

Scott Hodge: Thank you for tuning in today. I'm Scott Hodge, President of the Tax Foundation. Joining me for our weekly Tax Policy Podcast is David Brunori, who's the Executive Vice President of Editorial Operations at Tax Analysts. David writes The Politics of State Taxation, a column for State Tax Notes. He's a research professor of Public Policy at George Washington University where he also teaches state and local tax law. He's the author of several books and articles on state taxation. Before he was a tax analyst, David was an appellate trial attorney with the Tax Division of the U.S. Justice Department, and practiced with a Washington law firm. Thanks for joining us today, David.

David Brunori: It's a pleasure to be here, Scott.

Scott: Well, you have got a pretty special perch to look at national trends on state tax policy. One of the things that I think many people have been noticing is the clash of old tax systems and the new economy, and some are saying that we need a twenty-first century state tax system for a twenty-first century economy. What's your view on that?

David: Scott, well, I'll tell you. You know, since it's the twenty-first century, I'd say it would be good to have a twenty-first century tax system. It certainly would be better than having a nineteenth century tax system. You often hear this refrain when discussing tax reform and it's mainly because the current system was devised for a different time and a far different economy. The sales tax started during the Great Depression, the income taxes about a generation before that. The property tax, of course, has been around since the beginning of time, and these taxes have not changed significantly since their inception. The problem is our tax system was, and really is, built around places and things but the modern economy is increasingly not. So you know there's always going to be that discussion.

Scott: So we're trying to tax moving stuff, fugitive business or resources or what have you.

David: Yeah. I mean, we don't really think about taxing services and intangibles as much as we think about taxing manufacturing plants and personal property. And increasingly the economy has shifted towards more services, more intangibles, more global mobility and the system, at every level -- the corporate income tax, the personal income tax, the sales tax -- are all geared towards taxing things and places, and you know what? We're just not that way anymore, so there's a lot of work to be done.

Scott: So you mentioned corporate income taxes, and I think you've been pretty clear that you think that they're not only outdated but unsustainable. Can you give me a little more on that, your rationale on that, and what can be done to convince state lawmakers that the corporate income tax has got to go?

David: I don't know, Scott. I'm going to risk being thrown out of the Good Liberals Club here. I really believe the state corporate income tax should be repealed. It does not work for a variety of reasons, and the primary reason is the states themselves, and state

competition. Every state wants to attract business and they want to attract particularly high-paying, manufacturing-type jobs. The states will structure their corporate tax system to benefit in-state manufacturers, and all you need to do is look towards the movement towards single sales factor apportionment formulas to see that.

Scott: Yeah.

David: That in turn leads to a multitude of planning opportunities. And the truth is, very few national corporations pay very much state corporate income taxes now. They pay a lot of other taxes (property, sales, excise taxes) but they don't pay a lot of state corporate income taxes. I had a friend just the other day actually tell me that any corporation with a half-witted accountant can avoid the tax if they really want to. They just have so many planning opportunities. And the states don't want to fix those planning opportunities because they really want to attract high-paying, good corporations, good employers into their state. They don't want to do anything that would even hint of harming economic development. Now the compliance and administrative costs are very high for the tax, both for the corporations and for the government. The revenue is relatively low, and now that should be enough to get people talking about getting rid of the tax. Liberal politicians do not want to let corporations off the hook, so to speak, which is really a misguided, almost juvenile position. But the real problem arises from the people with vested interest in keeping the tax going, namely the tax lawyers and the accountants. They make lots of money helping corporations avoid the tax. They remain the biggest supporters of the state corporate income tax. You go to an ADA or an AICPA meeting and say, "Repeal the corporate income tax" and you are booed. The left, the progressives, won't push for repeal. The professions won't push for repeal. The tax is really not that big a factor in terms of the cost of doing business, so the business community is not really pushing for repeal. So it becomes kind of a nuisance tax, and it kind of hangs out there.

Scott: Well, you know some states have been repealing their corporate income tax but replacing it with a gross receipts tax. What's your take on that trend--is that a good one, bad one, or...?

David: Well the most recent I think would be Ohio that has repealed their corporate income tax. Right? By the way, they repealed their corporate income tax because they realized they could not make it work. They could not satisfy the in-state manufacturers while at the same time raising any substantial amounts of, any significant amounts of revenue. States returning to gross receipts taxes --Ohio, a few other states -- are thinking about it in the coming year for one reason, and that is to raise money. The gross receipts taxes are money machines.

Scott: Sort of like a value-added tax.

David: Well, actually more so than a value-added tax. Bigger money machines than value-added taxes because one: they're not tied to profits, and they allow the state to take a small piece of every transaction that rolls through. But they are far from ideal and in fact a lot of people, a lot of very smart people, think they are pretty lousy ways of raising

revenue. For one thing, they are hidden levies that are passed on in large part to consumers who do not really know they're paying the tax. And that's much different than the general sales tax, for instance, that you can figure out or see. Much more visible. It's a hidden tax, and that lack of transparency is part of the attractiveness to politicians, because you're taxing people, and they don't know it, and you can keep taxing them.

The structure of the United States gross receipts taxes is that they cascade, so that every stage the tax is imposed. So as a product is passed along down the chain, the tax keeps adding up. The tax is imposed on the cost of goods sold at every stage.

Scott: Unlike a VAT, which is deducted.

David: Unlike a VAT. Which is deducted. So it's certainly not as good as a VAT in that sense. In fact, it's much worse than a European style VAT. This whole system hurts retailers, it hurts consumers, it discriminates between capital intensive and production intensive business, because anybody who has to buy things along the chain gets hit by it. And it's hidden.

The other factor, and politicians don't care about this as much, most don't, is that the tax is very regressive. Because like all consumption taxes, it's going to hit the consumer, and the poorer you are, the more of it you're going to pay. But you know what? You're not even going to know it.

Scott: At the end stage it just kind of gets buried all in there.

David: Yeah, at the end stage you're not going to have any idea. You're not going to be able to say how much in gross receipts tax you paid at the end. Now it's difficult to say that about the sales tax unless you kept records. But if you wanted to, you can calculate to the penny how much sales tax you pay, at least directly, every year.

Scott: Just to stay on that for a second, there have been some who said, "Well the gross receipts taxes are great because at least it allows us to export our tax burden elsewhere, and that'll help make us more competitive." Does that logic make sense?

David: That would make sense if you were the only state imposing a gross receipts tax. There would be some argument for it. You can't really calculate that because you'd have to be exporting all of your goods to really know for sure. So the jury is way out on that because nobody could really figure out with any definitiveness in the American states how much of that is true. Because you'd really have to have a good number of how much "stuff" was exported from your state every year.

Scott: I want to go from the serious to maybe the ridiculous. You and I are pretty much in agreement that both sides of the political spectrum tend to use the tax code too frequently to advance their own agendas, political, social or what have you. What do you make of these attempts to cure obesity through fat taxes, soda taxes and the like. Is this just way off base? Where do you even go with that one?

David: [laughter] Fat taxes, soda taxes have been discussed for a couple of decades now, at least a decade now, and the cynical side of me says that they're merely a way of raising revenue under the veneer of doing good. But I guess supporters of such taxes really want to spend more on public services. They just don't really have the courage to get out there and raise real taxes to do so. There's a school of thought that says you should only use the tax system to raise revenue, and not to affect, as you mentioned, social policy, political policy.

The types of taxes you're talking about are excise taxes levied on specific products. And the only justification for an excise tax is to compensate for externalities, that is the harm caused to society by lots of people using the product. Now supporters of these taxes have never been able to articulate the societal harm from eating fatty foods or drinking soda. Love handles and bad teeth are not really societal harms. And why single out these particular items? Maybe we should tax parents who let their kids sit on the couch for hours playing video games. That certainly leads to the same outcome. And at the end, I think we should take a little responsibility for what we eat and drink.

I'm a big believer that taxes should be broad based, not singling out particular products or services. Broad based, low rates. That's the most efficient, effective way of doing it. Once you start either giving tax breaks to people or taxing particular activities, you run into all kinds of problems. In general, I think these are political gimmicks and not very good tax policy.

Scott: I want to wrap up our fun discussion here with maybe a little political prediction. We're just a short time from the elections and all kinds of things can change here in the next few weeks. What does that mean for tax policy next year? Specifically at the state level, but maybe just generally.

David: Well, you might think that state legislators will take the opportunity to make improvements to the tax system, especially since most states are flush with cash. Right now the economy is pretty good and the state budget picture is rosy. And if it stays rosy, that's the last thing they're going to do is fix anything. Because historically, surpluses burn holes in politicians' pockets. And I'll wager, in fact I'll almost guarantee you that no state will enact or even consider significant tax reform next year. And I'll also wager and almost guarantee you that most states will enact tax cuts *and* provide more governmental services. Because politicians can't help themselves, and that's what they always do when they have pretty big surpluses. That's what the trend has been, and that's just the nature of the beast.

Scott: So hang on to your wallet.

David: That's exactly it.

Scott: Well David, this has been just delightful. And I should tell you that my staff are regular and admiring readers of your column in *State Tax Notes*, and even when they

disagree with you at times, you are always provocative and very, very interesting. So thank you again for joining us.

David: Well thank you, Scott. Invite me back again.

Scott: You bet.

David: All right. Take care.

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