BUSINESS TAXES

Choice of Base

- Gross Receipts
- Value Added – Gross
- Value Added – Net
- Value Added – Consumption
- Profits

Rationale/Motives for Taxing Business

- Political – masks true cost of government
- Ability to pay
- Soak the rich
- Export the tax burden
- Close loopholes in personal income tax
- Payment for public services
- Payment for environmental damage
- Taxation of locational rents
Allocation of Base

- Separate accounting
- Specific accounting
- Formula apportionment
  - nexus
  - origin vs destination
  - different formulas

Incidence

- National tax on profits
- Uniform state taxes on profits
- Specific state tax on profits
<table>
<thead>
<tr>
<th>Item</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>3000</td>
</tr>
<tr>
<td>Purchase of materials</td>
<td>700</td>
</tr>
<tr>
<td>Wages</td>
<td>1200</td>
</tr>
<tr>
<td>Rent</td>
<td>200</td>
</tr>
<tr>
<td>Depreciation</td>
<td>100</td>
</tr>
<tr>
<td>Interest</td>
<td>150</td>
</tr>
<tr>
<td>Purchase of equipment</td>
<td>500</td>
</tr>
<tr>
<td>Dividends</td>
<td>200</td>
</tr>
</tbody>
</table>

Profit (accounting) = 3000 - 700 - 1200 - 200 - 100 - 150 = 650

VA – gross = 3000 - 700 = 1200 + 200 + 100 + 150 + 650 = 2300

VA – net = 3000 - 700 - 100 = 1200 + 200 + 150 + 650 = 2200 = income

VA – consumption

  Subtraction method: 3000 - 700 - 500 = 1800

  Adding up method: 1200 + 150 + 200 + 650 - (500 - 100) = 1800
Assume a 10% tax and VA-gross base

Firm 2: VA-gross = 2300
    10% of 2300 = 230

Invoice method:

Firm 1: VA = Sales = 700
    Tax = 700 x 10% = 70

Firm 2: Sales less depreciation of $3000 x 10% = 3000 x 10% = 300

    Credit = 70
    Net tax = 300 - 70 = 230, which is 10% of 2300 =

Gross receipts = 3000 = cost + profit = 700 + 1200 + 200 + 100 + 150 + 650

Apportionment:

3-factor formula: \[ A = \left( \frac{K_i}{\sum K_i} + \frac{S_i}{\sum S_i} + \frac{L_i}{\sum L_i} \right) / 3 \]
Incidence of CIT

Federal CIT is a tax on the equity return to capital.

Assume CIT is a tax on capital used in corporate sector.

Assume: two sectors, A and B; two factors K and L, fixed in total supply but perfectly mobile; tax on K in sector A.

There are 2 effects:

- Output effect. The tax increases the price of A. This shifts K and L from A to B. If A is capital intensive relative to B, r falls relative to w.

- Factor substitution effect. The tax reduces return to K in sector A. Shifts K from A to B. Results in a decrease in r.

State CIT:

- Apportionment

3 factor formula

\[
T_i = \left( t_i \times \frac{\pi}{3} \times \frac{K_i}{K} \right) + \left( t_i \times \frac{\pi}{3} \times \frac{S_i}{S} \right) + \left( t_i \times \frac{\pi}{3} \times \frac{L_i}{L} \right)
\]

\[
T_i = \left( t_i \times \frac{\pi}{3K} \right) \times K_i + \left( t_i \times \frac{\pi}{3S} \right) \times S_i + \left( t_i \times \frac{\pi}{3L} \right) \times L_i
\]