State Corporate Income Taxes

David L. Sjoquist
Andrew Young School
Georgia State University

Nebraska Tax Modernization Committee
Lincoln, Nebraska
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Outline

I. Background on Nebraska's CIT

II. Arguments For and Against State CIT

III. CIT Structure/Provisions
- Nebraska
- Comparison with Other States
- Evaluation

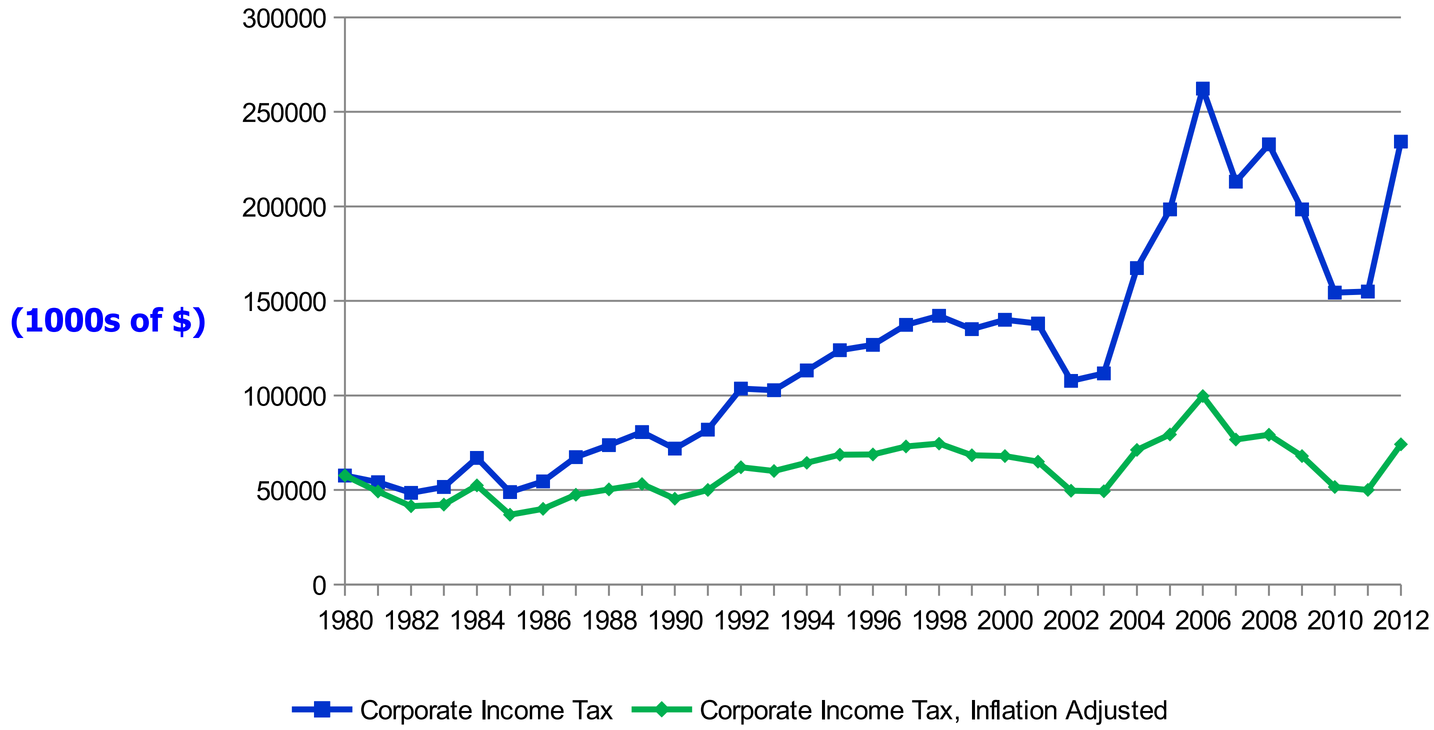
IV. Economic Incentive Effects

I. Background

Prevalence of CIT

- 43 states + DC have a CIT
- 4 states tax business other than with a CIT
  - MI: Business Income Tax & Gross Receipts Tax
  - OH: Commercial Activity Tax (a gross receipts tax)
  - TX: Margin Tax
  - WA: Business and Occupation Tax
- 3 states do not tax business income (NV, SD, WY)

Trend in CIT Revenue, Nebraska



Source: U.S. Bureau of the Census, State Government Tax Collection

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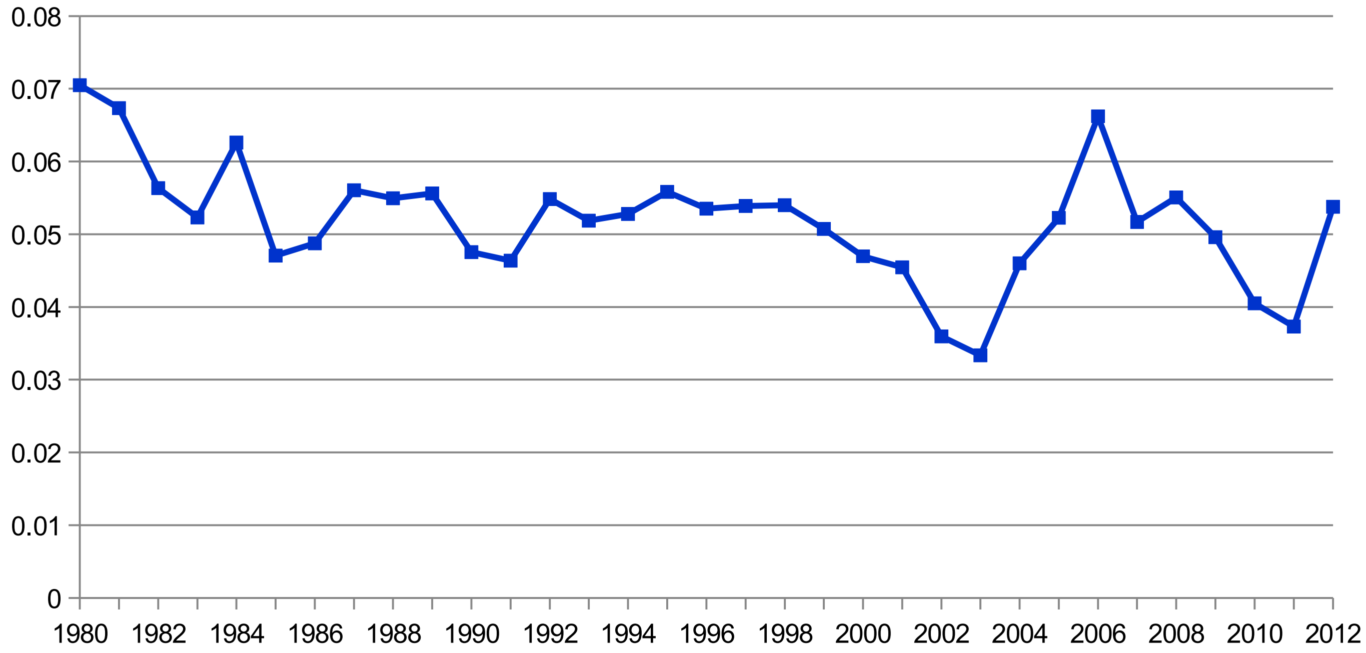
CIT as a Share of Total Tax Revenue, Nebraska



Source: U.S. Bureau of the Census, State Government Tax Collection

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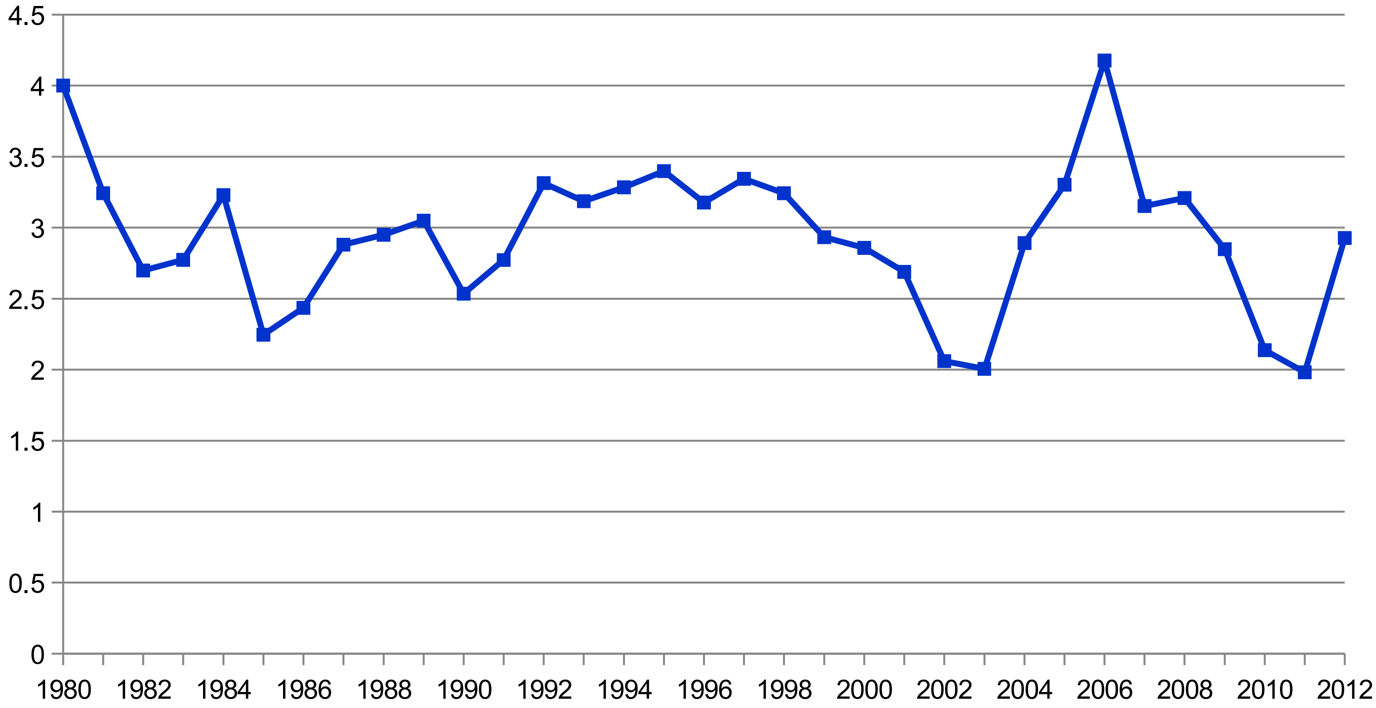
CIT Revenue per $1000 of Personal Income, Nebraska



Sources: U.S. Bureau of the Census, State Government Tax Collection;
U.S. Bureau of Economic Analysis

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Distribution of C-Corporations and CIT Revenue

Taxable Income	Number of C-Corps	Percent of C-Corps	Percent of CIT Revenue
< $0	7,068	34.1%	0.0%
$0 to 5,000	7,098	34.2%	0.1%
$5,001 to $100,000	4927	23.8%	6.4%
$100,001 to $500,000	1050	5.1%	9.8%
$500,000 to $5 million	512	2.5%	33.7%
> $5 million	86	0.4%	50.0%
Total	20,741	100.0%	100.0%

Source: Nebraska Department of Revenue, Analysis of Corporate Income Tax, 2010

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Comparison with Border States, 2012

State	CIT per Capita	CIT per $1000 of Income	CIT as a percent of taxes
Colorado	$94.89	$2.10	4.80%
Iowa	$138.50	$3.29	5.44%
Kansas	$110.04	$2.63	4.28%
Missouri	$50.10	$1.28	2.79%
Nebraska	*$126.27*	*$2.97*	*5.38%*
South Dakota	No income tax		
Wyoming	No income tax		

Sources: U.S. Bureau of the Census, State Government Tax Collection;
U.S. Bureau of Economic Analysis

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II. Justification

Some Possible Justifications for Having a State CIT

- Convenient source of revenue
- CIT is exported
- Corporations can afford it (ability to pay)
- Not taxing corporations would be unfair to non-corporations
- It is a payment for public services provided (benefit principle)

Some Possible Justifications for Not Having a State CIT

- Revenue is small, unstable, and declining relative to the economy
- Creates economic distortions
- Complications lead to too much spent on administration and compliance compared to revenue
- Can't accurately measure income earned in a state

III. CIT Structure

Corporate Income Tax

The CIT is a tax on income generated in the state, even if the income goes to nonresidents

Provisions of the CIT should adhere to general tax principles:

- **Minimize economic distortions**
- **Equitable**
- **Minimize compliance costs**

Starting Point

42 of the 44 states start with the Federal Taxable Corporate Income (AR and DC are exceptions)

State specific adjustments vary widely, but common adjustments are:

- **Interest on government bonds**
- **Net operating loss**
- **Federal bonus depreciation allowances (34 of 48 states decouple)**

Source: 2013 State Tax Handbook, CCH; bonus depreciation from Ernst & Young, 2011

Combined versus Separate Reporting

- **In 2000, 14 CIT states required combined reporting**
- **In 2013, 20 CIT states require combined reporting**

- **Nebraska: Mandatory combined reporting**

- **Tax principles: use combined reporting**

Source: 2013 State Tax Handbook, CCH

Apportionment for Multistate Firms

Types of Formulas:

- **3 factor formula: 10 states**
- **Double-weighted sales: 13 states**
- **Sales only: 24 states (increase from 4 states in 2005)**

- **Nebraska: Sales only formula**

- **Tax principles: weight sales more heavily**

Source: Federation of Tax Administrators

Measuring In-State Sales for Apportionment

- **Joyce Method:**
  include sales only for firms with nexus in the state

- **Finnigan Method:**
  include sales of all firms in the group
  (used by 10 states)

- **Nebraska: Joyce method**

- **Tax principles: use Finnigan**

Allocation of Non-Business Income

- Most states allocate non-business income on a residence basis (10 states apportion most or all non-business income)

- Nebraska: Apportion non-business income

- Tax Principles: apportion most non-business income

Source: 2013 State Tax Handbook, CCH

Throwback Rule

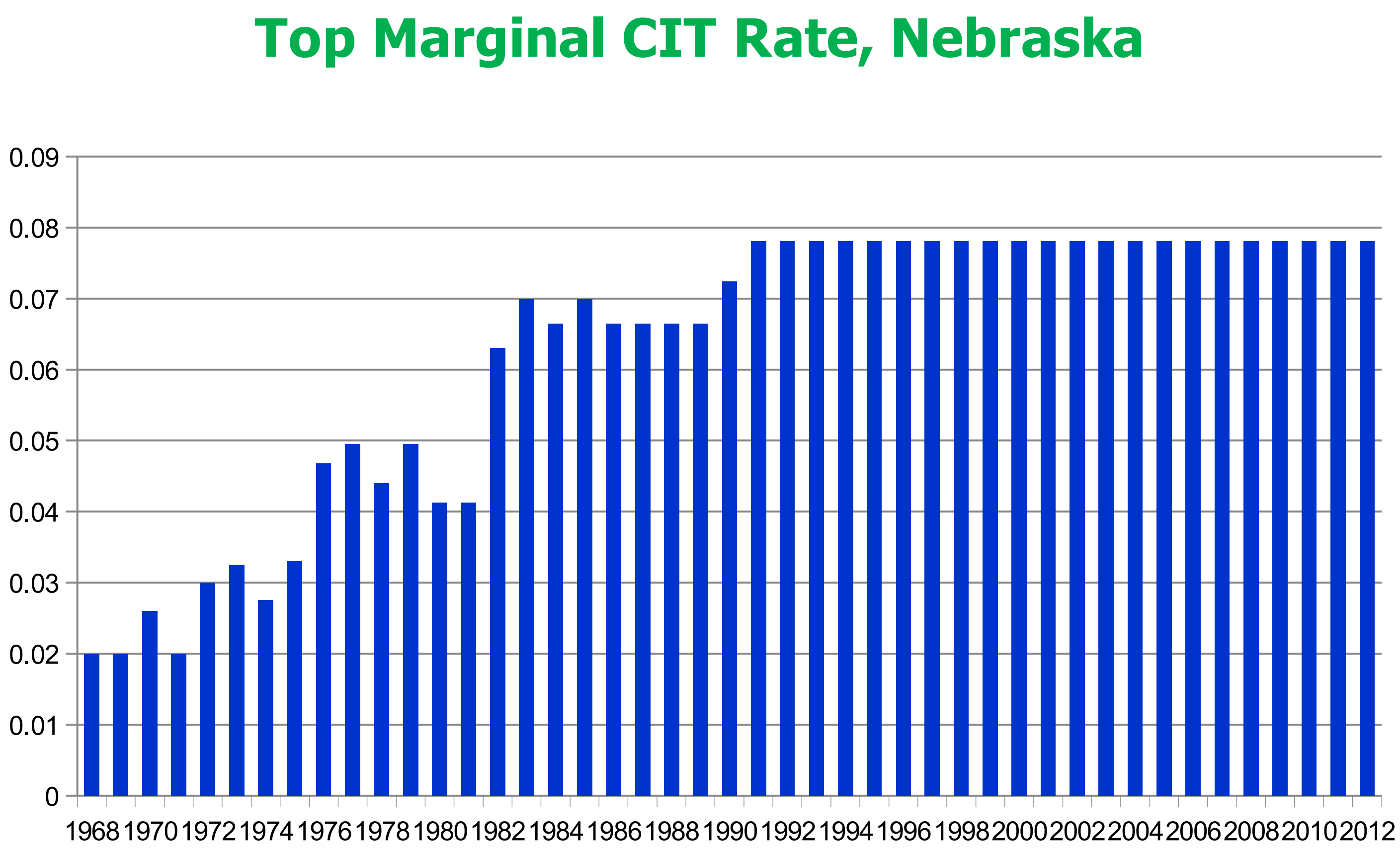
- 17 states have no throwback rule

- Nebraska: No throwback rule

- Tax principles: do not adopt a throwback rule

Source: 2013 State Tax Handbook, CCH

Tax Rates

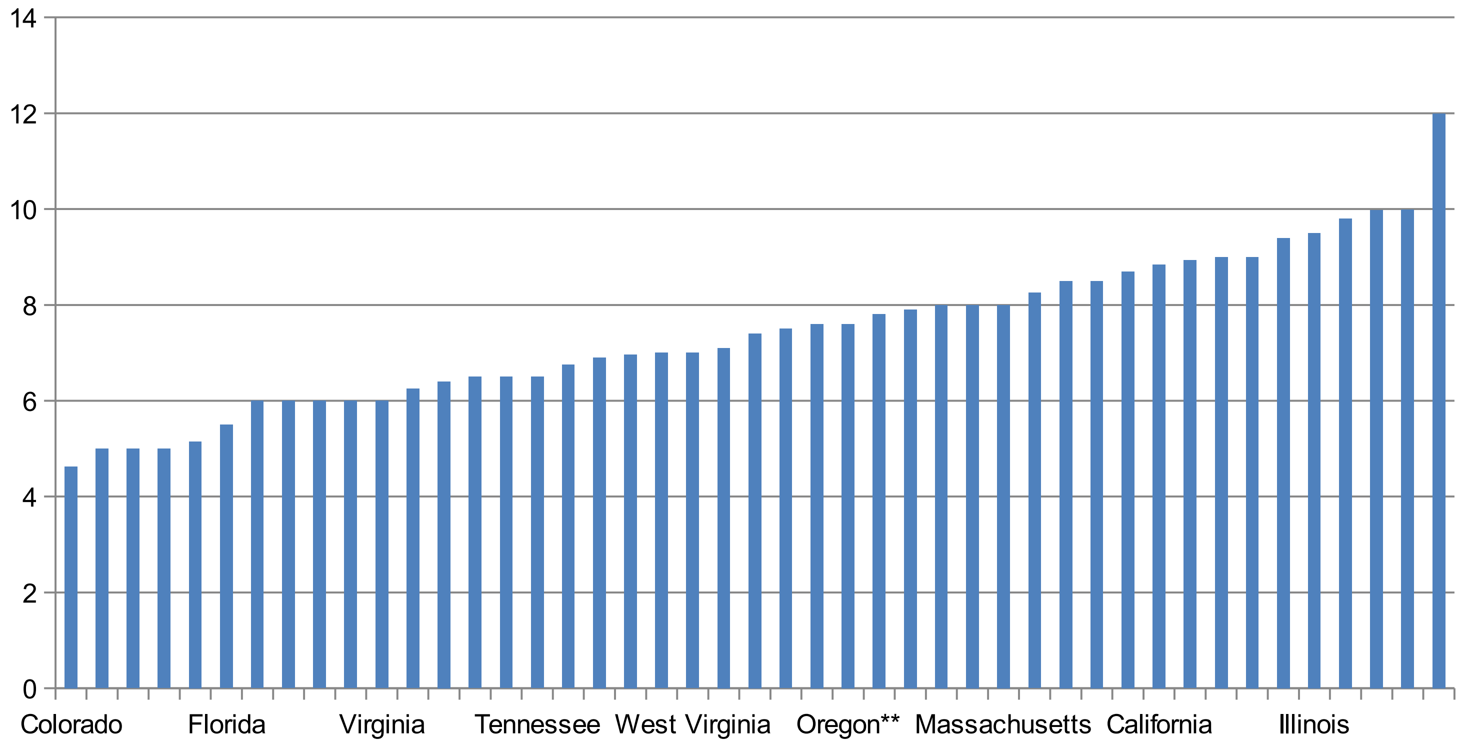

Top Marginal CIT Rate, Nebraska
0.09
0.08
0.07
0.06
0.05
0.04
0.03
0.02
0.01
0
1968
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012

Top Marginal Tax Rate, 2013	Number of States
<5.0%	1
5.0% to 5.9%	5
6.0% to 6.9%	13
7.0% to 7.9%	9
8.0% to 8.9%	9
9.0% to 9.9%	7
10.0%+	1

Tax rates for OH, TX, SD, NV, WA, WY are not included.

Source: Federation of Tax Administrators

Top CIT Rate, 2013



*New Mexico top bracket reached at $1 million
**Oregon top bracket reached at $10 million

Source: Federation of Tax Administrators

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Tax Brackets, Nebraska

Period	Tax Brackets
1968 – 1974	One
1975 – 1981	Two breaking at $25K
1982 – 2007	Two breaking at $50K
2008 – present	Two breaking at $100K

Number of Tax Brackets	Number of States
1	32
2	2
3	6
4	2
5	1
6	1
10	1

OH, TX, SD, NV, WA, and WY are not included.

Source: Federation of Tax Administrators

Changes in CIT Rates, 2002 to 2013

State	Tax Rate		Percent Point Changes in Top Rate
	2002	2013	
Idaho	7.6%	7.4%	-0.2
Illinois	7.3%	9.5%	+2.2
Indiana	7.9%	8.0%	-0.01
Kentucky	4.0% – 8.25%	4.0% – 6.0%	-2.25
Maryland	7.0%	8.25%	+1.25
Massachusetts	9.5%	8.0%	-1.5
New York	7.5%	7.1%	-0.4
North Dakota	3.0% – 10%	1.68% – 5.15%	-4.85
Oregon	6.6%	6.6% – 7.6%	-1.0
Vermont	7.0% – 9.65%	6.0% – 8.5%	-1.15
West Virginia	9.0%	7.0%	-2.0

Source: Federation of Tax Administrators

New Mexico is lowering its tax rate from 7.6% to 5.9% by 2018

North Carolina is lowering its tax rate from 6.9% to 5% in 2015

Economic Development Tax Credits

- Most states have
  - a job tax credit,
  - an investment tax credit,
  - a R&D tax credit,
  - a film tax credit, and
  - a deal closing fund.

- Nebraska: Has several economic development tax credit programs

- Tax Principle: no economic development tax credits

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IV. Incentives

What the Literature Says

- Empirical studies yield mixed results, but the better studies suggest that taxes matter, but not a lot.

- There is little evidence that tax credits affect economic development

Why CIT Has Little Effect

- Effect of reducing the state CIT:

  - CIT is a very small percentage of a corporation's total state taxes.

  - Federal deductibility reduces the effect of a change in state tax rate.

    A 2 percentage point reduction in the state tax rate reduces the corporation's total income tax rate by 1.3 percentage points.

- **The apportionment ratio further reduces the effect of a rate change.**

  - **Consider an investment that returns $100,000**
  - **Assume an apportionment ratio is 25 percent**

  - **A 2 percentage point reduction in the state tax rate reduces the corporation's total income tax rate by 0.325 percentage points.**

- **Under some reasonable assumptions, eliminating the CIT would have little or no effect on the relative tax advantage of locating a new facility in the state.**

Example:

- **Consider a firm deciding whether to make an investment in Nebraska or in State A.**

- **Assume a new investment that would generate $100 million in gross income.**

- **Assume a 50 percent sales only apportionment ratio in Nebraska and is unaffected by the location of the investment.**

	Tax to State A	Tax to Nebraska	Total Tax
Locate in A	$3 million	$3.9 million	$6.9 million
Locate in Nebraska	$2 million	$3.9 million	$5.9 million

Locate in Nebraska and save $1 million in taxes

Eliminate the CIT in Nebraska

	Tax to State A	Tax to Nebraska	Total Tax
Locate in A	$3 million	$0	$3 million
Locate in Nebraska	$2 million	$0	$2 million

Locate in Nebraska and save $1 million in taxes

Possible Readings:

- Jennifer Weiner, *State Business Tax Incentives: Examining Evidence of their Effectiveness*. New England Public Policy Center, December 2009. http://www.bos.frb.org/economic/neppc/dp/2009/dp093.htm

- David L. Sjoquist, Laura Wheeler, and Lorenzo N. Almada, *Georgia's Corporate Income Tax: A Description and Reform Options*. Fiscal Research Center Report 241, April 2012. https://aysps.gsu.edu/sites/default/files/documents/Rpt_241FIN.pdf

- William F. Fox, Matthew Murray, and LeAnn Luna, "How Should a Subnational Corporate Income Tax on Multistate Businesses Be Structured?" *National Tax Journal*, March 2005, v. 58, iss. 1, pp. 139-59.

Thank You

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