

Close Loopholes & End Senseless Exemptions

Common Sense Solutions that Put Tennessee First

Tennesseans for Fair Taxation (TFT) is supporting a package of legislation in 2009 that, taken together, will move Tennessee forward, close loopholes that benefit only a favored few, strengthen businesses that employ people here in Tennessee, reduce taxes for those hardest hit by the economic downturn, and raise much-needed funds to invest in Tennessee and avoid unnecessary and damaging budget cuts.

Close a Wide Array of Corporate Tax Loopholes that Give Large, Multi-State Corporations an Unfair Advantage over Locally-owned Businesses

The Food & Business Tax Fairness Act, sponsored by Sen. Tim Burchett (SB0502) and Rep. Charles Sargent (HB1350), stops the practice of shifting corporate profits to out-of-state subsidiaries to avoid paying Tennessee's business taxes... taxes that smaller, locally-owned businesses (who don't have Delaware subsidiaries) must pay. Toys-R-Us, for example, pays its own subsidiary in Delaware for the rights to use its corporate logo and trademark giraffe. While these are really the same company, such shell games mean that taxable profits in Tennessee can be greatly reduced or zeroed out on paper.

The Multi-State Tax Commission, an interstate agency, estimated that in 2001 alone, Tennessee lost between 14% and 32% of taxable revenue to these sheltering schemes. The Center on Budget and Policy Priorities in Washington, DC, has estimated that Tennessee would recover between \$100 million and \$250 million by requiring combined reporting of corporate profits.

This legislation would close these loopholes by enacting combined reporting, as 22 other states have already done. Part of the revenue would pay for another food tax reduction, while the remainder would help with the current shortfall.

Close the FONCE Loophole that Unfairly Benefits a Handful of Wealthy Property Owners

Legislation, sponsored by Sen. James Kyle (SB2290) and Rep. Mike Turner (HB2264), will repeal the FONCE (family-owned, non-corporate entity) loophole. A FONCE is a company that is owned by related individuals and whose income is derived primarily from real estate holdings or passive investments. In 2000, the General Assembly declared these entities to be tax-exempt. An otherwise identical organization would not be tax-exempt if owned by unrelated individuals. Approximately \$25 million dollars in lost revenue could be recaptured by closing this loophole.

In relation to the FONCE loophole, Governor Bredesen has observed: "I think it's sinful on the one hand to be talking about laying off people and on the other hand giving a huge loophole to relatively wealthy individuals in the state of Tennessee who found some ways of working the system." TFT agrees with the Governor on this issue.

Support Businesses that Employ Tennesseans by Ending the Tax Advantage for Out-of-State Merchants

Legislation to end the tax advantage for out-of-state merchants is being sponsored by Sen. Beverly Marroero (SB1741) and Rep. Johnny Shaw (HB1947). Under current law, if a company has a "bricks-and-mortar" presence in Tennessee or employs Tennesseans, it must collect the sales tax. If it doesn't have any stores or employees in the state, then the company is not required to collect the tax. This puts in-state merchants at a disadvantage.

While it is impossible for Tennessee to fully close the internet and mail-order loophole without federal action, we can make the loophole smaller. Some states have found a way to require at least

some out-of-state merchants to collect the sales tax if other businesses are acting on their behalf in Tennessee. The Marrero-Shaw bill would enact the same provision in Tennessee to give those businesses that employ Tennesseans a fair chance to compete while helping with the current budget shortfall.

End Senseless Exemptions in the Sales Tax, Such as Marina Docking and Fur Storage

Helping to address some of the flaws in our sales tax, SB1958/HB1913, by Sen. Tim Burchett and Rep. Harry Tindell, will examine sales tax exemptions and close those without justification. A major cause of the state’s inability to support a basic level of state programs is the steady shift of the state’s economy away from a manufacturing base to a service base. A long list of services, everything from fur storage to chartered flights, is exempt from the sales tax. Over time, the sales tax has come to apply to a smaller and smaller proportion of economic activity in the state.

Legislators should review each exemption and determine whether that exemption is still justified in light of today’s economy and the state’s growing budget deficit. What is the rationale, for example, for not collecting the state sales tax on such activities as private investigation (detective services), dating services, limousine services, and tennis and dance lessons, while food and clothing are still taxed?

Closing Loopholes and Ending Exemptions is a Good First Step, but Modernization Still Needed

While TFT supports all four proposals outlined in this fact sheet, we also acknowledge that these proposals are first steps in a much longer road to tax fairness and adequacy. Tennessee is facing a one billion budget shortfall, with deep cuts scheduled to be phased in over the next three or four years as the stimulus runs out.

Enacting these various reforms will help minimize the budget cuts and reduce the damage, but to fully avert the budget cuts would require \$1 billion, more than is possible through just loophole-closing measures. To bring Tennessee up to the regional average in funding for education, public safety, environment, and other programs would take another \$2.4 billion on top of that.

If Tennessee is ever going to close the budget gap, and ultimately make Tennessee competitive with our neighbors, we need to take bold steps and begin the discussion about real tax modernization.

By reducing taxes for low- and middle-income families, the modernization plan supported by TFT will help stimulate the economy by putting money in the hands of those most likely to spend it in the local economy.

Reducing the sales tax and repealing the food tax will help Tennessee merchants compete with their out-of-state neighbors.

By creating a more balanced system, including a state income tax, the plan will raise one billion dollars to avoid damaging cuts, begin investing in the common good, and better prepare our state for the 21st Century economy.

To learn more about the Tax Modernization and Economic Stimulus Act supported by TFT, visit <http://www.fairtaxation.org/reform/overviewofplan.php>

Putting it All in Perspective

The graph represents revenue to be recovered (or needed in the case of the current budget shortfall) by various proposals supported by TFT. Each bank is equal to \$50 million. Striped banks represent ranges of possible revenue.

