

Business Net Receipts Tax (BNRT) Proposal

Business Community Questions

August 21, 2009

Questions Related to Policy Implications of California Being One of Few States to Have Net Receipts Tax:

1. Per the founding charges to the Commission by the Governor, how will the BNRT: “Promote the long-term economic prosperity of the state and citizens” or “Improve California’s ability to successfully compete with other states and nations for jobs and investments”?
2. How will the BNRT affect specific industry sectors – who will pay more and who will pay less (in combination with changes if any to the current taxes) and how that may affect their inclination to do business in California? Will there be any provisions to minimize any disproportionate negative impact on certain industries, such as adopted by other states that have enacted a variation of a BNRT?
3. How will the BNRT affect California’s competitiveness, specifically with respect to domestically-produced goods and services exported at a new higher price and with respect to those same goods and services offered at lower prices by other states and countries?
4. How will the BNRT proposal affect California job creation, since it is, in effect, a tax on employees?
5. Will the BNRT pressure businesses to reduce California payrolls, especially for California headquarters, in favor of outsourcing or relocating? Will a new BNRT tax structure provide equitable treatment between taxpayers where one taxpayer fabricates an asset in house (presuming there is labor and overhead costs in the fabrication process) vs. another taxpayer that purchases the same asset from a third party? Will the BNRT provide equitable treatment between taxpayers where one taxpayer maintains a staff of employees vs. another taxpayer that maintains a staff of independent contractors?
6. Will the BNRT result in increased costs of doing business in California as it pushes up the cost of goods and services for vital California industries?
7. Will California allow businesses to disclose the amount of BNRT applicable to a transaction on customer bills?
8. Tax incentives: Will any tax credits, exemptions, or deductions to encourage certain activities, such as research and development be available? If not, how will CA be able to compete with most other states and countries that do have tax incentives?

9. Will there be any assurance that the BNRT rate would not be increased, and if replacing taxes such as the corporate income tax or state sales/use tax, that these taxes will not be brought back, for the foreseeable future?
10. Regarding whether the BNRT is good policy, what has been the feedback from the business community in states where it has been adopted?
11. Is the BNRT to be formed in a way to be revenue neutral vis a vis the current tax regime in California? What will be the basis for determining this revenue neutrality as the BNRT is supposed to provide a more consistent form of revenue from year to year vs. the corporate income tax, e.g., in determining the target revenue generation will the state be looking at just the past year, a 5 year average, anticipated forecast trends vs. income tax, etc?
12. If the BNRT is to replace corporate income tax and the state portion of the sales tax, why is it a superior alternative to those but not the personal income tax? Is consistency in tax standards/structures between individuals and business a policy goal that has been considered?
13. The State and local government entities are subject to sales tax when they sell goods. Will government entities be subject to the BNRT when they sell goods and services (such as utilities)?
14. Under Proposition 42 (Art. XIXB, sec. 1) sales tax on gasoline is constitutionally assured to be used for transportation purposes, but does itself impose the sale tax on gasoline. If the state portion of the sales tax is repealed, what is the proposal to fund transportation, and provide the type of constitutional protection transportation funding currently enjoys?
15. The Constitution (Art XIII, sec. 34) currently prevents the application of the sales tax to sales of food (except restaurant meals and a few other exceptions). Is it the Commission's intent to apply the BNRT to sales of food, and does it believe that the constitutional prohibition enacted by the voters does not apply to the BNRT?
16. The Legislature committed 0.5% of the state sales tax rate to "realignment," where certain program responsibility was shifted from the state and local level, along with the sales tax funding to pay for it. That 0.5% is not guaranteed in the Constitution. Is it the Commission's intent to repeal the portion of the sales tax rate set aside to pay for realignment?
17. The BNRT and the larger package appears to discriminate based on choice of entity. For example, the one package proposed by the Commission proposes to eliminate the Bank and Corporation tax, but only partially reduce the personal income tax rate (and also eliminate most deductions, throwing reductions in PIT liability into doubt). If you are a corporation, you would only pay BNRT, but if you were a sole-proprietor, partnership or pass-through entity, you would pay both BNRT *and* personal income tax. What are the Commission's plans to address this discrimination?

18. Will the BNRT be deductible against a corporation's federal income tax liability? How about an individual who has BNRT flowed through to them from a sole proprietorship or pass-through entity? Will BNRT be deductible against their federal personal income tax?
19. State and Local government currently share the administrative costs of the sales tax system by function and by share of revenue received by each. If the state portion of the sales tax is reduced or eliminated, will the costs of administering the sales and use tax system be shifted to local government?
20. Will the BNRT apply to those in the business of selling real property, or is it pre-empted by Article XIII A, sec. 3 of the State Constitution? If not pre-empted, does the Commission envision applying the new tax to those in the business of renting apartments and houses?
21. Other states that have implemented something similar to a BNRT have been compelled to do so because of a structural flaw in their existing tax system (Texas- constitutional ban on personal income tax creating incentive for business reorganizations as partnerships; Michigan- constitutional limitation on their sales tax rate). California has no similar structural flaw. What is the compelling policy reason to adopt the BNRT?
22. The BNRT proposal, as currently understood, would tax the sale of "necessities" that are currently exempt under the sales tax, including food, housing, prescription medicines, utilities, day care and elder care and educational services. What data has the Commission reviewed that shows that the BNRT will not be regressive?

Questions Related to Information that Companies Will Need to Determine Change in Tax Liability and Cost of Doing Business in CA if BNRT Imposed:

1. First and foremost, what is being proposed? Many of the details of the plan keep changing.
2. What will the rate be? Who will have authority to set and modify the rate? Will any kind of surcharge be associated with the new tax rates (like Michigan's MBT surcharge of 22%)? Will all taxpayers be subject to the same rate?
3. Which taxes will the BNRT replace and to what degree, e.g., all or a portion of the PIT, corporate, sales and use tax, LLC fees, other?
4. What entities are subject to the BNRT, e.g., corporations, partnerships, LLCs, sole proprietorships, Subchapter S corporations, nonprofits, other? What entities will be excluded, if any?
5. Are all industries subject to the BNRT, e.g., healthcare, leasing, staffing, transportation? Specifically, will insurers, subject to the premium tax, be subject to BNRT? Will financial

institutions be subject to BNRT? Will there be any provisions to minimize any disproportionate negative impact on certain industries? Will there be any exemptions for small businesses?

6. What is the basis for the imposition of the BNRT, e.g., doing business, incorporated, or making sales in California, doing work outsourced to you by a California company, other?
7. What will be the method of computation, e.g., separate company filing, combination or consolidation, other? Will there be a single mandatory filing method for all entities or will the taxpayer be allowed a choice of filing methods?
8. Please confirm whether receipts and deductible expenses are to be calculated on a GAAP (financial book) basis or a federal tax basis.
9. If the BNRT is computed on a combined basis, how will tax liability be apportioned, e.g., joint and several liability, "intrastate apportioned," other? Will companies be excluded from this tax based upon P.L. 86-272?; will either Joyce or Finnegan apply?
10. If replacing all or a portion of existing taxes, what will be the transition rules for going from one tax system to a new one, e.g., unclaimed tax credits, NOL carryback and carryforward, unclaimed depreciation on existing assets, other? Specifically, will R&D tax credits earned under the existing regime be allowed as credits against the BNRT? How about the Enterprise Zone Program tax credits? Will there be any limitations and, if so, how will they be computed?
11. What will be the tax base for BNRT?:
 - a. Please define a California "receipt."
 - i. Will receipts include the gross proceeds from sales of noninventory property or just the net gain on sale?
 - ii. Do receipts for either tax base or apportionment factor include treasury receipts? If yes, will there be a deduction for investments purchased with receipts, e.g., stocks/debt instruments? Correspondingly, what would be the treatment of loan proceeds or contributions to capital?
 - iii. Would receipts for purposes of the tax base include monies collected on behalf of others, e.g., excise taxes?
 - b. What purchases from other firms may be deducted?
 - c. Will all taxpayers be subject to the same deductions?
 - d. With respect to payments for labor and capital, how is "profits (retained or paid out)" defined?
 - e. Will any payroll costs and depreciation expense be deductible?

- f. Will an employer's purchases of health care and other employee benefits be deductible?
- g. With respect to treatment of capital purchases and capital expenditures for the production of property, will immediate expensing be allowed?
- h. Will all goods and services be allowed as a deduction?
- i. Will marketing and promotion costs be deductible?
- j. Will the expenses incurred for the acquisition or right to use intangible property be allowed as a deduction?
- k. If a combined return is required what types of inter-company transactions (if any) will be excluded from the tax base or apportionment calculation? If combined reporting is not required, what would be the treatment of inter-company interest and dividends?
- l. Will there be any deduction allowed for taxes paid either to other states or California, e.g., property, excise, etc.?
- m. Will payments for property include payments for intangibles, rents and royalties?
- n. Are inventories excluded from the calculation, i.e., no addback of inventories? Correspondingly, will there be a first year deduction for inventories that are carried on taxpayers' books as of the time the BNRT goes into effect? As a related concept to the above inventory question, will there be any FAS 109 relief and how will that be determined?
- o. Will businesses be allowed to include interest, taxes and other carrying costs as part of the cost of purchases?
- p. What will be the treatment of treasury stock purchases?
- q. With respect to specific industries/goods/services, will the following be deductible?
 - i. Programming costs paid by cable companies to other firms?
 - ii. Similar to Michigan and Texas, will labor costs be deductible for staffing companies?
 - iii. Will food purchased for resale?
 - iv. Prescription drugs purchased for resale?
 - v. Is software included with amortizable assets (7 ½ year writeoff) or depreciable (usually a 3-year writeoff)?
 - vi. Revenue for Medicare and Medicaid?

vii. Health care claims and the cost of the prescriptions paid by health plans and insurers?

12. Sales factor: Is the tax base apportioned to CA using a single sales factor?
13. Tax incentives: Will there be any tax credits, exemptions, or deductions to encourage certain activities? For example, will the research and development tax credit be available? Will Enterprise Zone tax credits still be available?
14. Net operating losses: Will there be a deduction, and if so, can they be carried forward or carried back? Additionally, how will they be apportioned, allocated, or shared?
15. What kind of administrative burdens will be imposed on taxpayers to transition to the new tax regime?