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**MEMORANDUM**

<b>FROM:</b>	Daniel M. McRae
<b>DATE:</b>	May 1, 2005
<b>RE:</b>	H.B. 191- Georgia Becomes a Tax Haven for Investors and Employers

**WHY THE NEW TAX RULES ARE IMPORTANT**

When a business is deciding where to locate a new investment, or where to invest in an expansion, it usually can choose from among a number of locations in a number of states. Today, how a state burdens a business with its tax structure is an important decision factor.

Georgia has decided that it wants to go beyond its current favorable corporate income tax structure, and become what is, in reality, a tax haven for investment. And for employing workers!

Georgia put its decision into practice by passing, in the 2005 Session of its General Assembly, H.B. 191. This new law made a simple change that has wide-ranging impact. The change was to change its apportionment formula, for purposes of Georgia taxation, of a business' interstate income, from the current three factor formula based on payroll, property and sales to one factor based solely on its Georgia gross receipts. This is called "single factor apportionment."

This change means that investing in Georgia, or employing workers in Georgia, does not "attract" Georgia income taxation. The value of this incentive to businesses has been estimated at over \$10 billion in taxes saved over the next 10 years alone!

As an example of how this works, assume that a business builds a new facility in a state that does not have single factor apportionment. That facility represents investment. So, even before the facility is placed in service, before it has a single person working there, and before it has generated a single dollar in revenue (much less profit), it is causing the business to pay income tax to that state. Why? Because the investment is a factor that causes a portion of the business' income in other states to be "apportioned" to the state where the new facility is located. And that state will tax that income.

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Georgia's new law, H.B. 191, will prevent that kind of taxation in Georgia. This means that a business investing and employing people in Georgia will pay Georgia income tax based solely on its revenues from its sales here.

H.B. 191 had bi-partisan support in the General Assembly, and, of course, the full support of Georgia's large and diverse business community that includes many international companies.

A member of the House Ways and Means Committee said: "Instead of punishing companies that have been loyal to Georgia... we should appreciate them. Over time, this legislation should help attract more companies here." A prominent member of the other party said that this bill was "... one of the strongest business incentives considered by the Legislature in more than 20 years." Another legislator said that what this means for companies is that they won't be taxed for: "... bricks and mortar and human resources."

A spokesman for the business community said that the new law would: "... export the tax burden to out-of-state companies." Tax counsel to a Fortune 50 company praised the bill, saying: "We believe this is an opportunity for Georgia to be the first state in the Southeast to adopt a single sales factor and take a major step in attracting and maintaining capital investment and jobs into the state."

#### HOW APPORTIONMENT OF INTERSTATE INCOME GENERALLY WORKS

Corporations that are "doing business" in states that have state corporate income taxes are subject to state income taxes in those states. In the case of corporations that are conducting multistate businesses, the state income tax laws generally tax corporate income that is apportioned to the state. Most state income apportionment formulas allocate income to the state based on three factors: (i) the value of property the corporation has in the state as a fraction of all of its property, (ii) the payroll of its employees in the state as a fraction of all of its payroll, and (iii) the dollar volume of the sales (or gross receipts) the corporation has in the state as a fraction of all of its sales (or gross receipts). The fractions are combined to arrive at a composite percentage of corporate income that is taxed in the state.

Some states give equal weight to all three factors, whereas other states weigh one factor more heavily. Because of differences in formulas and other differences in state tax laws, the total of the income taxed in all states may be more or less than 100% of the corporation's income.

#### HOW GEORGIA CHANGED THE RULES TO FAVOR BUSINESSES

In Georgia, under current law, sales make up 50 percent, while property and payroll comprise 25 percent apiece, in the state's apportionment formula. H.B. 191, which changes this, was signed by the Governor on April 6, 2005, and becomes effective on January 1, 2006.

H.B. 191 changes the formula by phasing out the payroll and property factors between 2006 and 2008, with the property and payroll factors remaining equally weighted, but the sales factor

weight steadily increasing. For taxable years beginning on or after January 1, 2006 (but before January 1, 2007) the formula would be 80% sales and 10% for each of property and payroll. For taxable years beginning on or after January 1, 2007 (but before January 1, 2008) the formula would be 90% sales and 5% for each of property and payroll. For all taxable years beginning on or after January 1, 2008, the sales factor would increase to a 100%, with the property and payroll factors being removed from the apportionment formula. Georgia will be the first state in the Southeast to implement this single factor formula.

According to the Federation of Tax Administrators, current states with single-factor sales for state apportionment of corporate income are: Iowa, Illinois, Nebraska, and Texas. This change in the formula is estimated to save Georgia corporations \$97.2 annually. Corporations in Georgia, such as Coca Cola and GE Power Systems, which currently have a large number of jobs or property investment in the state will also benefit from this formula change. The formula change will shift more of the tax burden to out-of-state companies that have a large amount of sales in Georgia, but little investment by way of jobs or property. The change in the formula provides an economic incentive for corporations to expand their investment and payrolls in Georgia.

The Bill also makes a minor change in the sales factor itself. Under existing law, companies engaged primarily in selling tangible personal property and included in their sales factor only those regular business receipts from the sale of tangible personal property; that is, the sales reflected on Federal Form 1120, line 1. H.B. 191 amends this provision to require these businesses to include in their sales factor the gross receipts from other regular business activities.

**MORE INFORMATION**

This Memorandum is a quick-reference guide for economic developers, participants in the real estate and financial industries, and company and public body directors, executives and managers and their advisors. The information in this Memorandum is general in nature. Various points that could be important in a particular case have been condensed or omitted in the interest of readability. Specific professional advice should be obtained before this information is applied to any particular case. If you have any questions or comments, we would be pleased to provide more information. Please contact:

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