

# Where is the State Corporate Income Tax Headed?

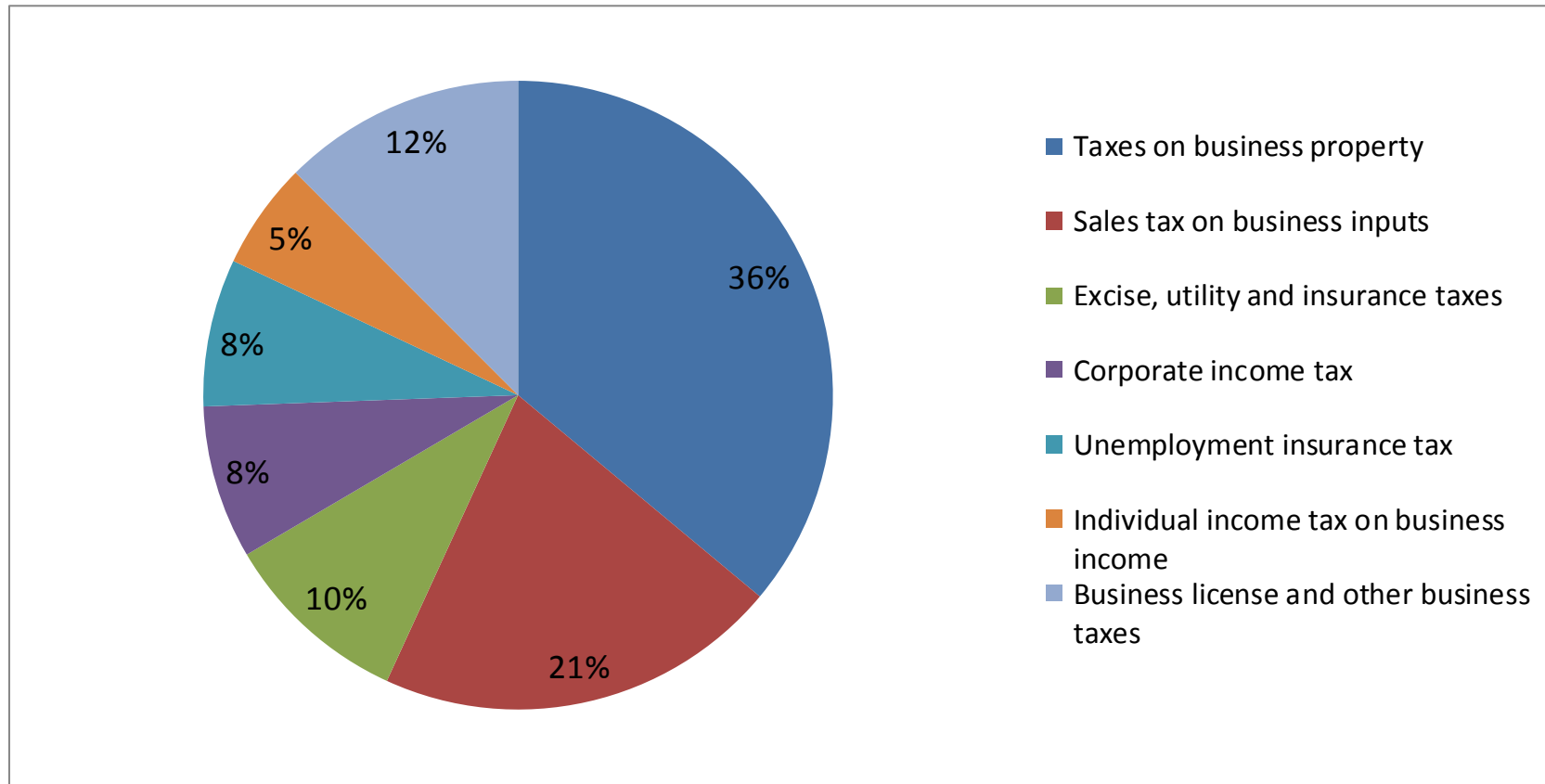
Presented to the  
Federation of Tax Administrators  
September 30, 2014

William F. Fox, Director  
Center for Business and Economic Research  
The University of Tennessee, Knoxville

# Why Tax Businesses?

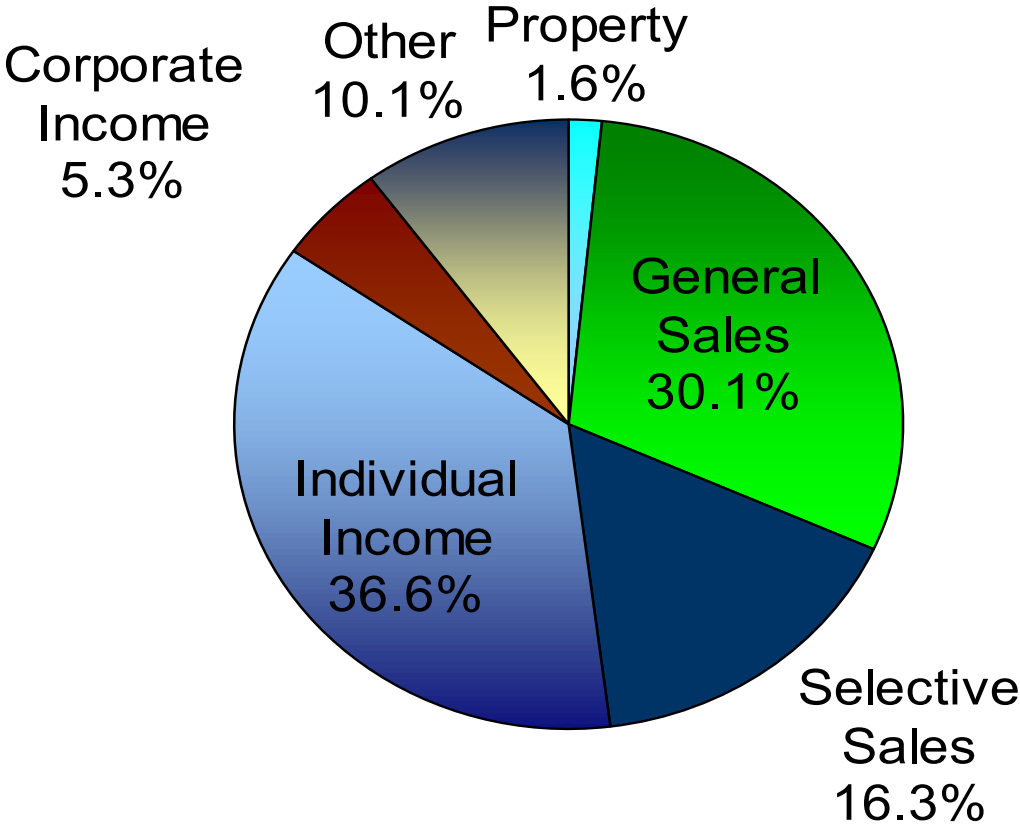
- ▶ Revenue
- ▶ Tax handles
- ▶ Tax exporting
- ▶ Tax portfolio balance
- ▶ Benefit tax

# Composition of Total State and Local Business Taxes, FY2013



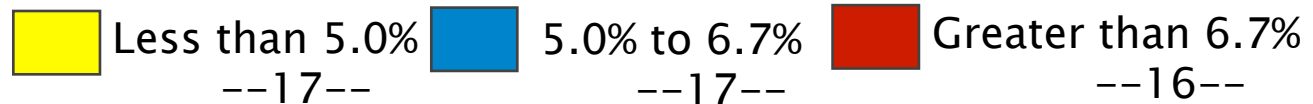
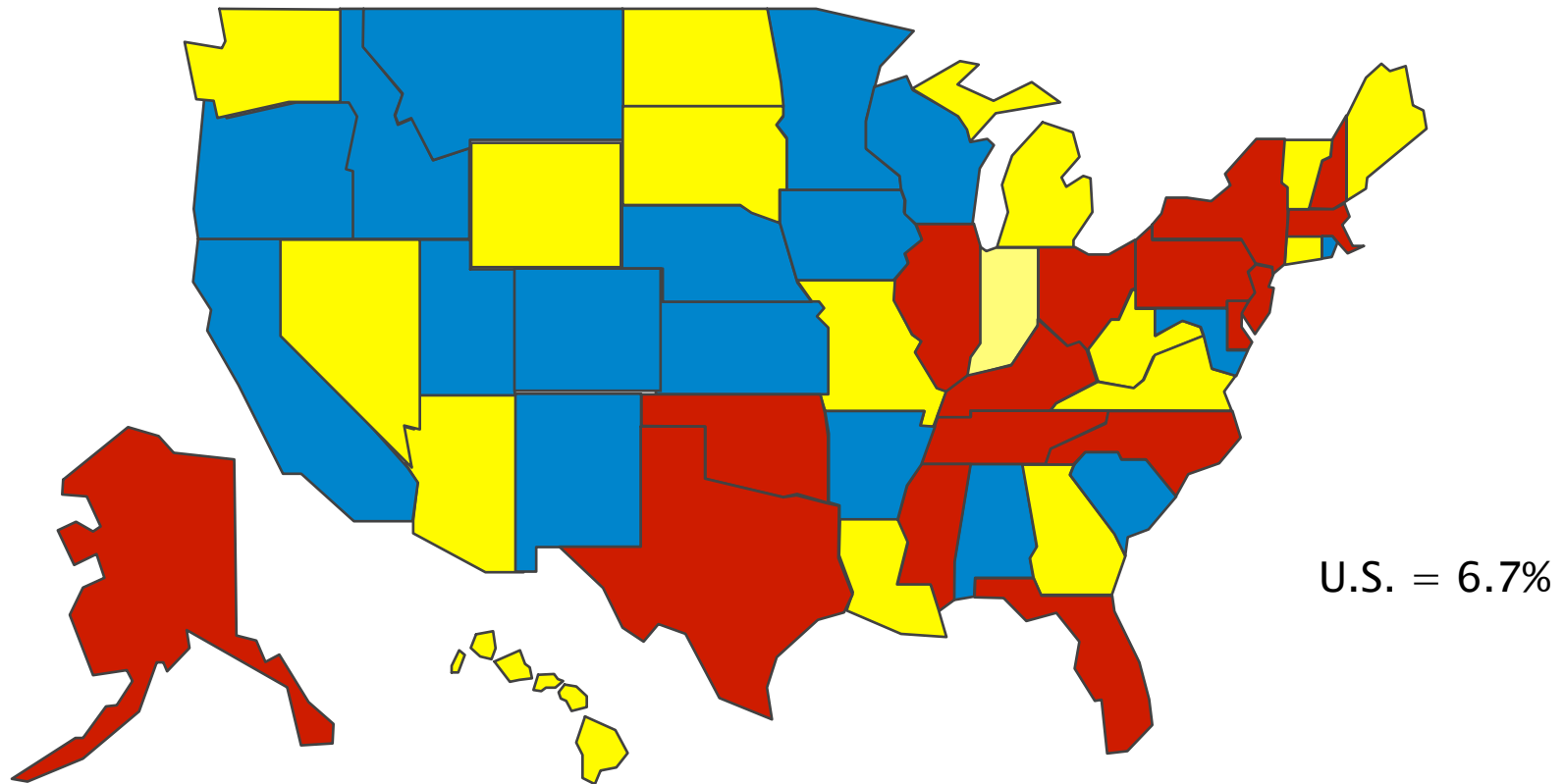
Source: Ernst & Young. "Total state and local business taxes: State-by-state estimates for fiscal year 2013." August 2014.

# PERCENTAGE DISTRIBUTION OF STATE TAX COLLECTIONS, 2013

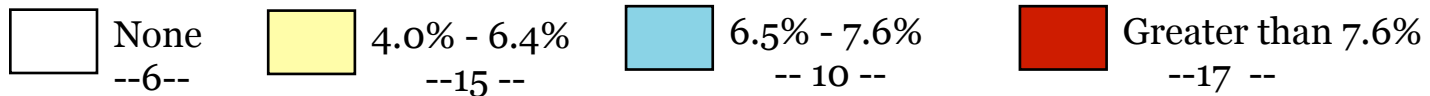
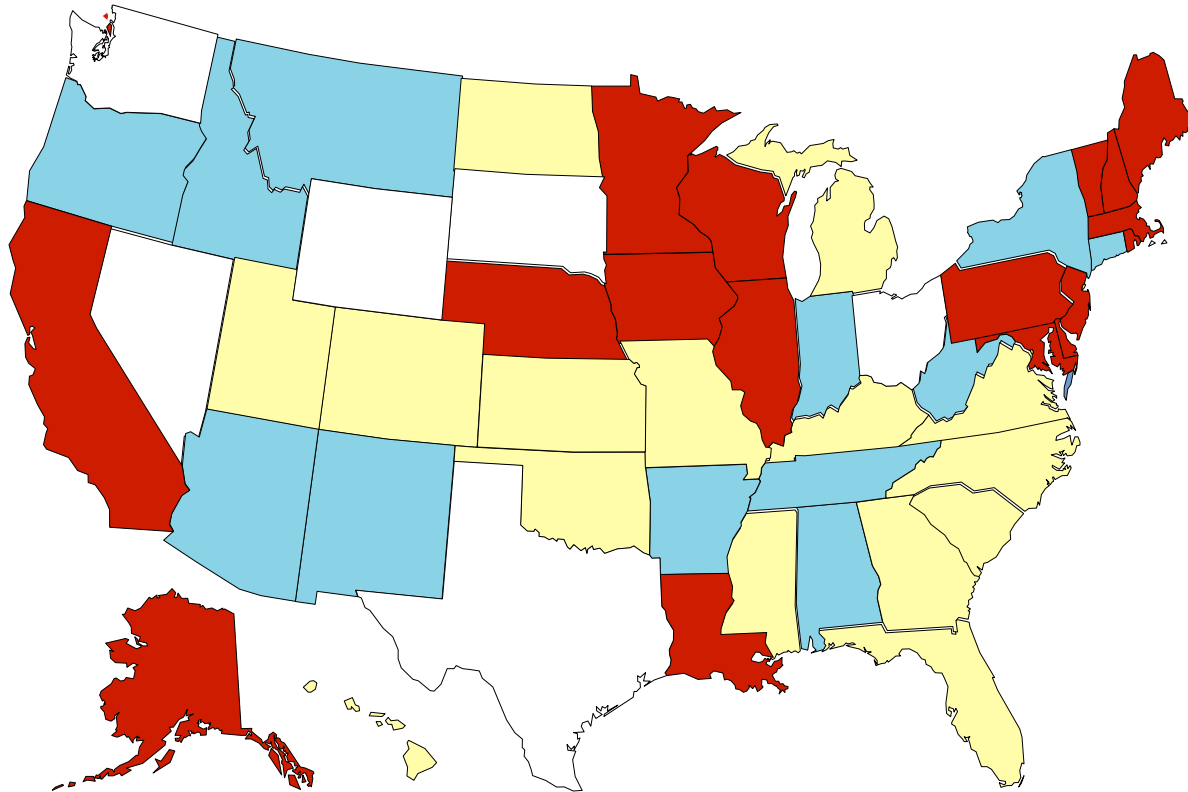


William F. Fox, Center for Business and Economic Research, <http://cber.bus.utk.edu>

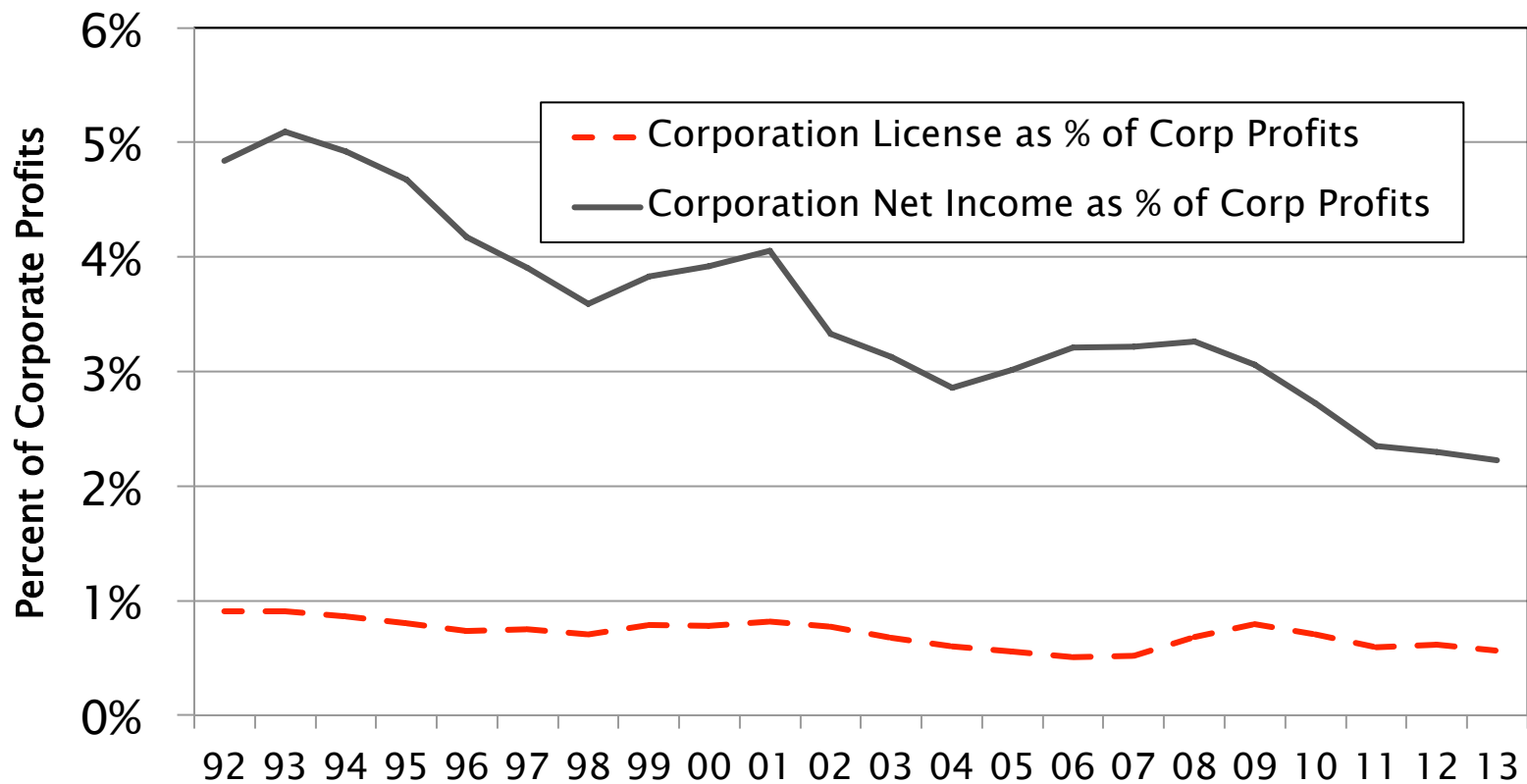
# Corporate Tax Revenues as a Share of Total Taxes



# STATE CORPORATE INCOME TAX RATES as of Jan. 1, 2014



# Corporation Net Income Tax and Corporation License Tax as a Share of Corporate Profits



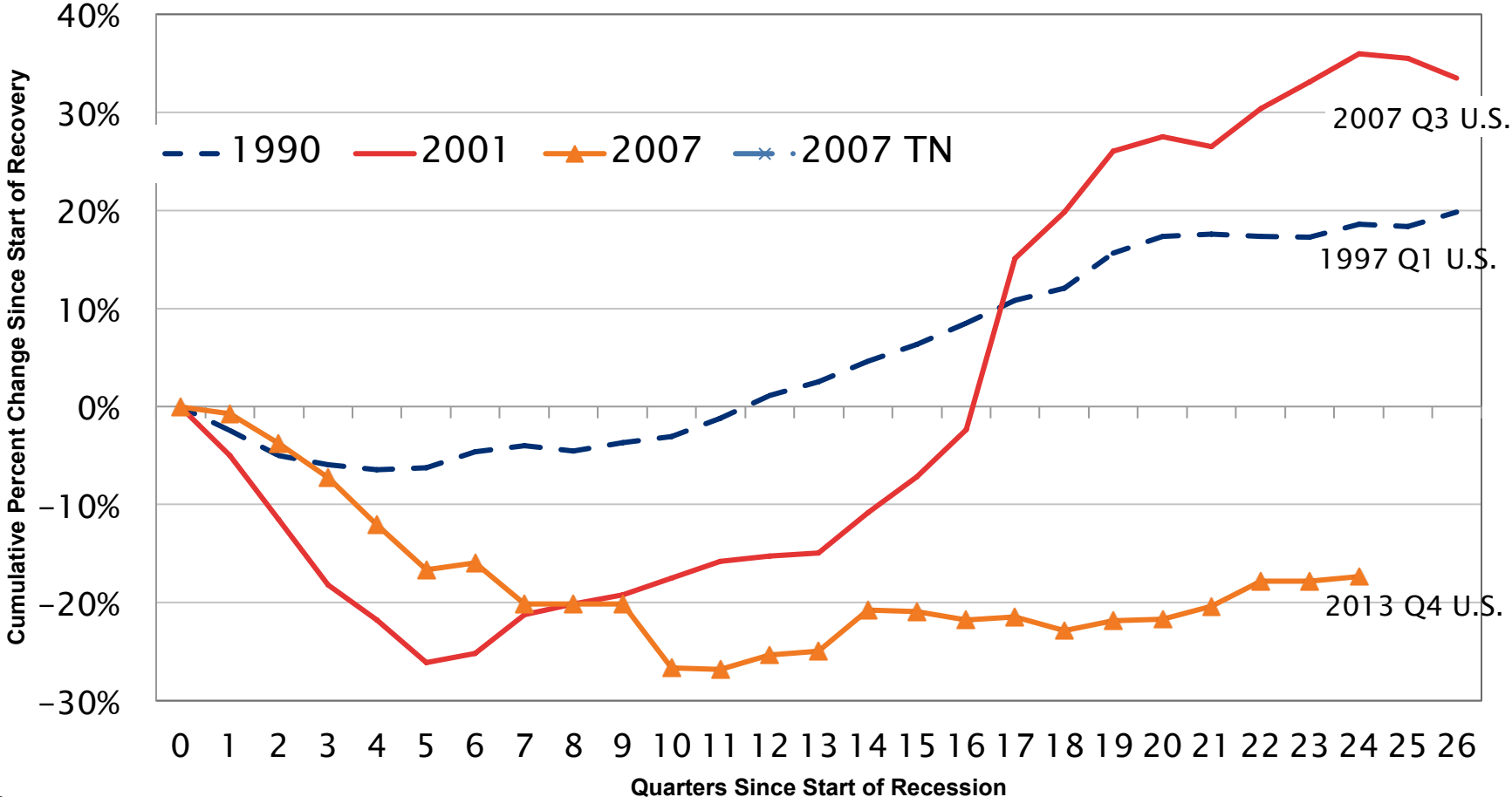
# Some reasons for decline in the effective rate

- ▶ Tax planning
  - Business structures – LLCs, LLPs, General partnerships
  - Planning around the sales factor
- ▶ Federal tax policy changes
- ▶ State policy changes
  - Single sales factor apportionment
  - No strong downward trend in nominal tax rates



# State Corporate Income Tax Revenue Since the Start of the Recession

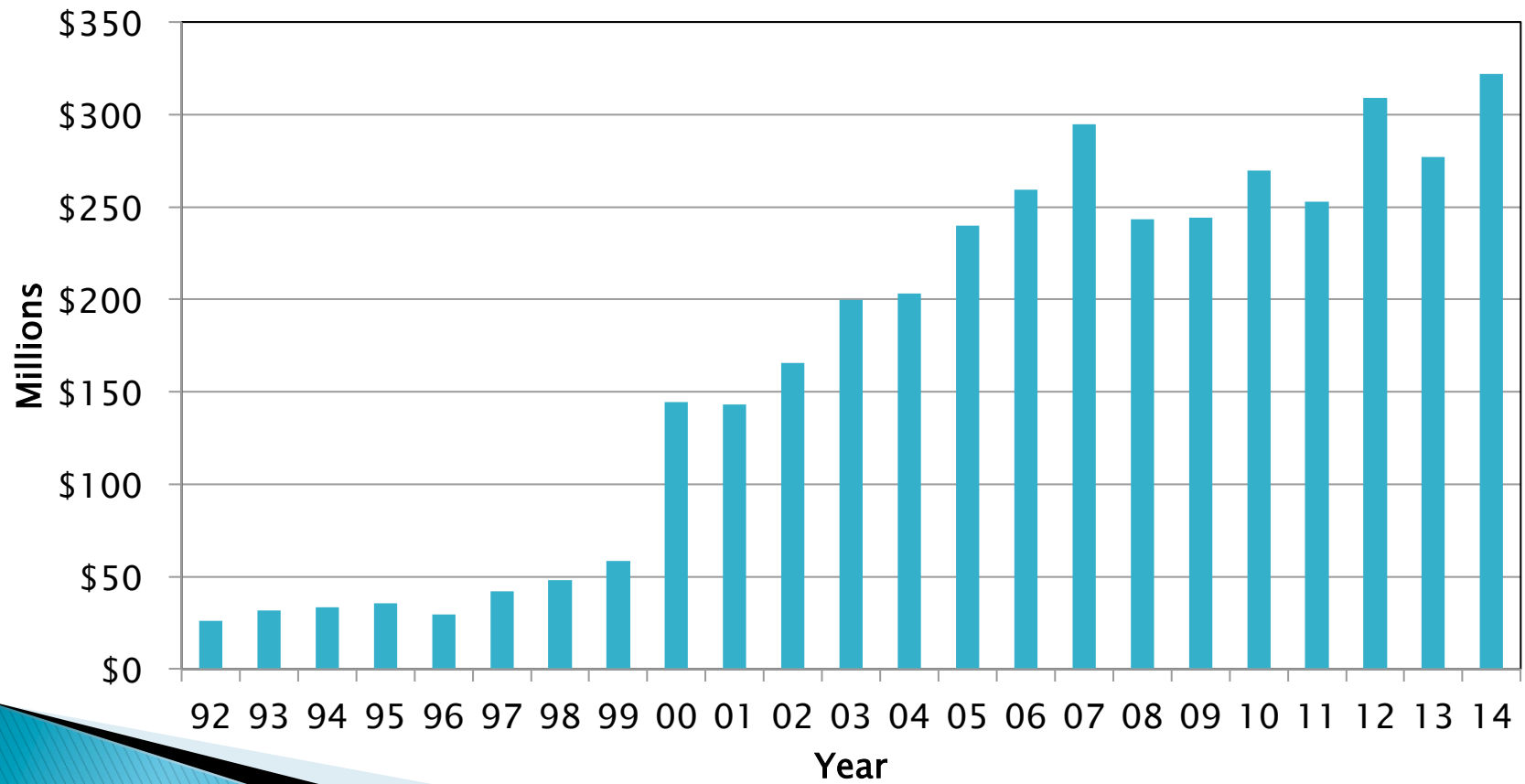
Four-Quarter Moving Average, Adjusted for Inflation



# Why is Forecasting Difficult?

- ▶ Unpredictability of corporate profits
- ▶ Differences between book earnings and tax earnings
- ▶ Impact of small number of firms
- ▶ Timing of tax payments and revenue recognition
- ▶ Tax incentives
- ▶ Loss carry-forwards
- ▶ Refunds associated with prior year activity

# Tennessee Franchise and Excise Collections, September



# What's driving current state and local tax changes/reform?

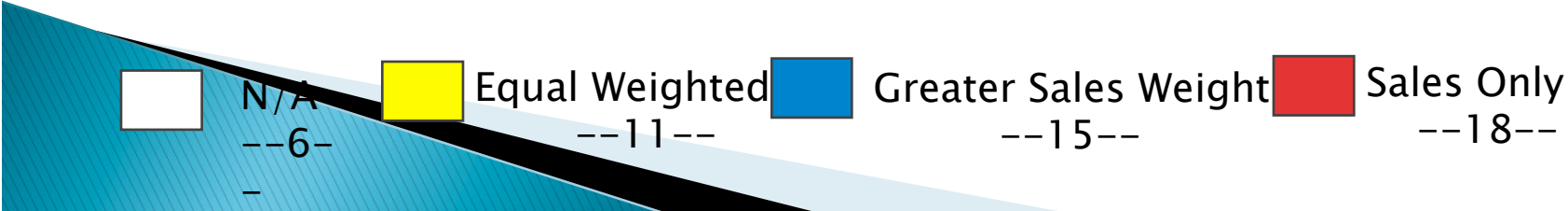
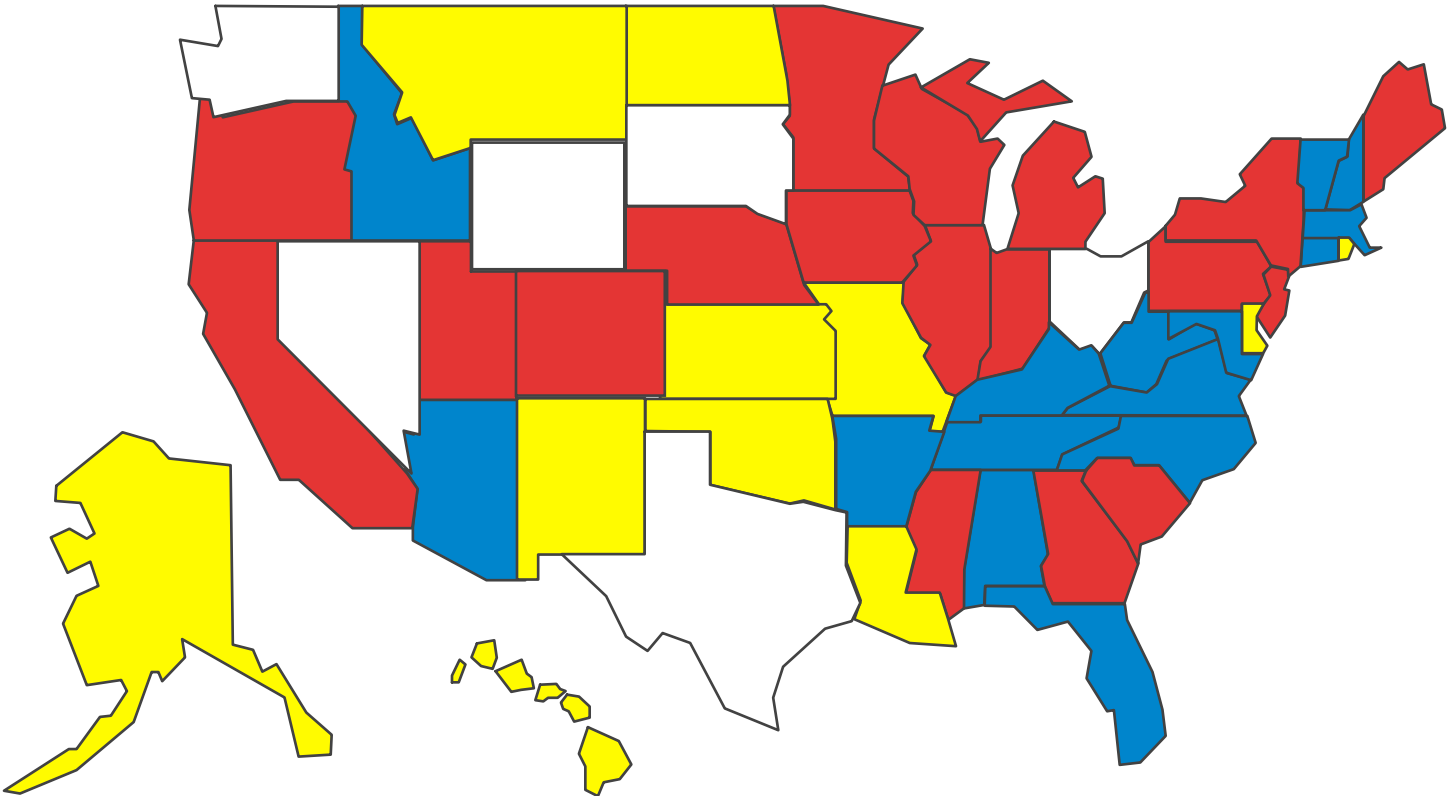
- ▶ Rebound in taxes, budget surpluses (e.g., CA) “tax fairness” debates, change in party/one-party control of state houses
- ▶ Responding to political base
  - Republicans pushing reduction of rates/elimination of entire taxes with emphasis on economic development
  - Democrats pushing fairness, increased progressivity, base expansion, restoration of spending cuts due to recession
- ▶ Why the move away from income-based taxes?
  - Continued decoupling from federal bases
  - State tax competition – everyone wants to be like Texas
  - Improved state tax rankings
- ▶ More general tax policy objective of shift to consumption taxes
  - Sales tax has its limitations
  - Alternative forms of business entity taxes?



# Trends in Corporate Tax Policy

- ▶ Two trends, that focus on two entirely different policy goals
- ▶ Destination based structures
  - Single sales apportionment
  - Destination situsing of services
  - Economic nexus

# State Apportionment of Corporate Income



# Single factor sales apportionment

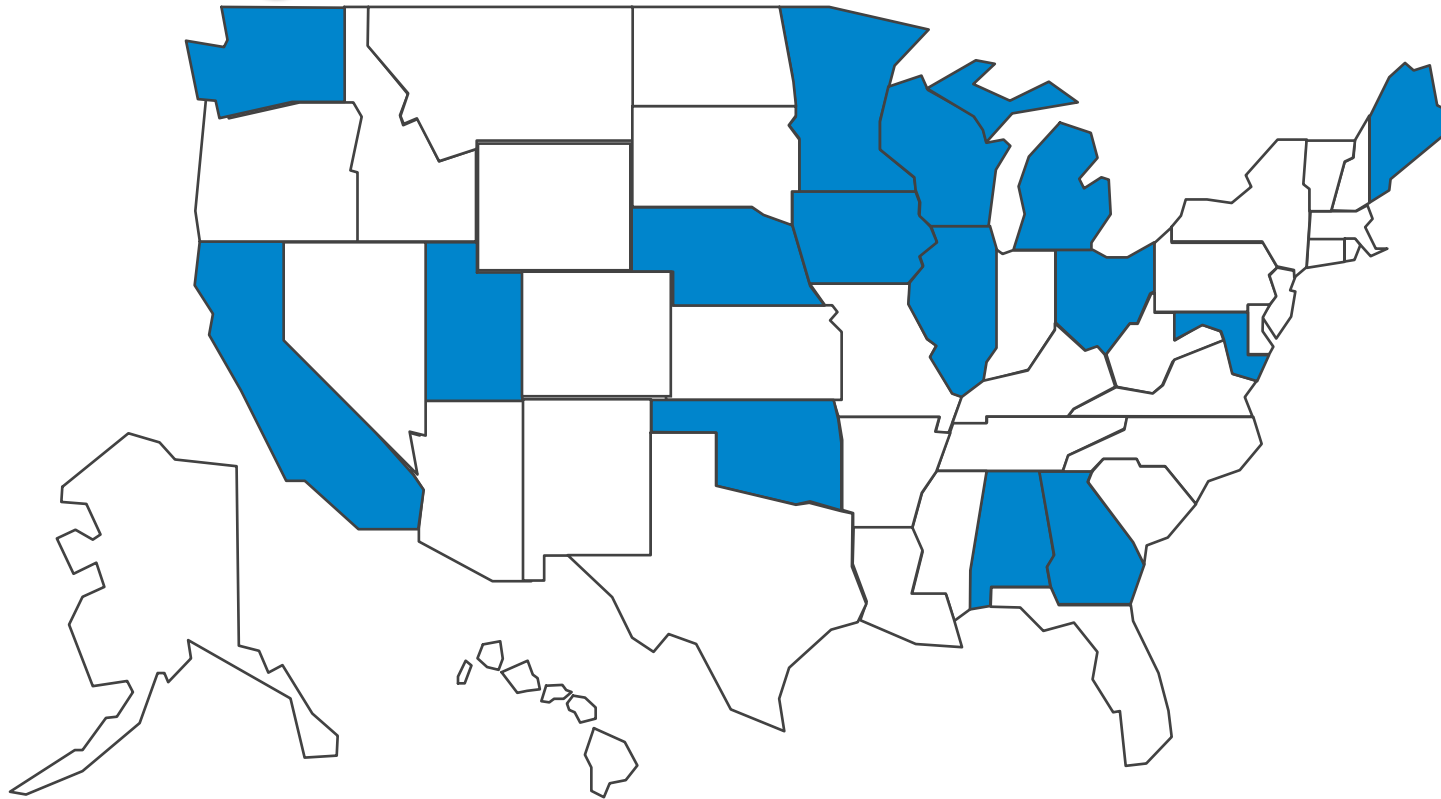
- ▶ Intended to eliminate excises on payroll and property to stimulate job creation. Effectively convert the CIT to a transactions tax.
- ▶ Taxable profits<sub>i</sub> =  
(sales<sub>i</sub>/national sales)\*national profits
- ▶ Potentially benefits some but not all businesses
- ▶ Statistical analysis suggests small economic stimulus from greater sales factor and less perverse effects of high marginal tax rates
- ▶ Sales only states rely more on CIT, suggesting the destination tax intended to mitigate the effects

# Two cases where single factor sales harms the economy

- ▶ Becomes a heavier tax at the origin on services unless have changed the situsing – benefits manufacturing more than services
- ▶ Tax is on all sales, not just final sales. So, can increase the tax implicit in the value of some items. E.g., tax implicit in purchases can be very large relative to value added for wholesalers who resell out of state. The important tax is on their purchases (which is increased) and not their sales (which are sitused out of state)



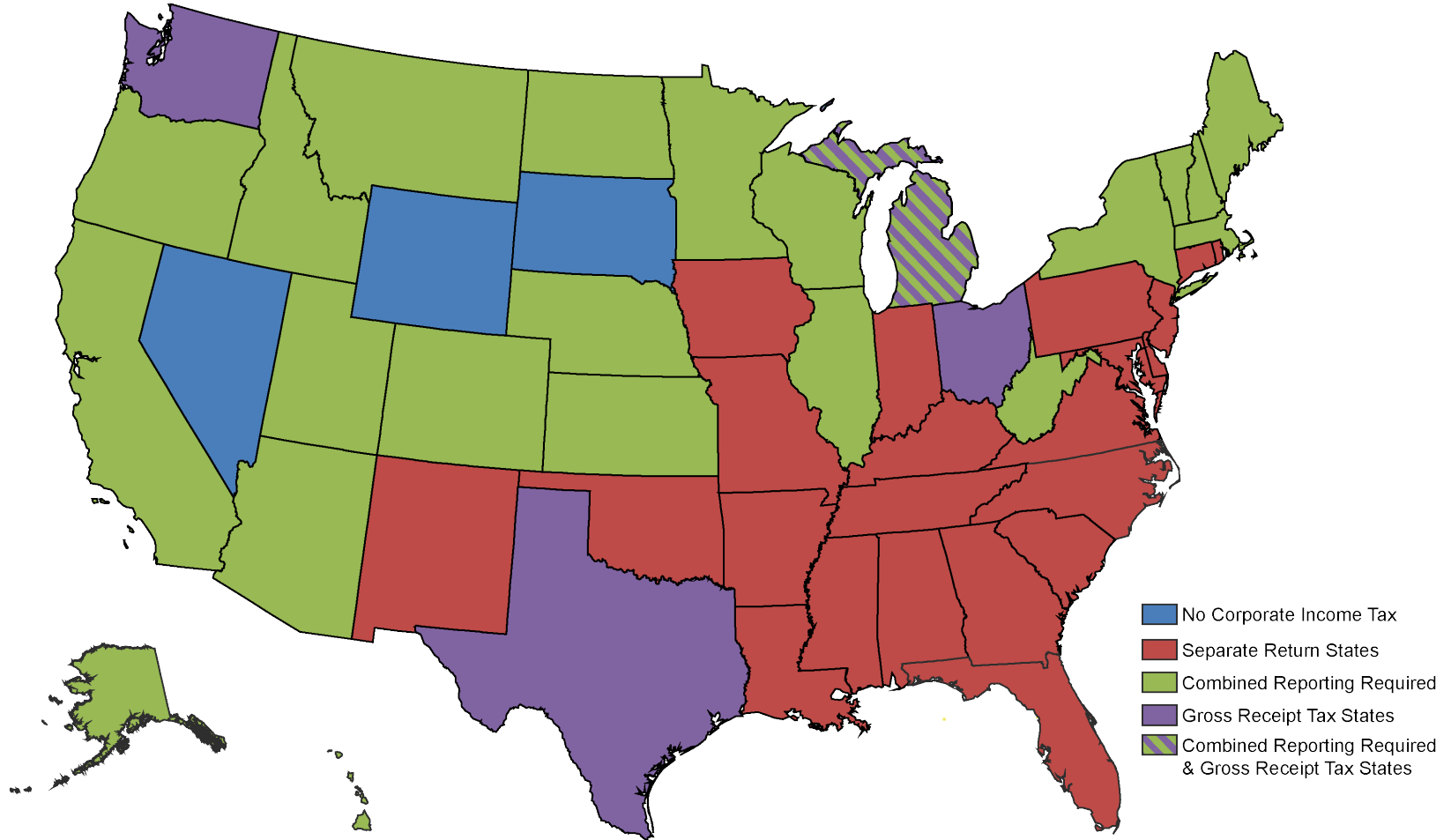
# States That Have Adopted Market Sourcing of Services



# Trends in Corporate Tax Policy

- ▶ Attempts to deal with tax planning. Planning has certainly been an important aspect of diminishing CIT revenues
  - Combined reporting
  - Addbacks
  - New structures – CAT, Margins Tax

# Mandatory Combined Reporting

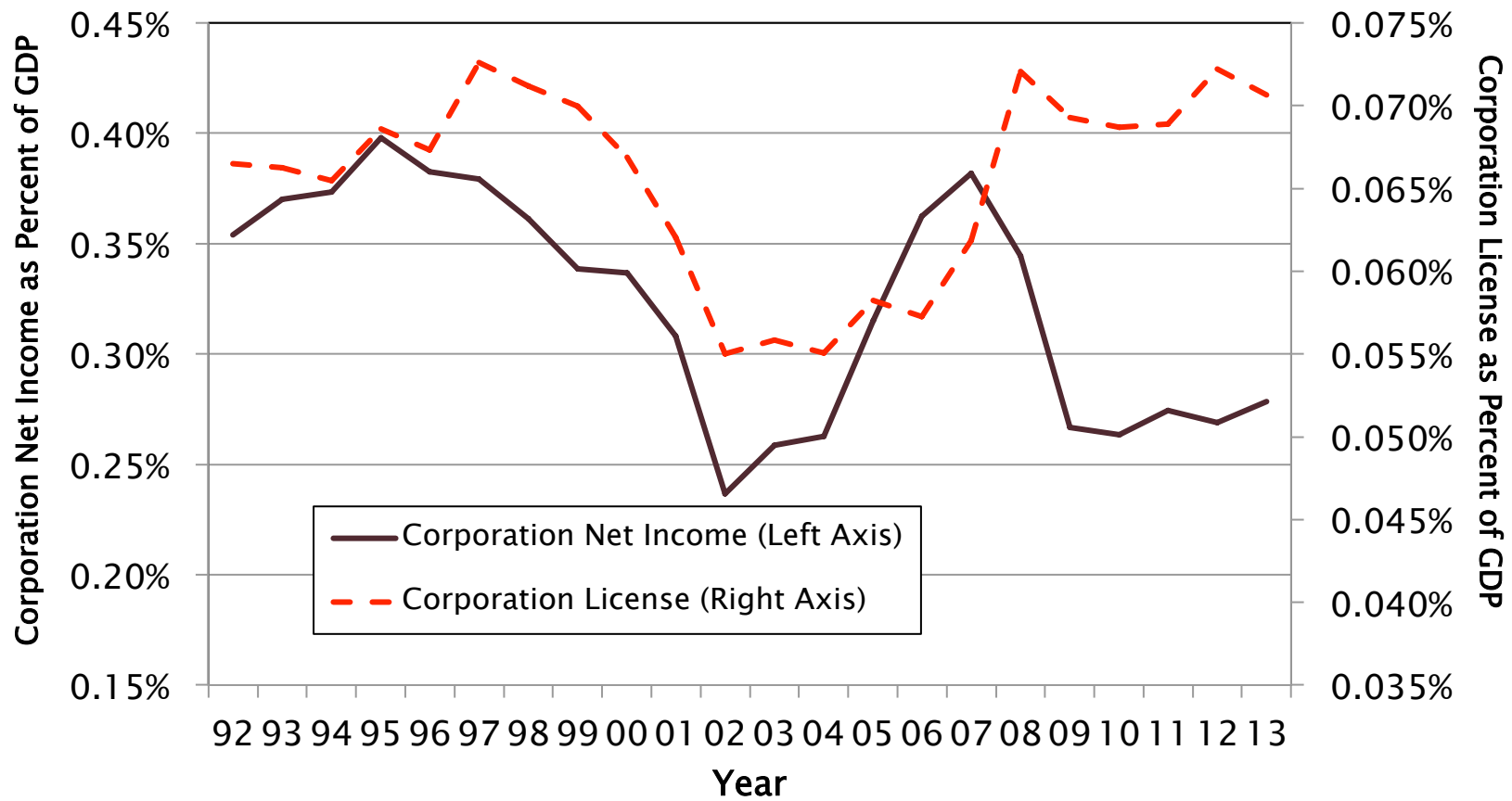


# What policies will states pursue?

- ▶ Depends on the goals, which may differ by state
  - Generating revenues
  - Stimulating the economy relative to existing structures
- ▶ Political/competitive pressures will continue to push towards destination taxation
- ▶ Taxation of other business structures? CAT
- ▶ Consider potential unintended consequences



# State Corporation License and Corporation Net Income as a Percent of GDP



# Average Share of Corporate Income/Total

- ▶ Equal Weighted = 5.14%
- ▶ Greater Sales Weighted = 5.87%
- ▶ Sales Only = 6.28%
  
- ▶ Correlation of Tax Rate to Corporate Income Share of Total = 0.29

