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A Review and Analysis of

***Total State and Local Business Taxes:
A 50-State Study of the Taxes Paid by Business in FY 2003***

Prepared for the Council on State Taxation by

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The size of the tax burden on business is a significant issue in many states at this time because of the financial condition of state budgets. The Council on State Taxation (COST), a national association whose objective is “to preserve and promote the equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities,” commissioned a detailed, state-by-state analysis of total state and local business taxes to serve as a factual basis for policy deliberations in state legislatures. The complete study is accessible from the COST web site.¹

The PARCA staff has analyzed the detailed figures for all states in this study from an Alabama-specific perspective, focusing on how our state and local business taxes compare to national averages and to business taxes in nine other southeastern states against which we customarily benchmark Alabama.² The comparisons address the reliance on six broad types of business taxes, the business share of total state and local taxes, and the burden of business taxes on private economic activity. The results of these comparisons are surprising in some respects; they show why it is important to have detailed information available when considering tax policy changes.

Taxes Included in the Study

The study is based on Ernst & Young methodology that uses data from public sources to estimate the business share of revenue from the following types of state and local taxes:

1. Property taxes. The estimates include ad valorem taxes on the real and tangible property of businesses, including farm and forestry property. Property taxes on residential rental property also were considered business taxes for this study. Where levied, state taxes on intangible property held by corporations and partnerships were included in the business tax category, while taxes on intangible property held by individuals were included in the household tax category.

2. General sales and use taxes. These estimates include the sales taxes paid by businesses on purchases of goods and services used in operations and production and on business purchases of capital equipment. Also included in this category were the general gross receipts taxes on business in a few states that are classified by the Census Bureau as general sales taxes, such as Washington State's business and occupations tax.

3. Excise and gross receipts taxes. These include:

a. Gross receipts taxes on insurance premiums and utility receipts. Gross revenue taxes on insurance and utility companies were counted as business taxes because they are often levied in lieu of generally applicable business taxes. Sales taxes on consumer purchases of these services were not counted as business taxes.

b. Motor fuel excise taxes. Motor fuel taxes were allocated to the purchaser of the fuel, with the taxes on business purchases of motor fuel counted as business taxes.

c. Other excise and selective sales taxes. Excise taxes on alcohol, pari-mutuels, and tobacco were considered consumer taxes and excluded from the business tax estimates. The remaining selective sales taxes were allocated 50% to business and 50% to households.

4. License and other taxes. These include:

a. Asset transfer taxes. Documentary and stock transfer taxes were allocated 80% to households and 20% to business, based on an estimated share of such transactions arising from business acquisitions. Estate and gift taxes were allocated 100% to households, and none to business.

b. License taxes. Business privilege or license taxes were allocated to business because the taxes are the statutory liability of the business. Taxes on motor vehicle licenses and registrations were allocated as follows: taxes on automobiles and a portion of trucks were allocated to households, while all fees by weight, motor carrier fees, and other truck fees were allocated to business. Driver licenses and hunting and fishing licenses were allocated entirely to households because they generally are the liability of individuals, even if directly related to the operation of a business or profession.

c. Other taxes. Local gross receipts and related taxes on business earnings were allocated to business; taxes on gross earnings or other income-equivalents of individuals were allocated to households.

5. Corporate income taxes. Net income taxes on corporations, including separate taxes on banks, were allocated entirely to business. Individual income taxes were allocated entirely to households, even though a portion of these taxes is due to income earned by pass-through entities. Individual income taxes paid on corporate dividends are allocated entirely to households.

6. Employer payroll taxes. Employer contributions for unemployment insurance, as well as worker compensation and disability insurance taxes, were allocated to entirely businesses.

Reliance on Various Business Taxes, as a Percentage of Total Business Tax Revenue

Table 1 shows the breakdown of estimated FY 2003 state and local business taxes by type for the nation as a whole, for nine southeastern states that surround Alabama, and for Alabama. The table shows the percentage of total business tax revenue raised from each of six broad groups of taxes. The largest source of state-local business tax revenue nationally is the property tax (38.6% of total business tax revenue), followed by the general sales tax on business inputs (24.8%). Together, these two taxes comprise 63.4% of total business tax revenue. Excise and gross receipts taxes rank third nationally, at 11% of the business-tax total, and license and other taxes rank fourth, at 9.5% of all business tax revenue. Corporate income taxes rank fifth, at 8.6% of the business-tax total, and payroll taxes comprise the remaining 7.5% of all business taxes.

Alabama's nine competitor states in the southeast raise state and local tax revenue from businesses in ways that are proportionally similar to the national average – yet there are some noticeable differences. When taxing businesses, the southeastern states rely more heavily on sales

taxes (29.2% vs. 24.8% of business tax revenues) and excise and gross receipts taxes (13.5% vs. 11.0%), but less heavily on property taxes (36.3% vs. 38.6%), corporate income taxes (7.0% vs. 8.6%), and payroll taxes (5.0% vs. 7.5%).

Table 1. Breakdown of State and Local Business Taxes for FY 2003

| Type of Tax on Business | National Average | Average of 9 S.E. States | Alabama |
|--|------------------|--------------------------|---------|
| Property taxes on business property | 38.6% | 36.3% | 24.7% |
| General sales taxes on business inputs | 24.8% | 29.2% | 26.3% |
| Excise and gross receipts taxes | 11.0% | 13.5% | 22.9% |
| License and other taxes | 9.5% | 9.0% | 11.1% |
| Corporate income tax | 8.6% | 7.0% | 8.8% |
| Payroll taxes | 7.5% | 5.0% | 6.2% |
| | 100.0% | 100.0% | 100.0% |

Source: Ernst & Young, *Total State and Local Business Taxes*

Alabama is dramatically below the national average in its reliance on the property tax as a business tax source (24.7% vs. 38.6% of total business-tax revenues), and dramatically above the national average in its use of business excise and gross receipts taxes (22.9% vs. 11.0% of total business-tax revenues). Alabama's business tax structure also is substantially different from the average of its competitor states in the southeast. It is below the regional average in reliance on business property and sales taxes, while it is above the regional average in the use of the other four types of business taxes shown in the table. Alabama derives only 51% of its state and local business tax revenue from property and sales taxes, while the nine-state southeastern average is 65.5%. Conversely, Alabama derives 49% of its business tax revenue from the other four types of taxes, while its neighbors average only 34.5% from those sources.

Alabama's low utilization of property taxes as a business revenue source is no surprise, since it ranks last among all states in the overall use of this tax source. Similarly, Alabama's high standing in the use of business gross receipts taxes and selective sales taxes has shown up in Census Bureau comparisons for many years. The two most surprising Alabama statistics in the table are those for sales taxes and corporate income taxes, but both appear to be explainable. The relatively low Alabama percentage of business tax revenue from sales taxes (in comparison to other states in the southeast, which share Alabama's relatively high sales tax rates) may be due to the abatement of sales taxes on business construction materials as a common tax incentive. The relatively high Alabama percentage for corporate income tax revenue may be due to the recent business tax legislation that reduced reliance on the business privilege tax and raised the rate of the corporate income tax to 6.5%.

Table 2 shows the percentage breakdown for business taxes in all ten southeastern states. Alabama relies less on the property tax for business tax revenue than any other southeastern state except Louisiana, and five of the nine other states show higher sales tax percentages. On the other hand, Alabama ranks first among these ten states in its reliance on excise and gross receipts taxes, second in reliance on corporate income taxes, third in reliance on payroll taxes, and fourth in reliance on license and other taxes. These percentages indicate only that the *proportion* of business tax revenue that comes from property and sales taxes is low in Alabama, while the *proportion* of business

tax revenue that comes from the other four types of taxes is high, in comparison with our nearest competitors. The figures say nothing about the absolute burden of these various taxes on businesses, which will be addressed later. Neither do they address the relative burden of the various kinds of taxes on businesses versus individuals. The figures do tell us, however, that Alabama's business tax structure is distinct from that of most of our neighbors in certain ways. The state that is closest to Alabama in terms of the proportions of business tax revenue from various sources is Kentucky.

Table 2. Breakdown of Southeastern State and Local Business Taxes for FY 2003

| Type of Tax on Business | AL | AR | FL | GA | KY | LA | MS | NC | SC | TN |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Property taxes on business property | 24.7% | 32.7% | 41.7% | 39.4% | 25.9% | 21.9% | 40.3% | 32.3% | 50.8% | 32.6% |
| General sales taxes on business inputs | 26.3% | 32.0% | 24.3% | 36.9% | 24.1% | 46.2% | 29.4% | 22.4% | 20.3% | 31.6% |
| Excise and gross receipts taxes | 22.9% | 10.2% | 16.3% | 8.0% | 18.1% | 10.5% | 8.7% | 21.6% | 9.0% | 8.7% |
| License and other taxes | 11.1% | 7.5% | 7.8% | 4.4% | 15.3% | 13.3% | 9.0% | 8.9% | 7.7% | 12.5% |
| Corporate income tax | 8.8% | 7.3% | 6.6% | 6.8% | 7.8% | 4.3% | 7.5% | 9.4% | 6.2% | 8.5% |
| Payroll taxes | 6.2% | 10.3% | 3.3% | 4.6% | 8.7% | 3.8% | 5.1% | 5.6% | 6.1% | 6.1% |
| | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

Source: Ernst & Young, *Total State and Local Business Taxes*

The Business Share of Total State and Local Taxes

Table 3 shows the business share of estimated total FY 2003 state and local taxes for the nation as a whole, for nine southeastern states, and for Alabama. The table shows the percentage of total tax revenue raised from taxes on individuals and on businesses, and within the business sector the share raised from each of six broad groups of taxes. (Note that the Ernst & Young study did not develop detailed estimates of taxes on individuals, and therefore we cannot compare the burden of property, sales, income, or other types taxes on individuals vs. businesses from these data.) The national-average business share of FY 2003 state and local taxes was 42.7%, and in Alabama business taxes raised only slightly less, an estimated 41.1% of the total. The 9-state southeastern business share (44.4% of total state and local taxes) was the largest in the table, and the details show that the difference was due mainly to higher-than-average sales taxes on business inputs.

When Alabama's business-tax share is compared with the national average, two large differences are seen: Alabama's business property taxes are a much-smaller share of total state and local taxes, and Alabama's business excise and gross receipts taxes are a much-larger share of total state and local taxes, than is true of the national average in each of those categories. In the other four categories (sales, license, corporate income, and payroll taxes), Alabama's business-tax share of total state and local taxes is relatively consistent with the national pattern. Alabama's business property and sales taxes are much smaller shares of total state and local taxes than the regional average, while its business taxes in the other four categories are larger shares of total state and local tax revenues than the regional averages in those categories.

Table 3. Business Share of State and Local Taxes for FY 2003

| Type of Tax | National Average | Average of 9 S.E. States | Alabama |
|--|------------------|--------------------------|---------|
| Individual taxes | 57.3% | 55.6% | 58.9% |
| Business taxes: | 42.7% | 44.4% | 41.1% |
| Property taxes on business property | 16.5% | 16.1% | 10.2% |
| General sales taxes on business inputs | 10.6% | 13.0% | 10.8% |
| Excise and gross receipts taxes | 4.7% | 6.0% | 9.4% |
| License and other taxes | 4.1% | 4.0% | 4.5% |
| Corporate income tax | 3.7% | 3.1% | 3.6% |
| Payroll taxes | 3.2% | 2.2% | 2.6% |
| Business share | 42.7% | 44.4% | 41.1% |

Source: Ernst & Young, *Total State and Local Business Taxes*

Table 4 shows the business-tax share of total state and local taxes in all ten southeastern states. Alabama's business-tax share of total state and local taxes is higher than in four of the neighboring states and lower than in five. This middle-of-the-pack status, however, results from two very different kinds of competitive positions. Seven of the nine other regional states raise larger shares of state and local tax revenue from business property and sales taxes than does Alabama. Most of these states raise about 30% of total state and local tax revenue from these sources; however, Alabama, North Carolina, and Kentucky raise only about 20% of state and local tax revenue from business property and sales taxes. On the other hand, Alabama ranks first regionally in the share of state and local taxes raised from business excise and gross receipts taxes, second on corporate income taxes, fourth on business

Table 4. Business Share of Southeastern State and Local Taxes for FY 2003

| Type of Tax | AL | AR | FL | GA | KY | LA | MS | NC | SC | TN |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Individual taxes | 58.9% | 60.8% | 52.1% | 61.0% | 59.1% | 42.8% | 54.5% | 63.6% | 57.2% | 49.8% |
| Business taxes: | 41.1% | 39.2% | 47.9% | 39.0% | 40.9% | 57.2% | 45.5% | 36.4% | 42.8% | 50.2% |
| Property taxes on business property | 10.2% | 12.8% | 20.0% | 15.4% | 10.6% | 12.5% | 18.3% | 11.8% | 21.7% | 16.4% |
| General sales taxes on business inputs | 10.8% | 12.6% | 11.6% | 14.4% | 9.9% | 26.4% | 13.4% | 8.1% | 8.7% | 15.9% |
| Excise and gross receipts taxes | 9.4% | 4.0% | 7.8% | 3.1% | 7.4% | 6.0% | 3.9% | 7.9% | 3.9% | 4.4% |
| License and other taxes | 4.5% | 2.9% | 3.7% | 1.7% | 6.2% | 7.6% | 4.1% | 3.2% | 3.3% | 6.3% |
| Corporate income tax | 3.6% | 2.8% | 3.2% | 2.6% | 3.2% | 2.4% | 3.4% | 3.4% | 2.7% | 4.3% |
| Payroll taxes | 2.6% | 4.0% | 1.6% | 1.8% | 3.6% | 2.2% | 2.3% | 2.0% | 2.6% | 3.0% |
| Business share | 41.1% | 39.2% | 47.9% | 39.0% | 40.9% | 57.2% | 45.5% | 36.4% | 42.8% | 50.2% |

Source: Ernst & Young, *Total State and Local Business Taxes*

license and other taxes, and fifth on payroll taxes. Alabama raises 20.1% of total state and local taxes from these four sources; in the region, only Kentucky raises more from the same sources (20.4%).

Business Taxes as a Percentage of Private Economic Activity in the State

Table 5 shows state and local business taxes as a percentage of private-sector economic activity, comparing the national average with the nine-state southeastern average and Alabama. This perspective focuses on the economic burden of business taxes, whereas the previous comparisons dealt with relationships among different kinds of taxes.³

The southeastern average business-tax burden (4.74% of private economic activity) is slightly lower than the national average (4.85%). Business property and sales taxes together represent about 3.1% of private economic activity in both cases, and the southeastern average burden for excise and gross receipts taxes is actually higher than the national average; but corporate income and payroll taxes in the southeast are substantially below the national averages for those taxes.

Table 5. Business Taxes as a % of Private Economic Activity, FY 2003

| Type of Tax | National Average | Average of 9 S.E. States | Alabama |
|--|------------------|--------------------------|---------|
| Property taxes on business property | 1.87% | 1.72% | 1.12% |
| General sales taxes on business inputs | 1.20% | 1.38% | 1.19% |
| Excise and gross receipts taxes | 0.53% | 0.64% | 1.04% |
| License and other taxes | 0.46% | 0.43% | 0.50% |
| Corporate income tax | 0.41% | 0.33% | 0.40% |
| Payroll taxes | 0.37% | 0.24% | 0.28% |
| All Business Taxes | 4.85% | 4.74% | 4.54% |

Source: Ernst & Young, *Total State and Local Business Taxes*

Alabama's business-tax burden (4.54% of private economic activity) is slightly below both the southeastern and national averages. The business property tax burden is substantially below both national and regional averages, while the business sales tax burden is at the national level. Together, these major taxes represent only 2.3% of private economic activity in Alabama – far below the national and regional levels. However, the business excise and gross receipts tax burden is almost double the national average and over 60% higher than the regional average. The corporate income tax burden is at the national average and higher than the regional average. The payroll tax burden is below the national average but higher than the regional average. When property and sales taxes are excluded from the comparison, Alabama's business tax burden is actually *higher* than the national and regional averages (2.23% in Alabama vs. 1.77% nationally and 1.63% in the southeast).

Table 6 shows the business tax burden on private economic activity in all ten southeastern states. Alabama's business property tax burden is lower than in any other southeastern state, while its business excise and gross receipts tax burden is higher than in any other southeastern state. The Alabama corporate income tax burden ranks second, behind Mississippi. In the other taxes, Alabama's position is closer to the middle of the ten southeastern states: the payroll tax burden ranks fourth, license tax burden fifth, and sales tax burden seventh.

Alabama’s business tax burden is divided almost equally between two groups of taxes: (1) property and sales taxes, which comprise 2.32% of private economic activity, and (2) the other four types of business taxes, which comprise 2.23% of private economic activity. Kentucky shows a similar business tax structure, but in all of the other southeastern states the combined property and sales tax burden is greater than the combined burden of the other four business taxes. This means that Alabama’s rankings for the two groups of business taxes are polar opposites: Alabama ranks ninth among the ten southeastern states in terms of the combined burden of business property and sales taxes (only North Carolina ranks lower), while it ranks second in terms of the combined burden of the other four types of business taxes (only Kentucky ranks higher).

Table 6. Business Taxes as a % of Southeastern State Private Economic Activity, FY 2003

| Type of Tax | AL | AR | FL | GA | KY | LA | MS | NC | SC | TN |
|--|--------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| Property taxes on business property | 1.12% | 1.56% | 2.24% | 1.58% | 1.22% | 1.28% | 2.41% | 1.21% | 2.29% | 1.48% |
| General sales taxes on business inputs | 1.19% | 1.52% | 1.30% | 1.48% | 1.14% | 2.69% | 1.76% | 0.84% | 0.91% | 1.43% |
| Excise and gross receipts taxes | 1.04% | 0.49% | 0.87% | 0.32% | 0.85% | 0.61% | 0.52% | 0.81% | 0.41% | 0.39% |
| License and other taxes | 0.50% | 0.36% | 0.42% | 0.18% | 0.72% | 0.77% | 0.54% | 0.33% | 0.35% | 0.57% |
| Corporate income tax | 0.40% | 0.35% | 0.35% | 0.27% | 0.37% | 0.25% | 0.45% | 0.35% | 0.28% | 0.39% |
| Payroll taxes | 0.283% | 0.49% | 0.18% | 0.18% | 0.41% | 0.22% | 0.31% | 0.21% | 0.27% | 0.275% |
| All Business Taxes | 4.54% | 4.75% | 5.36% | 4.02% | 4.71% | 5.83% | 5.99% | 3.74% | 4.50% | 4.53% |

Source: Ernst & Young, *Total State and Local Business Taxes*

¹ http://www.statetax.org/Content/ContentGroups/Home_Page_Content/Right_Column_Area/50-StateStudy.pdf

² Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, and Tennessee.

³ The Ernst & Young study includes two other measures of the burden of state and local business taxes: the amount of business taxes per employee, and the amount of business taxes per dollar of capital income. We have chosen to focus on the relationship between business taxes and private economic activity because it is the most comprehensive of these measures and the one most closely related to the “ability-to-pay” principle. A comparison based on business taxes per employee ignores any state-by-state variation in business profitability; thus, two states with equal taxes per employee but different industry structures may be placing very different burdens on their businesses. Since capital income is a component of private economic activity, a comparison based on this measure will be highly related to one based on the more comprehensive variable. For these reasons we have limited our analysis of the business tax burden to a single comparison based on total private economic activity within the state.