SIMPLIFY OKLAHOMA'S CORPORATE INCOME TAX RULES

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Oklahoma can improve its economic competitiveness by simplifying the rules governing the state's corporate income tax. Specifically, Oklahoma should (1) **repeal the Throwback Rule**, and (2) shift to **Single Sales Factor Apportionment** of corporate income.

OVERVIEW

Every company doing business in more than one state must allocate how much of its income was earned in each state in which it operates. This calculation is referred to as "**apportionment**." Generally speaking, a state's corporate income tax rate is only applied to the portion of the company's income that it earned in that state. **Oklahoma's Throwback Rule upends that general rule by taxing income earned in other states as though it was earned in Oklahoma**. This unusual quirk in the tax code discourages certain companies from investing in or locating in Oklahoma.

Single Sales Factor Apportionment is a simpler and fairer way to arrive at the apportionment calculation, and is a growing trend in state taxation. By failing to update its apportionment formula to Single Sales Factor, Oklahoma is out of step with the rest of the country. Worse, its disincentives the expansion of companies' in-state operational footprint.

Throwback Rule: Oklahoma's throwback rule treats sales made by Oklahoma companies into other states as though the sales were made in Oklahoma. The goal of the rule is to capture what is sometimes called "nowhere income. "Nowhere incomes" occurs when a business does not have "nexus" with a sate it makes sales into, typically because it lack a physical presence in that state. Legally, a state cannot tax the income of a company that lacks nexus, resulting in the "nowhere income" going untaxed. The throwback rule claims such sales as part of Oklahoma's portion of income for tax purposes, even though the sales were actually made into another state.

Removing the throwback "nowhere income" from the apportionment formula will reduce costs for Oklahoma based businesses who make sales into states where they have no "nexus", providing relief for both large and small businesses. For example, an Oklahoma manufacturer selling products into a state where the company has no physical presence, or a small business based in Oklahoma that only has an online presence making sales into surrounding states. For some types of businesses, the increased tax burden of operating in a throwback state is especially heavy. AS a result, those businesses simply locate in a non-throwback jurisdiction.

Oklahoma is one of 22 states with a throwback rule. **States without a throwback rule have a competitive advantage** when recruiting businesses to locate there because the tax burden would only be from activities occurring within that state. For businesses already in Oklahoma and making sales into other states, repeal fo the throwback rule will ensure that only the income truly earned in Oklahoma will be subject to Oklahoma corporate income tax.

SSF Apportionment: To determine a corporation's income that was earned in Oklahoma and thus subject to Oklahoma corporate income tax, the state looks at three factors: property, payroll, and sales. Each factor is given equal weight in the calculation unless a company invests at least $200 million in the state, in which case the sales factor is given double weight. The corporate tax rate (4%) is applied to the "Oklahoma portion" of the company's income, as calculated according to the three-factor apportionment computation.

In practical terms, Oklahoma's three-factor apportionment formula provides a tax benefit to out of state companies who sell into Oklahoma, but have little physical presence or investment in the state. In fact, at the margins, such companies are disincentivize from expanding their Oklahoma presence, because acquiring property or adding employees in the state will increase their tax liability. For this reason, sates are moving away from three-factor apportionment in favor of using only the sales factor to calculate income earned in the state. In addition to being simpler and not discouraging capital investment and job expansion in a state, Single Sales Factor Apportionment more closely tracks the realty of how companies consider where their income is earned---in the place where the sale was made.

WHY DOES THE BUSINESS COMMUNITY CARE ABOUT THESE ISSUES?

Impact of the Throwback Rule: The throwback rule can add considerable amounts of tax burden to a corporation if they operate in multiple states without nexus and end up with a significant amount of so-called "nowhere income." The throwback rule creates tax liability for sales that do not take place in Oklahoma.

The rule's continued existence harms business recruitment to the state. In fact, economic literature suggest that repeal f the throwback rule will likely bring enough additional business activity into the state that any revenue loss from the rule's repeal will be offset by the payment of taxes from new businesses who would have never located in Oklahoma were the throwback rule in place.

Impact of Apportionment: *Oklahoma is now one of only eight states that still uses a three-factor apportionment. Two out of the eight states are Oklahoma's neighbors (Kansas and New Mexico), so moving to single sales factor apportionment would increase Oklahoma's competitive advantage regionally*. Under our current three-factor apportionment, Oklahoma effectively discourages companies from locating or expanding their footprint in-state. Businesses are effectively punished for having a large operational footprint in Oklahoma under the state's current apportionment rules.

Fiscal Impact: Revenue neutral, but minor first-year transition costs for throwback.

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