

## How Do Business Taxes in MA Compare to Other States?

By Kurt Wise

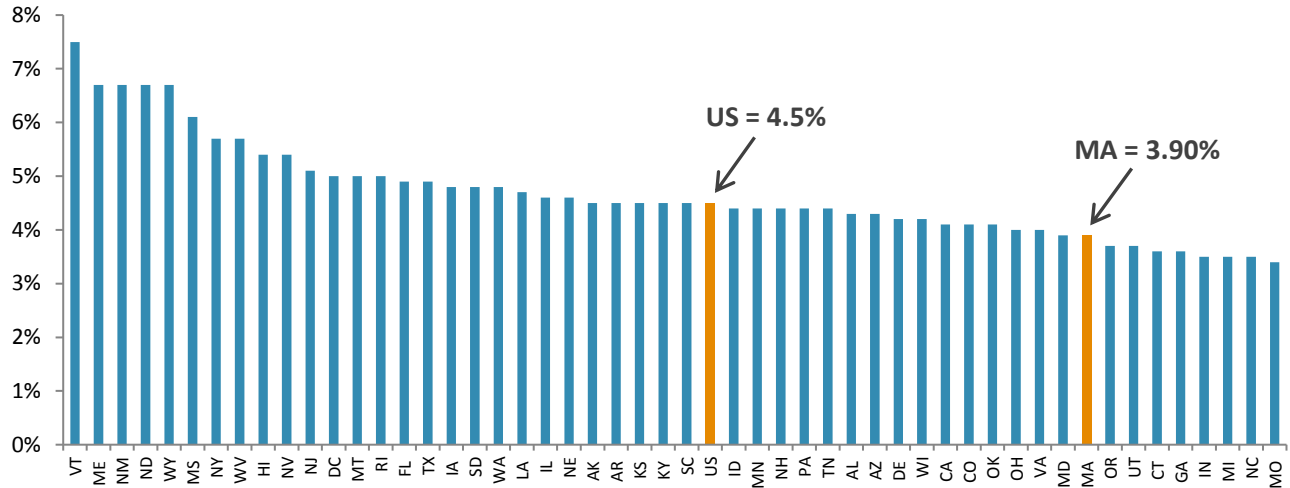
A wide variety of factors influence the decisions businesses make about whether to expand and where to locate their new or expanding operations. These factors include the quality of a state's infrastructure; the skills of its workforce; the proximity to materials and customers; and the overall quality of life available to employees.<sup>1</sup> A particular state's tax policy - including tax rates, rules for calculating taxable income, and the availability of tax breaks - also plays a role, though not a primary one.<sup>2</sup> This is not surprising given that state and local taxes account for as little as two percent of total business costs for the average corporation operating in the US.<sup>3</sup>

Nevertheless, if one wishes to compare relative levels of business taxation among the 50 states, it makes most sense to look at all state and local taxes paid by businesses. Some states collect more revenue from businesses using property taxes (typically, a local tax), while other states rely more heavily on corporate income taxes, gross receipts and excise taxes, or general sales taxes (typically, state-level taxes). A meaningful, apples-to-apples comparison of total business tax levels in different states must account for all of the various ways that state and local governments collect taxes from businesses.

A 2018 update of one prominent study - produced regularly by the Council on State Taxation (COST), a Washington DC based trade association representing some 600 multistate and multinational corporations - shows only eight other states with a lower "total effective business tax rate" (TEBTR) than Massachusetts.<sup>4</sup> (Massachusetts is tied with Maryland.) TEBTR is a measure of total, combined state and local taxes paid by businesses, as a share of private sector output.<sup>5</sup> By this measure, Massachusetts ranks in the bottom fifth of all states in terms of overall business tax levels.

## Business Taxes as a Share of Gross State Product Are Lower in Massachusetts than in Most Other States

State and local business taxes as a share of private sector Gross State Product, FY 2017



Source: Ernst & Young, FY 2017 COST report on state and local business taxes

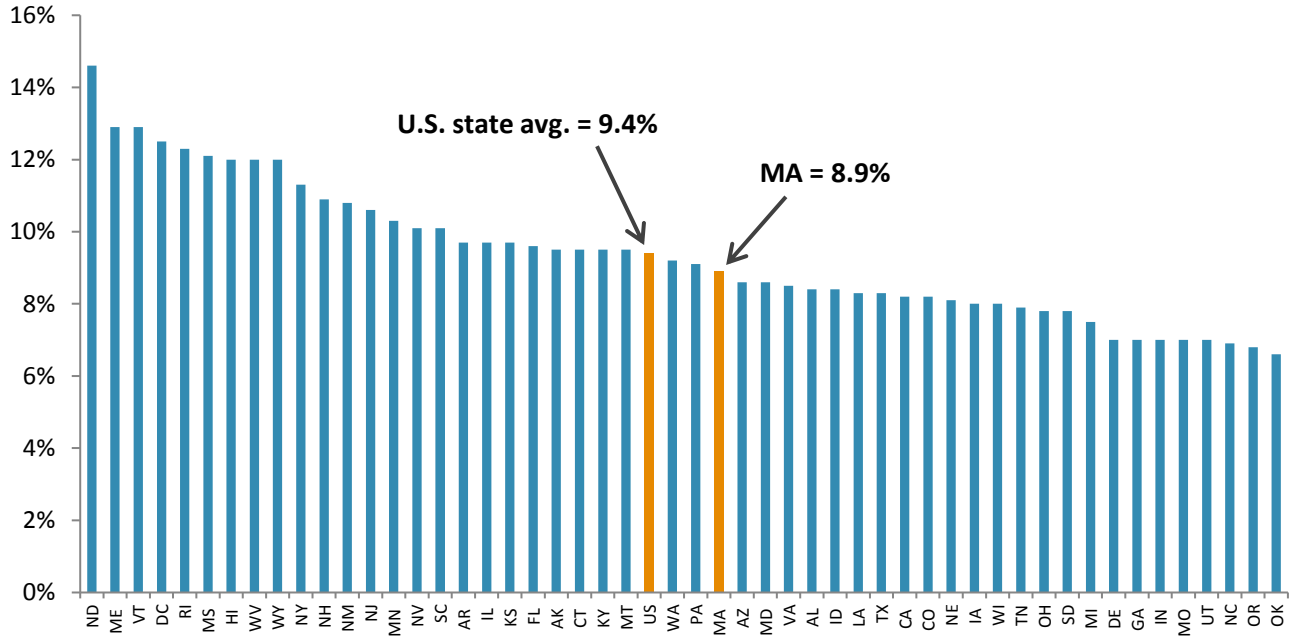
With a TEBTR of 3.9 percent, had business taxes in Massachusetts instead been equal to the U.S. average (4.5 percent), Massachusetts businesses would have contributed an additional \$2.9 billion in Massachusetts state and local revenues in FY 2017, using the COST report methodology.<sup>6</sup>

COST also reports the share of total state and local taxes paid by businesses in each state. The report concludes that Massachusetts businesses together pay 38.9 percent of all state and local taxes collected in the Commonwealth. There are only eight other states in which businesses pay a smaller share of the total.<sup>7</sup> (The methodology used in the COST study assumes that none of the cost of state and local business taxes is passed along to other economic actors. The general understanding among economists, however, is that a substantial portion of these tax costs in fact often are borne by a combination of workers and landowners, with variation by industry and location.<sup>8</sup>)

A separate analysis, performed by the Anderson Economic Group, uses a slightly different methodology, ranking states based on the amount of state and local business taxes paid as a share of pre-tax gross operating surplus, which is a measure of business profitability tracked and published by the US Bureau of Economic Analysis. The Anderson analysis finds that Massachusetts businesses in 2016 collectively paid taxes equal to 8.9 percent of their pre-tax profits.<sup>9</sup> By way of comparison, some states collected as little as about 6.5 percent while others collected some 13 percent or more.<sup>10</sup> Accordingly, Massachusetts ranks lower than 25 other states by this measure and is below the average rate among the states of 9.4 percent.<sup>11</sup> Had Massachusetts businesses paid taxes at the average rate among U.S. states, by this measure they would have contributed another 0.5 percentage points of their pre-tax profits to the Commonwealth, some \$928 million in additional taxes in 2016.<sup>12</sup>

## Business Taxes as a Share of Pre-Tax Profits in Massachusetts Are Below U.S. State Average

State and local business taxes as a share of pre-tax gross operating surplus, 2016



Source: Anderson Economic Group, 2018 State Business Tax Burden Rankings

The composition of business taxes differs across the states. Massachusetts collects a smaller share of state and local business taxes from sales taxes, excise taxes, and licensing fees than in U.S. states on average (see table, below).<sup>13</sup> On the other hand, a relatively large share of business taxes in Massachusetts is derived from property taxes and taxes on corporate profits. (Neighboring New Hampshire and New York, however, both collect a larger share of their business taxes from income taxes on corporate profits than does Massachusetts.<sup>14</sup>)

<b>BUSINESS TAXES (COST Study, FY 2017)</b>		
	MA	US
	% of Total Business Taxes	% of Total Business Taxes
Property Tax	45.5%	38.9%
Sales Tax	16.4%	21.3%
Corporate Income Tax	12.0%	8.5%
Unemployment Insurance	7.9%	5.4%
Individual Income Tax on "Pass-Thru" Business Profits	7.1%	5.3%
Excise Tax	6.6%	12.4%
Licenses and Other Taxes	4.4%	8.1%
<b>Total Business Taxes</b>	<b>100%</b>	<b>100%</b>

Source: Council on State Taxation, Total State & Local Business Taxes, FY 2017

## Impacts of Federal Tax Changes

To better understand the impact of state and local taxes on businesses it is useful to place these taxes in the broader corporate tax context, one that includes recent changes at the federal level. The federal 2017 "Tax Cuts and Jobs Act" (TCJA) delivered large tax cuts to many corporations. One of the central features of the TCJA was a sharp reduction in the federal corporate income tax rate, from 35 percent down to 21 percent.<sup>15</sup> The TCJA also greatly reduced the taxes owed by U.S. based multinational corporations on profits generated through their overseas operations.<sup>16</sup>

These federal corporate tax cuts effectively offset a sizable portion of the taxes businesses continue to pay at the state and local level. The Institute on Taxation and Economic Policy estimates that the TCJA resulted in a \$135.5 billion reduction in federal corporate taxes in 2018, a figure that will rise to \$138.4 billion in 2019.<sup>17</sup> This federal income tax cut for businesses (\$135.5 billion) is equal to roughly a fifth of *all* state and local taxes paid by businesses.<sup>18</sup> Expressed another way, this reduction in federal corporate income taxes effectively eliminates (and then some) the equivalent of *all the income taxes* paid by businesses at the state and local level (\$102.1 billion in FY 2017, including income taxes paid by individuals on business income). While the federal tax cuts do not directly reduce businesses' state and local tax obligations, the cuts do free up corporate resources, making state and local taxes a lighter lift.

<sup>1</sup>Iowa Policy Project, Peter Fisher, Grading the States (see third paragraph on landing page):

<http://www.gradingstates.org/the-problem-with-tax-cutting-as-economic-policy/state-and-local-business-taxes-are-not-significant-determinants-of-growth/>

<sup>2</sup> See Political Economy Research Institute, Thompson, Jeffrey, "Prioritizing Approaches to Economic Development in New England: Skills, Infrastructure, and Tax Incentives", September 2010, pg. 10:

[http://www.peri.umass.edu/fileadmin/pdf/published\\_study/priorities\\_September7\\_PERI.pdf](http://www.peri.umass.edu/fileadmin/pdf/published_study/priorities_September7_PERI.pdf)

<sup>3</sup> This is an average during the years 2003-2016. Iowa Policy Project, Peter Fisher, Grading the States (see second paragraph, accompanying pie chart, and endnote #2): <http://www.gradingstates.org/the-problem-with-tax-cutting-as-economic-policy/state-and-local-business-taxes-are-not-significant-determinants-of-growth/>

See also testimony to the New Hampshire Legislature from Robert Tannenwald, former Director of Research for the public policy division of the Federal Reserve Bank of Boston, 11-4-2010: <http://www.cbpp.org/cms/index.cfm?fa=view&id=3314>

<sup>4</sup> As in past years, the update to this study was conducted on behalf of COST by Ernst & Young. COST was founded originally through the Council of State Chambers of Commerce and remains associated with that organization.

<sup>5</sup> Council on State Taxation, FY17 Total State and Local Business Taxes, November 2018, pg. 11 and Table 4:

<https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/FY16-State-And-Local-Business-Tax-Burden-Study.pdf.pdf>

<sup>6</sup> The US Bureau of Economic Analysis measures Massachusetts's private-sector GSP at \$477.114 billion in Fiscal Year 2017. Business taxes as a share of GSP were 0.6 percentage points higher for the US as a whole than for Massachusetts in FY 2017, according to the E&Y study. Converting this percentage point gap into a dollar figure produces an estimate of approximately \$2.9 billion in reduced business taxes in Massachusetts relative to the US average in FY 2017 (\$477.114 billion x 0.006 = \$2.863 billion).

<sup>7</sup> Council on State Taxation, FY17 Total State and Local Business Taxes, November 2018, pg. 14, Table 5:

<https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/FY16-State-And-Local-Business-Tax-Burden-Study.pdf.pdf>

<sup>8</sup> See for example, Serrato & Zidar, "Who Benefits from State Corporate Tax Cuts?", American Economic Review 2016, 106(9): 2582-2624

Another useful review of the literature comes from Clemens Fuest via the European Tax Policy Forum. See "Who Bears the Burden of Corporate Income Taxation?": <http://www.etpf.org/respol.html>

<sup>9</sup> Anderson Economic Group, 2018 State Business Tax Burden Rankings (pg.17, Exhibit I):

<https://www.andersoneconomicgroup.com/our-work/reports-articles-and-working-papers/state-business-tax-rankings/>

<sup>10</sup> North Dakota, the highest tax state by this measure, collected 14.6 percent of pre-tax corporate profits in 2016. This is due to an especially heavy reliance on severance taxes, which can rise and fall significantly year-to-year depending on a number of factors, including global demand and pricing for particular commodities. Several other states also rely heavily on severance taxes, including Alaska, Wyoming and West Virginia. Because of this unusual tax structure, the tax levels in these states do not provide a good comparison to tax levels in other states.

<sup>11</sup> The U.S. state average of 9.4 percent appears on pg. 5, Table 4 of the Anderson Economic Group's 2018 report. In the accompanying chart of this MassBudget factsheet, where states are tied, they appear in alphabetical order.

<sup>12</sup> MassBudget's calculation:

A. Difference in percent of tax levels between Massachusetts and average among states: 9.4% - 8.9% = 0.5 percentage points

B. Percent change in tax amount from MA businesses to reach the average among states: 0.5 divided by 8.9 = +5.62 percent of actual tax level

C. Change in dollar amount to reach average among states: 5.62 percent of \$16,518 million in MA taxes paid = \$928.0 million additional tax

The Massachusetts tax total of \$16,518 million appears on pg. 17, Exhibit I of the Anderson Economic Group's 2018 report.

<sup>13</sup> Council on State Taxation, FY17 Total State and Local Business Taxes, November 2018, pg. 22 and Table A-3:

<https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/FY16-State-And-Local-Business-Tax-Burden-Study.pdf.pdf>

<sup>14</sup> Council on State Taxation, FY17 Total State and Local Business Taxes, November 2018, pg. 22 and Table A-3:

<https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/FY16-State-And-Local-Business-Tax-Burden-Study.pdf.pdf>

<sup>15</sup> Center on Budget and Policy Priorities, "New Tax Law Is Fundamentally Flawed and Will Require Restructuring", October 2018 (pg. 5): <https://www.cbpp.org/research/federal-tax/new-tax-law-is-fundamentally-flawed-and-will-require-basic-restructuring>

<sup>16</sup> Center on Budget and Policy Priorities, "New Tax Law Is Fundamentally Flawed and Will Require Restructuring", October 2018 (pg. 5): <https://www.cbpp.org/research/federal-tax/new-tax-law-is-fundamentally-flawed-and-will-require-basic-restructuring>

<sup>17</sup> Institute on Taxation and Economic Policy, analysis of Tax Cuts and Jobs Act, provided to MassBudget upon request.

Considering the cumulative tax reduction over the course of a full decade (2018 - 2028), ITEP estimates that the cost of TCJA's corporate tax law changes will exceed \$1.1 trillion in federal revenue.

<sup>18</sup> Council on State Taxation, FY17 Total State and Local Business Taxes, November 2018, pg. 10, Table 3:

<https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/FY16-State-And-Local-Business-Tax-Burden-Study.pdf.pdf>

According to U.S. Census data provided in the COST report, businesses collectively paid \$738.4 billion in all state and local taxes in FY 2017. The portion of this total paid on business profits alone was \$102.1 billion, including income taxes by individuals on business income.