

# FACT SHEET

## Gross Receipts Tax

### What is a Gross Receipts Tax?

- A Gross Receipts Tax (GRT) is a broad-based, low rate (generally less than 1%) tax imposed on *all income received by a business* without any deductions for costs of doing business, such as a deduction for wages. GRTs are not based on a company's profit or loss for a given tax year; rather, they are owed on all income, regardless of whether or not business is profitable.
- Currently, seven states impose a GRT: Delaware, Kentucky, Michigan, New Mexico, Ohio, Texas and Washington.

### How is the GRT Different from the Corporate Income Tax?

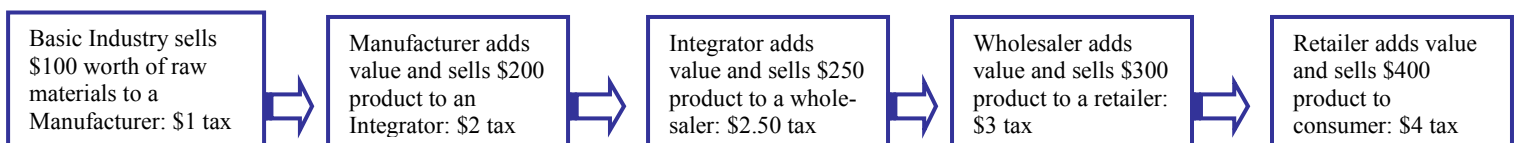
- Unlike the corporate income tax which is levied on a corporation's profits, the GRT is imposed on the gross receipts or, the total sales, of all goods and services each time they change hands in the distribution chain.
- The GRT is a stable revenue source because all firms, even unprofitable ones, pay some tax, which results in more revenue for the state. Estimates show that a 1-2% GRT would generate roughly \$6 billion for Illinois.
- In the few states that have a GRT, the rate is typically lower than a corporate income tax rate due to the much larger tax base.

### Why is the GRT Not a Good Solution for Illinois?

- *Research shows that new firms pay a much higher effective tax rate than established firms, no matter what the industry.*<sup>1</sup>
  - While tax scholars typically advocate low rate, broad-based income and sales taxes, experts also acknowledge that GRTs do not treat all taxpayers equally.
- *GRTs are regressive taxes for both businesses and consumers.*
  - GRTs are regressive for business. While proponents argue a broad-based, low rate tax imposed on the gross income of all business taxpayers is good tax policy and would require all businesses to pay their "fair share," in actuality, low-profit margin businesses and start up businesses would pay higher effective tax rates than established high-profit margin businesses.
  - GRTs are regressive for consumers. Higher tax rates for businesses, like most other business taxes, would likely be passed on to consumers. Further, GRTs are "pyramided" as a product moves through the economy. This pyramiding effect would also pass additional costs on to the consumer.

### What is the "Pyramiding Effect" of the GRT?

- The "pyramiding effect" of the GRT refers to the compounding nature of the tax. Since the GRT is imposed on every transaction of the business cycle, a product is subjected to multiple levels of taxation. The chart below illustrates this pyramiding effect, using a 1% GRT as an example.



- Research finds that tax pyramiding leads to tax evasion, since businesses use strategies to avoid the tax, such as conducting a portion of the manufacturing operation in another state or creating subsidiaries to receive part of their income in another state.<sup>2</sup>

## Which Businesses Win or Lose with a GRT?

- If a GRT were imposed in Illinois, winners would include those businesses that sell a high-profit margin product (low gross receipts compared to profit) or a service. Losers would include businesses that sell a low-profit margin product (high gross receipts compared to profit).
- All service-related businesses would pay the same amount of tax on \$100 per service rendered, regardless of total overhead costs and profit margins.
  - *For example, a consultant operating out of a home has very few overhead costs and would most likely only need an office, a computer and supplies. The consultant's income net of these costs might be 80%, so for every \$100 of sales, only \$20 goes to maintain the office. On the other hand, a doctor's office is expensive to maintain. Besides space, the doctor needs expensive equipment and experienced staff. Because of overhead costs, the doctor's income net of these costs is much lower since, so for every \$100 of sales, the doctor pays \$80 to maintain the office. Under a GRT, because all sales are taxed no matter what profit, both the consultant and the doctor would pay the same amount of tax, regardless of differing overhead costs. This example demonstrates one way in which the GRT is an unfair tax.*

## Transparency: Consumers Will Bear Some of the Burden

- A basic principle of good tax design is that taxes should be transparent to taxpayers. GRTs are commonly criticized for being non-transparent taxes.
- While it is legally the business' responsibility to pay the GRT, in many cases the economic burden of GRTs are passed on to consumers in the form of higher prices.
- Unlike the retail sales tax, GRTs cannot be printed on sales receipts given to consumers because it is not possible to know the final amount of the GRT that is pyramided into the final price of a good. Consumers bear the burden of the tax without any knowledge that it is imposed on them.
- Another way business may pass along the GRT is through offering lower wages to employees to offset the increased tax burden.

## Conclusion: GRTs Will Not Solve Illinois' Fiscal Crisis

- Illinois needs a fair and modern revenue system that eliminates additional tax burden on middle and lower income people. These families already pay a higher share of their income in taxes than do affluent families in Illinois.
- Illinois needs a revenue system that is less reliant on property taxes to fund education, as the state already relies more on property taxes than any other in the nation.
- Illinois needs a realistic pension payment plan to pay off its \$40.7 billion dollar debt so as to avoid passing on the problem to the next generation.
- Illinois needs a revenue system that closes the \$3 billion and growing structural deficit; otherwise, any new revenue will be eaten up by the state's pension debt and maintaining existing services.

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<sup>1</sup> Washington State Tax Structure Study Committee Report, Vol. I and II, 2002-2003.

<sup>2</sup> Ibid.