Tennessee Manufacturers Association <u>Economic Development Proposal for Manufacturing</u>



- <u>Strength of Manufacturing</u>: Tennessee's economic vibrance is dependent upon a strong and sustainable manufacturing base. This State enjoys a direct benefit from the substantial manufacturing capital and payroll invested in Tennessee. The economic ripple effect of manufacturing operations is a significant contributor to creating jobs throughout the impacted Tennessee communities, such as for suppliers and transportation services. Economists have estimated that every \$1 spent in the manufacturing sector can produce a real multiplying effect in the growth of the general economy.
- <u>Tennessee's Goal</u>: Tennessee has certainly taken steps during the last several decades, and as recently as the positive steps during the 2015 Legislative Session, to pursue the goal of becoming the national leader in manufacturing. Accomplishing such goal will require further revisions to this State's tax laws which adversely affects manufacturers.
- Tax Code Problem: Since the late 1990's, and through years beginning before July 1, 2016, Tennessee's tax laws have required use of a formula based on three factors (that is, property, payroll and sales, with double-weighting of sales) to apportion business income to this State for excise and franchise tax purposes. Tennessee manufacturers have long contended that such tax apportionment formula does not fairly attribute income to Tennessee where significant capital and payroll are invested in this State but where the predominate marketplaces for the manufacturer's products are outside Tennessee. Economic development advocates have also expressed concerns that Tennessee's current formula may impede the realization of expansions in this State by existing manufacturers as well as prevent serious consideration of new site locations in Tennessee by out-of-state manufacturers.

In partially addressing these concerns, positive legislation was enacted in 2015 which enhances the sales factor from a double weighting to a triple-weighting for tax years beginning on or after July 1, 2016. This enhancement will certainly be helpful, but transitioning to a single sales factor for manufacturing is crucial to both providing fairness for existing manufacturers and also inducing new and expanded manufacturing sites in this State.

- <u>Proactive Steps by Other States</u>: Other states are ahead of Tennessee in focusing upon both the established as well as the prospective manufacturers. Consider the following:
- Manufacturers that have significant capital investments and large employee numbers in Tennessee are subject to disproportionally higher tax burden than manufacturers located in a state with single sales factor apportionment.
- As to Tennessee, in future years the three-factor formula (even after implementation of triple-weighted sales factor in 2016) may well isolate this State from the national competitive focus on manufacturing investment.
- ➤ That national focus clearly includes implementation of a single sales factor apportionment formula.
- ➤ Of the 45 states and the District of Columbia with income/excise taxes:
 - o In 2016, 24 states have some form of single sales factor apportionment in place or being transitioned.
 - o <u>In 2004</u>, 7 states used single sales factor apportionment -- that number more than tripled in just 12 years.
 - North Carolina is a very recent state to enact in 2015 a three-year transition to single sales factor.
 - Other leading manufacturing states have already adopted some form of single sales factor apportionment, including California, Illinois, Indiana, Massachusetts, Michigan, New Jersey, New York, Pennsylvania, Texas, and Wisconsin.
 - o <u>Tennessee's regional neighbors</u> Georgia, South Carolina, Mississippi, Louisiana, Missouri, North Carolina (see above) and Virginia have some form of the single sales factor apportionment. Kentucky's Chamber has recommended the single sales factor; and Florida currently has a qualified single sales factor currently in place.
 - No repeal of single sales factor by the states adopting such factor to date.
- A single sales factor method of apportionment for manufacturers in this State would reduce the excise tax for those manufacturers having substantial property and payroll in Tennessee but whose predominate marketplaces are outside this State. Such an apportionment method could potentially increase the excise tax for manufacturers not invested heavily in property and payroll in the State but whose predominate marketplaces include Tennessee, thus assisting with the net impact overall.

• Example of Tennessee's Anti-Competitiveness: The example shown below is based upon two sample companies with sales throughout the country and nexus in both Georgia and Tennessee. One manufacturer ("Company A") has: (i) in Tennessee -- 50% of its manufacturing property and payroll, and 3% of its sales, and (ii) in Georgia -- 1% of property and payroll, and 3% of its sales, and (ii) in Tennessee -- 1% of property and payroll, and 3% of its sales.

Even with Tennessee's new triple-weighting of the sales factor for years beginning on or after July 1, 2016, the total state income subject to excise tax varies greatly depending on where the company locates its manufacturing operations. Company B, with 50% of its manufacturing located in Georgia, will have a total of 5.2% of its income taxed by Tennessee and Georgia (2.2% TN and 3% GA); whereas, and even under Tennessee's new formula (triple-weighting sales), Company A with 50% of its operations in Tennessee will have 24.8% of its income taxed in Tennessee and Georgia (21.8% TN and 3% GA).

In Tennessee: 3 Factor, Triple-Weighted Sales Apportionment	Company A Manufacturer	Company B Manufacturer
TN Payroll %	50%	1%
TN Property %	50%	1%
TN Sales % 3 times	9%	9%
Tennessee Apportionment (Sum /5):	21.8%	2.2%

In Georgia: Single Sales Apportionment	Company A Manufacturer	Company B Manufacturer
GA Payroll %	1%	50%
GA Property %	1%	50%
GA Sales %	3%	3%
Georgia Apportionment (Sales Only):	3%	3%

Company A: 21.8% in TN plus 3% in GA equals 24.8% of income taxed in these two states.

Company B: 2.2% in TN plus 3% in GA equals 5.2% of income taxed in these two states.

<u>Double-Wt.:</u> With the previous double-weighting of sales factor effective in TN, Company A incurs 26.5% in TN

plus 3% in GA equals 29.5%, while Company B incurs 2% in TN plus 3% in GA equals 5% of

income taxed in these two states.

Note: In that example, TN is taxing over 21% of Company A's income even though only 3% of A's sales are in TN.

- 2016 Site Selection Magazine's Top Ten Business Climate States: As published in the November 2016 edition of *Site Selection Magazine*, the top ten business climate states (showing below whether any type of single sales factor is utilized for purposes of apportioning business income) are as follows:
 - 1. Georgia (single sales factor)
 - 2. North Carolina (transitioning to single sales factor)
 - 3. Ohio (not an income tax, but rather a commercial activity tax measured by taxable gross receipts)
 - T4. Texas (single sales factor)
 - T4. Tennessee (three factor formula, triple weighting sales beginning in 2016)
 - 6. Virginia (elective single sales factor for qualifying manufacturers)
 - T7. Louisiana (single sales factor for most taxpayers beginning in 2016)
 - T7. South Carolina (single sales factor)
 - 9. Alabama (three factor formula, double weighting sales)
 - 10. Indiana (single sales factor)

Seven of these top ten states obviously consider the single sales factor to be a vital economic development tool.

• Tennessee's Solution: In order to support existing manufacturing in this State, as well as to incentivize new manufacturers to locate in this State, Tennessee should continue the positive momentum of the recently enacted triple weighting by enacting a transition to a single sales factor apportionment formula for manufacturers. The net impact is expected to further strengthen this State's manufacturing environment.

Thank you for your consideration of our proposal.