

Location Matters and Connecticut

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Connecticut State Tax Panel

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Co-Chair Dyson, Co-Chair Nickerson, and members of the Panel:

My name is Joseph Henchman, and I'm vice president for state projects at the Tax Foundation. I am pleased to appear before you again and reiterate our willingness to provide any materials or research you may find helpful as you evaluate Connecticut's tax system.

In that spirit, I would like to share an analysis we recently released called *Location Matters: The State Tax Costs of Doing Business*. This major study calculates the total tax cost faced in each state by seven hypothetical businesses: a corporate headquarters, an R&D facility, a retail store, a capital-intensive manufacturer, a labor-intensive manufacturer, a call center, and a distribution center.

Our economists developed profiles for each of these firms based on comparative data: so many square footage, so many employees, and so forth. We then worked with the audit, tax, and advisory firm KPMG LLP to calculate the tax bills for each of these firms in all 50 states. We included all applicable state and local taxes, including corporate income taxes, property taxes, sales taxes on business inputs, unemployment insurance taxes, and franchise taxes. We calculated the tax bill twice: once for a new firm eligible for available incentives, and once for a mature firm that generally cannot access such incentives. We used the tax code as it stood on April 1, 2014, the most recent date where we had all available data from all 50 states. It does not include federal taxes: just state and local taxes.

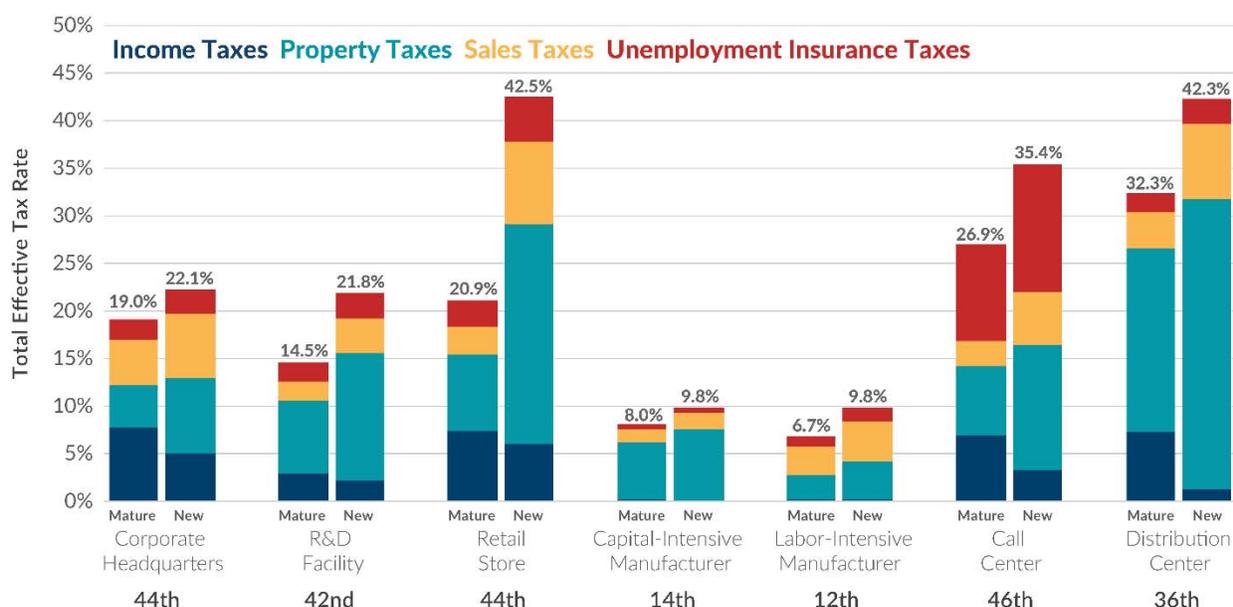
Connecticut's results are attached to this testimony. A hypothetical corporate headquarters, for example, would pay a 19 percent effective tax rate to Connecticut, the 44th lowest (or 6th highest), beaten only by New Jersey, Washington state, Iowa, Minnesota, Pennsylvania, and New York. A hypothetical R&D facility would pay a 14 percent total tax rate, 42nd lowest (or 8th highest). Distribution centers, call centers, and retailers also would have relatively high tax bills in Connecticut. Manufacturing facilities, by contrast, face relatively lower tax bills.

The main driver of these results is the state’s high corporate income tax and the surtax. While Connecticut offers generous credits to some firms, the credits in most cases cannot overcome the high tax rate. The state’s capital stock tax, one of only 18 left in the United States, is also a contributing factor.

As I expressed previously, taxes are just one component of what makes a successful economy able to retain talent and encourage innovation. But the real-world impact of Connecticut’s tax system is important to understand as you consider a tax structure that works best for the state, that is friendly to economic growth, and that balances a number of important priorities.

The full report is 118 pages, and is available on our website, www.TaxFoundation.org. On our website we also have a data lookup tool where the data for each state can be downloaded in graphical and table form. I would be happy to provide print copies of the report to the Panel if that is of interest.

Thank you.



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LOCATION MATTERS

THE STATE TAX COSTS OF DOING BUSINESS

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Introduction

State and local taxes represent a significant business cost for corporations operating in the United States and can have a material impact on net operating margins. Consequently, business location decisions for new manufacturing facilities, corporate headquarter relocations, and the like are often influenced by assessments of relative tax burdens across multiple states.¹

Widespread interest in corporate tax burdens has resulted in a range of studies produced by think tanks, media organizations, and research groups. None of these other studies, however, provide comparisons of actual state tax costs faced by real-world businesses.

Some studies compare total tax collections or business tax collections per capita or as a percent of total tax revenue. The shortcoming of this approach is that collections are not burdens: many business taxes are collected in one state but paid by companies in other states. Comparing state collections thus does not accurately portray the relative tax burden that real-world businesses would incur in each state.

Some studies assess the relative value of tax incentives available for different types of businesses, such as new job tax credits, new investment tax credits, sales tax exemptions, and property tax abatements. However, these studies can give the incorrect impression that all businesses in a state enjoy such incentives. They also do not typically account for increased tax rates for mature businesses that may be required to support such incentives.

Some studies, including the Tax Foundation's widely cited annual State Business Tax Climate Index, define model tax structure principles and measure the state's tax code relative to those principles. The *State Business Tax Climate Index* is a useful tool for lawmakers to understand how neutral and efficient their state's tax system is compared to other states and to identify areas where their system can be improved. However, this does not address the bottom line question asked by many business executives: "How much will our company pay in taxes?"

An individual firm considering expansion frequently calculates its tax bill in various states, but these calculations are not often released publicly and are usually confined to a small number of states.

To fill the void left by these studies, the Tax Foundation collaborated with U.S. audit, tax, and advisory firm KPMG LLP to develop and publish a landmark, apples-to-apples comparison of corporate tax costs in the 50 states. Tax Foundation economists designed seven model firms—a corporate headquarters, a research and development facility, an independent retail store, a capital-intensive manufacturer, a labor-intensive manufacturer, a call center, and a distribution center—and KPMG tax specialists calculated each firm's tax bill in each state. This study accounts for all business taxes: corporate income taxes, property taxes, sales taxes, unemployment insurance taxes, capital stock taxes, inventory taxes, and gross receipts taxes. Additionally, each firm was modeled twice in each state: once as a new firm eligible for tax incentives and once as a mature firm not eligible for such incentives.

¹ See, e.g., Sanja Gupta & Mary Ann Hoffman, *The Effect of State Income Tax Apportionment and Tax Incentives on New Capital Expenditures*, JOURNAL OF THE AMERICAN TAXATION ASSOCIATION, SUPPLEMENT 2003, pp. 1-25; Timothy Bartik, *Business Location Decisions in the United States: Estimates of the Effects of Unionization, Taxes, and Other Characteristics of States*, JOURNAL OF BUSINESS AND ECONOMICS STATISTICS, VOL. 3, No. 1., Jan. 1985, pp. 14-28; James Papke and Leslie Papke, *Measuring Differential State-Local Tax Liabilities and Their Implications for Business Investment Location*, NATIONAL TAX JOURNAL, VOL. 39, No. 3, 1986, pp. 357-366.

Tax Foundation economists then used the raw model results to perform the ensuing industry and state comparisons. The result is a comprehensive calculation of real-world tax burdens, now in its second edition, that we designed as a valuable resource for a variety of stakeholders, to ensure that:

- Governors, legislators, and state officials can better understand and address their states' competitive positions among the 50 states;
- CEOs, CFOs, and other corporate stakeholders can better evaluate the relative competitiveness of states in which they operate or states in which they are contemplating business investments;
- Businesses and trade organizations can better identify policy improvements for each state;
- Site-selection experts can screen states more quickly and accurately for consideration by their clients; and
- National, state, and local media organizations can more effectively report on the tax competitiveness of the 50 states.

The *Location Matters* study, together with our annual *State Business Tax Climate Index*, provides the tools necessary to understand each state's business tax system and the burdens it imposes, offering a roadmap for improvement.

Study Overview and Key Findings

Chapter 1 outlines the objectives and scope of the study. This chapter describes the seven model firms that were analyzed, the specific taxes that were included in the study, the locations that were chosen in each state, and the other factors that could influence the results.

Chapter 2 presents an overview of the effective tax rates experienced by both new and mature operations for each of our seven model firm types and summarizes how various components and features of state tax systems contribute to the overall tax burdens these firms experience.

Chapter 3 summarizes the results for each state. The chapter is aimed at legislators and reporters seeking insight into states' business tax systems, as well as at business owners and location consultants investigating the effects of states' tax systems. The chapter outlines the major factors contributing to the effective tax rates experienced by our model firms in each state.

The Appendices provide further detail on the components comprising effective tax rates for each state and firm type and compare states' incentives for new businesses. They also detail the study's methodology and assumptions. The Appendices are valuable for conducting 50-state comparisons, understanding our modeling, and reviewing our source data.

For many readers, *Location Matters* will serve as a reference guide, not a book to read from cover to cover. As such, it may be valuable to summarize a few key findings:

- *Statutory tax rates only tell part of the story.* While topline rates are important and high rates may provide “sticker shock” for corporations considering locating within a given state, they are just one component of effective tax burdens. Tax incentives, apportionment, throwback rules, and other factors can have a dramatic impact on effective tax burdens. In some cases, states with low statutory tax rates can impose high effective tax burdens, and *vice versa*.
- *Corporate income taxes are just one part of the corporate tax burden.* Sales, property, and unemployment insurance taxes are highly significant components of a firm's overall tax burden. In fact, corporate income taxes are responsible for more than a third of the average corporate tax burden for only four of the fourteen new and mature iterations of the seven firm models.
- *Incentives chiefly benefit new firms, often to the disadvantage of established operations.* Because most tax incentives are developed to convince firms to relocate to, or increase hiring in, a given state, they tend to benefit new firms, which can shift costs to mature firms. Businesses with longer time horizons may have cause to be wary of states which too substantially prioritize attracting new industries over maintaining modest rates for established operations.
- *Incentive-heavy tax structures can reduce tax equity even among newly-established firms.* While incentives favor new firms over mature operations, they often differentiate among firm types as well, with some incentives that favor one operation but do little or nothing to help another. As such, they tend to pick winners and losers and, while potentially making the state highly attractive to specific industries or firm profiles, can limit the state's broader economic appeal across diversified business types.
- *Different firm types experience dramatically different effective tax rates.* Both because different firm types will vary in their exposure to major state and local taxes—distribution centers will be more sensitive to property tax burdens, for instance, while retail establishments may be more significantly impacted by the sales tax—and because of differential treatment of different firm types under the tax code, businesses can experience dramatically different effective tax rates. The median effective tax rate for new retail operations (which rarely receive tax incentives) is 31.0 percent, while the median rate for highly-favored new R&D centers is 11.4 percent. The median rate for a mature labor-intensive manufacturing firm is 9.2 percent; the median mature distribution center, by contrast, experiences a 26.7 percent tax burden.

- *The impact of corporate income and gross receipts taxes depends heavily on structure and firm type.* Although gross receipts taxes generally have much lower statutory rates than traditional corporate income taxes, they are assessed on firms' total receipts (sometimes less certain subtractions), not just net income. Some firm types benefit from this structure, while others do not. The relative impact of these two approaches to business taxation for any given firm type can also depend heavily on how nexus or, in the case of corporate income taxes, apportionment is treated.

Tax structure and ease of compliance are also important considerations for many firms but are not the subject of this study, which focuses exclusively on effective tax burdens. Our annual *State Business Tax Climate Index* takes tax structure into account and includes further analysis of the impact of tax structure on business decision-making and economic growth.

Corporate Headquarters

	Mature Rank	Mature Rate	New Rate	New Rank
WY	1	6.9%	10.0%	12
SD	2	8.2%	10.9%	16
MT	3	9.0%	10.8%	15
ND	4	9.6%	12.2%	20
NC	5	10.4%	6.9%	6
NV	6	10.6%	15.2%	29
AK	7	11.2%	12.4%	21
KY	8	11.2%	7.1%	7
OK	9	11.5%	6.4%	5
OH	10	11.5%	10.8%	14
FL	11	11.7%	15.2%	28
VA	12	12.0%	16.4%	31
NH	13	12.0%	13.1%	22
TX	14	12.0%	18.5%	40
AZ	15	12.4%	17.0%	35
GA	16	12.5%	13.5%	25
MD	17	12.6%	17.8%	37
IN	18	12.8%	8.6%	9
UT	19	12.8%	13.3%	23
AL	20	13.0%	13.3%	24
VT	21	13.1%	11.3%	17
CO	22	13.1%	17.2%	36
DE	23	13.3%	12.2%	19
AR	24	13.6%	8.9%	11
ID	25	13.7%	16.9%	34
KS	25	13.7%	5.0%	3
LA	27	13.7%	5.2%	4
NM	28	13.8%	8.8%	10
MS	29	14.1%	11.3%	17
SC	30	14.2%	13.5%	26
TN	31	14.5%	17.8%	38
NE	32	14.5%	-0.8%	1
HI	33	14.6%	16.6%	32
MO	34	14.8%	10.2%	13
ME	35	15.1%	16.2%	30
OR	36	15.3%	16.7%	33
MA	37	15.3%	19.1%	41
MI	38	16.0%	21.1%	45
RI	39	16.1%	19.1%	42
WI	40	16.5%	7.7%	8
CA	41	16.8%	20.9%	44
WV	42	17.2%	18.4%	39
IL	43	18.3%	14.3%	27
CT	44	19.0%	22.1%	46
NJ	45	19.3%	3.6%	2
WA	46	19.4%	25.9%	49
IA	47	20.4%	20.8%	43
MN	48	21.5%	25.0%	47
PA	49	23.1%	25.2%	48
NY	50	25.3%	28.3%	50
DC	(35)	14.9%	20.6%	(43)

For this firm type, we modeled a high-wage regional corporate office with 200 employees, including management, financial operations, IT, sales, and administrative personnel. Our model firm has a capital investment of \$10 million and leases 60,000 square feet of Class A downtown office space. Its revenue is approximately \$31 million with a gross profit ratio of 17 percent and earnings before tax of 14 percent. The equity ratio is assumed to be 100 percent. Our apportionment methodology assumes 50 percent of property and payroll to be located in the state. The income-producing activities of the office are assumed to occur in state, provide all benefits in state, and relate exclusively to the marketplace of the state.

Many of the states with the lowest total tax costs for mature corporate headquarters do without one or more of the major taxes, such as a corporate income or sales tax. Wyoming and South Dakota, both of which forego corporate income taxes, offer the lowest effective tax rates for mature corporate headquarters at 6.9 percent and 8.2 percent respectively, and Montana and Alaska, which do without state sales taxes, are also very competitive at 9.0 and 11.2 percent. A highly competitive business tax structure and favorable legal and regulatory environment combine to make Wyoming one of the most popular states in which to incorporate. Conversely, high statutory corporate tax rates are responsible for the preponderance of the tax burdens experienced by these firms; six of the 10 highest tax cost states for mature corporate headquarters have statutory tax rates above 8.5 percent, led by Iowa's 12 percent top marginal rate.

The majority of the lowest tax burden states for new corporate headquarters offer generous tax incentive programs to minimize these firms' tax burdens. Seven of the 10 states with the lowest tax costs for new corporate headquarters offer generous withholding tax credits that greatly reduce the corporate income tax burden for these operations, and states with the six largest withholding tax rebates are all among the ten lowest tax cost states for new corporate headquarters. Conversely, high tax cost states for new firms tend to combine high tax rates with few incentives programs.

Unemployment insurance taxes tend to comprise a relatively modest share of the overall tax burden for high-wage firms like a regional corporate headquarters, while sales and property tax burdens can account for a substantial share of firms' total liability, especially for new firms receiving generous income tax incentives.

Research & Development Facility

Our model research and development (R&D) facility is a pharmaceutical R&D facility for product development. The facility is assumed to have 50 employees, including management, business and financial, computer and math, science, and administrative positions. We assume capital investment of \$4 million and the lease of 30,000 square feet of Class A suburban commercial space. Annual revenue is approximately \$8 million with earnings before tax of 14 percent and an equity ratio of 100 percent. The apportionment methodology assumes 100 percent of property and payroll are in state. While all income-producing activities are assumed to be performed in state, those activities are also assumed to serve clients nationally and therefore generate benefits and relate to the marketplaces of all 50 states in proportion to the relative population of each state.

State economic development offices tend to prize R&D facilities and heavily incentivize them through the tax code. As such, while some states (like North Dakota, South Dakota, and Wyoming) offer a highly competitive tax environment for mature R&D facilities even in the absence of R&D tax credits, most low tax cost states for these firms provide substantial R&D incentives which limit, or even eliminate, income tax liability. This is particularly true for new R&D operations, but can apply to mature operations as well.

New R&D facilities experience a negative overall tax liability in five states (Louisiana, Nebraska, New Jersey, Hawaii, and New Mexico). In Nebraska, available credits are so generous that they even exceed the mature firm's total tax liability. With income tax burdens likely to be low, property taxes typically represent the largest share of an R&D firm's total tax liability by a substantial margin.

Since an R&D facility's income is assumed to be mostly outside the home state, these firms' income tax burdens are greatly reduced in states which tax income where the benefits are received. Maine, Maryland, and Wisconsin stand out as particularly attractive in this regard. Market-based sourcing rules, such as the one that propels Oklahoma to an attractive effective tax rate for new firms, can have a similar effect. Conversely, states that impose above-average tax costs on R&D firms tend to (1) offer few incentives, (2) source income to where the income-producing activity is performed, thus exposing all of the firm's income to in-state taxation, and (3) impose heavy unemployment insurance, sales, or property tax burdens.

	Mature Rank	Mature Rate	New Rate	New Rank
NE	1	-2.3%	-7.4%	2
HI	2	0.9%	-0.6%	4
LA	3	1.8%	-10.3%	1
IN	4	5.8%	1.6%	6
WY	5	6.2%	10.7%	22
ND	6	6.9%	11.1%	24
SD	7	7.4%	11.4%	25
UT	8	7.6%	8.4%	15
ME	9	7.8%	8.4%	15
MD	10	7.9%	10.4%	19
AZ	11	7.9%	13.2%	27
CA	12	8.0%	13.4%	28
IA	13	8.2%	10.7%	20
MN	13	8.2%	10.7%	22
GA	15	8.4%	7.6%	12
NC	16	8.9%	10.7%	20
WA	17	9.5%	14.2%	31
OR	18	10.0%	11.4%	25
OH	19	10.1%	8.1%	13
WI	20	10.5%	2.5%	8
NV	21	10.8%	17.9%	41
VT	22	10.9%	6.3%	9
FL	23	11.0%	14.9%	34
NM	24	11.5%	-0.2%	5
OK	25	11.8%	7.4%	10
TX	26	12.1%	21.5%	48
ID	27	12.2%	15.0%	35
MS	28	12.4%	8.9%	17
PA	29	12.5%	14.1%	30
RI	30	12.7%	22.4%	50
MI	31	13.0%	19.7%	47
MT	32	13.0%	13.6%	29
KY	33	13.3%	7.5%	11
NH	34	13.5%	14.6%	33
VA	35	13.5%	18.8%	45
SC	36	13.6%	14.5%	32
MA	37	13.8%	19.5%	46
CO	38	14.0%	18.2%	43
AR	39	14.1%	8.1%	13
TN	40	14.1%	16.8%	38
AK	41	14.4%	15.8%	36
CT	42	14.5%	21.8%	49
IL	42	14.5%	17.0%	39
AL	44	14.5%	15.8%	36
DE	45	15.4%	18.1%	42
NJ	45	15.4%	-1.1%	3
KS	47	16.9%	8.9%	17
WV	48	17.3%	17.5%	40
MO	49	17.9%	18.4%	44
NY	50	24.8%	1.9%	7
DC (49)		17.9%	25.7%	(51)

Retail Store

	Mature Rank	Mature Rate	New Rate	New Rank
WY	1	6.6%	17.7%	2
SD	2	8.1%	18.0%	3
NV	3	9.6%	25.4%	15
ND	4	10.9%	20.3%	5
NC	5	11.9%	23.6%	10
WA	6	12.1%	30.7%	23
AK	7	12.6%	16.8%	1
AL	8	13.0%	29.0%	19
MT	8	12.9%	24.0%	11
NM	10	13.1%	22.2%	8
OH	10	13.1%	25.7%	16
UT	12	13.3%	28.7%	18
IN	13	13.6%	18.2%	4
KY	14	13.8%	24.5%	12
TX	15	13.9%	37.9%	40
VA	16	14.1%	30.7%	23
OR	17	14.3%	20.3%	5
GA	18	14.5%	30.8%	23
FL	19	14.6%	32.9%	31
OK	19	14.6%	31.1%	26
AR	21	15.1%	32.2%	30
MS	21	15.1%	34.9%	36
NE	21	15.1%	31.8%	28
AZ	24	15.2%	33.1%	32
LA	25	15.4%	35.4%	38
ID	26	15.6%	27.8%	17
CO	27	15.8%	37.3%	39
HI	27	15.8%	23.0%	9
NH	27	15.8%	21.5%	7
CA	30	16.1%	29.9%	21
TN	30	16.1%	33.7%	34
MD	32	16.4%	38.6%	41
VT	32	16.4%	24.8%	13
ME	34	16.6%	24.8%	13
WV	35	17.1%	33.7%	34
SC	36	17.4%	46.3%	49
KS	37	17.6%	29.9%	21
MO	38	19.3%	43.1%	47
MI	39	19.4%	40.1%	43
IL	40	19.7%	33.1%	32
NJ	40	19.7%	31.9%	28
WI	42	19.9%	40.0%	43
DE	43	20.1%	29.0%	19
CT	44	20.9%	42.5%	46
MA	44	20.9%	43.6%	48
IA	46	21.8%	35.0%	36
RI	47	22.1%	49.3%	50
PA	48	22.9%	31.6%	27
MN	49	24.3%	40.0%	43
NY	50	26.5%	39.1%	42
DC	(38)	18.4%	38.2%	(41)

Our model retail operation is an independent clothing store with 25 employees, most of whom are sales employees. The business has a capital investment of \$2 million and leases 10,000 square feet of downtown commercial space. It brings in \$2.9 million in annual revenue with a gross profit ratio of 45 percent and earnings before tax of 9 percent. The equity ratio is assumed to be 100 percent, and the apportionment methodology assumes that property, payroll, and sales are all in state.

The three states with the lowest tax costs for mature retail operations—Wyoming, South Dakota, and Nevada—all forego a corporate income tax. Two other states that fare well for established retail operations, Washington and Ohio, also do without a traditional corporate income tax but instead levy gross receipts taxes.

While one might expect the sales tax to work uniquely to the detriment of retail stores, our study only looks at sales taxes paid directly by the firms themselves—that is, sales taxes they pay on the purchase of business inputs, not sales taxes they collect on their retail sales—and a high sales tax burden is not insurmountable if the rest of the tax system is largely favorable. For instance, Alabama combines a high effective sales tax burden with modest income, unemployment insurance, and property tax burdens to provide a low overall tax burden for mature retail stores. At the other end of the spectrum, Delaware does not levy a sales tax but still imposes one of the highest aggregate tax burdens for mature operations due to its high corporate income tax rate, property tax burden, and a gross receipts tax.

In fact, property taxes turn out to be a much more significant burden than sales taxes for this firm type, and the corporate income tax burden can often outstrip the impact of the sales tax as well. Whereas other firm types may experience substantial sales tax burdens when the sales tax is improperly applied to business inputs, retail stores will tend to have fewer such business-to-business transactions and can generally pass along to consumers a sizable percentage of the cost associated with sales taxes imposed on their own merchandise. We do not consider sales taxes on merchandise sold to consumers in this study.

Finally, retail stands out as having lower effective tax rates for mature than for new operations. This is because few states offer incentives for retail operations—typically a driver of lower tax burdens for new operations—and new retail stores tend to have initial expenses (such as the purchase of store fixtures and other materials subject to personal property taxes) that subject them to more extensive taxation.

Capital-Intensive Manufacturer

Our model capital-intensive manufacturing operation is a steel company with 200 positions, including management, administrative, installation and maintenance, production, transportation, and materials employees. The scenario assumes \$300 million in capital investment, including a 250,000 square foot suburban industrial building owned by the firm. Revenue is assumed to be approximately \$200 million with a gross profit ratio of 25 percent, earnings before tax of 10 percent, and an equity ratio of 50 percent. The apportionment methodology assumes 100 percent of property and payroll is in the state in which the manufacturer is located, while sales are assumed to be distributed among all 50 states in proportion to the relative population of each state.

Interestingly, many of the states with the lowest overall tax burdens for this firm have high corporate statutory income tax rates. For these firms, favorable apportionment factors and an absence of throwback rules are often more important. Of the ten lowest tax cost states, eight impose income or gross receipts taxes, and seven of those use single sales factor apportionment, meaning that the amount of the firm's sales subject to home-state taxation is very low. A state's decision not to tax "nowhere income"—income attributable to states with which a firm lacks nexus—through throwback rules similarly lightens overall tax burdens for this firm type. Conversely, nine of ten highest tax cost states for mature operations employ throwback or throwout rules.¹⁰

Many high tax cost states either have high property tax rates on land, buildings, and equipment, or broader property tax bases that include inventories, while more competitive states frequently avoid taxing equipment and inventory. These burdens are frequently offset in part by property tax abatements (and occasionally freeport exemptions), which can be substantial for new firms. Thirty-nine states offer some degree of property tax abatement for new capital-intensive manufacturers, a few of which all but wipe out overall tax liability for this firm type.

Finally, due to the effect of tax incentives, income tax burdens tend to be much more substantial for mature manufacturers than for new operations. Given that capital-intensive manufacturers tend to have long time horizons, however, many manufacturers that initially benefit from relatively low income tax burdens in incentive-heavy states can anticipate significantly higher taxes down the line.

	Mature Rank	Mature Rate	New Rate	New Rank
IA	1	3.9%	4.5%	8
MN	2	4.0%	4.6%	9
WY	3	4.1%	8.7%	26
PA	4	4.2%	5.4%	12
SD	5	4.2%	10.1%	34
NY	6	4.5%	2.3%	5
NJ	7	5.0%	2.1%	4
OH	8	5.1%	2.8%	6
GA	9	6.0%	6.0%	15
AZ	10	7.5%	14.3%	41
NE	11	7.5%	2.0%	3
MO	12	7.8%	7.4%	21
NV	13	7.9%	21.6%	48
CT	14	8.0%	9.8%	30
MI	15	8.5%	9.7%	29
LA	16	8.5%	0.1%	1
NC	17	8.9%	10.2%	35
ND	18	9.0%	5.6%	14
AL	19	9.3%	7.1%	18
VA	20	9.3%	23.8%	49
DE	21	9.3%	4.6%	10
WA	22	9.5%	17.1%	42
TX	23	9.9%	19.8%	45
MD	24	10.3%	26.0%	50
KY	25	10.3%	9.8%	32
UT	26	10.8%	8.3%	23
NM	27	11.0%	12.1%	37
TN	28	11.1%	8.8%	28
OK	29	11.3%	4.8%	11
KS	30	11.3%	1.8%	2
FL	31	11.3%	19.6%	44
AK	32	12.3%	5.6%	13
NH	33	12.6%	7.4%	22
HI	34	12.8%	8.8%	27
OR	35	13.7%	9.8%	31
ID	36	13.9%	8.5%	24
MA	37	13.9%	7.2%	19
IL	38	14.2%	6.5%	17
RI	39	14.5%	6.4%	16
MT	40	14.5%	14.1%	40
CO	41	14.7%	21.0%	47
SC	42	15.6%	20.9%	46
WV	43	15.9%	4.5%	7
AR	44	16.2%	8.6%	25
CA	45	16.2%	17.7%	43
WI	46	16.5%	9.8%	33
VT	47	17.2%	12.2%	38
ME	48	17.6%	7.3%	20
MS	49	17.8%	13.8%	39
IN	50	19.2%	11.7%	36

¹⁰ See the discussion of apportionment and throwback rules on page 9-10.

Labor-Intensive Manufacturer

	Mature Rank	Mature Rate	New Rate	New Rank
WY	1	4.3%	7.7%	18
VA	2	4.3%	11.4%	36
GA	3	4.6%	2.8%	4
MD	4	4.9%	12.6%	42
NE	5	5.5%	1.6%	2
MO	6	5.8%	3.3%	5
AZ	7	6.0%	10.8%	32
SD	8	6.0%	9.9%	28
LA	9	6.3%	-1.9%	1
MI	10	6.3%	8.2%	20
PA	11	6.6%	10.2%	30
CT	12	6.7%	9.8%	26
OH	13	6.9%	4.8%	9
TX	14	7.0%	14.8%	46
NV	15	7.0%	14.3%	45
IA	16	7.1%	9.6%	25
MN	17	7.2%	9.8%	27
NY	18	7.2%	3.8%	8
NC	19	7.3%	6.5%	11
SC	20	7.7%	8.0%	19
FL	21	7.8%	11.2%	33
KY	22	8.0%	6.5%	10
NJ	23	8.5%	1.8%	3
AL	24	8.5%	6.7%	12
ND	25	9.1%	9.4%	24
DE	26	9.2%	7.6%	15
UT	26	9.2%	9.0%	23
MT	28	9.8%	11.4%	35
OK	29	10.0%	3.5%	7
TN	30	10.2%	11.3%	34
NM	31	10.2%	8.5%	21
CO	32	10.3%	15.2%	47
OR	33	10.5%	13.0%	44
WA	34	10.5%	17.0%	50
MS	35	11.2%	8.8%	22
AK	36	11.7%	10.7%	31
ID	37	11.7%	11.5%	39
NH	38	12.1%	12.9%	43
AR	39	12.5%	7.3%	13
KS	40	12.6%	3.5%	6
VT	41	12.8%	11.6%	40
WI	42	13.0%	7.7%	17
CA	43	13.2%	16.3%	48
ME	44	13.4%	11.5%	38
MA	45	13.5%	11.4%	37
IN	46	13.5%	7.6%	16
WV	47	13.6%	7.3%	13
IL	48	14.4%	10.0%	29
HI	49	14.8%	16.9%	49
RI	50	14.9%	12.0%	41

Our model labor-intensive manufacturing operation is a manufacturer of trucks or buses, employing 300 people, chiefly in management, installation, maintenance, production, and assembly. The model assumes capital investment of \$65 million, including a 250,000 square foot suburban industrial building owned by the business. Revenue is approximately \$174 million with a gross profit ratio of 20 percent and earnings before tax of 7 percent. The equity ratio is assumed to be 30 percent. The apportionment methodology assumes 100 percent of property and payroll is in the state in which the manufacturer is located, while sales are assumed to be distributed among all 50 states in proportion to the relative population of each state.

Labor-intensive manufacturers with the lowest overall tax burdens tend to experience relatively light corporate income tax burdens, either due to low statutory rates or apportionment rules that limit the income subject to tax. Of the ten mature manufacturing operations with the lowest combined tax burdens, nine employ single sales factor apportionment for this firm type (or forgo corporate income taxes), and the one state that does not (Arizona) forgoes a throwback rule. Favorable apportionment rules are how a state like Maryland, with its 8.25 percent corporate income tax, can still look attractive for manufacturing, but not for many other firm types: the state gives preferential tax treatment to manufacturers with single sales factor apportionment, while many other businesses must use a three-factor formula with double-weighted sales.

Property taxes are less important to labor-intensive manufacturing operations than they are to capital-intensive operations, as the former have less equipment potentially subject to tax. Still, states which limit their property tax base to land and buildings offer a lower tax environment for these firms, all else being equal.

Similarly, while unemployment insurance tax burdens have the potential to be more significant to labor-intensive manufacturing, corporate income tax burdens are by far the most significant. Sixteen states offer withholding tax rebates, 24 states offer investment tax credits, and 24 states offer job tax credits to new labor-intensive manufacturers, all holding down—and in some cases eliminating—income tax burdens, at least for the first few years of operations. New manufacturing operations in states with high income taxes, unfavorable apportionment rules, and limited incentives tend to experience the highest aggregate tax costs.

Call Center

Our model call center is a relatively low-wage service business with 600 employees including management, sales, and administrative positions. It has a capital investment of \$10 million and leases 100,000 square feet of Class A suburban office space, with revenue of approximately \$29 million, earnings before tax of 7 percent, and an equity ratio of 100 percent. All property and payroll is located in state, though the firm's activities are assumed to serve customers and clients nationally, in proportion to the relative population of each state.

Unemployment insurance (UI) taxes play an outsized role in this firm's tax burden because call centers represent a labor-intensive business. As UI taxes are paid on a per-employee basis, state UI tax rates take on considerable salience for low-wage employers. Consequently, UI taxes tend to outstrip corporate income taxes and rank second only to property taxes as a share of a mature call center's overall tax burden. Property taxes represent, on average, the single largest tax expenditure for both new and mature call centers.

The impact of corporate income taxes, meanwhile, is heavily dependent upon sourcing rules. For instance, California imposes the lowest effective tax rate on mature call centers despite the state's high statutory corporate income tax rate since, due to a favorable benefits-received sourcing rule, very little of the firm's income is taxed in California. Arizona, Georgia, and Utah also stand out as states with dramatically lighter tax burdens on this firm due to benefits-received sourcing rules. Notably, of the ten states with the highest tax burdens for mature call center operations, only two—Illinois and Minnesota—have a benefits-received sourcing rule, and the Illinois operation is subject to a throw-out rule for services receipts attributable to a state where the taxpayer is not taxable, eliminating much of the advantage of benefits-received sourcing for this firm type.

For new firms, tax incentives—especially those aimed at lowering employment costs—are an important factor. Seven of the 14 states that offer withholding tax rebates to new call centers also offer among the ten lowest burdens overall. In some cases, these incentives (often refundable) are sufficient to yield a negative income tax burden, or even a negative overall tax burden. The costs of such generosity are, of course, borne by mature firms, including mature call centers in these states.

	Mature Rank	Mature Rate	New Rate	New Rank
CA	1	11.4%	19.2%	15
GA	2	12.0%	-15.8%	2
AZ	3	12.1%	20.7%	17
NE	4	12.5%	2.9%	3
SD	5	12.8%	18.9%	14
UT	6	13.1%	15.9%	10
AL	7	13.5%	17.2%	12
WY	8	14.4%	22.3%	19
MD	9	14.8%	24.4%	23
ME	9	14.8%	19.2%	16
WA	11	15.3%	25.5%	25
NC	12	15.7%	22.4%	20
OH	13	15.8%	14.0%	9
FL	14	16.3%	26.5%	27
MS	15	16.4%	11.0%	8
MI	16	16.4%	26.5%	26
OK	17	16.6%	4.0%	6
ND	18	16.8%	22.9%	21
KY	19	17.6%	3.2%	5
TX	20	17.9%	30.9%	38
VA	21	18.1%	26.9%	29
IA	22	18.8%	27.1%	30
WI	23	19.1%	3.0%	4
NM	24	19.2%	23.6%	22
TN	24	19.2%	25.5%	24
LA	26	19.6%	31.2%	40
CO	27	20.1%	29.1%	33
MT	28	20.3%	26.6%	28
VT	29	20.3%	16.8%	11
AR	30	20.3%	10.9%	7
MO	31	21.1%	32.3%	42
DE	32	21.3%	22.2%	18
OR	33	22.0%	29.2%	34
PA	34	22.3%	31.1%	39
NV	35	22.6%	34.9%	45
ID	36	23.1%	30.7%	37
IN	37	23.5%	17.9%	13
AK	38	23.7%	28.3%	32
KS	39	23.8%	31.9%	41
NH	40	24.2%	29.3%	35
SC	41	24.6%	27.8%	31
NY	42	24.9%	33.4%	44
WV	43	25.6%	36.6%	47
HI	44	26.3%	32.7%	43
MN	45	26.8%	38.0%	49
CT	46	26.9%	35.4%	46
IL	46	26.9%	29.3%	36
MA	48	28.0%	37.9%	48
RI	49	30.7%	42.2%	50
NJ	50	35.4%	-53.5%	1

Distribution Center

	Mature Rank	Mature Rate	New Rate	New Rank
WY	1	12.9%	21.5%	6
CA	2	15.2%	26.3%	17
AL	3	16.4%	22.3%	7
GA	4	18.7%	13.0%	1
OK	5	19.1%	24.6%	9
WA	6	19.4%	33.0%	27
UT	7	19.5%	18.4%	3
NC	8	19.9%	24.9%	11
NV	9	20.2%	33.7%	30
AZ	10	20.3%	32.6%	26
HI	11	21.7%	25.0%	12
NM	12	21.8%	27.4%	19
OR	13	22.0%	28.5%	22
MD	14	22.0%	37.2%	32
VA	15	22.1%	35.2%	31
KY	16	22.7%	24.7%	10
AR	17	22.9%	27.9%	21
ME	18	22.9%	31.3%	25
SD	19	23.1%	33.1%	28
NE	20	23.9%	29.0%	24
ND	21	25.2%	23.7%	8
ID	22	25.6%	33.6%	29
MS	23	25.6%	20.0%	5
MT	24	26.3%	26.1%	16
AK	25	26.5%	19.8%	4
WI	26	26.9%	37.4%	33
TN	27	27.1%	27.0%	18
OH	28	27.6%	14.9%	2
FL	29	28.3%	44.2%	40
DE	30	28.5%	25.0%	13
MO	31	28.6%	25.6%	15
MI	32	29.0%	45.0%	41
WV	33	31.1%	41.7%	37
LA	34	31.6%	42.4%	39
TX	35	32.2%	52.7%	46
CT	36	32.3%	42.3%	38
NH	37	32.4%	38.0%	34
VT	38	32.7%	28.7%	23
CO	39	35.2%	46.0%	43
IL	40	36.0%	25.5%	14
IA	41	38.1%	41.6%	36
MN	42	38.4%	45.6%	42
KS	43	38.6%	50.6%	45
NY	44	40.5%	49.0%	44
IN	45	40.8%	27.9%	20
PA	46	41.0%	56.8%	49
MA	47	41.1%	55.6%	48
RI	48	41.8%	55.2%	47
SC	49	45.6%	68.1%	50
NJ	50	48.2%	41.5%	35

Our model distribution center is a warehouse facility operated by an independent third-party logistics provider for a large company. This firm has 95 employees in transportation and material handling, administrative, and management occupations, and leases 350,000 sq. ft. of Class B suburban industrial space. With a capital investment of \$11 million, the firm has \$13 million in revenue with a gross profit ratio of 68 percent and earnings before tax of 12 percent. The equity ratio is assumed to be 50 percent, and the apportionment methodology assumes 100 percent of property and payroll are in state. The income-producing activities of the distribution center are assumed to occur in state, with the benefit of those activities also being received in state. However, the sole customer contracting for the operation of the distribution center is assumed to be located out of state.

Property taxes are far and away the most significant tax type for both new and mature distribution centers, frequently responsible for more than two-thirds of a firm's overall tax burden. Predictably, the ten mature operations with the lowest overall tax burdens all experience property tax burdens among the lowest third nationwide, and the states that impose the highest property tax burdens tend to rank among the worst for aggregate tax burden. At the extreme, property taxes account for an astonishing 94 percent of the state and local tax burden experienced by the new distribution center in South Carolina. This phenomenon is largely the result of job tax credits and withholding tax rebates that essentially wipe out the firm's income tax burden and much of its sales tax burden.

For these firms, property taxes are about more than just millages. Equally, if not more important, is whether a state's property tax burden extends to inventory, business equipment, or both. For instance, states like Indiana, Massachusetts, Rhode Island, and South Carolina impose unusually high property tax burdens on mature operations in significant part because their property taxes extend beyond land and buildings.

Twenty-six states offer property tax abatements to new distribution centers, which substantially lower these firms' effective tax rates, although in many cases these benefits may be short-lived, exposing firms to heavy tax burdens once the abatements expire. Corporate income taxes can also be a significant component of distribution centers' effective tax rates, albeit not on par with property taxes. Consequently, many new distribution centers benefit from investment tax credits which reduce corporate income tax liability.

Connecticut

Connecticut imposes an above-average tax burden on all non-manufacturing operations, due in large part to the state's high corporate income tax rate. The state then accentuates its already high corporate income tax with a 20 percent surtax on businesses with at least \$100 million in annual gross income, bringing the tax rate to the equivalent of 9.0 percent for these firms.

Connecticut's tax burden has increased across all categories since our last edition, with mature research and development (R&D) facilities and new retail operations seeing the greatest increase in their tax burdens relative to other states. The state's investment credit, withholding tax rebate, and R&D credit cannot overcome the state's high statutory rates.

Manufacturing and services firms in Connecticut benefit from single sales factor apportionment, while retail uses double-weighted sales factor apportionment. Since our model retail firm is assumed to sell exclusively in state, either apportionment formula would have the same impact on it.

Connecticut ranks 12th for mature labor-intensive manufacturing firms, which have a total effective tax rate of 6.7 percent. The state also ranks 14th for mature capital-intensive manufacturing, with an effective tax rate of 8.0 percent. These relatively light tax costs are driven by the firms' low income tax burdens, which benefit from Connecticut's single sales factor income apportionment formula and the lack of a throwback rule. The state does, however, extend its property tax base to include equipment.

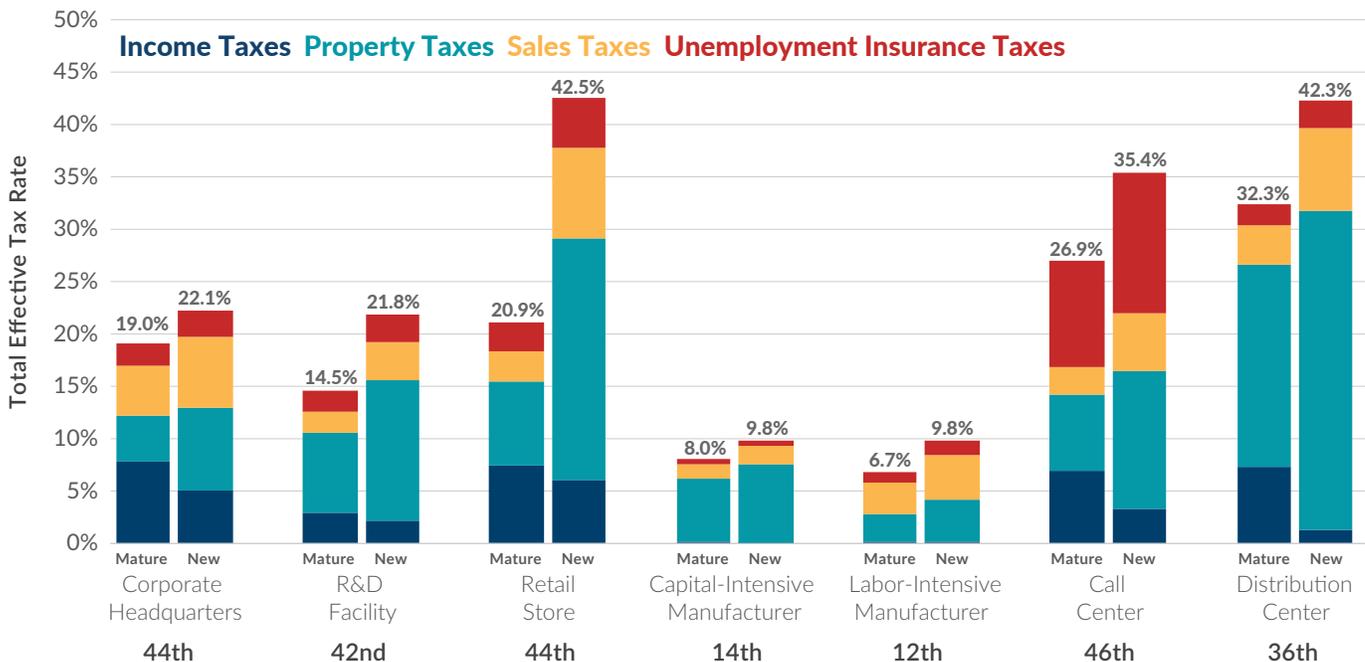
Finally, Connecticut imposes the highest capital stock tax in the country, and is one of only 18 states imposing any such a tax, which can greatly hinder capital formation.

Top Tax Rates

Corporate Income	9.0%*
Individual Income	6.7%†
State Sales	6.35%
Avg. Local Sales	—

* Rate includes a 20 percent surtax that effectively increases the rate from 7.5 to 9 percent. Surtax is required by businesses with at least \$100 million in annual gross income.

† Connecticut has an income "recapture" provision whereby the benefit of lower tax brackets is removed for the top bracket.



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