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## State Corporate Income Taxes

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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**

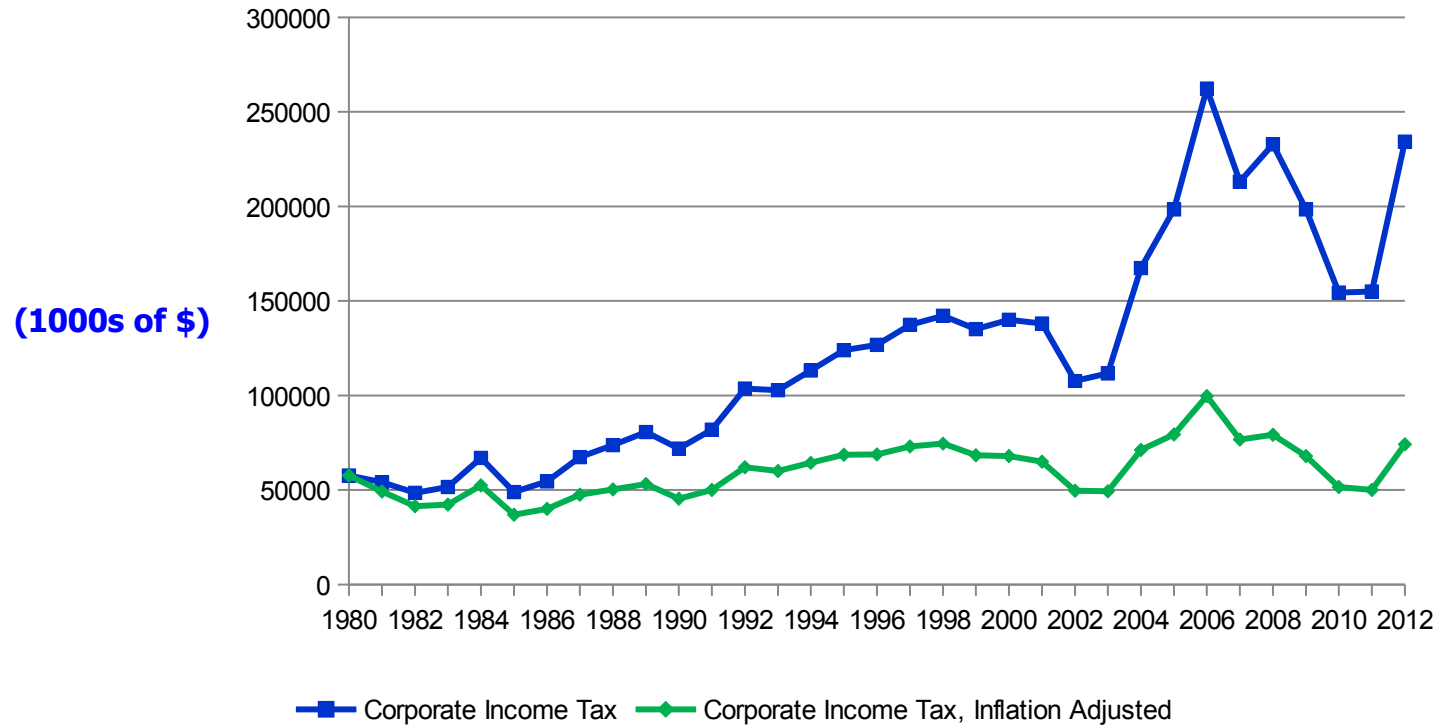
## **IV. Economic Incentive Effects**

# I. Background

# Prevalence of CIT

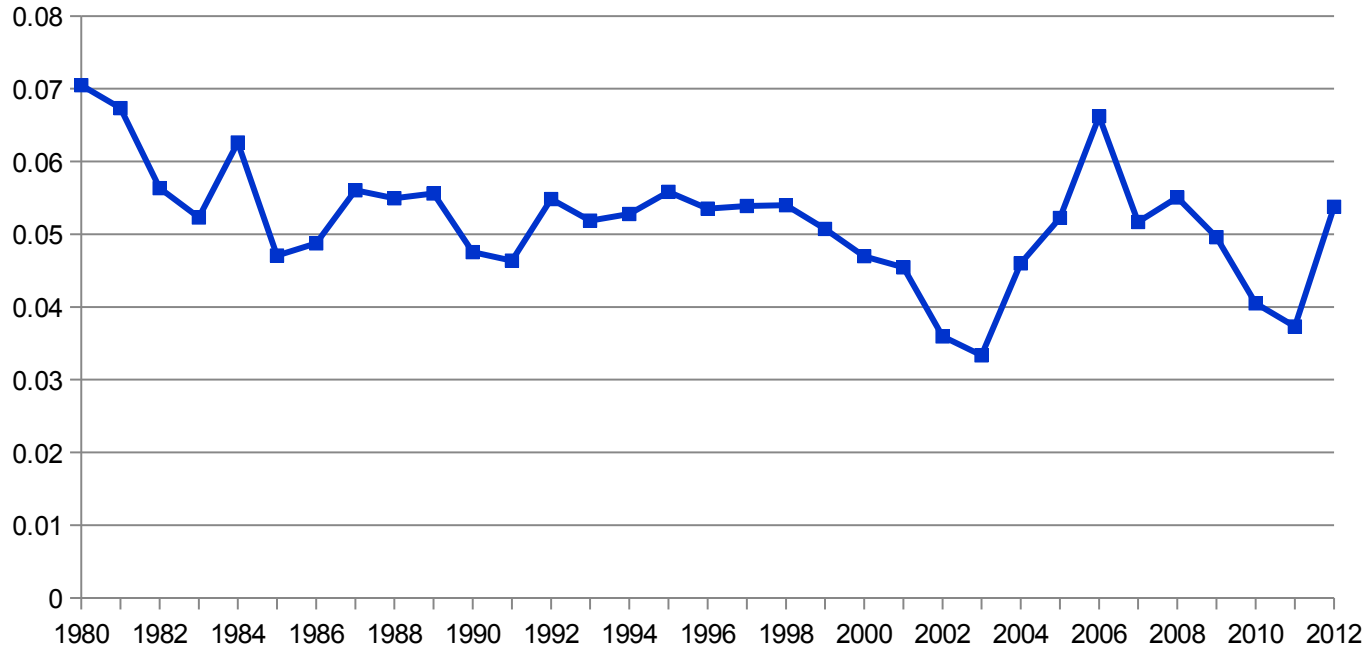
- **43 states + DC have a CIT**
- **4 states tax business other than with a CIT**
  - **MI: Business Income Tax & Gross Receipts Tax**
  - **OH: Commercial Activity Tax (a gross receipts tax)**
  - **TX: Margin Tax**
  - **WA: Business and Occupation Tax**
- **3 states do not tax business income (NV,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

## Trend in CIT Revenue, Nebraska



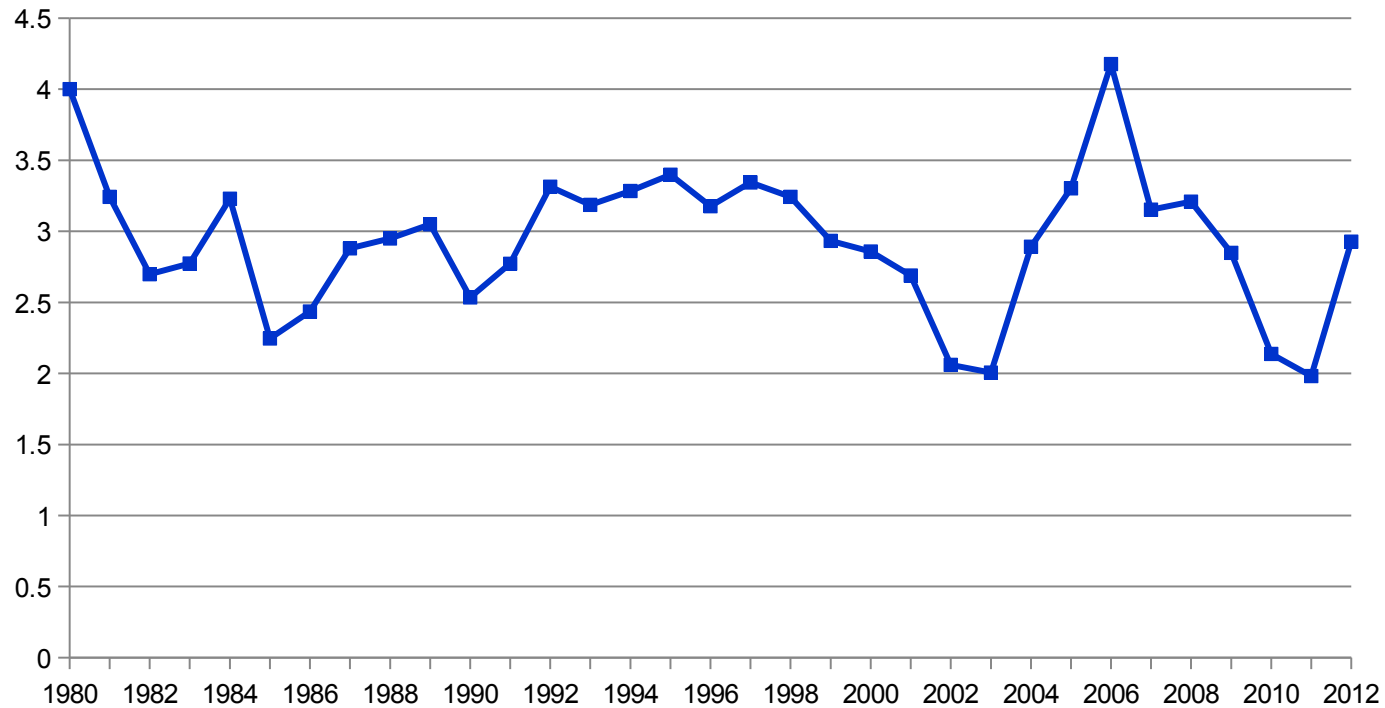
Source: U.S. Bureau of the Census, State Government Tax Collection

## CIT as a Share of Total Tax Revenue, Nebraska



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

## 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

# 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

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

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

# 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**

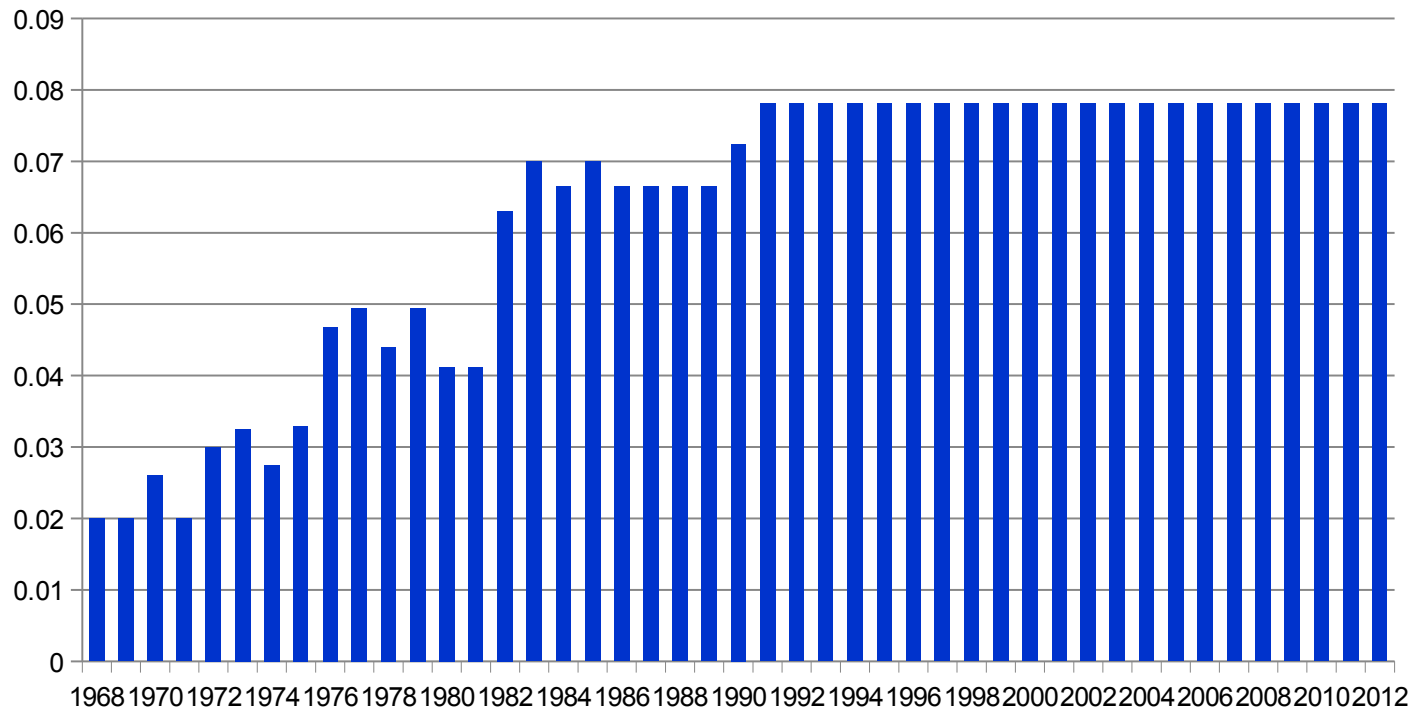
- **Nebraska: No throwback rule**

- **Tax principles: do not adopt a throwback rule**

Source: 2013 State Tax Handbook, CCH

# Tax Rates

## Top Marginal CIT Rate, Nebraska



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

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

Source: Federation of Tax Administrators



# Tax Brackets, Nebraska

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

<b>Number of Tax Brackets</b>	<b>Number of States</b>
<b>1</b>	<b>32</b>
<b>2</b>	<b>2</b>
<b>3</b>	<b>6</b>
<b>4</b>	<b>2</b>
<b>5</b>	<b>1</b>
<b>6</b>	<b>1</b>
<b>10</b>	<b>1</b>

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

# 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.**

	<b>Tax to State A</b>	<b>Tax to Nebraska</b>	<b>Total Tax</b>
<b>Locate in A</b>	<b>\$3 million</b>	<b>\$3.9 million</b>	<b>\$6.9 million</b>
<b>Locate in Nebraska</b>	<b>\$2 million</b>	<b>\$3.9 million</b>	<b>\$5.9 million</b>

**Locate in Nebraska and save \$1 million in taxes**

### **Eliminate the CIT in Nebraska**

	<b>Tax to State A</b>	<b>Tax to Nebraska</b>	<b>Total Tax</b>
<b>Locate in A</b>	<b>\$3 million</b>	<b>\$0</b>	<b>\$3 million</b>
<b>Locate in Nebraska</b>	<b>\$2 million</b>	<b>\$0</b>	<b>\$2 million</b>

**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](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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