

Thinking About State and Local Tax Competitiveness

presented to

The Three Rs: What's in Store for California

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The Issue

Does California's state and local tax system attract or repel businesses?

Key Elements to the Puzzle

- Which taxes “matter” most to businesses?
- How to compare states in terms of how taxes affect profitability?

Solving the Puzzle

Which taxes “matter” most?

Those cited by Council on State Taxation, prominent nationwide business group as mattering the most.

These are all state and local taxes that businesses must pay by law, even if ultimately they shift burden of taxes to customers or workers

Taxes that Businesses Pay

- Corporate income tax
- Personal income taxes paid by LLCs, LLPs, partnerships, sole proprietorships
- Nonresidential property tax
- Residential property tax on rental property

Taxes that Businesses Pay (cont'd)

- Sales tax on purchases of business input
- Taxes on purchases of fuel by businesses
- License taxes
- Unemployment insurance taxes
- Miscellaneous other taxes

As Opposed to Taxes that Households Pay

- Income tax paid on non-business income
- Sales tax on household purchases
- Taxes on fuel paid by households
- Property tax paid by homeowners
- Miscellaneous others

The Significance of All Business Taxes According to Ernst and Young in Study Done for Associated Industries of Massachusetts

“From an economic development perspective, Massachusetts policymakers should carefully evaluate the *competitiveness* of the state and local business tax structure, *including all of the business taxes identified in this study* (italics added)”

Second Part of Puzzle: Estimating Business Profits by State

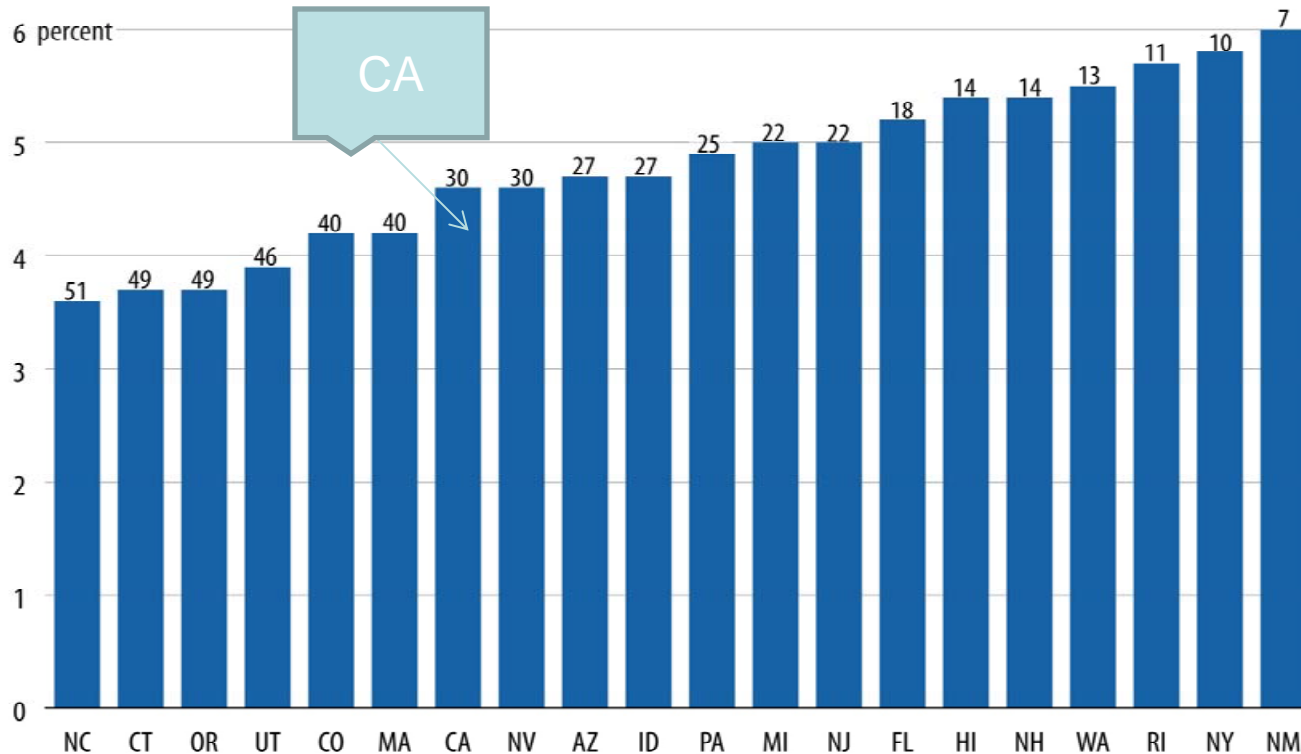
- Readily available data don't exist
- Multi-state, multi-national corporations are too integrated to break out profits by state

Second Part of Puzzle: Estimating Business Profits by State (cont'd)

- Ernst and Young suggests state gross domestic product in private sector (private GSP) as a crude proxy for dominator in taxes/profits ratio.
- Proxy helpful for *comparing* overall business tax burdens by state; not absolute measure of taxes/profits
- So, proxy for relative business tax burden is $(\text{business taxes})/(\text{private GSP})$

- CALIFORNIA'S BUSINESS TAX BURDEN COMPETITIVE!
RANKS IN MIDDLE OF PACK

State and Local Business Taxes As a Percentage of Private-Sector GSP, by State, FY2008



*Denominator is calendar year 2007

Source: "Total State and Local Business Taxes: 50-State Estimate for FY2008", by Andrew Phillips, Robert Cline, and Thomas Neubig, *State Tax Notes*, March 17, 2009

ROLE OF SPECIAL INCENTIVES

- Can appeal to particular firms for particular projects, even in states with high business tax burden

- Investment and R&D tax credits are particular cases in point
- But, at what cost per dollar of new investment, dollar of new R&D?
- How many new jobs, how much additional income at what cost?
- How financed? Cut spending?
Tax hikes elsewhere?

Alternatives to Tax Breaks Likely to Pack More Bang for Buck

- Increased investment in early childhood education
- Vocational education
- Other targeted job training skills
- Investment in public infrastructure
- Fostering partnerships with universities

- Econometric Evidence on Importance of Tax Factors in Determining Location and a State's Economic Performance

- Matter more than they used to
- So do spending programs: public infrastructure, schooling, environment

- Results on tax studies fragile. Some find tax impact, while similar study done years later shows little or no impact—and vice versa.
- Impacts take a long time to be felt
- Time lag varies by state.

Survey Evidence from *Site Selection Magazine*

Factors related to public spending more important than tax characteristics in survey of site location consultants

Most Significant Locational Determinants According to *Site Selection Magazine* Survey of Location Consultants

2009

- Transport infrastructure
- Workforce skills
- State/local tax scheme
- Utility Infrastructure

2008

- Ease of permitting and regulatory incentives
- Transport infrastructure
- Existing workforce skills
- State/local tax scheme

Common misperceptions in debate about tax competitiveness

The most readily available and most widely quoted comparative statistics are not necessarily the most useful in debates about tax competitiveness.

Don't show how state's taxes affect business's bottom line

Examples of statistics not useful in evaluating tax competitiveness

- Total taxes per capita
- Total taxes per \$1,000 of personal income
- Corporate tax collections per \$1,000 of personal income

None shows how much of a bite business taxes take out of profits

Allegation:

Tax cuts get immediate results; spending improvements take years to have an impact

“...unlike changes to a state's health care, transportation or education system, which can take decades to implement, changes to the tax code bring almost instantaneous benefits to a state's business climate .”

Summary of Tax Foundation Report on Its 2010 State Business Index

<http://www.taxfoundation.org/files/bp59.pdf>

Reality:

- Businesses anticipate the future benefits of needed spending programs and capitalize them into their evaluation of a state's business climate
- Businesses anticipate possibility that tax cuts will be rescinded in evaluating a state's tax climate.