# The Business Tax Burden: How Big a Touch on North Carolina Companies?

by Mebane Rash Whitman

North Carolina Department of Revenue


Karen Tam

## Summary

*Just how high are business taxes in North Carolina? Is the tax burden competitive? Is it fair? Depending on one's perspective, business taxes are high, low, or about right.*

*Several studies have compared the percentages of state and local taxes paid by corporations in North Carolina with those in other states. For example, in 1990, the U.S. Advisory Commission on Intergovernmental Relations ranked North Carolina's business tax burden 36th of 50 states. In 1997, the Institute on Taxation & Economic Policy found that businesses in North Carolina paid 31.7 percent of state and local taxes, ranking 48th among the states in the share of taxes paid by business, while households in North Carolina paid 64.1 percent of the state and local taxes, ranking seventh highest in the nation.*

*Other studies comparing the tax liability for hypothetical corporations in different states have reached different results. For example, a 1994 study by KPMG Peat Marwick, a big-four accounting firm, concluded that the business tax burden in North Carolina was the fourth lowest compared to 20 other states. Another study using similar methodology, but comparing cities instead of states, found that the business tax burden on a hypothetical business at a site in Greenville, N.C., was higher compared to most of the 14 other sites. A study of 12 states by accountants and tax experts found that the total tax bill for corporations in North Carolina was below the regional average.*

*The National Federation of Independent Business reached a similar conclusion in its 1996 report on the taxes paid by small businesses: Of the 44 locations compared, taxes on a small business in Raleigh, N.C., ranked 39th, with only five locations in other states having a lower tax burden. As a percentage of total tax revenue, the corporate income tax share in North Carolina has declined from 27 percent in 1947–48 to 9 percent in 1997–98, while during the same 50-year period, individual taxpayers' share has increased from 19 percent to almost 51 percent.*

*But economic developers question whether the business tax burden is competitive. If the goal is to attract new corporations to this state, the corporate income tax rate—even after it is phased down to 6.9 percent in the year 2000—is the third highest compared to other Southern states. In addition, North Carolina's corporate income tax revenue per capita is the highest among Southern states. Corporate tax rate sticker shock may deter corporate executives from making North Carolina their business location of choice.*

*Is the business tax burden too high or too low? Like so many other things, where you sit may determine where you stand on this issue.*


---


*Mebane Rash Whitman is the Center's policy analyst.*

There is an old fable from India about six blind men who are invited by their prince to touch his new elephant. Each blind man, depending on which part of the elephant's body he touched, thought that the elephant resembled a different animal or object. One blind man, feeling the elephant's trunk, decided elephants must be like snakes. Another blind man stroked the elephant's big, floppy ear and noted that it felt like a fan. The last blind man ran his hands along the elephant's long tail and found that elephants are like ropes.

Not able to understand why they each had such different impressions of the elephant, the prince remarked that all of them were right *and* wrong because they each touched only one part of the elephant. To fully understand what an elephant is, said the prince, they must put all those parts together.

Many North Carolinians, including liberals, the working poor, and other individual taxpayers, think the business tax burden in North Carolina is low, and that future cuts should benefit those who need it most—using their definition, any taxpayer except corporations. But conservatives and representatives of the business community argue that because our corporate income tax rate stands out when compared to other states, the tax burden in North Carolina is not perceived to be competitive, deterring economic development statewide. It depends on your perspective. It depends on which part of the elephant you touch.

Public perception of the business tax burden is important when evaluating the business climate of a state. Hal Hovey, the editor of *State Policy Reports* and former state budget director for the state of Illinois, in a 1996 report analyzing state and local business taxes, found that the public thinks taxes on corporations are too low, but that economists generally think they are too high.[1]

To promote economic development, many analysts have suggested that business taxes be cut. "Proponents of cuts argue that these levels, whatever they might be, must be cut to stimulate economic development," writes Hovey. "Opponents of the cuts argue—implicitly or explicitly—that taxes on business are better than those on individuals. They point out that cutting business taxes must result in either shifting tax burdens to individuals or in cutting public services." Again, it depends on your perspective.

***Don't tax him. Don't tax me.***
***Tax that man behind that tree.***

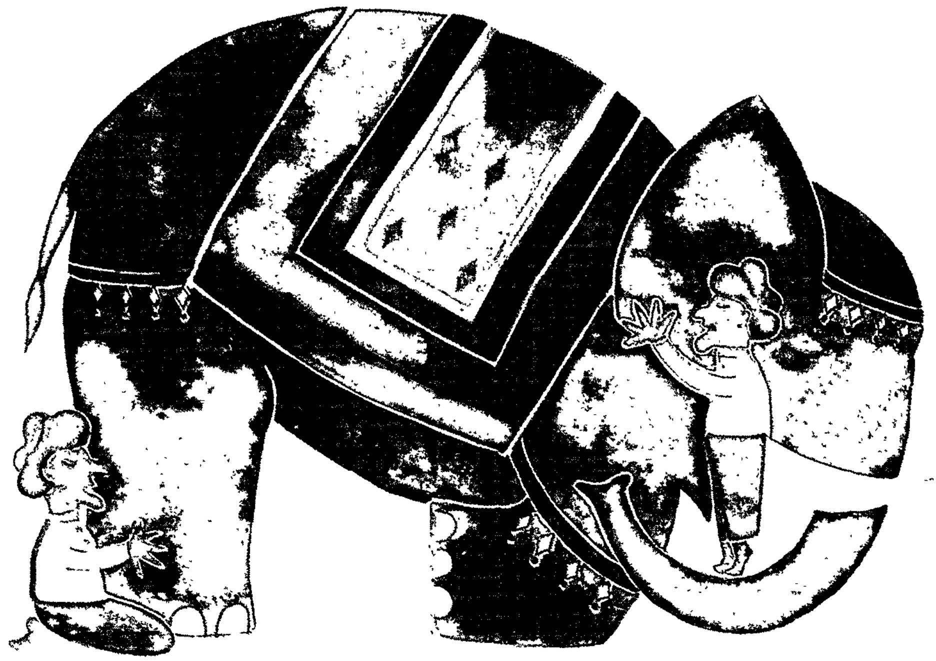
## Defining Business Taxes and Various Rationales

States have a long history of taxing big business. "By 1776, tariffs, excise taxes, and real estate taxes were being levied on businesses throughout the thirteen original states," writes Steven Galginaitis, a senior director with the economic consulting services of KPMG Peat Marwick LLP, a big-four accounting firm in Washington, D.C.[2] Today, states impose so many different taxes on business that many analysts even disagree on the definition of "business tax."

One definition is "any levy upon a firm's purchase of inputs, its transfer or ownership of assets, its earnings, or its right to do business—in short, any levy which would, in the absence of price adjustments, reduce the bottom line. Included in this definition are corporate profits taxes; real and personal property taxes on business assets; franchise taxes and business license fees; sales and use taxes and gross receipts taxes upon a firm's purchase of equipment, services, and materials; and those payroll taxes for which the [corporation] is the statutory taxpayer."[3] Excluded from this definition are sales taxes on items purchased by customers and any personal income taxes owed on the profits of corporations.

While most definitions of business tax focus on the corporation's income, assets, purchases, and sales, the debate occurs because analysts disagree about whether, in addition to taxes imposed on business by the tax laws of a state, the definition also should consider tax incidence—who really pays each business tax. Such a definition would account for the ability of a corporation to raise prices to offset its tax burden, for instance.[4] Whatever the definition, most analysts agree that ultimately all taxes on business are paid by individuals through lower profits for shareholders, limited wage increases for workers, and higher prices on goods and services for consumers.

So why not just tax individuals? A 1995 poll by FGI—a public opinion research firm based in Chapel Hill, N.C.—conducted for *The News & Observer* of Raleigh found that 69 percent of North Carolinians believe the corporate income tax is fair.[5] As compared to the personal income tax, property tax, and sales tax, the corporate income



*From* The Blind Men and the Elephant; *illustrated by Annie Mitra.*
*Copyright © 1982 by Annie Mitra. Reprinted by permission of Scholastic, Inc.*

tax is popular among citizens because they think profitable corporations should be taxed and because citizens do not pay the tax directly, and thus the tax burden on them is not obvious. There are many other rationales given for taxing corporations:

■ *Payment for Government Services.* Governments provide services that benefit corporations, including fire and police protection; the maintenance of the transportation infrastructure; the provision of public water and sewer services; trash collection; education, including the training and retraining of workers; and judicial services, such as the maintenance of the civil court system to handle disputes involving business. Business taxes can be viewed as payment for these services. The problem with this rationale from a business perspective is that there is little relationship between the benefit the corporation actually receives from government services and how much they pay in taxes.

In 1992, according to one estimate, it cost state and local governments $12.8 billion to provide various government services to corporations, but governments received $23.8 billion in business taxes.[6] These estimates are based on data collected by the Census Bureau, which tracks expenditures of state-local tax revenue by function—police, education, agricultural programs, and legislative administration, for example.[7]

Some analysts argue that the disparity between taxes paid and services received is more pronounced for some business sectors than others. As *State Policy Reports* notes, "It is clear that the disparity . . . is even wider for manufacturing than for all business. The major services manufacturers receive from government—such as water supply, sewage treatment, and use of the roads—are mostly paid for by user charges, not general taxes. Industrial facilities make few demands on the police or corrections system. But 43 percent of the business tax burden comes through property taxes and 14 percent through corporate income taxes, both of which bear heavily on manufacturing."[8]

Charles D. "Don" Liner, a member of the faculty at the Institute of Government in Chapel Hill, N.C., asserts a different perspective. "The main point should be that businesses do use public services directly and do impose some costs on the public, but more importantly they enjoy the general benefits of public services, and therefore they should pay some share of the total costs of providing those services. Those payments by a business, whether taxes or charges, are a legitimate cost of doing business and a legitimate cost of producing a product."

■ *Payment for External Costs.* A byproduct of many businesses is environmental damage, including air, water, and soil pollution. Business taxes can be justified as a way to recoup these external costs.[9] This year, for example, hog farms are in the news in North Carolina for several accidents that polluted the Neuse River and other waterways.

■ *Shift Taxes to Nonresident Consumers.* Business taxes allow a jurisdiction to export some of the tax burden to nonresident consumers. Many corporations sell their products to out-of-state individuals or companies. Because taxing the end user is impractical for administrative and legal rea-

## *Business Tax Studies: The Findings in Brief*

*This article reviews several studies that have developed different methodologies for comparing the business tax burden among the states. Below is a summary of the studies discussed in this article. For an in-depth discussion of each study, please see the text.*

### U.S. Advisory Commission on Intergovernmental Relations—"Business's Share"

In 1990, North Carolina ranked 36th in terms of the tax burden placed on business. Corporations paid 26 percent of total taxes in North Carolina. The U.S. average was 30 percent.

### The Institute on Taxation & Economic Policy: The Business Share of State and Local Taxes

This study found that businesses in North Carolina paid 31.7 percent of the state and local taxes, ranking 48th among the states in the share of taxes paid by business. Households in North Carolina paid 64.1 percent of the state and local taxes, ranking seventh highest in the nation.

### Corporate Income Tax Per Capita

In 1996, North Carolina collected $128.26 in corporate income taxes per capita, ranking 16th among the states and first among southern states. *Congressional Quarterly's State Fact Finder* uses corporate income tax per capita to compare the corporate income tax among the states.

### KPMG Peat Marwick's Business Tax Competitiveness

In terms of the average effective business tax rate, North Carolina ranked 18th, or fourth lowest, of the 21 states compared in this 1994 study of business tax competitiveness by the policy economics group of KPMG, a big-four accounting firm.

### The Representative Firm Approach

The business tax burden on a hypothetical business at a site in Greenville, N.C., was higher compared to most of the 14 other sites reviewed in this 1993 study by an economist at the Federal Reserve Bank of Boston.

### The N.C. Business Council of Management and Development Report

This 1994 study by accountants and tax experts found that the total tax bill for corporations in North Carolina was below the regional average. North Carolina's corporate income tax was higher than average.

sons, the state taxes the corporation operating in the state instead. "Whether it be through taxing the profits of out-of-state shareholders, taxing out-of-state consumers of goods produced locally, or taxing the income of out-of-state landowners, business taxation may be viewed as a means of transferring some of the costs of . . . government to other jurisdictions."[10]

In reality, the opportunities for tax exporting are limited. Raising prices usually is not feasible if a corporation is to remain competitive. Shareholders will sell their stock if they are expected to absorb the tax through reduced profits. And lowering wages does not export the burden. "In general, the ability to export taxes is restricted to situations where the state has some competitive advantage, owing to superior or unique natural resources."[11]

—*continues on page 58*

### The Corporation for Enterprise Development's *Development Report Card for the States*

This annual study compiles economic benchmarks for all 50 states and issues grades for a variety of economic performance indicators. North Carolina's report card included the following grades in 1996:

| | |
|---|---|
| Economic Performance | C |
| Business Vitality | A |
| Business Competitiveness | C |
| Entrepreneurial Energy | B |
| Structural Diversity | B |
| Development Capacity | C |
| Tax and Fiscal System | + |

### Citizens for Tax Justice and the Institute on Taxation & Economic Policy: *Who Pays?*

One part of this 1996 study evaluates the burden of the corporate income tax on families. For families earning $113,000 or less, 0.1 percent of their income absorbs the costs of the corporate income tax. For families earning $113,000–262,000, the figure is 0.2 percent, and for families earning more than $262,000, it is 0.4 percent.

### The Taxes Small Business Pay

Of the 44 locations compared in this 1996 report, taxes on a small business in Raleigh, N.C., ranked 39th, with only five locations in other states having a lower tax burden.

### Regional Financial Associates, Inc.: *The Cost of Doing Business*

North Carolina's effective tax burden ranked 34th among the 50 states, with Kentucky and Mississippi the only Southern states with higher tax burdens for business. Florida and Georgia were the two Southern states with business costs higher than North Carolina, which ranked 27th. North Carolina's business costs were lower than the national average.

### Taxes, Public Spending, and Economic Growth in North Carolina

This 1996 report predicts that increasing the personal income tax rate would retard economic growth much more than increasing the corporate income tax rate.

### Corporate Income Tax Rate: General Information

*The corporate income tax rate in North Carolina will be reduced from 7.5 percent in 1997 to 7.25 percent in 1998, 7 percent in 1999, and 6.9 percent in 2000. Only two Southern states—Louisiana and Kentucky—have corporate income tax rates higher than 6.9 percent, and they only impose those rates on net income over $100,000.*

—*Mebane Rash Whitman*

## Table 1. Rankings of the Share of State and Local Taxes Paid by Businesses and Households, by the *Institute on Taxation & Economic Policy*

| State | Share of State and Local Taxes: Business Rankings | Share of State and Local Taxes: Household Rankings |
|---|---|---|
| Alabama | 49 | 6 |
| Alaska | 1 | 51 |
| Arizona | 15 | 35 |
| Arkansas | 36 | 21 |
| California | 26 | 27 |
| Colorado | 33 | 23 |
| Connecticut | 32 | 12 |
| Delaware | 24 | 18 |
| Florida | 6 | 47 |
| Georgia | 25 | 26 |
| Hawaii | 34 | 33 |
| Idaho | 35 | 14 |
| Illinois | 8 | 39 |
| Indiana | 10 | 36 |
| Iowa | 29 | 20 |
| Kansas | 38 | 13 |
| Kentucky | 46 | 8 |
| Louisiana | 11 | 42 |
| Maine | 22 | 28 |
| Maryland | 51 | 1 |
| Massachusetts | 40 | 9 |
| Michigan | 18 | 30 |
| Minnesota | 17 | 32 |
| Mississippi | 21 | 34 |
| Missouri | 37 | 16 |
| Montana | 9 | 40 |

*—continues*

## Table 1, *continued*

| State | Share of State and Local Taxes: Business Rankings | Share of State and Local Taxes: Household Rankings |
|---|---|---|
| Nebraska | 30 | 19 |
| Nevada | 42 | 49 |
| New Hampshire | 16 | 31 |
| New Jersey | 31 | 11 |
| New Mexico | 23 | 38 |
| New York | 19 | 29 |
| **North Carolina** | **48** | **7** |
| North Dakota | 7 | 44 |
| Ohio | 47 | 3 |
| Oklahoma | 44 | 10 |
| Oregon | 43 | 5 |
| Pennsylvania | 28 | 15 |
| Rhode Island | 20 | 25 |
| South Carolina | 41 | 22 |
| South Dakota | 14 | 41 |
| Tennessee | 12 | 43 |
| Texas | 3 | 48 |
| Utah | 39 | 17 |
| Vermont | 27 | 24 |
| Virginia | 50 | 2 |
| Washington | 4 | 45 |
| West Virginia | 13 | 37 |
| Wisconsin | 45 | 4 |
| Wyoming | 2 | 50 |

*Source:* The Institute on Taxation & Economic Policy, *The Business Share of State and Local Taxes: How Oregon Compares to Other States*, April 1997, p. 1. The closer the ranking to one, the higher the share of taxes paid.

An example would be Alaska, which levies severance and property taxes on fossil fuels.

■ *Easy Money.* Business taxes are popular among citizens because most of them do not pay the taxes directly. Many politicians support business taxes because of this "low visibility."[12] Others support taxing corporations because they have "deep pockets" and are able to pay. In addition, from an administrative standpoint, business taxes are easy money, producing a lot of money which is easy to collect from a relatively small number of taxpayers. Legislators regularly hear the old adage: "Don't tax him. Don't tax me. Tax that man behind that tree."

## Business's Share: Evaluating Tax Burdens for Corporations

If it is hard to get analysts to agree on how to define "business tax," it is impossible to get them to agree on how business tax burdens should be evaluated. In 1981, the U.S. Advisory Commission on Intergovernmental Relations (ACIR), a bipartisan commission established by Congress to monitor the American federal system, developed a methodology for estimating "business's share" of state and local taxes, or the percentage of state and local taxes paid by corporations instead of individuals. According to ACIR, in 1990, corporations paid more than 26 percent of total taxes in North Carolina, ranking the state 36th in the nation in terms of the tax burden placed on business.[13] The U.S. average was 30 percent.

Although these figures reflect favorably on North Carolina's business tax burden and are cited often, the methodology used by ACIR has been criticized. Robert Tannenwald, a senior economist with the Federal Reserve Bank of Boston, writes, "The share of a state's taxes collected from business has nothing to do with how heavily or how fairly the state taxes its businesses. . . . The share of a state's taxes paid by businesses, as opposed to households, depends primarily on the labor intensity of the state's economy."[14]

According to Tannenwald, business's share of state taxes tends to be low in labor-intensive states and high in capital-intensive states. Whether a state is labor- or capital-intensive depends on (1) how well employees are paid in salary and wages (compared to how well owners of business property are compensated in terms of profits), and (2) the value of residential property compared to business property. In labor-intensive states, salary and wages tend to be high relative to profits, and the value of

***Only two Southern states—Louisiana and Kentucky—have corporate income tax rates higher than North Carolina's 6.9 percent, and they only impose those rates on net income over $100,000.***

residential property tends to be high compared to business property. Because taxes on profits and business property are the two primary business taxes, in labor-intensive states where profits and the value of business property are relatively low, business's share will tend to be low.

North Carolina is labor-intensive, according to Tannenwald's analysis, partially explaining why the state ranked 36th in terms of business's share. In North Carolina, business taxes are low because more revenue flows to workers through wages and salaries than to profits. Thus, the workers pick up a larger share of taxes. It is not that all workers in North Carolina are paid well: In 1995, the average annual pay in manufacturing in North Carolina ranked 43rd among the states, according to *CQ's State Fact Finder*. However, because industries across North Carolina are less mechanized, North Carolina remains labor-intensive.

Business's share also is influenced by a state's per-capita income, as well as its reliance on the extraction of natural resources or on an agricultural economy.[15] States with a high per-capita income generally are ranked low in terms of business's share because any personal income tax structure implemented by a state will result in a high yield, usually reducing the pressure to increase business's share. Business's share is very high in several states—Alaska, Montana, and Wyoming, for example—because of severance taxes and property taxes levied on the extraction of natural resources. In these states, business's share does not measure the burden of business taxes borne by the average company. And states with economies that rely on agriculture may be capital-intensive, but rank low in terms of business's share. "State and local governments tend to tax farmers lightly because of the volatility of their income, the illiquidity of their assets, and their political clout," writes Tannenwald.[16] He concludes that business's share of total state tax burden has nothing to do with how heavily or how fairly corporations are

## Table 2. 1997 State Corporate Income Tax Rates

| State | Net Income Brackets | Rate (percent) | Notes |
|---|---|---|---|
| Alabama | Flat Rate | 5.0% | |
| Alaska | First $9,999 | 1.0% | |
| | $10,000–19,999 | 2.0% | |
| | $20,000–29,999 | 3.0% | |
| | $30,000–39,999 | 4.0% | |
| | $40,000–49,999 | 5.0% | |
| | $50,000–59,999 | 6.0% | |
| | $60,000–69,999 | 7.0% | |
| | $70,000–79,999 | 8.0% | |
| | $80,000–89,999 | 9.0% | |
| | $90,000 or more | 9.4% | |
| Arizona | Flat Rate | 9.0% | |
| Arkansas | First $3,000 | 1.0% | |
| | $3,001–6,000 | 2.0% | |
| | $6,001–11,000 | 3.0% | |
| | $11,001–25,000 | 5.0% | |
| | $25,001–100,000 | 6.0% | |
| | Over $100,000 | 6.5% | |
| California | Flat Rate | 8.84% | |
| Colorado | Flat Rate | 5.0% | |
| Connecticut | Flat Rate | 10.5% | |
| Delaware | Flat Rate | 8.7% | |
| Florida | Flat Rate | 5.5% | |
| Georgia | Flat Rate | 6.0% | |
| Hawaii | First $25,000 | 4.4% | |
| | $25,001–100,000 | 5.4% | |
| | Over $100,000 | 6.4% | |
| Idaho | Flat Rate | 8.0% | |
| Illinois | Flat Rate | 4.8% | An additional 2.5% personal property replacement tax imposed. |
| Indiana | Flat Rate | 3.4% | |
| | Supplemental Tax | 4.5% | |
| Iowa | First $25,000 | 6.0% | |
| | $25,001–100,000 | 8.0% | |
| | $100,001–250,000 | 10.0% | |
| | Over $250,000 | 12.0% | |
| Kansas | Flat Rate | 4.0% | |
| Kentucky | First $25,000 | 4.0% | |
| | $25,001–50,000 | 5.0% | |
| | $50,001–100,000 | 6.0% | |
| | $100,001–250,000 | 7.0% | |
| | Over $250,000 | 8.25% | |

*—continues*

## Table 2, *continued*

| State | Net Income Brackets | Rate (percent) | Notes |
|---|---|---|---|
| Louisiana | First $25,000 | 4.0% | |
| | $25,001–50,000 | 5.0% | |
| | $50,001–100,000 | 6.0% | |
| | $100,001–200,000 | 7.0% | |
| | Over $200,000 | 8.0% | |
| Maine | First $25,000 | 3.5% | |
| | $25,001–75,000 | 7.93% | |
| | $75,001–250,000 | 8.33% | |
| | Over $250,000 | 8.93% | |
| Maryland | Flat Rate | 7.0% | |
| Massachusetts | | | A surtax of 14% is imposed. Corporations pay an excise tax equal to the greater of the following: (a) $2.60 (includes surtax) per $1,000 of value of Massachusetts tangible property not taxed locally or net worth allocated to Massachusetts, plus 9.5% (includes surtax) of net income; or (b) $400, whichever is greater. |
| Michigan | | | A single business tax rate of 2.3% is imposed. |
| Minnesota | Flat Rate | 9.8% | |
| Mississippi | First $5,000 | 3.0% | |
| | $5,001–10,000 | 4.0% | |
| | Over $10,000 | 5.0% | |
| Missouri | Flat Rate | 6.25% | |
| Montana | Flat Rate | 6.75% | |
| Nebraska | First $50,000 | 5.58% | |
| | Over $50,000 | 7.81% | |
| Nevada | | | No Corporate Income Tax |
| New Hampshire | Flat Rate | 7.0% | |
| New Jersey | Flat Rate | 9.0% | |
| New Mexico | First $500,000 | 4.8% | |
| | $500,001–1,000,000 | 6.4% | |
| | Over $1,000,000 | 7.6% | |
| New York | Flat Rate | 9.0% | |
| **North Carolina** | **Flat Rate** | **7.5%** | |
| North Dakota | First $3,000 | 3.0% | |
| | $3,001–$8,000 | 4.5% | |
| | $8,001–20,000 | 6.0% | |
| | $20,001–30,000 | 7.5% | |
| | $30,001–50,000 | 9.0% | |
| | Over $50,000 | 10.5% | |

*—continues*

## Table 2, *continued*

| State | Net Income Brackets | Rate (percent) | Notes |
|---|---|---|---|
| Ohio | First $50,000<br>Over $50,000 or<br>5.82 mills* times<br>the value of the stock,<br>whichever is greater | 5.1%<br>8.9% | |
| Oklahoma | Flat Rate | 6.0% | |
| Oregon | Flat Rate | 6.6% | |
| Pennsylvania | Flat Rate | 9.99% | |
| Rhode Island | Flat Rate | 9.0% | |
| South Carolina | Flat Rate | 5.0% | |
| South Dakota | | | Banks and financial institutions pay 6.0% of net income with modifications. |
| Tennessee | Flat Rate | 6.0% | |
| Texas | | | No Corporate Income Tax |
| Utah | Flat Rate | 5.0% | |
| Vermont | First $10,000<br>$10,001–25,000<br>$25,001–250,000<br>Over $250,000 | 5.5%<br>6.6%<br>7.7%<br>8.25% | |
| Virginia | Flat Rate | 6.0% | |
| Washington | | | No Corporate Income Tax |
| West Virginia | Flat Rate | 9.0% | |
| Wisconsin | Flat Rate | 7.9% | |
| Wyoming | | | No Corporate Income Tax |

* A mill is a monetary unit of the United States equal to one-tenth of a cent.

*Source:* Commerce Clearinghouse, *State Tax Guide,* "Corporate Income Taxes-Charts: Table of 1997 Rates," ¶10-050, pp. 2531–33.

taxed and is a poor indicator of the tax competitiveness of a state.

Hal Hovey, editor of *State Policy Reports,* agrees that there are major conceptual and data problems with the ACIR methodology.[17] For example, he notes the problems of accounting for taxes paid by a business person operating a company out of the home. A residential property tax is imposed and individual income taxes are paid, but these taxes are not reflected in a state's "business's share."

Because of Congressional budget cuts, ACIR is now defunct. Although the ACIR methodology is rarely used anymore, business's share is a useful concept for many citizens who want the tax structure to reflect an equitable division of the burden between individuals and corporations.

In April 1997, the Institute on Taxation & Economic Policy (ITEP)[18] released a report, *The Business Share of State and Local Taxes*, which uses the same concept but a different methodology to rank the percentage of state and local taxes paid in each state by business. The ITEP model analyzes state and local taxes and allocates them to households or businesses based on initial tax incidence.[19] Hal Hovey recently reviewed the ITEP study in an issue of *State Policy Reports* and found the methodology to be "good enough for government work."[20]

ITEP found that businesses in North Carolina paid 31.7 percent of the state and local taxes, ranking 48th among the states in the share of taxes paid by business. Households in North Carolina paid 64.1 percent of the state and local taxes, ranking seventh highest in the nation. The ITEP study concluded that in North Carolina, Ohio, and Oregon, there is a link between the high reliance on personal income taxes and the relatively low share of total taxes paid by business. (See Table 1, pp. 56–57.)

## The History of the Corporate Income Tax

Because it is the tax most easily identifiable as a business tax, often a state's corporate income tax is compared when evaluating tax burdens. In 1911, Wisconsin was the first state to levy a corporate income tax.[21] Forty-six states now rely on this tax to raise revenue: Only Nevada, Texas, Washington, and Wyoming do not tax corporate income.[22] South Dakota imposes its corporate income tax only on banks and financial institutions.

Thirty-three states use a flat rate; 13 states vary the rate according to the net income of the corporation.[23] (See Table 2, pp. 59–61 for state corporate income tax rates in 1997.) States use different tax bases as well, and 22 states use more than one primary base. Forty-six states use net income as a tax base, 22 use capital stock or net worth, and three use gross receipts of the corporation.[24]

In 1921, North Carolina first levied a corporate income tax, setting the rate at 3 percent.[25] The rate was increased to 4 percent in 1925, 4.5 percent in 1927, 5.5 percent in 1931, 6 percent in 1933, and 7 percent in 1987.[26] In 1991, faced with a $1.2 billion state budget crisis, the legislature raised the corporate income tax to 7.75 percent, and a temporary surtax was enacted.[27]

The surtax was 4 percent of the tax due at the 7.75 rate in 1991, 3 percent in 1992, 2 percent in 1993, 1 percent in 1994, and the surtax expired on January 1, 1995. Thus, the effective corporate income tax rate was 8.06 percent in 1991, 7.98 percent in 1992, 7.91 percent in 1993, and 7.83 percent in 1994.

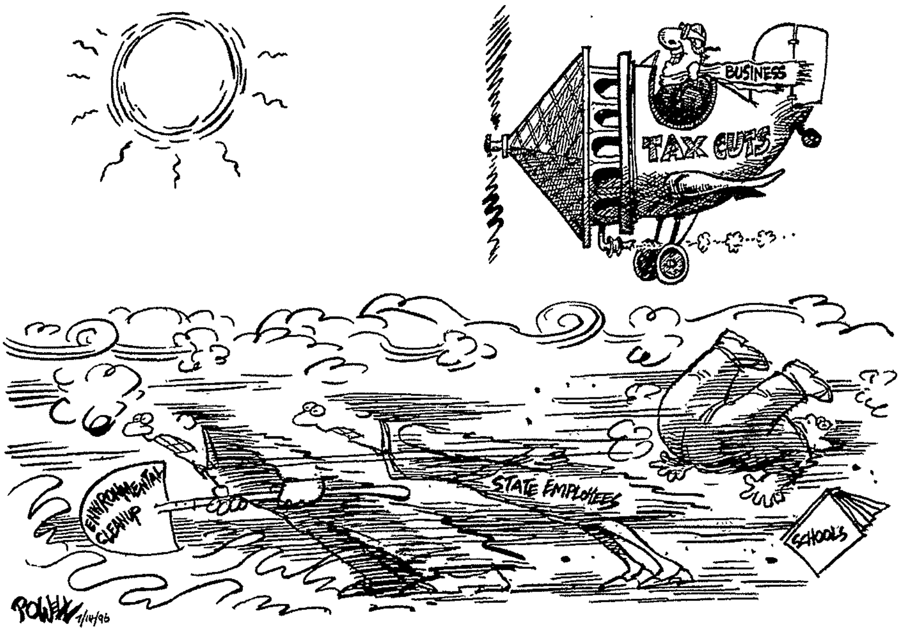
The 1991 corporate tax increase generated $85 million in revenue out of the $617 million tax hike package needed that year to balance the budget. Most of the additional revenue from raising taxes ($430 million) came in the form of a sales tax increase. There also was an increase in the personal income tax rate for higher income taxpayers to 7.75 percent. In addition, the legislature enacted $592 million in state budget cuts. Even though consumers took the brunt of the tax hike, North Carolina's corporate tax rate was already higher than most of its neighbors. The tax hike exacerbated the state's image problem in being perceived as a high tax state in the Southeast by corporate executives.

The 1996 session of the General Assembly amended the corporate income tax laws to reduce the rate from 7.75 percent to 6.9 percent over four years. The rate will be 7.5 percent in 1997, 7.25 percent in 1998, 7 percent in 1999, and 6.9 percent in 2000.[28] Only two Southern states—Louisiana and Kentucky—have corporate income tax rates higher than 6.9 percent, and they only impose those rates on net income over $100,000. (See Table 3, p. 64.)

The *corporate income tax* is levied on all corporations—other than S corporations[29]—licensed to do business or actually doing business in North Carolina. The tax is imposed on net income. An additional *franchise tax* is imposed on the net worth of the corporation, its total actual investment in tangible property in this state, or 55 percent of its appraised tangible property plus taxable intangible property, whichever is greatest.[30]

In the past, the corporate income tax rate in North Carolina may have produced sticker shock for some corporate executives considering a move to the Tar Heel state. "Our goal was to get the corporate income tax rate below 7 percent," says Phil Kirk, president of North Carolina Citizens for Business and Industry, a statewide chamber of commerce that represents businesses of all types and sizes. "We don't have plans to seek a further reduction in the near future, but the 6.9 percent rate is still higher than our competitor states of Virginia, South Carolina, Georgia, and

***Phil Kirk***




Dwane Powell, The News and Observer

Tennessee. That doesn't help any when you are trying to recruit businesses to locate in North Carolina."

After the personal income tax (more than $5 billion) and the sales and use tax (about $2.9 billion), the corporate income tax generates more revenue than any state tax. In fiscal year 1997–98, the state estimates that it will collect $999.8 million in corporate income tax, 8.9 percent of the state's general fund.[31] (See Table 4, p. 66.) As a percentage of total state tax revenue, the corporate income tax share has declined from 27 percent in 1947–48 to 9 percent in 1997–98. Even so, in 1996, 34 states relied less on the corporate income tax to generate revenue.[32] And as North Carolina's reliance on the corporate income tax has decreased, its reliance on individual income taxes as a percentage of total revenue has increased from 19 percent to almost 51 percent during the same 50-year period.

"In North Carolina, more than in other states, taxation has been shifted from the local level to the state level," says Don Liner with the Institute of Government. That means that both individuals and businesses have lower property tax rates but high levels of state taxes. The effect has been to increase dramatically the taxes on individuals, because the personal income tax has grown disproportionately because of its progressive structure and because retail sales taxes have doubled since 1971. Businesses get lower property taxes, but the corporate income tax has not grown like the personal income tax because it does not have the same progressive rate structure."

Hal Hovey criticizes the comparison of corporate income tax rates among states. "Because of the widespread use of special tax credits for investment, research and development, job expansion and other purposes, and differences among states in how much income of multi-state corporations is attributed to the taxing state, comparisons of corporate income tax rates are not particularly meaningful," he writes.[33] However, he advises using corporate income taxes per capita in *Congressional Quarterly's State Fact Finder* as the "best of many unsatisfactory ways of comparing corporate income taxes in the 50 states."[34] Based on state tax collections in 1996, North Carolina collected $128.26 in corporate income taxes per capita, ranking 16th among the states and first among Southern states. (See Tables 3, p. 64 and 5, pp. 68–69.)

The *Triangle Business Journal* of Raleigh used this approach in its study of tax burdens in 1996.[35] Based on fiscal year 1994 data, researchers at American City Business Journals, Inc., publisher of the *Triangle Business Journal*, found that North Carolina had the highest per-capita state tax burden of seven states in the Southeast (17th highest in the nation). North Carolina also had the highest per-capita individual income tax (10th highest in the nation) and corporate income tax (16th highest in the nation) in the Southeast. The *Journal* concluded that the tax burden "could keep prize companies from landing on the state's trophy shelf."

The *Journal's* study was criticized for using per-capita figures based on state collections be-

## Table 3. Corporate Income Tax Data: The South

| State | Rank | Highest Corporate Tax Rate | Rank | Corporate Income Tax Collections Per Capita 1996 |
|---|---|---|---|---|
| Kentucky | 1 | 8.25% | 6 | $73.31 |
| Louisiana | 2 | 8.0% | 4 | 75.28 |
| **North Carolina** | **3** | **7.5%** | **1** | **128.26** |
| Tennessee | 4 (tie) | 6.0% | 2 | 100.35 |
| Georgia | 4 (tie) | 6.0% | 3 | 97.84 |
| Virginia | 4 (tie) | 6.0% | 9 | 54.36 |
| Florida | 7 | 5.5% | 7 | 69.97 |
| Mississippi | 8 (tie) | 5.0% | 5 | 74.28 |
| South Carolina | 8 (tie) | 5.0% | 8 | 67.82 |
| Alabama | 8 (tie) | 5.0% | 10 | 50.93 |

*Sources:* Commerce Clearinghouse, *State Tax Guide,* "Corporate Income Taxes Charts: Table of 1997 Rates," ¶10-050, pp. 2531–33; U.S. Department of Commerce, Bureau of the Census, State Government Tax Collections: 1996. See http://ftp.census.gov/pub/govs/statetax/96tax.dat.

cause local and county taxes are not included (ignoring the significant local property tax), and thus the total tax burden on a business is not pictured. The *Journal* acknowledged this flaw up front: "Because North Carolina since the 1930s has assumed the burdens of paying for education and roads, state taxes here will be higher than in states where local governments pay those bills," observed *Journal* writer L. Scott Tillett.[36]

### Business Tax Competitiveness

Most analysts agree that the best way to make appropriate comparisons of business tax burdens is to evaluate tax liability for hypothetical corporations in different states. The Governor's Policy Office commissioned a study of North Carolina's business tax competitiveness in 1994 by the policy economics group of KPMG. The goal of the project was to evaluate a state's tax structure and its ability to "attract investment, support job creation, and eliminate obstacles to economic development."[37]

KPMG has developed a Business Tax Competitiveness Model that it uses to evaluate the business tax burden of a given state. The model calculates the effective tax rate on a hypothetical investment by representative corporations in 12 selected industries.[38] The taxes of 20 comparison states are analyzed so that the tax burdens can be compared.[39] The analysis includes corporate income and franchise taxes; property taxes, including real, personal, and intangible property; sales and use taxes on business purchases; and state gross receipts taxes on utilities.

Using this model, KPMG found that North Carolina's business taxes were competitive in comparison to the states studied. "North Carolina," the study finds, "ranks eighteenth (or fourth lowest) of the twenty-one states in terms of the average effective tax rate on investment for the twelve industries covered by the study." The effective business tax rate in North Carolina was 6.48 percent, compared to an average of 8.6 percent in competitor states. (See Table 6, p. 73.) Property taxes in North Carolina were found to be well-below average and sales taxes on business purchases were also below average. Corporate income and franchise taxes were a little above average, but the corporate income tax currently is being phased down to 6.9 percent. For families living in North Carolina, the study found that property taxes were below average, but personal income and sales taxes were above average.

In a column reacting to the KPMG study, *The News & Observer* associate editor Steve Ford wrote, "The case for business tax breaks usually leans heavily on comparisons with tax loads imposed in other states," noting that the corporate income tax rate is high for the Southeast.[40] "But," Ford concluded based on the KPMG study, "it's been established that the overall tax burden on Tar Heel businesses is not one to double them over in pain." Rob Christensen, a capital news correspondent with *The News & Observer*, put it more colorfully: "The [KPMG] study found that Big Business Inc. pays less in taxes in North Carolina than it does in most states. But Billy Bob Six Pack, the guy who punches his time card at the plant every day, has a relatively heavier tax burden than elsewhere."[41]

Robert Tannenwald, the economist with the Federal Reserve Bank of Boston, also uses a representative firm approach to evaluate tax competitiveness. His approach evaluates the comparative tax burdens in different cities by looking at business taxes in different locations through the eyes of a corporate executive in the process of making a location decision. The representative firm approach assesses most business taxes, evaluating how they affect a corporation's rate of return. In a 1993 study, Tannenwald used this approach to evaluate the tax burden on various industries in Massachusetts and 10 other states, including a site in Greenville, N.C.[42] (See Table 7, p. 74.)

For the representative firm, a rate of return is calculated for each location. The higher the rate of return for a representative firm, the lower the state's tax burden. Sites then are ranked one to 15, with one representing the lowest tax burden. Among the 15 sites, Greenville ranked 11th for apparel industries; 13th for fabricated metals, electronics, and instruments; and 14th for computers.[43] Using this method, the tax burden at the location site in North Carolina was higher than most of the other sites compared. Ranking first in all industry categories was El Paso, Texas, which has a high rate of return because Texas does not tax corporate income.[44] However, this approach has some methodological problems. Individual firms generally cannot be representative of a whole industry, and taxes in one locality may or may not be indicative of the average taxes in a state.[45]

**As a percentage of total state tax revenue, the corporate income tax share in North Carolina has declined from 27 percent in 1947–48 to 9 percent in 1997–98, while during the same 50-year period, individual taxpayers' share has increased from 19 percent to almost 51 percent.**

## Other Studies, Mixed Findings

In 1994, a study released prior to the KPMG report concluded that the tax burden on North Carolina businesses was competitive. The North Carolina Business Council of Management and Development, Inc., a group of 21 corporate executives and the Governor of North Carolina, commissioned the study, which was conducted by accountants and tax experts. The study assessed the tax burden imposed by the property tax, corporate income tax, intangibles tax, franchise tax, and sales and use tax on eight hypothetical corporations[46] in 12 Southeastern states on a scale of one to 12, with one representing a high tax burden. (See Table 8, p. 75, for comparisons by business.)

The results of the study showed that for corporations in North Carolina the total tax bill was below the regional average.[47] Predictably, North Carolina's corporate income and intangibles taxes were higher than average,[48] the sales and franchise taxes were average, and the property tax was below average. Despite conservative commentary which honed in on the part of the study that found "that North Carolina has prohibitively high corporate income taxes and intangibles taxes,"[49] the study generally undermined efforts of the business lobby in North Carolina which was pressing for business tax cuts.[50]

George Autry, executive director of MDC, a nonprofit specializing in economic policy and workforce development, criticized the methodology utilized by the accountants, noting that not all Southeastern states are North Carolina's chief competitors.[51] For example, the Business Council's study included Alabama, Louisiana, and West Virginia which are not North Carolina's *primary* competitors, but excluded Connecticut, Indiana, Ohio, and Texas, all major players in the economic development battle among the states. The KPMG report that followed used a more sophisticated methodology to correct this problem.

Still another approach is used by the Corporation for Enterprise Development (CFED), a nonprofit in Washington, D.C., that promotes widely shared and sustainable economic well-being. Each year, CFED publishes its *Development Report Card for the States*, a compilation of economic benchmarks for state and corporate decision-makers.[52] CFED gives each state a grade for economic performance,[53] business vitality, and development capacity.[54] In 1996, North Carolina received a C for economic performance, an A for business vitality—up from a D in 1995, and a C for development capacity. Three subindexes are used to

**Table 4. N.C. State General Fund Tax Revenues, in Millions**

| Tax | 1947–48 Revenue | Percent of Total | 1997–98 Revenue Estimated | Percent of Total |
|---|---|---|---|---|
| *Personal Income* | *$24.5* | *18.8%* | *$ 5675.5* | *50.7%* |
| Sales and Use | 39.3 | 30.2 | 2892.7 | 25.9 |
| *Corporate Income* | *35.1* | *27.0* | *999.8* | *8.9* |
| Public Utility Excise | 6.8 | 5.2 | 681.1 | 6.1 |
| Insurance Premiums | 4.3 | 3.3 | 269.7 | 2.4 |
| Corporate Franchise | 3.2 | 2.5 | 238.0 | 2.1 |
| Alcoholic Beverage | 10.4 | 8.0 | 171.1 | 1.5 |
| Inheritance | 1.7 | 1.3 | 137.8 | 1.2 |
| Cigarette | 0.0 | 0.0 | 46.7 | 0.4 |
| Privilege License | 3.9 | 3.0 | 43.8 | 0.4 |
| Soft Drink | 0.0 | 0.0 | 22.3 | 0.2 |
| Gift | 0.1 | 0.1 | 12.7 | 0.1 |
| Other | 0.6 | 0.5 | 1.2 | 0.0 |
| **Total** | **$130.2** | **100.0%** | **$11192.4** | **100.0%** |

*Note:* Numbers in this chart do not add up due to rounding. The numbers are based on net collections prior to earmarking. The portion of the sales tax and franchise tax that is comprised of the gross receipts tax on public utilities is combined into the public utility excise tax.

*Source:* Fiscal Research Division, North Carolina General Assembly.

***The schoolboy whips his taxed top—the beardless youth manages his taxed horse, with a taxed bridle, on a taxed road;—and the dying Englishman, pouring his medicine, which has paid seven per cent, into a spoon that has paid fifteen per cent—flings himself back upon his chintz bed, which has paid twenty-two per cent—and expires in the arms of an apothecary who has paid a license of a hundred pounds for the privilege of putting him to death.***

—REV. SYDNEY SMITH, 1771–1845

evaluate business vitality: competitiveness of existing business, entrepreneurial energy,[55] and structural diversity.[56] North Carolina received a C, B, and B, respectively.

CFED uses four measures to evaluate business competitiveness: traded strength sector,[57] change in traded strength sector, business closings, and manufacturing capital investment. North Carolina industries compete well with out-of-state industries, ranking 16th in traded sector strength and 12th in change in traded sector strength from 1990 to 1994.[58] However, North Carolina did not fare well compared to other states in terms of business closings and capital investments. From October 1994 to September 1995, 15.83 percent of businesses reported being out-of-business or reported no employment for two years, ranking North Carolina 40th in this category. The investment in new and used machinery equipment was low—4.7 percent, 44th among the states. (See Table 9, p. 75.)

Because it believes that tax competitiveness and tax rates are overemphasized and that "it is the overall soundness of a state's tax and fiscal system that impacts development,"[59] CFED evaluates the tax and fiscal system of the states in a separate index. The index measures fiscal stability[60] and balanced revenue,[61] tax fairness, and fiscal equalization.[62] The 15 highest ranking states receive a plus, the 15 lowest ranking states receive a minus, and the rest of the states receive a check mark. North Carolina's tax and fiscal system ranked fifth overall: the fiscal stability and balanced revenue of the state's system ranked second; its tax fairness ranked 30th; and its fiscal equalization ranked 13th.[63]

CFED evaluates the corporate income tax in each state as a component of balanced revenue. This approach looks at the corporate income tax as a percent of total revenue: Based on 1993 data, CFED found that revenue from the corporate income tax generated 7.28 percent of North Carolina's total tax revenue. (For 1997–98 estimates of revenue generated by various taxes in North Carolina, see Table 4, p. 66.) Compared to the U.S. average, CFED judged the percentage of total revenue from the North Carolina corporate income tax to be within the range of a well-balanced and diversified revenue system.[64]

Yet another study, *Who Pays?: A Distributional Analysis of the Tax Systems in All 50 States*, by Citizens for Tax Justice and the Institute on Taxation & Economic Policy, looks at various state taxes as shares of income for each state.[65] "Our primary finding," concludes the group, "is that by an overwhelming margin, most state and local tax systems take a greater share of income from middle- and low-income families than from the wealthy. That is to say, most state tax systems are regressive."

According to *Who Pays?*, the effective tax rate for the top one percent of families in North Carolina, those earning more than $262,000 a year, is 6.0 percent. The U.S. average is 5.8 percent. The effective rate for families earning less than $23,000 in North Carolina is 9.6 percent. The U.S. average is 12.4 percent.[66]

The study also evaluated the burden of the corporate income tax on these families. Although the taxes are initially paid by business, the methodology used establishes the business tax incidence on families. For families earning $113,000 or less, 0.1 percent of their income absorbs the costs of the corporate income tax. For families earning $113,000 –$262,000, the figure is 0.2 percent, and for families earning more than $262,000, it is 0.4 percent. Although this study addresses issues of fairness of the North Carolina tax system, it does not evaluate the competitiveness of the system from an economic development standpoint.

## Table 5. State Tax Collections 1996: Rank By Per Capita Corporate Net Income Collections, in Thousands of Dollars

| Rank | State | Total Tax Collections | Corporate Net Income Tax Collections | Corporate Net Income Taxes as a % of Total Tax Collections | Per Capita Collections |
|---|---|---|---|---|---|
| 1 | Alaska | $ 1,519,082 | $ 326,270 | 21.478% | $537.51 |
| 2 | Delaware | 1,688,349 | 166,021 | 9.833 | 228.99 |
| 3 | Michigan | 19,128,687 | 2,189,742 | 11.447 | 228.24 |
| 4 | Massachusetts | 12,453,370 | 1,227,861 | 9.859 | 201.55 |
| 5 | Connecticut | 7,830,181 | 641,389 | 8.191 | 195.90 |
| 6 | California | 57,746,664 | 5,831,072 | 10.097 | 182.92 |
| 7 | New Hampshire | 837,092 | 179,652 | 21.461 | 154.61 |
| 8 | Indiana | 8,437,031 | 894,403 | 10.600 | 153.12 |
| 9 | Minnesota | 10,055,523 | 703,089 | 6.992 | 150.94 |
| 10 | New York | 34,150,039 | 2,729,835 | 7.993 | 150.11 |
| 11 | New Jersey | 14,384,897 | 1,155,270 | 8.031 | 144.63 |
| 12 | Pennsylvania | 18,725,016 | 1,705,813 | 9.109 | 141.49 |
| 13 | Illinois | 17,277,319 | 1,621,276 | 9.383 | 136.85 |
| 14 | West Virginia | 2,770,888 | 235,123 | 8.485 | 128.76 |
| 15 | Idaho | 1,857,006 | 152,735 | 8.224 | 128.46 |
| ***16*** | ***North Carolina*** | ***11,882,318*** | ***939,278*** | ***7.904*** | ***128.26*** |
| 17 | North Dakota | 985,327 | 74,299 | 7.540 | 115.37 |
| 18 | Wisconsin | 9,616,833 | 579,311 | 6.023 | 112.27 |
| | **United States** | **418,606,087** | **29,425,386** | **7.029** | **111.15** |
| 19 | Arizona | 6,409,395 | 448,040 | 6.990 | 101.18 |
| 20 | Tennessee | 6,184,562 | 533,862 | 8.632 | 100.35 |
| 21 | Kansas | 3,978,761 | 254,873 | 6.405 | 99.10 |
| 22 | Georgia | 10,292,371 | 719,400 | 6.989 | 97.84 |
| 23 | New Mexico | 3,060,637 | 163,402 | 5.338 | 95.39 |
| 24 | Oregon | 4,415,725 | 300,459 | 6.804 | 93.78 |
| 25 | Arkansas | 3,708,744 | 228,801 | 6.169 | 91.16 |
| 26 | Utah | 2,913,960 | 176,781 | 6.066 | 88.39 |
| 27 | Rhode Island | 1,549,195 | 86,973 | 5.614 | 87.85 |
| 28 | Montana | 1,256,416 | 75,762 | 6.030 | 86.19 |
| 29 | Nebraska | 2,369,462 | 126,801 | 5.351 | 76.76 |
| 30 | Vermont | 841,029 | 44,818 | 5.328 | 76.09 |
| 31 | Louisiana | 4,906,283 | 327,543 | 6.675 | 75.28 |
| 32 | Mississippi | 3,862,541 | 201,742 | 5.223 | 74.28 |
| 33 | Kentucky | 6,489,256 | 284,733 | 4.387 | 73.31 |
| 34 | Ohio | 15,649,492 | 807,435 | 5.159 | 72.27 |

Finally, the National Federation of Independent Business examined the tax burdens on *small* businesses in a 1996 report, *The Taxes Small Business Pay.* According to the report, a typical small business (in this study, a corporation grossing almost $4.5 million with 15 employees) in Raleigh, North Carolina, pays $22,805 in state taxes and $5,569 in local taxes.[67] The total state and local tax burden ($28,374) is 70 percent of the 44-city average ($40,671). North Carolina ranks 39th, with only five locations in other states having a lower tax burden. State tax liability accounts for 80.4 percent of that burden in North Carolina, compared to an average of 52.6 percent in state tax liability, according to a review of this study in *State Policy Reports.*[68]

## The Effect of Business Taxes

The policy decision to tax business does have consequences. Business taxes can have an impact on economic development in a state, because taxes may affect corporate decision-making. "Until the late 1980s, when states and localities began to fall over themselves giving incentives to businesses and when corporations discovered that they could play off one state against another, there was no question that taxes were an insignificant location determinant," says Don Liner with the Institute of Government.[69] According to the CFED, surveys of corporate executives indicate that taxes influence their location decisions less than other factors such as "quality of labor, market potential,

### Table 5, *continued*

| Rank | State | Total Tax Collections | Corporate Net Income Tax Collections | Corporate Net Income Taxes as a % of Total Tax Collections | Per Capita Collections |
|---|---|---|---|---|---|
| 35 | Missouri | 7,300,119 | 375,029 | 5.137 | 69.98 |
| 36 | Florida | 19,699,256 | 1,007,556 | 5.114 | 69.97 |
| 37 | South Carolina | 5,113,034 | 250,867 | 4.906 | 67.82 |
| 38 | Maryland | 8,166,692 | 330,553 | 4.047 | 65.17 |
| 39 | Maine | 1,896,564 | 71,062 | 3.746 | 57.17 |
| 40 | Hawaii | 3,069,300 | 65,547 | 2.135 | 55.36 |
| 41 | Virginia | 8,900,413 | 362,830 | 4.076 | 54.36 |
| 42 | Colorado | 4,820,163 | 205,700 | 4.267 | 53.81 |
| 43 | South Dakota | 730,251 | 38,099 | 5.217 | 52.05 |
| 44 | Alabama | 5,257,771 | 217,616 | 4.138 | 50.93 |
| 45 | Oklahoma | 4,617,778 | 163,734 | 3.545 | 49.60 |
| 46 | Iowa | 4,440,540 | 202,929 | 4.569 | 28.01 |
| 47 (tie) | Nevada | 2,889,254 | N/A | 0.000 | 0.00 |
| 47 (tie) | Texas | 21,259,072 | N/A | 0.000 | 0.00 |
| 47 (tie) | Washington | 10,586,463 | N/A | 0.000 | 0.00 |
| 47 (tie) | Wyoming | 625,966 | N/A | 0.000 | 0.00 |

*Source:* U.S. Department of Commerce, Bureau of the Census, State Government Tax Collections: 1996. See http://ftp.census.gov/pub/govs/statetax/96tax.dat.

access to raw materials, and so forth."[70]

Paul Lawler, executive director of the North Carolina Economic Developers Association, observes, "The plant may have to be proximate to its customer base. Or the plant may have to be near a raw material source or an energy source. A plant must have access to sufficient labor, to transportation, to utilities, and so forth. But once it gets past these 'must haves,' which vary according to the business, then variables such as taxes and other cost items can come into play."

***Chuck Neely***

Rep. Chuck Neely (R-Wake) notes, "If taxes create a marginal difference between one state and another, then there is a disincentive to investment."

State business taxes also have an effect on the "business climate" or "business image" of a state. North Carolina's Department of Commerce boasts that the Old North State has earned its distinction as "The Better Business Climate State." They cite numerous advantages to lure corporations to North Carolina including a community college program that trains industrial workers; funds that are available for water, sewer, gas, and electric lines to a new site; a variety of tax credits; assistance with business start-up costs; and improved highway access.

Regional Financial Associates, Inc., an economic consulting firm specializing in the U.S. economy, uses a "cost of doing business index" to assess the effect of business costs—including labor costs, effective tax burdens, and energy costs—on economic development. "Because they influence the profitability and locational decisions of expanding or relocating firms, differences in business costs across the states are an important determinant of long-term relative growth."[71]

Based on data from 1994–96, North Carolina's effective tax burden ranked 34th among the 50 states, with Kentucky and Mississippi the only Southern states with higher *tax burdens* for business. Florida and Georgia were the two Southern states with *business costs* higher than North Carolina, which ranked 27th. (See Tables 10, p. 76, and 11, p. 77.) However, North Carolina's business costs were lower than the national average. "Low business costs," notes the August 1997 report, "are a near necessity for above-average growth .... Oklahoma, in particular, is attracting a large number of business expansion and relocations as a result of its low-cost structure coupled with an aggressive, pro-business government." (For more on efforts to lure industry to North Carolina, see John Manuel, "N.C. Economic Development Incentives: A Necessary Tool or Messing with the Market?," p. 23.)

## Other Approaches to Thinking About Business Taxes

In 1996, the John Locke Foundation, a conservative think tank organization in Raleigh, N.C., released a report by N.C. State University professor Michael Walden, examining tax rates, tax collections, government spending, and economic statistics for North Carolina from 1957 to 1992.[72] The economist found that increasing the personal income tax rate retards economic growth much more than increasing the corporate income tax rate. "The economy does not respond as much to changes in the corporate income tax as it does to changes in the personal income tax rate," says Walden.

For example, Walden predicts that if you double the North Carolina corporate income tax rate, corporate income would drop by 5 percent, but doubling this state's personal income tax rate would reduce personal income by 50 percent. According to supply-side economics theory, take-home-pay motivates people to work. As the personal income tax increases, take-home-pay decreases. Employees work less, spending declines, and the effect is a more significant reduction in personal income. Walden cautions that his predictions regarding corporate taxes were not based on the

***It is not a tax bill but a tax relief bill providing relief not for the needy but the greedy.***

—Franklin Delano Roosevelt,
February 1944
Tax Bill Veto Message

*effective* corporate income tax rate, which would account for corporate tax deductions and tax credits and might impact the effect the corporate income tax rate has on corporate income.

By contrast, the North Carolina Budget and Tax Center (BTC), a progressive think tank that is a special project of the North Carolina Justice and Community Development Center, has analyzed the impact of business tax cuts on low- and moderate-income North Carolinians. The BTC maintains that the tax burden on business in North Carolina is very low and that business has benefited from tax cuts and tax credits in 1995 and 1996. "Policymakers should be careful to consider 'Who benefits' from these cuts," concludes Dan Gerlach, author of *BTC Reports*. Gerlach asks, "Do economically robust counties need new job creation tax credits? Do corporations need more tax relief, much of which will accrue to out-of-state shareholders and out-of-state consumers at the expense of the State's own taxpayers? Do such tax relief measures help the State to remain competitive if they come either now or in the future at the cost of measures to improve education and promote public health and safety?"[73]

Rep. Paul Luebke (D-Durham) notes, "Beyond the narrow dollars and cents debate of whether tax incentives are necessary to bring jobs to North Carolina, a fundamental question is what social responsibility corporations have to pay their fair share of public investment. For example, I am critical of business interests in North Carolina for touting their support of public education as they work quietly behind the scenes for additional tax breaks."

***Paul Luebke***

## The Business Climate in North Carolina

Thanks to bipartisan cooperation, since 1995 the North Carolina General Assembly has cut individual and business taxes significantly. The personal exemption for individual income tax was raised from $2,000 to $2,500, and a $60 per child tax credit was created in 1996. The corporate income tax rate will be phased down from 7.75 percent in 1995 to 6.9 percent in 2000. The intangibles tax—a tax on stocks, bonds, and accounts receivable—was eliminated in 1995, and the soft drink tax will be phased out over three years beginning July 1997. The *state* sales tax on food was reduced from four to three cents in 1996 and from three to two cents in 1997.

"We got one cent off the food tax in 1996, one cent off in 1997, and in 1998 we'll go after the remaining two cents,"[74] says Marian Dodd, state president of the League of Women Voters of N.C. "This tax should have been repealed decades ago. It's a regressive tax, penalizing the people that can afford it the least—low income North Carolinians."

***Marian Dodd***

According to the N.C. Budget and Tax Center, in fiscal year 1996–97, individuals will receive two-thirds of the tax relief afforded by 1996 tax cuts, but by 2000–01, corporations will receive 61.5 percent of the benefit.[75] Dan Gerlach, director of the BTC, says, "Tax policy should not be about who wins and who loses. But obviously, looking at the tax burden on corporations and individuals in North Carolina, we are competitive on the corporate side and not on the personal side."

The method North Carolina uses to assess the corporate income tax also is important. For companies that conduct business across state lines, states have adopted methods of apportioning nationwide corporate income so that businesses are not over- or under-taxed. Traditionally, states have weighted equally three factors—property, payroll, and sales used in determining the amount of income generated by business activity in a given state. Since 1989, North Carolina has double-weighted the sales factor, benefiting companies with operations concentrated in North Carolina but with significant sales in other states.[76] Twenty-nine states weight the sales factor more than the traditional 33 percent.[77]

"The trend has been toward the double-weighted sales tax," says Rick Carlisle, former economic policy advisor to the Governor and now deputy secretary of the Department of Commerce.

"There are sound policy reasons for it—it rewards companies that establish an investment and employment presence in the state more than those that conduct economic activity but create jobs and investment elsewhere."

Tax breaks often are used by North Carolina as incentives for corporations deciding to locate here. In fact, the double-weighted sales factor was a tax break used to encourage RJR Nabisco to build an Oreo cookie factory in Garner. The factory was never built because RJR was involved in a leveraged buyout, but some North Carolina corporations still benefit from this tax break to the tune of more than $33.6 million a year in foregone revenue, according to the latest estimate by the Fiscal Research Division of the General Assembly.[78]

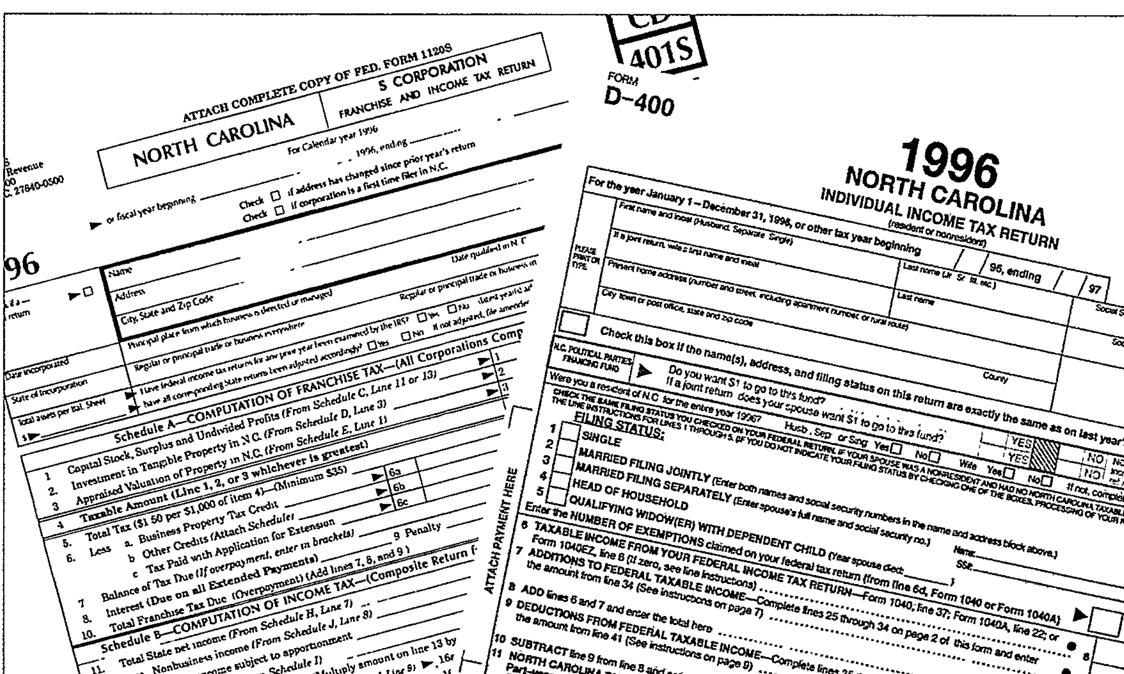
A variety of tax credits and tax exemptions are offered to corporations in North Carolina. For instance, the property tax on inventory was repealed in 1985. There are many sales tax exemptions and discounts, including an exemption for sales of custom computer software. Tax credits also are available for constructing or installing solar equipment and for utilizing the Wilmington or Morehead City ports. In 1996, new corporate tax credits were enacted to encourage investment, worker training, job creation, and research and development.[79] (See John Manuel, "N.C. Economic Development Incentives: A Necessary Tool or Messing with the Market?," p. 23.)

"Generally," says Rep. Neely, "I would prefer to see taxes cut across the board rather than giving selected preferences. There should be a compelling reason for policymakers to elect to discriminate by providing a tax incentive to some businesses and not others. The General Assembly should always be on guard against advocates for special treatment of different interests because you end up playing favorites."

## Four Options for the Future of Business Taxation

In 1993, the National Conference of State Legislatures and the National Governors' Association co-authored a report, *Financing State Government in the 1990s*, evaluating state tax systems. "In order to preserve a viable, fair system of business taxation," the report concludes, "states have to cooperate in formulating policy, drafting laws, and administering their business taxes."[80] Because many corporations conduct business in more than one state, corporations and states are worried about the issues of double taxation and tax base erosion, respectively. Interstate cooperation may be essential in the future to address these tax equity issues.[81]

States also could deal with these issues by allowing the federal collection of state business taxes. Because "the inter-state conflict over state taxation of business income leads at a minimum to poorly worded statutes, taxpayer uncertainty, and higher compliance costs, and revenue uncertainty for governments," corporation income should be uniformly



taxed and collected for the states by the federal government, argues Robert Strauss, a professor of economics and public policy at Carnegie-Mellon University.[82] Historically, there has been a lot of resistance to this idea, because states do not want to delegate collection responsibility to the Internal Revenue Service. However, if the tension between the business community and the states continues to escalate, this may become a viable option.

This tension also could be alleviated if states adopted a value-added tax (VAT) to replace current business taxes. The VAT is a tax imposed on the value added to a good or service at each stage of its production or distribution.[83] Although Michigan is currently the only state using a tax similar to the VAT, it is the principal business tax in Canada, Japan, and European countries.[84]

As different policy options like the VAT are considered by states as they evaluate the best way to tax corporate America, the need for a high quality revenue system may drive the decisions being made. In *Financing State Government in the 1990s*, the authors propose that "a state tax system should provide appropriate and timely revenues, distribute burdens equitably, promote economic efficiency and growth, be easily administered, and ensure accountability."[85]

The Corporation for Enterprise Development offers these additional recommendations to guide the debate:

- "Reframe the debate about taxes and business climate so that adequate tax competitiveness becomes only one of a number of important goals of a quality fiscal system;
- Review the ways that changing conditions affect a specific state's tax structure and develop a reform approach that creates a better fit between a state's fiscal system and its underlying economic base;
- Explore more comprehensive tax reforms rather than adopting inadequate, 'only-just-getting-by' solutions;
- Curb wasteful expenditures;
- Cooperate with other states around uniformity issues, taxing multi-state corporations, and restraining the incentives 'arms race'; and
- Create a tax system with lower rates, greater predictability, a broader base, more equity, and greater simplicity."[86]

Bill Schweke, an analyst at CFED, sums up the organization's position on taxes this way: "We want policymakers (1) to look at all dimensions of tax policy and what a change might mean; (2) not to let simplistic views on tax competitiveness trump

### Table 6. Effective Tax Rates, *KPMG Peat Marwick* Study

| Rank | State | Effective Tax Rate |
|---|---|---|
| 1 | Louisiana | 11.54% |
| 2 | Arizona | 11.14 |
| 3 | Texas | 11.11 |
| 4 | Indiana | 10.96 |
| 5 | Ohio | 10.78 |
| 6 | Pennsylvania | 10.43 |
| 7 | Florida | 10.25 |
| 8 | Tennessee | 9.86 |
| 9 | Michigan | 9.74 |
| 10 | Mississippi | 9.56 |
| 11 | South Carolina | 8.44 |
| 12 | Massachusetts | 8.02 |
| 13 | Georgia | 7.77 |
| 14 | Kentucky | 7.59 |
| 15 | Arkansas | 7.14 |
| 16 | Illinois | 6.80 |
| 17 | California | 6.73 |
| **18** | **North Carolina** | **6.48** |
| 19 | New York | 6.41 |
| 20 | Virginia | 5.03 |
| 21 | Alabama | 4.91 |
| | 21-State Average | 8.60 |

*Source:* Policy Economics Group, KPMG Peat Marwick LLP, *Comparative Analysis of the Relationship of North Carolina's Tax Structure to Economic Development,* Washington, D.C., Nov. 30, 1994, p. 44. This study assessed business tax competitiveness in 20 states and North Carolina. The taxes covered include federal income taxes; state income and franchise taxes; state and local property taxes, including intangibles; state and local sales taxes; and state utility taxes. The effective tax rate is calculated based on the difference between pretax and after-tax rates of return and accounts for the impact of taxes on investment decisions. See pp. 18 and 64–65 of the KPMG report for an in-depth discussion of effective tax rates.

## Table 7. The Rankings of Industry-Specific Representative Firms at Selected Locations, 1993

| | Apparel | | Fabricated Metals | | Computers | | Electronics | | Instruments | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Site of Facility** | **Rate** | **Rank** | **Rate** | **Rank** | **Rate** | **Rank** | **Rate** | **Rank** | **Rate** | **Rank** |
| Los Angeles, CA | 16.5 | 7 | 17.3 | 12 | 17.4 | 12 | 17.3 | 12 | 17.1 | 10 |
| Stamford, CT | 16.4 | 11 | 17.2 | 13 | 17.3 | 13 | 17.2 | 13 | 16.9 | 13 |
| Rockford, IL | 16.5 | 7 | 17.5 | 7 | 17.6 | 8 | 17.6 | 6 | 17.2 | 7 |
| Bedford, MA | 16.4 | 11 | 17.5 | 7 | 17.7 | 7 | 17.6 | 6 | 17.2 | 7 |
| Chelmsford, MA | 16.6 | 6 | 17.7 | 4 | 17.9 | 4 | 17.7 | 4 | 17.4 | 4 |
| Foxboro, MA | 16.5 | 7 | 17.6 | 5 | 17.8 | 5 | 17.7 | 4 | 17.4 | 4 |
| Greenfield, MA | 16.5 | 7 | 17.6 | 5 | 17.8 | 5 | 17.6 | 6 | 17.3 | 6 |
| Waltham, MA | 16.3 | 14 | 17.4 | 9 | 17.6 | 8 | 17.5 | 9 | 17.1 | 10 |
| Hagerstown, MD | 16.9 | 2 | 18.0 | 2 | 18.1 | 2 | 17.9 | 2 | 17.7 | 2 |
| Nashua, NH | 16.7 | 3 | 17.4 | 9 | 17.5 | 11 | 17.4 | 11 | 17.1 | 10 |
| Poughkeepsie, NY | 16.7 | 3 | 17.9 | 3 | 18.0 | 3 | 17.8 | 3 | 17.5 | 3 |
| **Greenville, NC** | **16.4** | **11** | **17.2** | **13** | **17.2** | **14** | **17.2** | **13** | **16.9** | **13** |
| Lancaster, PA | 15.8 | 15 | 16.7 | 15 | 16.8 | 15 | 16.8 | 15 | 16.5 | 15 |
| Memphis, TN | 16.7 | 3 | 17.4 | 9 | 17.6 | 8 | 17.5 | 9 | 17.2 | 7 |
| El Paso, TX | 17.5 | 1 | 18.4 | 1 | 18.5 | 1 | 18.4 | 1 | 18.0 | 1 |
| Tax-Free Site | 18.6 | | 19.0 | | 19.2 | | 18.9 | | 18.8 | |

*Note:* The methodology assumes a pre-tax rate of return of 25 percent on all investments undertaken by each representative firm. Costs other than taxes are assumed to be the same. After-tax rates of return for the representative firms vary only because of differences in the state and local tax burdens.

*Source:* Robert Tannenwald, "Massachusetts' Tax Competitiveness," *New England Economic Review,* Boston, Mass., Jan./Feb. 1994, Table 5, p. 43.

all other tax policy objectives; and (3) to weigh all these aspects before making a final decision."

Paul Lawler, executive director of the North Carolina Economic Developers Association, questions CFED's recommendation to reframe the debate so that competitiveness is reduced in importance. "They might as well ask for a reduction in the physicalness of NBA basketball play and a return to the two-hand set shot," says Lawler. "The debate is not one of our choosing; it is one of the very tough competitive environment that is not just national but international in scope. We can add other considerations to the debate but the setting of the frame is beyond our scope."

Rep. Luebke believes that the intellectual debate about tax policy is very valuable, but adds, "We shouldn't forget that each month during a General Assembly session new corporate tax breaks are passed. So as we debate this issue, the state tax burden is shifting away from business towards middle- and low-income consumers."

### So, Is the Business Tax Burden High or Low?

Generally, business proponents think that business taxes need to be fair, but more

## Table 8. Overall Business Tax Burden As Calculated by the *North Carolina Business Council of Management and Development Report*

| Business | Ranking in Overall Business Tax Burden Out of 12 States | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | AL | AK | FL | GA | KY | LA | MS | NC | SC | TN | VA | WV |
| Paper Products | 12 | 11 | 6 | 5 | 7 | 1 | 3 | 9 | 4 | 8 | 10 | 2 |
| Machinery Products | 12 | 12 | 9 | 4 | 5 | 2 | 3 | 8 | 6 | 7 | 11 | 1 |
| Food Products | 12 | 10 | 7 | 4 | 5 | 1 | 3 | 9 | 6 | 8 | 11 | 2 |
| Textiles | 12 | 10 | 6 | 3 | 5 | 1 | 4 | 8 | 7 | 9 | 11 | 2 |
| Groceries | 12 | 10 | 9 | 4 | 5 | 3 | 2 | 11 | 8 | 6 | 7 | 1 |
| Department Stores | 12 | 11 | 10 | 5 | 3 | 4 | 2 | 8 | 9 | 6 | 7 | 1 |
| Home Improvement | 12 | 9 | 7 | 4 | 3 | 5 | 2 | 8 | 11 | 6 | 10 | 1 |
| Banks | 10 | 9 | 1 | 7 | 4 | 8 | 6 | 6 | 11 | 2 | 12 | 3 |

*Note:* The number one denotes a high tax burden.

*Source:* The North Carolina Business Council of Management and Development, Inc., *The Tax Burden on Businesses: A Comparison of the Twelve Southeastern States*, Sept. 1, 1994, pp. 3, 5, and 7.

## Table 9. Competitiveness of Existing Business in North Carolina

| Measure | | Rank Among the 50 States |
|---|---|---|
| Traded Strength Sector | $10,775 | 16 |
| Change in Traded Sector Strength | $1,218 | 12 |
| Business Closings | 15.83% | 40 |
| Capital Investment | 4.70% | 44 |

*Notes:*

- Traded Sector Strength: Traded sector personal income per worker in dollars, 1994. The traded sector of each state is comprised of industries which compete in multistate, national, and international markets.
- Change in Traded Sector Strength: Change in traded sector strength per worker in dollars, 1990–94. This addresses the changing conditions of a state's traded sector industries.
- Business Closings: Percentage rate of business closings from October 1994–September 1995.
- Manufacturing Capital Investment: Investment in new and used machinery and equipment as a percentage of manufacturing value added, 1991.

*Source:* The Corporation for Enterprise Development, *The 1996 Development Report Card for the States*, Washington, D.C., Business Vitality Index, pp. 155–57.

## Table 10. *Regional Financial Associates* Rankings of Effective Tax Burdens on Business

| Rank | State | State and Local Tax Index |
|---|---|---|
| 1 | New York | 132.9 |
| 4 | Michigan | 113.6 |
| 12 | Ohio | 105.5 |
| 21 | Arizona | 102.8 |
| 24 | Massachusetts | 100.1 |
| 25 | California | 99.3 |
| 26 | Pennsylvania | 99.3 |
| 29 | Kentucky | 97.8 |
| 31 | Mississippi | 96.3 |
| 33 | Illinois | 93.9 |
| **34** | **North Carolina** | **92.5** |
| 35 | Georgia | 91.9 |
| 36 | South Carolina | 91.8 |
| 39 | Arkansas | 89.9 |
| 40 | Indiana | 89.2 |
| 41 | Florida | 87.4 |
| 43 | Texas | 85.8 |
| 45 | Virginia | 84.6 |
| 46 | Louisiana | 84.5 |
| 49 | Alabama | 77.8 |
| 50 | Tennessee | 77.6 |

*Source:* Patrick J. Howie, "Cost of Doing Business: An Update," August 1997. This report is available from Regional Financial Associates, Inc., 600 Willowbrook Lane, Suite 600, West Chester, PA 19382-5500, Telephone (610) 696-8700. This index compares total taxes paid by businesses to total income earned. "Since states and municipalities levy charges for a variety of items, which affects the profitability of a business as if it were a tax, total taxes includes both taxes and charges. Total taxes paid is the addition of total taxes less severance taxes, which are dependent upon region-specific land conditions, plus total charges less education and hospital charges, which are the result of government owned operations not paid by business. The effective tax burden is created by summing the state and local taxes and dividing by total personal income." Regional Financial Associates ranks all 50 states. North Carolina's neighboring and competitor states are presented in this table. A ranking of one is indicative of a higher effective tax burden. The national average is 100.0. The index is based on 1994–96 data.

## Table 11. *Regional Financial Associates* Rankings of Overall Cost of Doing Business

| Rank | State | Cost of Doing Business Index |
|---|---|---|
| 5 | New York | 113.1 |
| 6 | Michigan | 111.0 |
| 9 | California | 107.9 |
| 13 | Pennsylvania | 104.7 |
| 15 | Illinois | 102.5 |
| 17 | Florida | 100.3 |
| 19 | Ohio | 99.8 |
| 22 | Arizona | 99.0 |
| 26 | Georgia | 96.0 |
| **27** | **North Carolina** | **96.0** |
| 28 | Virginia | 96.0 |
| 30 | Indiana | 95.1 |
| 32 | Alabama | 94.7 |
| 33 | South Carolina | 94.6 |
| 36 | Tennessee | 92.8 |
| 38 | Texas | 90.9 |
| 39 | Mississippi | 90.7 |
| 41 | Louisiana | 89.6 |
| 42 | Arkansas | 89.5 |
| 47 | Kentucky | 86.5 |

*Source:* Patrick J. Howie, "Cost of Doing Business: An Update," August 1997. This report is available from Regional Financial Associates, Inc., 600 Willowbrook Lane, Suite 600, West Chester, PA 19382-5500, Telephone (610) 696-8900. The index, which compares business costs in each state to the national average, is comprised of unit labor costs, effective tax burdens, and energy costs. Regional Financial Associates ranks all 50 states. North Carolina's neighboring and competitor states are presented in this table. A ranking of one is indicative of a higher cost of doing business. The national average is 100.0. The index is based on 1994–96 data.

importantly, they need to be competitive. They argue that state taxes should be evaluated and compared from the perspective of a corporate executive making a location decision. Since business taxes ultimately are paid by individuals, so the argument goes, business taxes should be as low as possible to lure companies to the area, maximize profits, generate more jobs, increase wages, and promote economic development across the board. According to corporate executives and lobbyists for the business community, this is the reason to keep business taxes low or cut them further.

But like the blind men touching the elephant, opponents to business tax cuts caution against looking at just one aspect of North Carolina's tax structure. They argue that individuals, especially the working poor, should be the primary beneficiary of any future tax cuts, noting that North Carolina's reliance on individual income taxes as a percentage of total revenue has increased from 19 percent in 1947–48 to almost 51 percent in 1997–98. And, even if business taxes are ultimately paid by individuals, citizens think that corporations are better able to afford the direct burden of paying these taxes.

Is the business tax burden too high, too low, or about right? Like so many other things, it depends on your perspective.

## FOOTNOTES

[1] *State Policy Reports*, Vol. 14, Issue 16 (Aug. 1996), p. 7.

[2] Steven Galginaitis, "What Taxes Do States Impose on Business?," *State Taxation of Business: Issues and Policy Options*, Westport, Conn., Thomas F. Pogue, ed., 1992, p. 3.

[3] William H. Oakland and William A. Testa, "State-local business taxation and the benefits principle," *Economic Perspectives,* Federal Reserve Bank of Chicago, Chicago, Ill., Jan./Feb. 1996, p. 3.

[4] Galginaitis, note 2 above, pp. 3–5.

[5] "Rating the issues," *The News & Observer*, Raleigh, N.C., Apr. 29, 1995, p. 15A. The poll was conducted by the consulting firm FGI in Chapel Hill, N.C. Telephone interviews with 608 adults were conducted from April 20–23, 1995. The margin of error is plus or minus four percentage points.

[6] Oakland and Testa, note 3 above, Table 2, p. 10.

[7] Estimates of spending on the business sector are generated by classifying expenditures in four categories: business; household; prorated—expenditures in this category are allocated to the business sector proportionately; and joint—expenditures in this category are shared equally by households and businesses. *Business expenditures* include agricultural programs and water transportation terminals. *Household expenditures* include education, welfare, health, parks and recreation, and housing. Arguably, the business sector benefits indirectly from these services. *Prorated expenditures* include overhead for public buildings and legislative and financial administration. And *joint expenditures* include police, fire, corrections, and transportation.

[8] *State Policy Reports*, note 1 above, p. 8.

[9] Another way to recoup such costs—for example the disposal of hazardous wastes—is user fees.

[10] Oakland and Testa, note 3 above, p. 5.

[11] *Ibid.*

[12] *Ibid.*, p. 4. See also William H. Oakland, "How Should Businesses Be Taxed?," *State Taxation of Business: Issues and Policy Options*, Westport, Conn., Thomas F. Pogue, ed., 1992, p. 20.

[13] Robert Tannenwald, "Massachusetts' Tax Competitiveness," *New England Economic Review,* Boston, Mass., Jan./Feb. 1994, Table 4, p. 39, citing the Advisory Commission on Intergovernmental Relations (ACIR). ACIR's findings are consistent with a May 1993 report by the Office of State Budget and Management, *Business Taxes in North Carolina,* which found that businesses paid 26 percent of state and local taxes in North Carolina in 1990–91, compared to 26.6 percent in 1980–81.

[14] *Ibid.*, p. 40.

[15] For an extensive discussion of the problems with ACIR's methodology, see *ibid.,* p. 40.

[16] *Ibid.*

[17] *State Policy Reports,* note 1 above, p. 7.

[18] The Institute on Taxation & Economic Policy (ITEP) is a nonprofit in Washington, D.C., that has researched tax issues since 1980, looking at the distributional consequences of both current law and proposed changes.

[19] ITEP, *The Business Share of State and Local Taxes: How Oregon Compares to Other States*, April 1997, p. 10. The taxes analyzed include personal income, payroll, corporate income, property, gift and inheritance, general sales, special sales, motor fuel, beer, cigarette, utility, hotel, severance, and unemployment insurance. See the report for a detailed explanation of the methodology, including how the taxes were allocated to households and businesses.

[20] *State Policy Reports*, Vol. 15, Issue 17 (Sept. 1997), p. 15.

[21] Galginaitis, note 2 above, p. 6.

[22] ACIR, *Significant Features of Fiscal Federalism: Volume 1,* Washington, D.C., Sept. 1995, Table 22, pp. 74–77.

[23] Commerce Clearinghouse, *State Tax Guide,* "Corporate Income Taxes-Charts: Table of 1997 Rates," ¶10-050, pp. 2531–33.

[24] ACIR, note 22 above, Table 24, p. 88.

[25] Larry Rogers, "Corporate Income Tax," N.C. Department of Revenue, presented to the Tax Fairness Study Commission on Jan. 13, 1988 and reprinted in *Synopsis of State and Local Tax Material Presented to Tax Fairness Study Commission,* June 1988, pp. IV–77 to IV–85, at p. IV–78. See also N.C.G.S. § 105-130 *et al.*

[26] See Tax Fairness Study Commission, note 25 above, p. IV–78.

[27] Institute of Government, "State Taxation," *North Carolina Legislation 1991,* Chapel Hill, N.C., p. 228.

[28] N.C.G.S. § 105-130.3 (1996 Cum. Supp.).

[29] S Corporations enjoy many attributes of the corporate business structure (typically incorporated as C Corporations), but S Corporations avoid federal tax liability. S Corporations pass through on a prorated basis the income of the corporation to its shareholders, who pay personal income tax on the profits in lieu of the corporation paying corporate income tax. In 1988, the North Carolina General Assembly passed the S Corporation Income Tax Act, regarding the state corporate tax liability of S Corporations. See N.C.G.S. §§ 105-131 to -131.8.

[30] N.C.G.S. § 105-122 (c) and (d).

[31] Fiscal Research Division, North Carolina General Assembly.

[32] Based on calculations performed by the N.C. Center for Public Policy Research on data from the U.S. Department of Commerce, Bureau of the Census, 1996 State Government Tax Collections.

[33] Harold A. Hovey and Kendra A. Hovey, *CQ's State Fact Finder*, Washington, D.C., 1997, Table F-17, p. 152, with notes on p. 161.

[34] *Ibid.*

[35] L. Scott Tillett, "State's tax bite tops in region, says TBJ study," *Triangle Business Journal,* Raleigh, N.C., May 24, 1996, p. 1.

[36] *Ibid.*, p. 50.

[37] KPMG Peat Marwick LLP, *Comparative Analysis of the Relationship of North Carolina's Tax Structure to Economic Development,* Washington, D.C., Nov. 30, 1994, pp. 1–63.

[38] The industries evaluated include food products manufacturing, textile products manufacturing, pharmaceuticals manufacturing, machinery (including computer manufacturing), automotive components manufacturing, wholesale trade manufacturing, commercial banking, furniture manufacturing, instruments (including medical technology manufacturing), retailing, computer services, and biotechnology.

[39] The states included for comparison are Alabama, Arizona, Arkansas, California, Florida, Georgia, Illinois, Indiana, Kentucky, Louisiana, Massachusetts, Michigan, Mississippi, New York, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, and Virginia.

[40] Steve Ford, "Business tax breaks—what's the rush?," *The News & Observer*, Raleigh, N.C., July 14, 1996, p. 26A.

[41] Rob Christensen, "Audit shifted tax-cut focus away from Big Business," *The News & Observer*, Raleigh, N.C., Dec. 10, 1994, p. 1A.

[42] See Tannenwald, note 13 above, Appendix 1, for a com-

prehensive discussion of the methodology used in the representative firm approach.

[43] *Ibid.*, Table 5, p. 43.

[44] *Ibid.*, Footnote 28, p. 43.

[45] *Ibid.*, p. 42.

[46] The eight corporations included four manufacturers, three retailers, and one bank.

[47] The North Carolina Business Council of Management and Development, Inc., *The Tax Burden on Businesses: A Comparison of the Twelve Southeastern States*, Sept. 1, 1994, pp. 3, 5, and 7.

[48] The North Carolina General Assembly repealed the intangibles tax in 1995, effective for taxes due April 15, 1996. See the 1995 N.C. Session Laws, Chapter 41, Senate Bill 8.

[49] The John Locke Foundation, "Business Taxes Reviewed: Study finds N.C. imposes heavy income-tax burden," *Carolina Journal*, Vol. 2, No. 29 (Nov. 14, 1994), p. 1.

[50] See "Study shows North Carolina is no beast of tax burden," *Business North Carolina*, Charlotte, N.C., March 1995, p. 10.

[51] "Business tax fallacy," *The News & Observer*, Raleigh, N.C., Dec. 4, 1994, p. 24A.

[52] Corporation for Enterprise Development (CFED), *The 1996 Development Report Card for the States*, Washington, D.C., 10th ed., 1996, pp. 102–03.

[53] CFED bases its assessment of **economic performance** on three subindexes: *the employment subindex,* including long-term employment growth, short-term employment growth, unemployment rate, and unemployment duration; *the earnings and job quality subindex,* including average annual pay, average annual pay growth, and health coverage; and *the equity subindex,* including poverty rate, income distribution, income distribution change, and rural/urban disparity.

[54] CFED bases its assessment of **development capacity** on four subindexes: *the human resources subindex,* including high school graduation, high school education attainment, and college education attainment; *the technology resources subindex,* including Ph.D. scientists and engineers in the workforce, science and engineering graduate students, patents issued, university research and development, federal research and development, and small business innovation research grants; *the financial resources subindex,* including commercial bank deposits, loans to deposits, loans to equity, commercial and industrial loans, commercial and industrial loans to other loans, venture capital investments, and small business investment capital financing; and *the infrastructure and amenity resources subindex,* including highway deficiency, bridge deficiency, urban mass transit availability, energy cost, sewage treatment needs, urban housing costs, health professional shortage areas, and tourism spending.

[55] Includes new companies, change in new companies, and new business job growth.

[56] Includes sectoral diversity—the range of industries that comprise a state's traded sector—and dynamic diversity—the degree of employment change across traded sector industries.

[57] The traded sector of each state is comprised of industries which compete in multistate, national, and international markets.

[58] CFED, note 52 above, p. 156.

[59] *Ibid.*, p. 179.

[60] **Fiscal stability** is based on a state's rainy day fund, net operating loss carrybacks, and the breadth of the sales tax base. Net operating loss carrybacks allow corporations to offset current losses against past profits, making tax collections unpredictable.

[61] **Balanced revenue** assesses diversity of a revenue system based on reliance on the personal income tax, general sales tax, property tax, and corporate income tax.

[62] **Fiscal equalization** is a term used to describe the fiscal capacity of local governments in a state as measured by the extent state governments finance key services and share revenue with local communities. See CFED, note 52 above, p. 190.

[63] *Ibid.*, p. 181.

[64] *Ibid.*, pp. 182–83.

[65] The Citizens for Tax Justice (CTJ) and the Institute on Taxation & Economic Policy (ITEP), *Who Pays?: A Distributional Analysis of the Tax Systems in All 50 States*, Washington, D.C., June 1996, p. 1. CTJ is a public interest research and advocacy group focusing on federal, state, and local tax policies and their impact upon the nation.

[66] *Ibid.*, Appendix 1, pp. 34 and 52. The methodology used to evaluate the effective tax rate assesses the combined incidence of the major state and local taxes affecting individuals and businesses.

[67] The National Federation of Independent Business, *The Taxes Small Business Pay*, June 1994, Table 3, pp. 18–20.

[68] *State Policy Reports*, Vol. 14, No. 13 (July 1996), p. 14.

[69] See Zsolt Becsi, "Do State and Local Taxes Affect Relative State Growth?," *Economic Review*, Federal Reserve Bank of Atlanta, Vol. 81, No. 2 (March/April 1996), pp. 18–36.

[70] CFED, *Innovations: Positive Business Climates Project (No. 5),* Chapel Hill, N.C., Aug. 1996, p. 2.

[71] Patrick J. Howie, "Cost of Doing Business: An Update," August 1997. This report is available from Regional Financial Associates, Inc., 600 Willowbrook Lane, Suite 600, West Chester, PA 19382-5500, Telephone (610) 696-8700.

[72] Dr. Michael L. Walden, *Taxes, Public Spending, and Economic Growth in North Carolina*, Raleigh, N.C., Dec. 1996, p. 26.

[73] North Carolina Budget and Tax Center (BTC), "Is this the time for more business tax cuts?," *BTC Reports*, Raleigh, N.C., Vol. 2, No. 10, p. 9.

[74] The food tax then would be two cents, imposed by *local* governments.

[75] BTC, "The 1996 North Carolina Tax Reduction Initiatives," *BTC Reports*, Raleigh, N.C., Vol. 2, No. 16, p. 8.

[76] See N.C.G.S. § 105-130.4 (i). The tax break was passed in 1988.

[77] See the website for the State Services Organization at http://sso.org/fta/corp_app.html.

[78] For a discussion of the cookie tax break, see Jim Jensen, "The Barbarians Are Doing All Right, Thank You But What About North Carolina Taxpayers?," *The Journal of Common Sense*, Common Sense Foundation, Raleigh, N.C., Vol. 1, No. 2 (May 1995), pp. 4–5, 14. For a list of North Carolina's major tax breaks, see William Schweke and Carl Rist, Corporation for Enterprise Development, "Managing for Higher Returns: What Does North Carolina Actually Spend on Economic Development and How Can These Investments Be Better Managed?," Chapel Hill, N.C., March 1997, Table 3, p. 34.

[79] The William S. Lee Quality Jobs and Business Expansion Act, 1996 N.C. Session Laws, Chapter 13 (2nd Extra Session), House Bill 18.

[80] National Conference of State Legislatures and the National Governors' Association, *Financing State Government in the 1990s*, Washington, D.C., 1993, p. 84.

[81] *Ibid.*, p. 89.

[82] Robert P. Strauss, "Federal Collection of State Corporate Income Taxes," *State Taxation of Business: Issues and Policy Options*, Westport, Conn., Thomas F. Pogue, ed., 1992, p. 70.

[83] The VAT is a regressive tax because the ratio of tax to income falls as income rises.

[84] *Financing State Government*, note 80 above, pp. 92–97.

[85] *Ibid.*, p. vii.

[86] *Innovations*, note 70 above, p. 3.