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Supporting Racial Equity and a Robust Recovery with a Corporate Income Tax Rate Increase

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Snapshot of Findings

- Returning the state's corporate income tax (CIT) rate to pre-2010 levels could raise $375-500 million a year in new revenue.
- Cutting budgets and failing to invest in communities hardest hit by the pandemic perpetuate the deep racial inequities built into the current system.
- Raising the CIT rate would make our state and local tax system more equitable, across both race and income groups.
- Raising additional revenue from high-income households and profitable corporations is better for our economic recovery than are budget cuts.
- By important measures, MA is a low-tax state for businesses, meaning the CIT can be raised without placing MA at a competitive disadvantage, tax-wise.
- The investments we need to make to achieve a robust and just recovery are the same ones we need over the long term to build a just and thriving Commonwealth.

By returning the state corporate income tax to pre-2010 rates, the Commonwealth could raise $375 million to $500 million a year to help fund a racially equitable, economically just, and robust recovery. As is now clear, low-income communities and communities of color have been hurt far more deeply by the COVID-19 pandemic than wealthier and whiter communities—both in terms of health impacts and the growing economic fallout. As a Commonwealth, we must respond to these intertwined health and economic crises in ways that acknowledge and correct for these deep-seated and longstanding inequities. Fortunately, the policies that will help us address the immediate impacts of the pandemic also will speed us toward a just and robust recovery.

Why should profitable corporations contribute more in state taxes?

Businesses depend on the overall, long-term health of our state economy for their success and profitability. Therefore, they have a strong, vested interest in supporting the many investments made by our state and local governments. These include investments in transportation infrastructure, in a healthy and well-educated workforce, in high-quality and affordable child care options for families, and in a legal system that enforces contracts and settles business disputes—to name just a few. As important participants in our state's political and civic life, businesses likewise have an obligation to support government efforts to create a racially and economically just society, one that is built on a bedrock of diverse and thriving communities.

In the context of the current health and economic crises we face, this means contributing more in taxes so the Commonwealth can support *all* families and businesses, and avoid damaging budget cuts that will delay and weaken our recovery. To address immediate needs *and* realize a longer-term vision of a racially and economically just Commonwealth, significant additional state resources will be required. It is reasonable to expect profitable businesses to pay a bit more than they currently do to cover a portion of the related costs. This is especially true given that the Commonwealth today relies less heavily on taxes collected from corporate profits than it has in the past. Equally, if not more importantly, the federal 2017 Tax Cuts and Jobs Act delivered a huge boost to the after-tax profits of corporations, by providing massive federal tax cuts worth some $4 billion a year to Massachusetts businesses. Collecting, through higher state taxes, a portion of this federal largesse still would leave corporations with billions more in net profits than they would have enjoyed under tax laws in place just a few years ago.

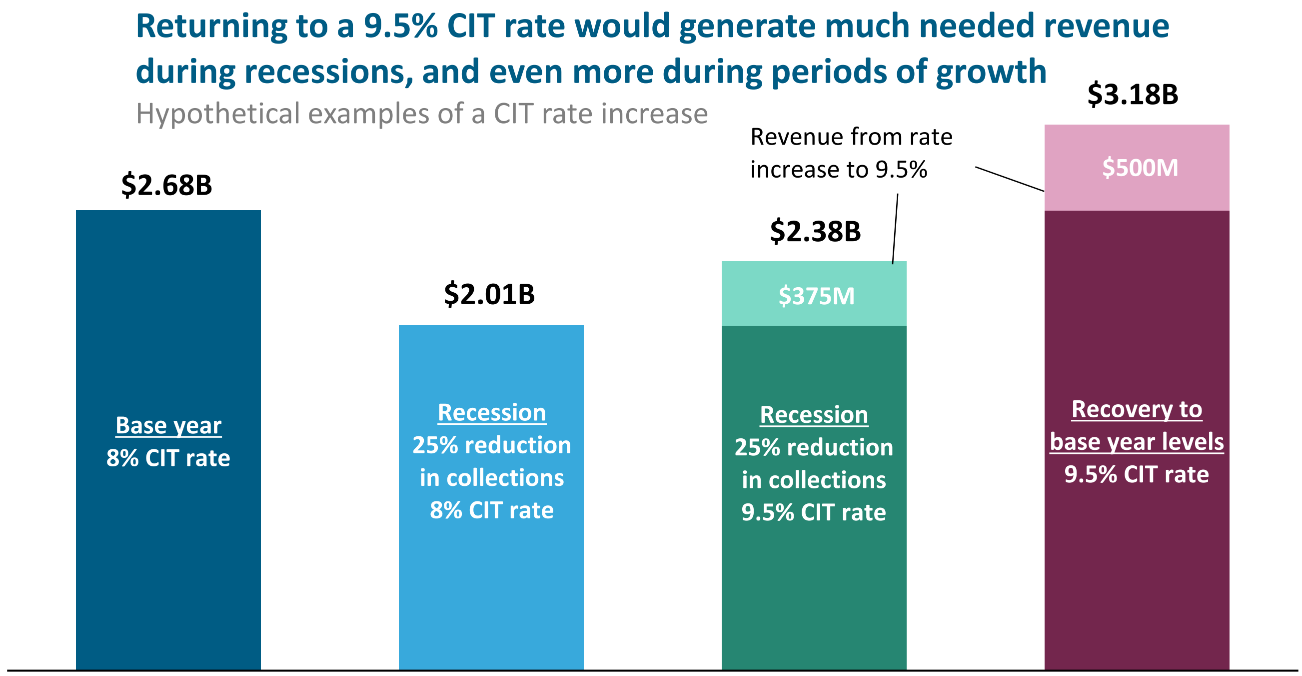
Notably, Massachusetts has room to collect more corporate taxes while remaining an attractive place for businesses to locate and expand. Several useful measures, developed by business advocates, show that Massachusetts is a relatively low-tax state for businesses. For example, the Council on State Taxation (COST), a Washington D.C. based trade association representing some 550 multistate and multinational corporations, ranks Massachusetts in the lowest 20 percent of all states for its "total effective business tax rate." As a global leader in several important industries, with a well-educated workforce and a competitive tax structure, Massachusetts is well-positioned to raise additional, much-needed revenue from profitable businesses operating in our Commonwealth.

What would an increase in the corporate income tax (CIT) rate generate?

Taxing corporate profits (also called "corporate income") is one of the primary ways the Commonwealth generates revenue from businesses. Massachusetts currently applies a tax rate of 8.0 percent to most corporate profits.[1] In fiscal year (FY) 2019, the CIT (and related corporate taxes) generated approximately $2.68 billion for the Commonwealth.[2] Each percentage point in the CIT rate thus generates roughly $335 million a year during economic boom times.

Looking back at recent recessions, in the year immediately following the onset of recession, CIT and related collections have dipped markedly: a 19 percent decline from FY 2008 to FY 2009, and a 26 percent decline from FY 2001 to FY 2002 (adjusted for inflation). These declines in collections suggest that during periods of recession, each percentage point in the CIT rate would generate something closer to $250 million a year.[3]

As recently as 2009, the CIT rate applied to most corporate profits was 9.5 percent. Returning to this rate (with a comparable percent increase in related business taxes), could generate roughly $375 million a year during recessions and $500 million a year during periods of strong economic growth.



Is raising the CIT rate the best business tax option?

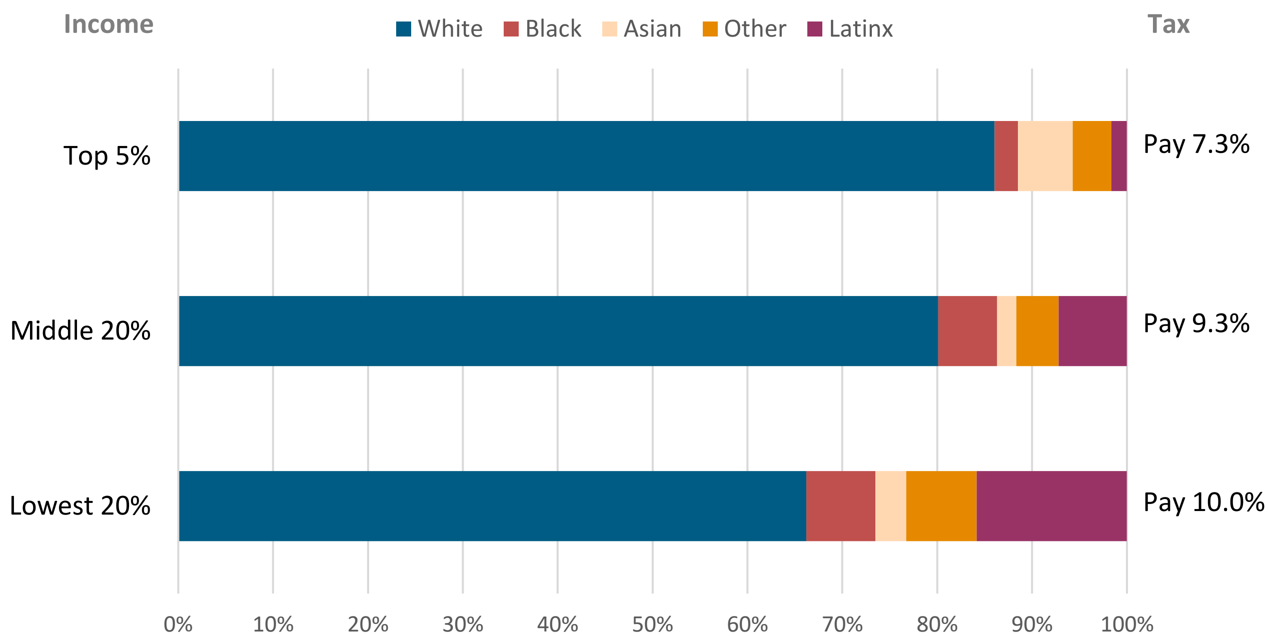
Raising additional revenue from businesses by increasing the state's corporate income tax rate is an approach with several advantages. Only businesses that generate a net taxable profit pay the state CIT. (Net taxable profit is the profit that remains after deducting all operating expenses and applying all of the many tax breaks for which a business may be eligible.) During tough economic times, this is an especially valuable feature of the CIT; any increase in the CIT rate would affect only those businesses that continue to generate a profit, while leaving untouched those businesses suffering losses or just breaking even. Moreover, a rate increase would collect most from businesses that are generating windfall profits from the COVID pandemic. To ask those businesses that are prospering during a global health and economic catastrophe to contribute a bit more of their pandemic profits toward the general well-being of people and other businesses in the Commonwealth makes good economic sense—and good moral sense.[4]

Would raising the CIT rate support economic and racial justice in the Commonwealth?

Raising the CIT rate would make our tax system fairer among income groups. Massachusetts has an upside down state and local system, meaning that low- and middle-income households pay a substantially larger share of their income toward state and local taxes than high-income households do. (This is referred to as a "regressive tax structure." The opposite is referred to as a "progressive tax structure.") Business taxes, however, are paid disproportionately by high-income households, as these are the households that own the large majority of corporate stock.[5] Much of the cost of business taxes—including the corporate income tax—ultimately falls on corporate owners (i.e., those who own corporate stock).[6] As a result, any increase in the CIT rate will help turn our tax system right-side up, by asking high-income households to pay something closer to their fair share.

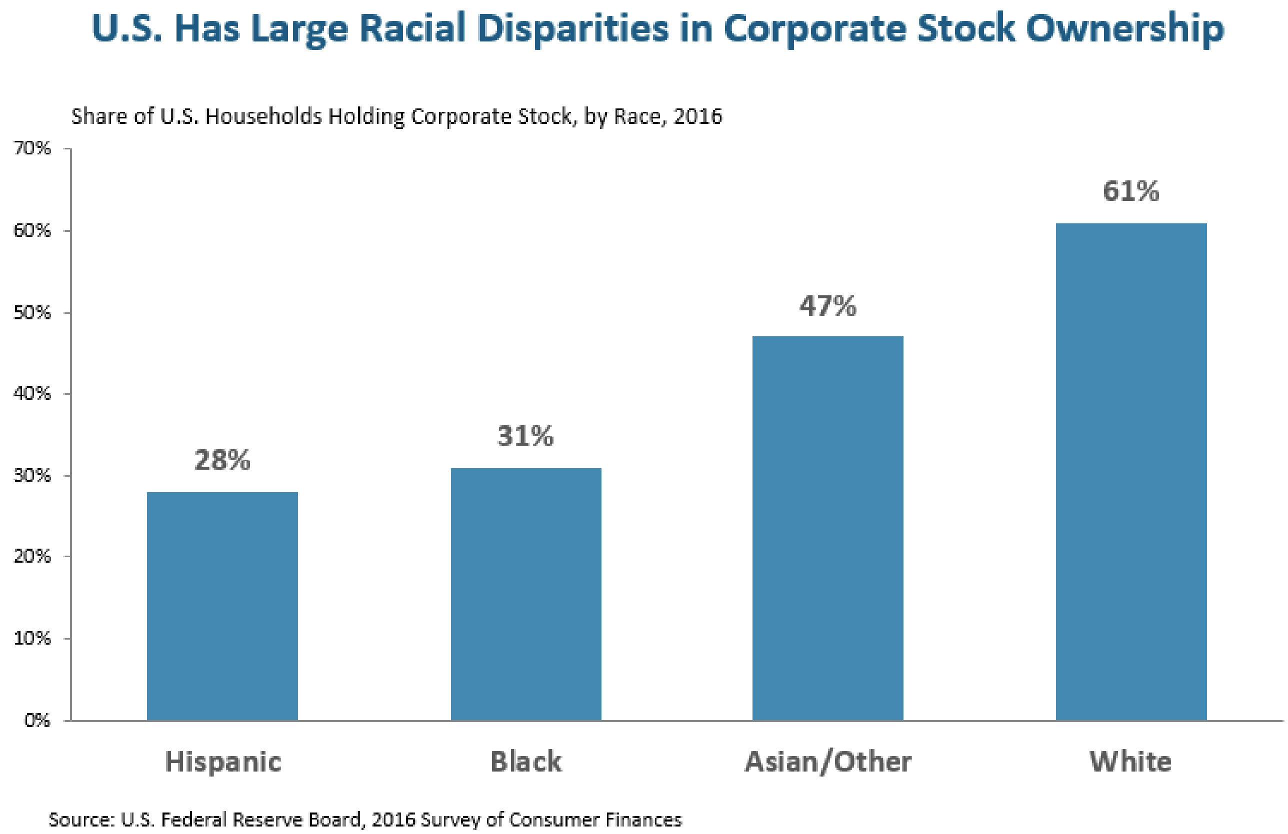
In addition to increasing tax equity among income groups, raising the CIT rate also would support greater racial equity in the Commonwealth. A centuries-long history of systemic racism has denied people of color access to economic opportunity. The result is that Black and Latinx households now are overrepresented in lower-income groups, which tend to pay a larger share of their income toward state and local taxes than upper-income groups do.

Black and Latinx Taxpayers Tend to Be in Income Groups Paying Larger Portion of Income in State and Local Taxes



Source: Institute on Taxation and Economic Policy

Any tax increase that falls primarily on upper-income filers thus will affect disproportionately fewer Black and Latinx households, nudging the tax system toward greater racial equity. This is especially true of business tax increases. High-income households own most corporate stock (as noted above) and White households are twice as likely as Black or Latinx households to own any corporate stock. In other words, corporate ownership (i.e., stock ownership) is highly concentrated in the hands of wealthy, White households.



Avoiding state budget cuts and increasing investments in education, transportation, healthcare and more, likewise is [central to pursuing racial justice] in the Commonwealth. Our state and local governments have an important role to play in reversing the legacy of deep, systemic racism woven into the fabric of American social and economic life. Doing so will require additional resources. It is reasonable that these additional resources be drawn in large part from those who benefit most from the current, unjust system, including profitable corporations and their high-income shareholders.

Conclusion

Today, Massachusetts families are confronted with profound health and economic challenges, the scale of which we have not seen in the U.S. for generations. The toll the pandemic is taking on communities around the Commonwealth is severe and likely to get worse in the months ahead. Meanwhile, just as the need for increased support from state government is rising, state revenue collections are tumbling. There is good reason to expect that collections will not return to pre-pandemic levels for years to come. Generating additional revenue to help fill all-but-certain, large gaps in the state budget will be essential if we are to address Massachusetts people's near-term needs. Additional revenue likewise will be required to make the long-term investments necessary for a robust and just recovery. Raising the corporate income tax rate is one good option for generating the additional revenue the state needs now - and will continue to need in the future.

[1] Financial institutions are taxed at a slightly higher rate. Insurance companies are taxed based on the value of the policies they issue, rather than directly on their profits. Corporations eligible for and electing S-corp status do not pay the C-corp income tax, though S-corps with receipts exceeding $6 million per year are subject to a separate state tax on their profits. Massachusetts Department of Revenue Corporate Tax Guide: https://www.mass.gov/guides/corporate-excise-tax#-calculating-the-corporate-excise-tax

[2] Total corporate excise and related taxes here include income and non-income excise taxes collected from regular C-corps, as well as income excise collections from S-corps. The corporate total likewise includes similar excise and excise-like taxes on financial, insurance and public utilities companies; collections arising from corporate tax settlements and judgments; and from additional, corrective corporate payments. The business tax total here does not include licensing and other fees paid by businesses or sales taxes collected on purchases made by businesses.

Collections resulting from the income measure (and related taxes for the financial and insurance industries) account for approximately 80 percent of total corporate excise collections. Corporate excise (and related tax) collections totaled $3.35 billion in FY 2019. The income measure therefore accounts for about $2.68 billion of this total ($3.35 billion x 0.80 = $2.68 billion). Each percentage point (PP) of the corporate income tax rate (currently set at 8.0 percent) thus produced approximately $335 million in revenue ($2,680 million/8.0 PP = $335 million/PP).

[3] Adopting as a model the larger percent decline in corporate excise tax and related collections seen in 2001 to 2002, the calculation for estimating a percentage point (PP) dollar decline at current CIT collection levels runs as follows: $335 million/PP x 0.74 = $248 million/PP of the CIT and related business taxes.

[4] Additionally, it has become increasingly important to tax corporate profits at the business entity-level—or risk losing the opportunity to tax many of these profits at all. A growing body of research has shown that once business profits are distributed to individual shareholders, a large share of these profits is never taxed. Three-quarters of corporate stock is held in tax-exempt accounts (like IRAs), or by foreigners and non-profits. While the stock market typically delivers 7 to 10 percent annual returns over the long term, a study of 2007 U.S. tax returns found that wealthy filers claimed an average taxable gain of less than 2 percent on their capital investments. See National Tax Journal, Bourne et al., *More than They Realize: The Income of The Wealthy*, June 2018: https://econpapers.repec.org/article/ntjjournl/v_3a71_3ay_3a2018_3ai_3a2_3ap_3a335-356.htm
See also Tax Policy Center, TaxVox blog, Eugene Steuerle, September 6, 2018: https://www.taxpolicycenter.org/taxvox/individuals-pay-very-little-individual-income-tax-capital-income

[5] Over 80 percent of U.S. stock value is held by the top 10 percent of households. See Federal Reserve Bank of St. Louis, *On the Economy Blog*, Feb. 27, 2018: https://www.stlouisfed.org/on-the-economy/2018/february/when-stock-market-rises-who-benefits

[6] Institute on Taxation and Economic Policy, *Who Pays? Sixth Edition*, pg. 136: https://itep.org/wp-content/uploads/whopays-ITEP-2018.pdf