Fiscal Note

BILL # SB 1046

TITLE: corporate tax allocation; sales factor

SPONSOR: Murphy

STATUS: As Amended by Senate FIN

PREPARED BY: Eric Jorgensen

Description

This bill would allow companies who provide services to reduce their Arizona corporate tax liability through a change in the sales factor calculation. To be eligible for the change, the company must derive at least 85% of their sales of services from out-of-state customers. The change would be phased-in between Tax Year (TY) 2014 and TY 2017.

Estimated Impact

This bill would reduce revenues to the General Fund. The magnitude of the reduction would depend on the extent to which companies elected the new sales factor definition.

Due to Department of Revenue (DOR) taxpayer confidentiality requirements, JLBC Staff does not have access to the data needed to derive an independent estimate of the impact. As a result, this analysis relies on information provided by DOR. According to DOR, if the bill were fully implemented in the current tax year, it would cost between $(2) million and $(3) million annually. This would translate into approximately $(3) million in FY 2014, growing to $(4.4) million by the time the change is fully phased-in in FY 2017.

Last year, DOR estimated this same change to cost $(33.2) million annually. According to DOR, taxpayer confidentiality prohibits the agency from discussing the reason for the change in their estimate.

Analysis

Multi-state corporations have operations in several states or countries. If a multi-state corporation has business activity in Arizona, a share of the corporation's total business income, referred to as Arizona Taxable Income, is subject to the state's corporate income tax. That share is determined by the apportionment formula, which computes the percentage of a corporation's total business income that is allocated to Arizona for tax purposes.

The apportionment formula defines a corporation's Arizona Taxable Income based on the proportion of payroll, property, and sales the corporation has within the state. The percentage of a corporation's Arizona payroll is referred to as the payroll factor. Likewise, the percentage of a corporation's property value located in Arizona is referred to as its property factor and the percentage of a corporation's sales occurring in Arizona is referred to as its sales factor.

Currently, corporations may choose between a 50% and 80% sales factor, which means that the other 2 factors count for either 25% or 10% of the taxable income calculation. Between FY 2014 and FY 2017, the 80% sales factor will incrementally increase to 100%.

The sales factor for services is determined differently than the sales factor for goods. For services, sales are determined to be in-state if more of the costs of producing the services occur within Arizona than in any other state. If any other state has a higher cost of production, all sales are considered out-of-state. Thus, for services, the sales factor is either 100% of sales or 0%.

This bill would provide an option for corporations that sell more than 85% of their services to consumers outside of Arizona to use the location of the buyer in calculating the sales factor, which is how the sales factor for goods is calculated. This would mean that only sales to buyers in Arizona would be included in the calculation of taxable income.

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The bill phases in this change between TY 2014 and TY 2017. Beginning in TY 2014, the location of sales would account for 85% of the sales factor. This would increase by 5% each year until TY 2017 when it would account for 100% of the sales factor.

Using the midpoint of the DOR estimate, and growing annual revenues by the estimated corporate income tax growth rate set by the 4-sector consensus process, the first impact would be a loss of $(3.0) million in FY 2014, reflecting an 85% phase-in. That amount would grow to $(3.5) million in FY 2015, $(3.9) million in FY 2016 and $(4.4) million when fully implemented in FY 2017.

Local Government Impact

The Urban Revenue Sharing (URS) formula distributes 15% of corporate income taxes collected 2 years prior to incorporated cities and towns. The provisions contained in this bill would impact the URS distributions, with local governments' URS distributions decreasing about $(660,000), when the provisions are fully implemented.

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