.1
2009	590.0	215.3	126.9	30.7	15.6	50.6	28.8	26.3	38.3	32.3	25.2
(Percent)											
1980	100.00%	36.22	21.54	5.24	2.96	12.77	5.62	4.39	1.33	1.62	6.86
1985	100.00%	35.10	22.61	5.55	2.74	11.76	6.09	4.39	1.71	1.34	7.19
1990	100.00%	36.92	23.28	5.41	3.23	10.33	4.97	4.62	3.18	2.92	5.14
1995	100.00%	36.51	23.15	5.21	2.84	10.46	4.95	5.28	3.76	3.20	4.65
2000	100.00%	35.77	24.69	5.47	2.56	9.52	4.63	5.26	3.87	3.92	4.31
2001	100.00%	36.07	24.69	5.26	2.61	9.06	4.53	5.11	3.79	4.10	4.78
2002	100.00%	38.05	24.37	5.23	2.79	7.09	5.05	5.18	4.23	3.68	4.33
2003	100.00%	37.93	23.79	5.63	2.97	7.52	5.00	5.16	3.96	3.44	4.60
2004	100.00%	36.90	23.33	6.94	3.04	7.41	4.63	5.09	4.11	3.81	4.74
2005	100.00%	35.18	22.95	7.07	2.97	8.67	4.50	4.76	5.88	4.28	3.75
2006	100.00%	34.38	22.65	6.66	2.85	9.75	4.32	4.59	6.95	3.88	3.95
2007	100.00%	34.62	22.77	6.20	2.79	10.55	4.64	4.90	5.70	4.09	3.74
2008	100.00%	34.30	21.80	5.32	2.68	9.51	4.58	4.78	6.14	6.14	4.76
2009	100.00%	36.49	21.51	5.20	2.64	8.58	4.88	4.46	6.49	5.47	4.27

Sources: Robert Cline, Tom Neubig, and Andrew Phillips, Total State and Local Business Taxes: 50-State Estimates for Fiscal Year 2006, Ernst & Young, Washington, DC, February 2007, p. 15; and, 50-State Total State and Local Business Taxes, for 2009.

Three ways to measure the relative size of SLTIIB are to compare them all state and local taxes; and to the size of the business sector as measured by the Gross Domestic Product of Private Business, and by business income. State and local governments currently rely on SLTIIB for about 45 percent of all their tax collections (see Table 2 below). This ratio has been fairly constant since 1990, rising with economic expansions and falling during periods of economic contraction. In 1980 and 1985, SLTIIB accounted for nearly 47 percent of all state and local taxes.

SLTIIB are a significant cost for private businesses – accounting for more than 5 percent of the Gross Domestic Product of Private Business. In comparison, labor compensation accounts for more than half of all income generated in the domestic business sector.¹⁰ SLTIIB, as a percentage of Gross Domestic Product of Private Business, has been rising fairly consistently since 2002, the trough of the last recession. This coincides with the rapid rise in both state and local taxes on corporate profits and corporate profits before taxes.¹¹ SLTIIB when measured against business income, a narrower measure of

Table 2: State and Local Taxes Initially Imposed on Business: Total and as Percent of Gross Domestic Product of Private Business, Business Income, and as Percent of Total State and Local Tax Receipts: Selected Years 1980 to 2009

Year	All State & Local Taxes Initially Imposed on Business	Total State and Local Taxes	Gross Domestic Product of Private Business	Business Income	All State & Local Taxes Initially Imposed on Business		
					As Percent of:		
	(billions)				All State and Local Taxes	Gross Domestic Product of Private Business	Business Income
1980	\$104.9	\$223.4	\$2,186.1	\$756.2	46.96%	4.80%	13.87%
1985	164.1	350.3	3,461.5	1,257.1	46.85	4.74	13.05
1990	229.4	514.0	4,453.9	1,695.0	44.63	5.15	13.53
1995	303.2	676.4	5,677.8	2,280.3	44.83	5.34	13.30
2000	382.4	892.6	7,715.5	3,098.5	42.84	4.96	12.34
2001	395.3	929.4	7,913.6	3,144.7	42.53	5.00	12.57
2002	401.8	926.1	8,132.8	3,236.7	43.39	4.94	12.41
2003	424.2	966.2	8,502.8	3,376.2	43.90	4.99	12.56
2004	459.9	1,041.2	9,084.6	3,742.0	44.17	5.06	12.29
2005	502.0	1,130.0	9,695.5	4,108.7	44.42	5.18	12.22
2006	546.5	1,227.0	10,284.1	4,479.4	44.54	5.31	12.20
2007	577.4	1,311.3	10,771.4	4,421.9	44.03	5.36	13.06
2008	611.1	1,355.5	10,863.5	4,331.8	45.08	5.63	14.11
2009	590.0	1,299.1	10,520.8	4,272.5	45.42	5.61	13.81

Sources: 50- State Total State and Local Business Taxes for Fiscal Year 2009, " State Tax Notes, Tax Analysts, Inc, Falls Church, VA, April 10, 2010 Gross Domestic Product of Private Business and Business Income: Department of Commerce, Bureau of Economic Analysis..

incomes generated in the private sector, is now back to the ratios of SLTIIB to business income that occurred in the 1980's. From 200 through 2006, this ratio hovered around 12.4 percent.

B. Business Activity Taxes

There are no official definitions of Business Activity Taxes. For the sake of simplicity, we will use a subset of all SLTIIB defined by Cline, Fox, Neubig and Phillips – corporate income taxes; public utility taxes; excise and gross receipts taxes; business and corporate license taxes; and individual income taxes on business income. BATS currently constitutes about 30 percent of total SLTIIB; and, on average, has constituted about 28 percent of all SLTIIB since 1980. Currently, BATS comprises more than 13 percent of all state and local taxes. And have averaged about 12.4 percent of all state and local taxes since 1980 (see Table 3 below).

Although BATS as a percentage of all SLTIIB has remained fairly constant from 1980 to present, the composition of BATS has changed significantly (see Figure 1). For example, corporate income taxes, which accounted for more about one-half of BATS in 1980, made up slightly more than 28 percent of those taxes in 2002. Since then the share of BATS going to corporate income taxes has risen to more than 35 percent in 2007. This increase in the corporate income tax share of BATS is due to the rapid growth of corporate profits and thus corporate income taxes. In 2009, corporate income taxes were 27.7 percent of all BATS. Public utility taxes as a share of all BATS have declined fairly consistently since 1980, except for the period of 2001 to 2002. Conversely, business and corporate license taxes and individual income tax on business income have risen from \$1.4 billion and \$1.7 billion respectively in 1980 to \$338.3 billion and

Table 3: Business Activity Taxes, by Type: Total and as Percent of: All State and Local taxes Initially Imposed on Business, All State and Local Taxes, and Business Income, Selected Years 1980 to 2009

Year	Business Activity Taxes						As Percent of:			
	Total	Corporate Income Taxes	Public Utility Taxes	Excise & Gross Receipts Taxes	Business and Corporate License Taxes	Individual Income Tax on Business Income	All State and Local Taxes Initially Imposed on Business	All State and Local Taxes	Gross Domestic Product of Private Business	Business Income
	(billions)									
1980	\$27.0	\$13.4	\$5.9	\$4.6	\$1.4	\$1.7	25.74%	12.09%	1.24%	3.57%
1985	41.5	19.3	10.0	7.2	2.8	2.2	25.29	11.85	1.20	3.30
1990	59.7	23.7	11.4	10.6	7.3	6.7	26.02	11.61	1.34	3.52
1995	83.8	31.7	15.0	16.0	11.4	9.7	27.64	12.39	1.48	3.67
2000	104.0	36.4	17.7	20.1	14.8	15.0	27.20	11.65	1.35	3.36
2001	105.1	35.8	17.9	20.2	15.0	16.2	26.59	11.31	1.33	3.34
2002	101.4	28.5	20.3	20.8	17.0	14.8	25.24	10.95	1.25	3.13
2003	106.4	31.9	21.2	21.9	16.8	14.6	25.08	11.01	1.25	3.15
2004	115.2	34.1	21.3	23.4	18.9	17.5	25.05	11.06	1.27	3.08
2005	141.0	43.5	22.6	23.9	29.5	21.5	28.09	12.48	1.45	3.43
2006	161.2	53.3	23.6	25.1	38.0	21.2	29.50	13.14	1.57	3.60
2007	172.5	60.9	26.8	28.3	32.9	23.6	29.88	13.15	1.60	3.90
2008	190.3	58.1	28.0	29.2	37.5	37.5	31.14	14.04	1.75	4.39
2009	176.3	50.6	28.8	26.3	38.3	32.3	29.88	13.57	1.68	4.13

Source: Table 1 and Table 2.

\$32.3 billion respectively in 2009. Business and corporate license taxes, as a proportion of all BATS, have quadrupled since 1980. In 1980, these taxes were slightly more than 5 percent of all BATS; in 2009 their share had risen to 21.7 percent. The rise in the share of individual income tax on business income can be attributable to the rise in the use of pass-through entities rather than traditional corporations as the preferred business form. Fox and Luna show that the rise of pass-through entities has reduced the rate of growth of corporate profits taxes.¹²

BATS remains a relatively small percentage of “business” income. During the period studied, BATS, as a proportion of business income, has ranged from a low of 3.1 percent in 2002 to 4.4 percent in 2008. When compared to the Gross Domestic Product (GDP) of these companies BATS is quite small. In 2009 BATS was approximately 1.7 percent of the GDP of private businesses (1.68%). Similarly, for the two preceding decades BATS has been roughly 1.5 percent of their GDP (averaging 1.31%). In 1980 and 1985, BATS as a proportion of GDP of private business were about 1.2 percent. Thus, while BATS is an important source of revenue for the State and local governments, it is a relatively small component of business costs in general and when compared to other SLTIIB.

In the next section, we will discuss the possible impacts of the uncertainty of BATS nexus and the impact on electronic commerce and new business investment and.

III. BATS Impact on Electronic Commerce and Potential Business Investment

A. *Electronic Commerce*

As stated earlier, the purpose of H.R. 1439 is to facilitate the continued growth of e-commerce, job creation and the overall strength of the American economy. The use of the tax system to promote one form of commerce over other forms of commerce violates a canon of good tax policy – tax neutrality. Tax neutrality can be defined as;

“...the tax being so designed as not to affect resource allocation either within or among the affected categories or between them and the other activities not subject to the tax.”¹³

In less formal terms, the use of the tax system to promote e-commerce over other forms of commerce misallocates the nation’s resources resulting in lower output and undue interference in consumer preferences. The use of the tax system to correct market imperfections is justified; however the taxes used to correct these imperfections are usually commodity taxes. If it can be shown with some degree of statistical certainty that state BATS nexus laws interfere with optimal consumer preferences regarding the type of commerce – e-commerce versus all other forms of commerce – than the use of the tax system to correct the resultant misallocation of resources. However, there is no evidence that current state BATS nexus laws have actually impeded the growth of electronic commerce, nor is there evidence that H.R. 1439 is the optimal tax policy to correct market distortions caused by state BATS nexus laws if such distortions actually exist. Furthermore, a 2004 study by, Bruce, Fox, and Deskins, showed that if there is a tax instrument that limits internet access and therefore the growth of e-commerce it is sales taxation of computer purchases.¹⁴

B. *Effect on Business Investment*

The expected rate of return, after taxes, and the risk or uncertainty regarding the rate of return is major determinants of new business investment. That being said, *all* taxes – Federal and state and local – play a significant role in determining the expected after-tax rate of return. When all SLTIIB are considered, it seems logical to expect that property taxes on business properties and sales and use tax on business inputs would have a larger impact on the investment decision than would BATS. These taxes account for approximately 60 percent of all SLTIIB; and, they directly affect the cost of acquiring and using physical capital. BATS are smaller, and indirectly affect the expected rate of profit. This hypothesis has not

been tested here. It is logical to assume that uncertainty about whether a new investment would create nexus for a company would not cause that company to completely forego the investment; given that BATS are approximately 4 percent of business income. It would be the case of the tip of the tail wagging the dog.

IV. Conclusion

While BATS remains an integral part of State revenues it is a small factor in terms of business income. The argument that uncertainty in states' BATS policy will have a "chilling" effect on new business investment is clearly not very convincing. In fact, property and use taxes, which are far greater costs, are much more likely to hinder investment than the relatively tiny BATS. Therefore, any attempts to make BATS nexus standards more uniform across states should be undertaken for the sake of reducing compliance costs for both businesses and revenue agencies and not for the sake of creating a new wave of investment.

More research is needed on the subject of how aspects of the administrative structure of business activity taxes affect business investment decisions.

(Endnotes)

- ¹Elliott Dubin and Cameron Snow, "Musings from the BATS Cave," *Multistate Tax Commission Review*, Volume XX, No. 3, Summer 2008, pp. 17-22.
- ²Benjamin Franklin in a letter to Jean Baptiste Leroy (1789)
- ³Adam Smith, *The Wealth of Nations*, page 639 (Edited by S.M. Soares, MetaLibri Digital Library, May 29, 2007)
- ⁴<http://BATScoalition.org/about.html>
- ⁵http://BATScoalition.org/files/Goodlatte_02132009.pdf
- ⁶PLA, 1883-05-03
- ⁷Robert Cline, William Fox, Thomas S. Neubig, and Andrew Phillips, "A Closer Examination of the Total State and Local Business Tax Burden," *State Tax Notes*, Tax Analysts, Inc., Arlington, VA, January 23, 2003, p.295.
- ⁸Gross Domestic of Private Business is a set of accounts that present the contribution of each private industry to the Nation's gross domestic product (GDP). An industry's contribution is measured by its value added, which is equal to its gross output minus its intermediate purchases from domestic industries or from foreign sources. Business income is defined as Gross domestic income (GDI), is the costs incurred and the incomes earned in the production of gross domestic product (GDP) plus taxes on production and imports less subsidies. <http://www.bea.gov/glossary/glossary.cfm?letter=G>
- ⁹Andrew D. Phillips, Robert Cline, Thomas Neubig, and Julia C. Thayne, "50-State Total State and local Business taxes for 2009," *State Tax Notes*, April 26, 2010, pp. 275-295. Tax Analysts, Inc., Falls Church, Virginia.
- ¹⁰Bureau of Economic Analysis, <http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=293&ViewSeries=NO&Java=no&Request3Place=N&3Place=N&FromView=YES&Freq=Year&FirstYear=1980&LastYear=2006&3Place=N&Update=Update&JavaBox=no#Mid>
- ¹¹Elliott Dubin, "Trends in State Corporate Income Taxes Revisited," *Multistate Tax Commission Review*, Winter 2007, Vol. XX, No. 1, page 9.
- ¹²William F. Fox and LeAnn Luna, "Do Limited Liability Companies Explain Declining State Corporate Tax Revenues?" *Public Finance Review*, Vol. 33 No. 690-720.
- ¹³Harberger, Arnold C. "neutral taxation." *The New Palgrave Dictionary of Economics*. Second Edition. Eds. Steven N. Durlauf and Lawrence E. Blume. Palgrave Macmillan, 2008. *The New Palgrave Dictionary of Economics Online*. Palgrave Macmillan. 14 April 2011 <http://www.dictionaryofeconomics.com/article?id=pde2008_N000053> doi: 10.1057/9780230226203.1178
- ¹⁴Donald Bruce, John Deskins, and William F. Fox, "Has Internet Access Taxation Affected Internet Use?" *State Tax Notes*, May 17, 2004, Tax Analysts, Inc., Falls Church, VA, pp. 519-525. This article was originally published in *Public Finance Review*, Vol 3, No.2, pp. 131-147, copyright 2004 Sage publications.