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State Corporate Income Taxes

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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

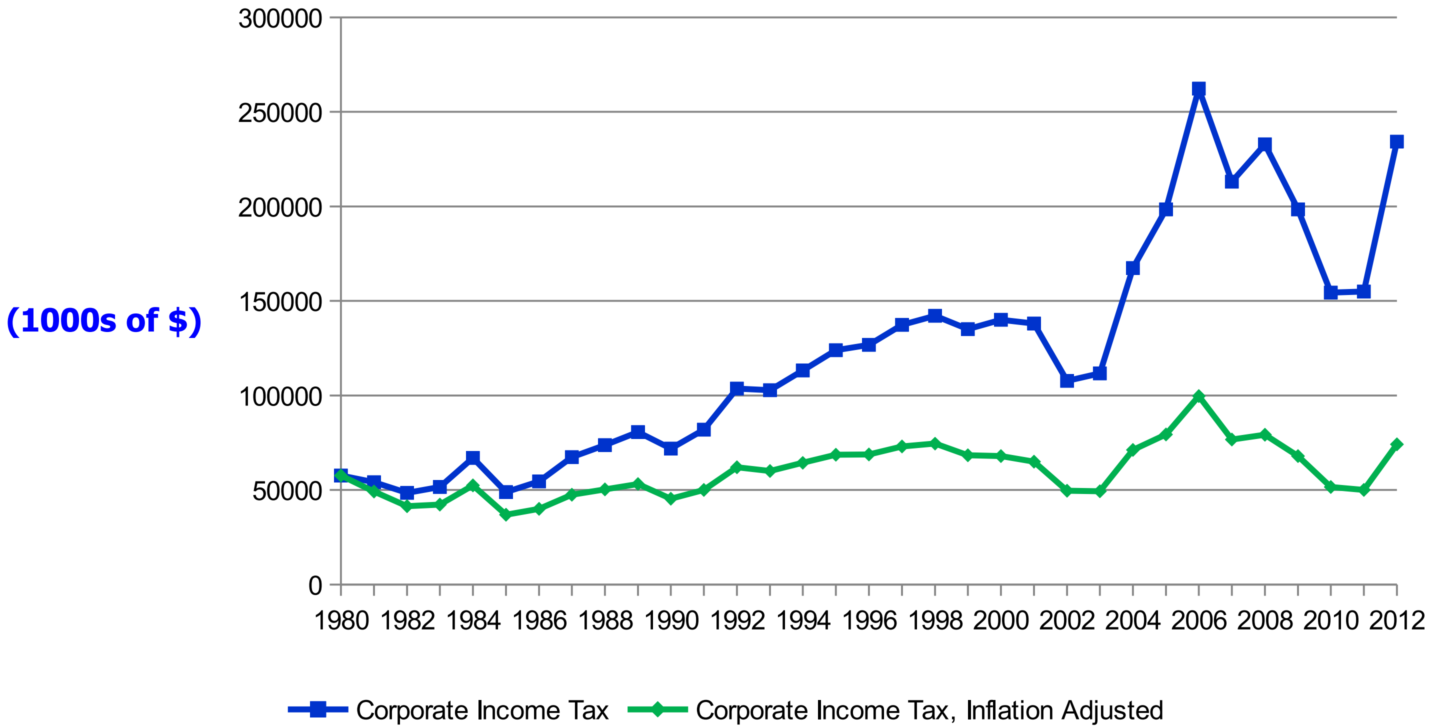
Prevalence of CIT

- 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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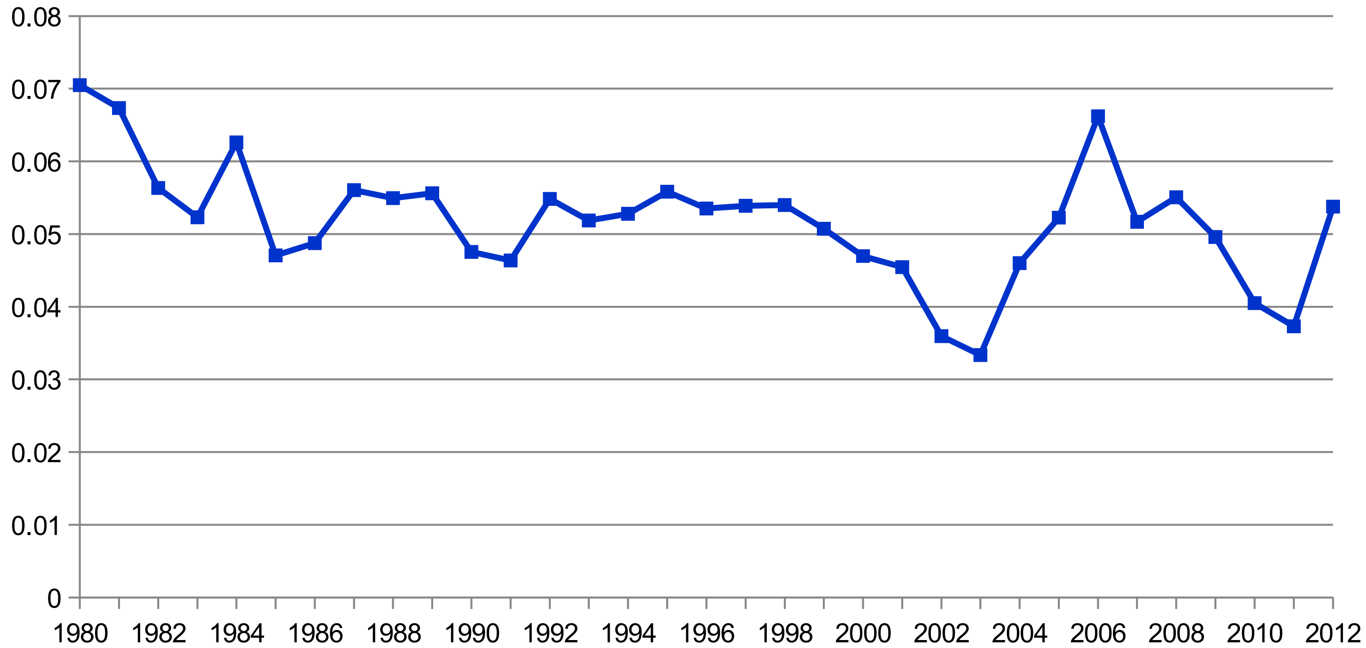
CIT as a Share of Total Tax Revenue, Nebraska



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

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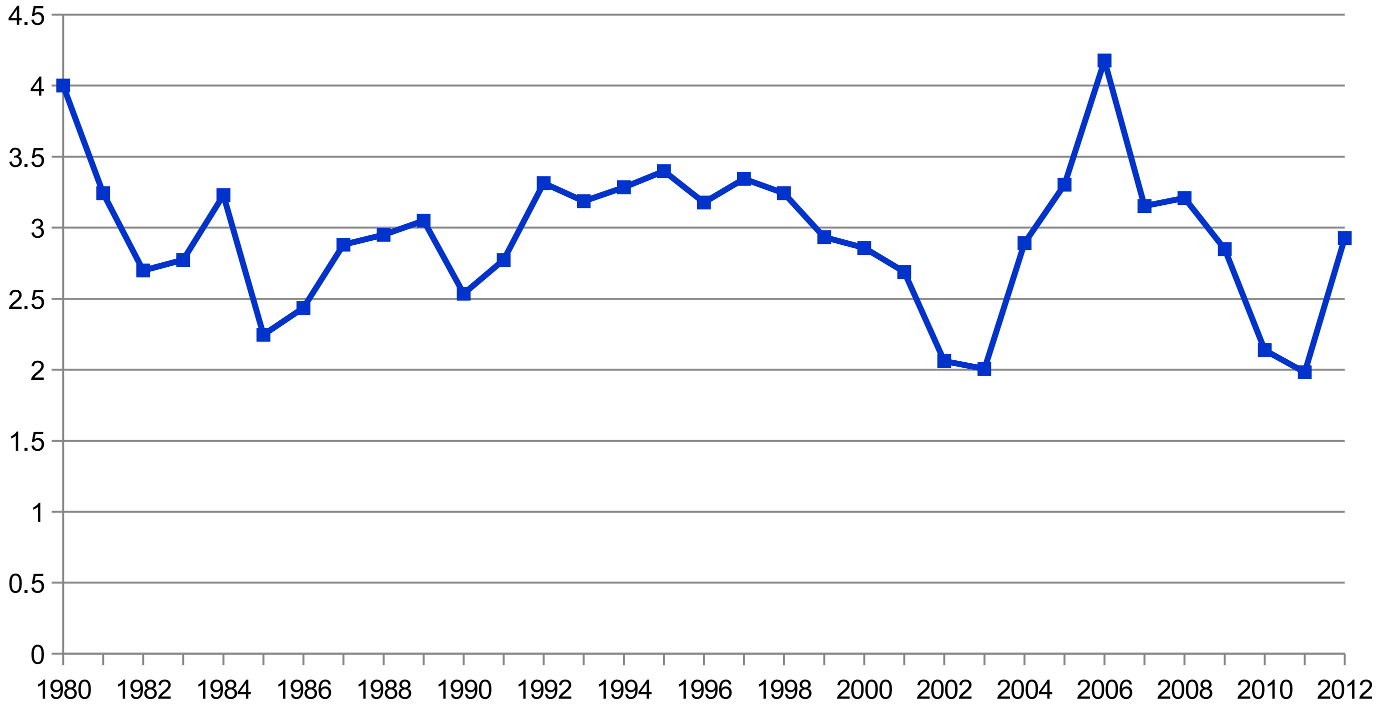
CIT Revenue per $1000 of Personal Income, Nebraska



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

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

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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

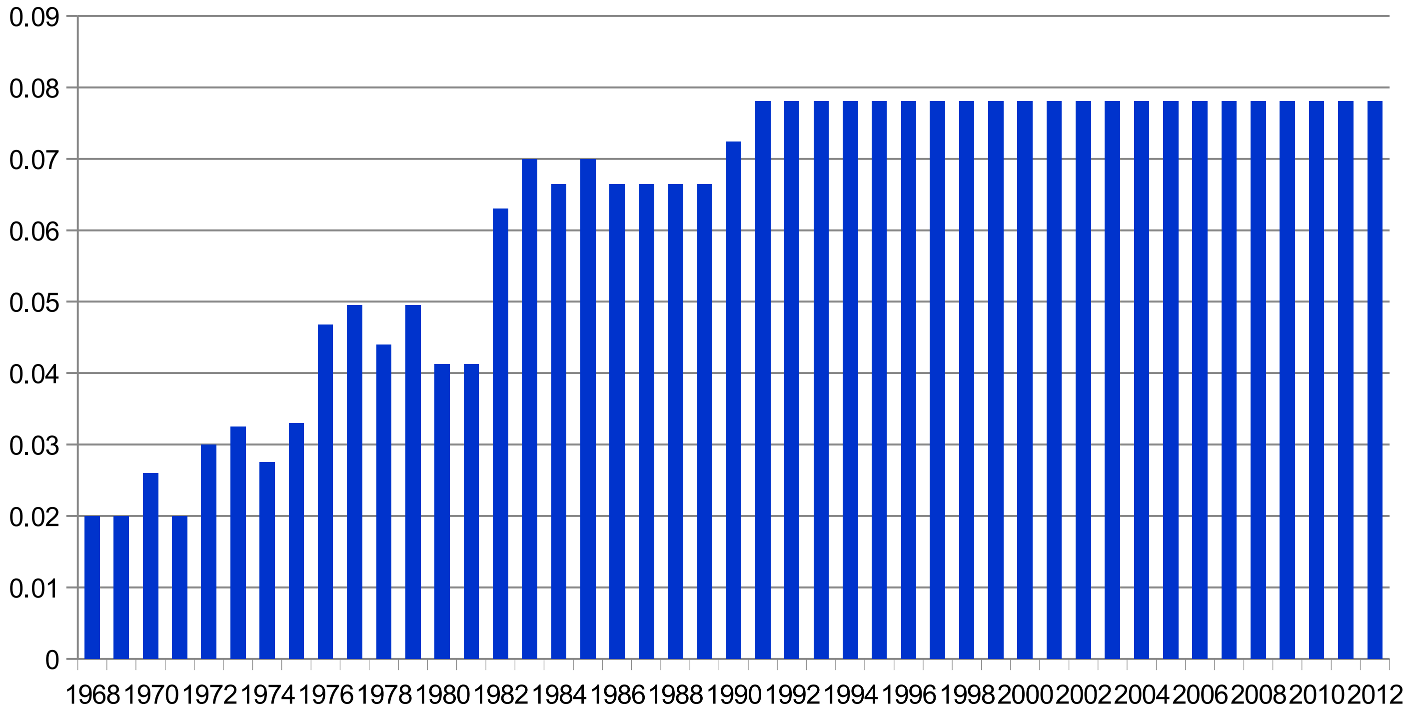
- Nebraska: No throwback rule

- Tax principles: do not adopt a throwback rule

Source: 2013 State Tax Handbook, CCH

Tax Rates

Top Marginal CIT Rate, Nebraska



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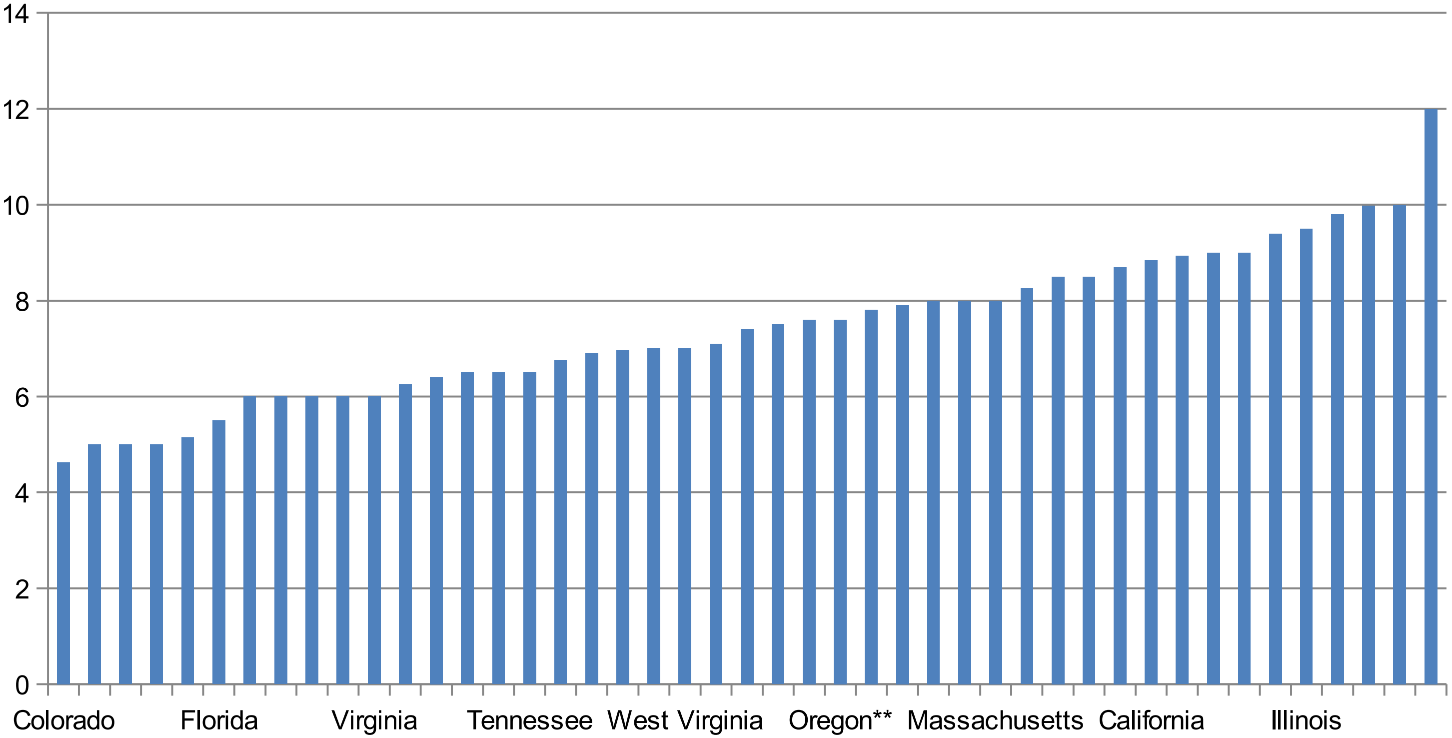
Top Marginal Tax Rate, 2013	Number of States
<5.0%	1
5.0% to 5.9%	5
6.0% to 6.9%	13
7.0% to 7.9%	9
8.0% to 8.9%	9
9.0% to 9.9%	7
10.0%+	1

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

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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

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