

Total State and Local Business Taxes

Fiscal Year 2003 Update

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Prepared for The Council On State Taxation



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The views expressed are those of the individual authors, not their respective organizations

This study was prepared for the Council On State Taxation (COST). COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of 550 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities.

Introduction and Summary

State legislatures continue to struggle to close the budget deficits for fiscal year 2004 that were estimated earlier this year to be as high as \$85 billion. A key question being raised in the budget debates is: “Are businesses paying their fair share of taxes?” The first step in answering this question is to determine how much businesses are currently paying in state and local taxes. The COST study, “A Closer Examination of the State and Local Business Tax Burden,” published in January provided estimates of total state and local taxes paid by business in fiscal year 2002.¹ This study updates the state and local tax estimates through fiscal year 2003.

State and local taxes paid by businesses totaled almost \$400 billion in fiscal year 2003, 43 percent of all state and local taxes. State and local business taxes increased by \$20.3 billion or 5.3% in fiscal year 2003 compared to fiscal year 2002. Total state and local business taxes are almost twice as large as individual income taxes and exceed other state and local non-business taxes by more than 20%. State and local business taxes include many taxes in addition to the corporate net income tax, such as sales, excise, property, and license taxes.

Since fiscal year 2000, the last full fiscal year before the 2001 recession, total state and local business taxes have increased by over 9%, an increase of \$34 billion in three years. In sharp contrast, non-business taxes – including individual income taxes – have increased by less than 2% over the last three years. As a result, business taxpayers have accounted for over 80% of all of the increase in state and local taxes collected since fiscal year 2000.

Although the corporate income tax has been the focus of intense legislative debate in a number of state legislatures in the last two years, it accounts for only 9% of total state and local business taxes. However, due to the combination of renewed growth in profits and discretionary corporate tax changes in rates and bases, state and local corporate income taxes increased over 18% in fiscal year 2003.

The rebound in corporate taxes, combined with a stagnant individual income tax base and legislators’ reluctance to increase individual income and sales tax rates, has increased business’s share of state and local taxes to 42.8% in fiscal year 2003. Adding an estimated \$28.6 billion of individual income taxes that are paid on business income received from non-corporate business entities, including partnerships, S corporations and limited liability partnerships, business’s share of total state and local taxes was 45.9% in fiscal year 2003.²

¹ Cline, Fox, Neubig, and Phillips, “A Closer Examination of the Total State and Local Business Tax Burden” January 2003. This study presents trends in state and local business taxes since 1980 and includes an appendix explaining the methodology used in both studies.

² Based on 2001 federal individual income tax data showing 13% of total individual income from non-wage business income.

Estimated Total State and Local Business Taxes

The specific state and local taxes included in the estimates of state and local business taxes are:

- ▶ Real and personal business property taxes;
- ▶ General sales taxes on business inputs;
- ▶ Excise taxes on business purchases, e.g., fuel taxes;
- ▶ Corporate net income and franchise taxes based on income;
- ▶ Gross receipts taxes, including utility taxes and insurance premium taxes;
- ▶ State unemployment, disability, and workers' compensation taxes; and
- ▶ Other state and local taxes, including taxes based on net worth, license taxes, and severance taxes.

As shown in Table 1, businesses paid almost \$400 billion in total state and local taxes in FY2003. These taxes are generally considered the liability of business taxpayers. Therefore, sales and use taxes on business input purchases (non-manufacturing computers and office furniture, for example) are included while retail sales taxes imposed on consumer purchases are excluded. Excise taxes imposed on business purchases, such as motor fuels, are included, but gasoline taxes paid by consumers

Table 1
FY2003 State and Local Business Taxes
(\$ Billions)

Business Tax	Business Taxes	% of Total Business Tax
Property taxes on business property	\$153.1	38.3%
General sales taxes on business inputs	77.5	19.4%
Excise and gross receipts taxes	72.5	18.1%
<i>Motor fuel purchases by business</i>	20.3	5.1%
<i>Public utility sales</i>	18.0	4.5%
<i>Insurance premiums</i>	11.1	2.8%
<i>Other sales and gross receipts</i>	23.1	5.8%
Corporate income tax	35.9	9.0%
Payroll taxes	29.8	7.5%
Corporate franchise and business license	22.3	5.6%
Other business taxes	8.6	2.1%
Total State and Local Business Taxes	\$399.6	100%

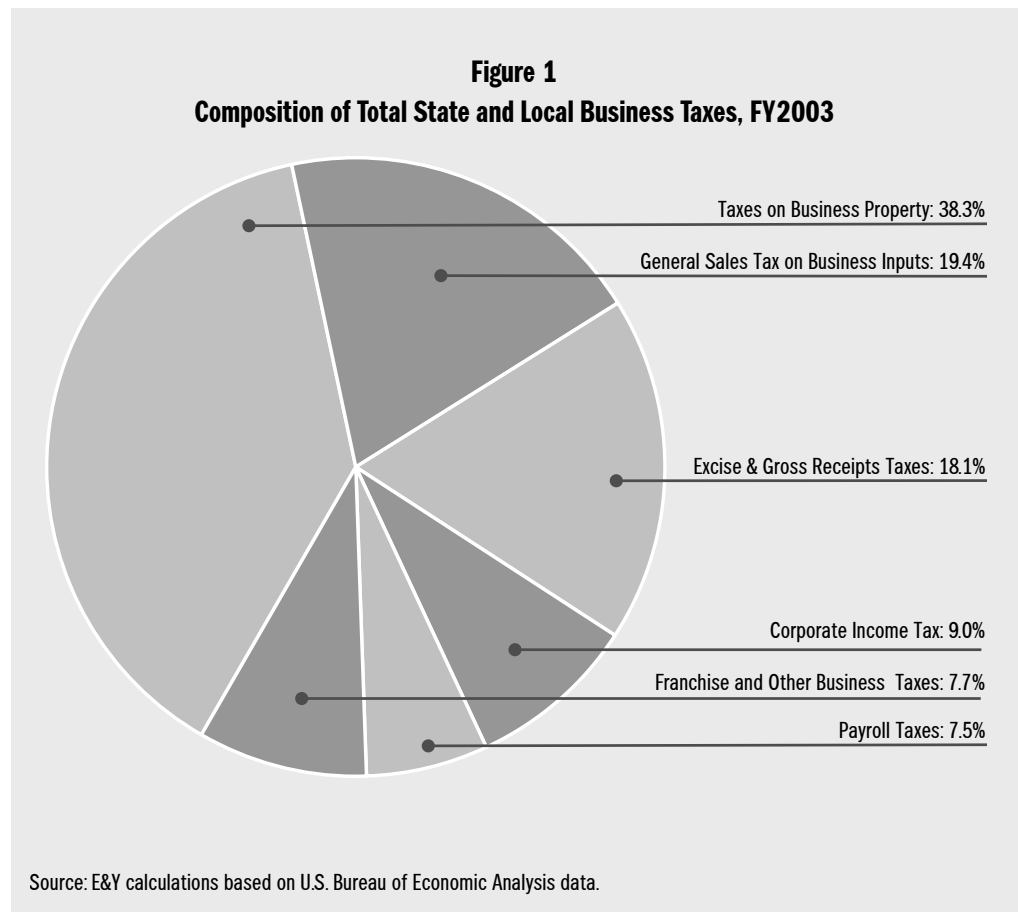
Source: E&Y calculations based on U.S. Bureau of Economic Analysis data.

are not. All tobacco, alcohol, and amusement excise taxes are considered to be taxes on consumer purchases and are excluded from the business tax total.

Figure 1 illustrates the distribution of the total state and local business tax burden by type of tax.

- ▶ Real and personal property taxes account, by far, for the largest share (38%) of total state and local business taxes.
- ▶ General sales taxes on business production input purchases and capital investments account for almost 20% of the total, while excise and gross receipts taxes generate over 18% of the total.
- ▶ Corporate income taxes account for 9% of total state and local business taxes.

These estimates clearly indicate that the corporate income tax is only one component of total state and local taxes paid by business. From a tax policy perspective, this information highlights the need to consider the corporate income tax within the broader picture of total state and local business tax burdens.



Trends in State and Local Taxes

Growth in Business Taxes, Fiscal Year 2003

Total state and local taxes increased by \$20.3 billion (5.3%) from fiscal year 2002 to fiscal year 2003. As shown in Table 2, the growth of total business taxes in FY2003 results from increases in nearly all business taxes.

- ▶ Property taxes increased \$7.5 billion (5.1%) in fiscal year 2003.
- ▶ Corporate income taxes grew \$5.6 billion or 18%, the largest percentage increase of any business tax.
- ▶ Sales taxes on business purchases grew nearly \$3.2 billion (4.2%).
- ▶ Excise and gross receipts taxes combined increased \$2.1 billion.
- ▶ Payroll taxes grew by \$0.8 billion.
- ▶ Other business taxes grew by \$1.2 billion.

Table 2
Change in State and Local Business Taxes, Fiscal Years 2002 to 2003
(\$ Billions)

Business Tax	FY2002	FY2003	Change in Taxes
Property taxes on business property	\$145.6	\$153.1	\$7.5
General sales taxes on business inputs	74.3	77.5	3.2
Excise and gross receipts taxes	70.4	72.5	2.1
<i>Motor fuel sales</i>	19.6	20.3	0.7
<i>Public utility sales</i>	17.9	18.0	0.0
<i>Insurance premiums</i>	10.3	11.1	0.8
<i>Other sales and gross receipts</i>	22.5	23.1	0.6
Corporate income tax	30.3	35.9	5.6
Payroll taxes	29.0	29.8	0.8
Corporate franchise and business	21.5	22.3	0.8
Other business taxes	8.2	8.6	0.3
Total State and Local Business Taxes	\$379.4	\$399.6	\$20.3

Source: E&Y calculations based on U.S. Bureau of Economic Analysis data.

Note: FY2002 business tax estimates have been revised since the January 2003 study to incorporate revisions in the U.S. Bureau of Economic Analysis's data.

Business's Growing Share of State-Local Taxes

As shown in Table 3, since fiscal year 2000, the last full fiscal year prior to the 2001 recession, total state and local business taxes have increased by over 9%, an increase of \$34 billion in three years. In sharp contrast, non-business taxes – including individual income taxes – have increased by 1.6% over the last three years. As a result, business taxpayers have accounted for over 80% of all of the increase in state and local taxes collected since fiscal year 2000.

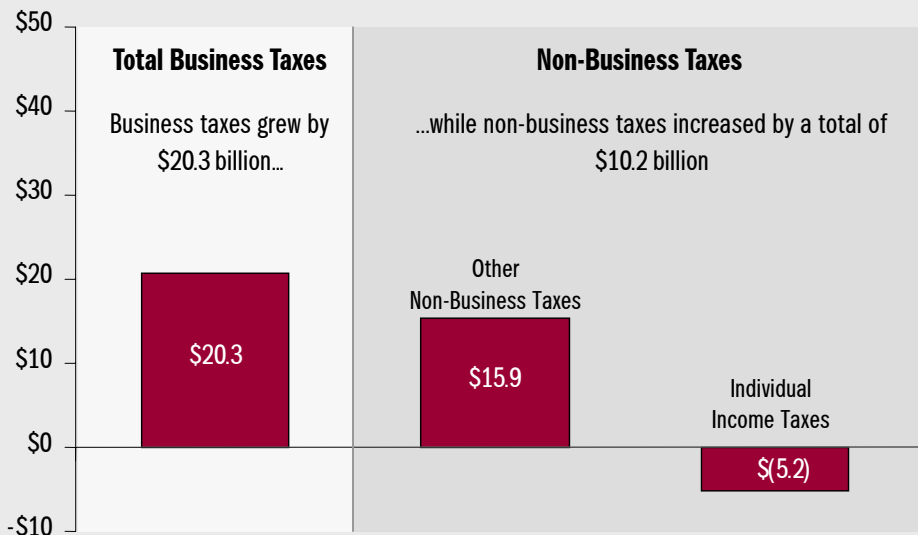
Table 3
State and Local Tax Revenue Composition, FY2000 –FY2003
(\$ Billions)

State and Local Taxes	FY2000	FY2001	FY2002	FY 2003
Total State and Local Business Taxes	\$365.6	\$371.6	\$379.4	\$399.6
State and Local Individual Income Taxes	209.6	220.0	209.1	204.0
Household Non-Income-Based Taxes	315.8	323.3	313.7	329.6
Total State and Local Taxes	\$891.0	\$914.9	\$902.2	\$933.2
% of Total State and Local Taxes Paid by Business	41.0%	40.4%	42.0%	42.8%

Source: E&Y calculations based on U.S. Bureau of Economic Analysis data.

Figure 2 illustrates how significant business tax increases were in providing state and local governments with additional tax revenues in fiscal year 2003. The \$20.3 billion increase in business taxes provided over two-thirds of the total state and local tax increase in fiscal year 2003. Contrasting the strong growth in business taxes, total state and local individual income taxes actually fell over the three-year period.

Figure 2
FY2003 Change in State and Local Tax Revenue from Business and Non-Business Taxes
(\$ Billions)



Source: E&Y calculations based on U.S. Bureau of Economic Analysis data.

Taxes Paid by the Fortune 1000

Table 4 presents additional information on the state and local taxes paid by businesses. The table presents estimates of the portion of total business taxes paid by the Fortune 1000 largest corporations, as measured by sales. The Fortune 1000 corporations paid an estimated 47% of total state and local business taxes in FY2003.³ As shown in Table 4, in fiscal year 2003 Fortune 1000 corporations paid:

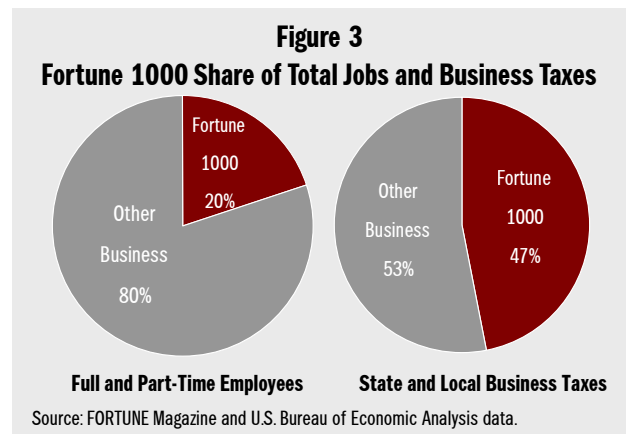
- ▶ 54% of corporate income taxes,
- ▶ 46% of property taxes, and
- ▶ 51% of sales and excise taxes,
- ▶ 21% of payroll taxes.

Table 4
State and Local Taxes Paid By All Businesses and Fortune 1000 Corporations, FY2003
(\$ Billions)

Business Tax	All Business	Fortune 1000	% of All Business
Property taxes on business property	\$153.1	\$70.3	45.9%
General sales taxes on business inputs	77.5	39.8	51.4%
Excise and gross receipts taxes	72.5	36.9	51.4%
<i>Motor fuel sales</i>	20.3	7.2	35.7%
<i>Public utility sales</i>	18.0	16.2	90.0%
<i>Insurance premiums</i>	11.1	6.6	59.2%
<i>Other sales and gross receipts</i>	23.1	6.9	29.8%
Corporate income tax	35.9	19.3	53.8%
Payroll taxes	29.8	6.2	20.8%
Corporate franchise and business license	22.3	9.4	42.1%
Other business taxes	8.6	4.2	49.0%
Total State and Local Business Taxes	\$399.6	\$186.1	46.6%

Source: E&Y calculations based on U.S. Bureau of Economic Analysis data.

As illustrated in Figure 3, the share of business taxes paid by the Fortune 1000 far exceeds the companies' share of total employment. While the Fortune 1000 companies pay nearly 47% of state and local taxes, they account for only 20% of total jobs. The share of total business taxes, by tax type, paid by the Fortune 1000 companies reflects the level of profits, the capital intensity, and the inputs purchased by these businesses.



³ Taxes paid by Fortune 1000 companies were estimated using FY2003 tax data and the Fortune 1000 tax shares presented in the previous study, "A Closer Examination of the Total State and Local Business Tax Burden" January 2003.

Taxes on Business Income Paid by Individual Taxpayers

The corporate income tax paid by C corporations is the only income-based business tax discussed up to this point. However, over the last two decades there has been a significant growth of non-C corporations and a shift of business income from C corporations to other forms of businesses, including S corporations, limited liability corporations, and limited liability partnerships. The income from these “pass-through” entities is generally taxed under the individual income tax instead of the corporate income tax. The shift toward non-corporate forms of business has reduced the percentage of total state and local taxes from the corporate net income tax.

As illustrated in Figure 5, the percentage of individual income from business activities has grown significantly since 1980.⁴ During the 1980-2001 period, pass-through business income grew at an annual average rate of 8.8%, compared to C corporation net income, which grew at an annual average rate of 5.9%.

Table 5 presents estimates of the individual income taxes paid on pass-through entity net income in 2001. The analysis shows that non-corporate business income accounted for 7.1% of total individual income liability in 1980. By 2001, that percentage had nearly doubled to 13.1%. When state and local

taxes on corporate net income, individual business income, and other business taxes are combined, they make up 45.9% of total state and local tax collections in FY2003.⁵

⁴ This measure of income includes the net income of proprietorships, trusts, partnerships, limited liability partnerships, limited liability companies, and S-corporations that is paid to individuals and included in the federal individual income tax base. The methodology was revised in this study to use the business income reported on federal individual income tax returns. This adjustment resulted in lower estimates of pass-through business income than those reported in the first study based on data from tax returns filed by each business entity.

⁵ Assuming the share of individual income taxes resulting from business income is constant between 2001 and 2003.

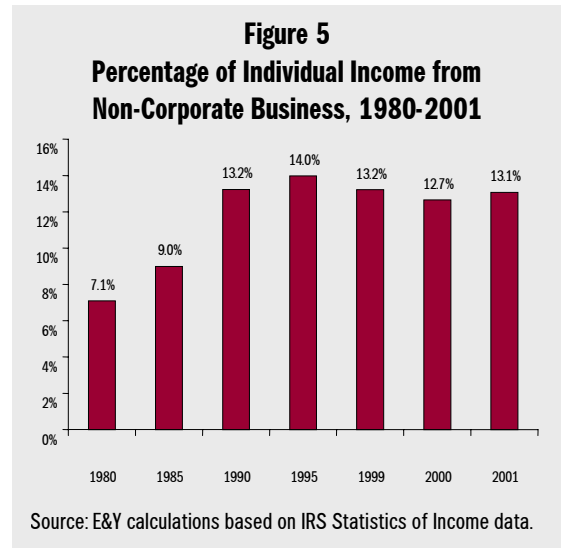


Table 5
Individual Income Tax on Non-Corporate, Business-Related Income, 2001
(\$ Billions)

Source of Individual Income	Amount
Business or Profession Net Income	\$241.7
Partnership and S Corp. Net Income	271.3
Rental and Other Net Income	54.7
Total Business Related Income	\$559.7
Avg. State Individual Income Tax Rate	5.10%
Individual Income Tax on Business Income	\$28.6

Source: E&Y calculations based on IRS Statistics of Income data.

Conclusions

State and local taxes paid by business in fiscal year 2003 totaled almost \$400 billion, an increase of 5.3% from the level in fiscal year 2002. The \$400 billion figure is 43% of all state and local taxes collected in fiscal year 2003.

The study also finds that the rate of growth in business taxes is accelerating. State and local business taxes grew 1.6% in fiscal year 2001, 2.1% in fiscal year 2002 and 5.3% in fiscal year 2003. Because business taxes are growing significantly faster than non-business taxes, the share of total taxes paid by business has risen in recent years.

The results of this study of state and local business taxes have important implications for the public debate over the proper role of business taxation in: 1) addressing the short-run fiscal problems, and 2) achieving long-run economic growth objectives of state and local governments. The important implications include:

- ▶ The corporate income tax is a relatively small component of the total state and local tax burden imposed on businesses. It is the combined burden of all the state and local business taxes that should be the focus of business tax reform debates.
- ▶ Any business tax proposals considered in response to the current state budget shortfalls should be evaluated in the context of the longer-run economic policy objectives of the state.
- ▶ The continued rebound in business profits and the accelerating upward pressure on the local property tax – the largest state and local business tax – due to state aid reductions can be expected to add to near-term business tax increases.
- ▶ The estimated national state and local business tax burden reported in this study masks important differences in both the levels and rates of growth across states. These differentials can have a detrimental effect on a state's business tax competitiveness and its economic growth.
- ▶ States that focus on only one part of the total state and local business tax picture, such as the corporate income tax, are likely to exacerbate an already significant and rising level of state and local business taxation. Any proposed state or local business tax changes should be debated in the context of total state and local business taxes and their effect on a state's or locality's economic health.