

2007 State Business Tax Burden Rankings

2nd Annual State Rankings

Caroline M. Sallee, Consultant

Patrick L. Anderson, Principal and CEO

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STATE RANKINGS ON BUSINESS TAX BURDEN MEASURE

To understand the burden taxes place on businesses in each state, it is important to look beyond the amount of tax revenue governments collect and instead analyze how taxes paid by businesses compare to income available to pay the tax. The best measure of tax burden is taxes paid as a share of profits, as this measure directly compares taxes paid to business income available to pay the tax.

We constructed a measure that compares taxes businesses pay to business profits earned within each state. We rank all 50 states and the District of Columbia from 1 to 51. A score of “1” indicates the state with the lowest tax burden. Table 1 below shows the ten states with the lowest business tax burdens and the ten states with the highest burdens. See Exhibit I, “All Taxes Paid by Businesses as a Share of Business Profits Earned Within the State, 2005,” on page 5 for the ranking of all states.

TABLE 1. States with Lowest and Highest Business Tax Burdens, 2007

| Ten States with Lowest Tax Burdens | | | Ten States with Highest Tax Burdens | | |
|------------------------------------|--------|------|-------------------------------------|--------|------|
| | % | Rank | | % | Rank |
| Delaware | 15.89% | 1 | North Dakota | 29.28% | 42 |
| Missouri | 17.45% | 2 | Mississippi | 30.00% | 43 |
| Tennessee | 18.00% | 3 | District of Columbia | 30.48% | 44 |
| Minnesota | 18.07% | 4 | Hawaii | 30.56% | 45 |
| Connecticut | 18.08% | 5 | West Virginia | 31.50% | 46 |
| New Mexico | 18.11% | 6 | Alaska | 33.78% | 47 |
| North Carolina | 18.15% | 7 | New Hampshire | 34.92% | 48 |
| South Dakota | 18.42% | 8 | Maine | 37.72% | 49 |
| Ohio | 18.58% | 9 | Vermont | 39.37% | 50 |
| Georgia | 18.93% | 10 | Montana | 44.24% | 51 |
| <i>Memo:</i> | | | | | |
| <i>U.S. State Average</i> | | | 24.2% | | |

Note: Data is from FY 2005

Source: Anderson Economic Group LLC

The state with the lowest tax burden is Delaware with businesses taxes equal to 15.89% of business profits. The state with the highest tax burden is Montana at 44.24%. The average across all states is 24.2%.

The ten states with the lowest tax burdens are: Delaware, Missouri, Tennessee, Minnesota, Connecticut, New Mexico, North Carolina, South Dakota, Ohio, and Georgia. No single geographical region dominates in our ranking; states with low tax burdens can be found in the Northeast, Midwest, South, and West. The tax burdens among the ten lowest states are mostly between 18% and 19%, however Delaware's tax burden is much lower than the rest. Delaware, the state with the lowest tax burden, is 3 percentage points lower than the 10th lowest state (Georgia).

As shown in Table 1 on page 1, the ten states with the highest tax burdens are: North Dakota, Mississippi, District of Columbia, Hawaii, West Virginia, Alaska, New Hampshire, Maine, Vermont, and Montana.

COMPARISON TO 2007 STATE RANKINGS

Overall, business tax burdens improved from the 2006 to 2007 rankings. The average state tax burden fell from 29.9% in 2006 (using FY 2004 data) to 24.2% in 2007 (FY 2005 data). The state with the lowest business tax burden, Delaware, experienced a decline in tax burden from 17.41% to 15.89%, as shown in Table 2. The highest tax burden state in both 2006 and 2007, Montana, experienced a fall in tax burden from 55.18% to 44.24%—a decline of over 10 percentage points.

The decline in tax burdens can be explained by the large increase in business profits relative to business taxes paid. In other words, FY 2005 taxes made up a smaller share of business profits. As shown in Table 4 on page 4, between FY 2004 and FY 2005 taxes paid by businesses increased 7.3%, while profits of corporations, partnerships and sole proprietorships increased 33%. Taxes directly related to business profits increased at a similar rate as corporate profits (corporate income profits increased 28% between FY 2004 and FY 2005); however most other tax revenue rose only slightly—by less than 6%.

States With Lowest Tax Burdens. Ohio and Georgia are new to the list this year, replacing Utah and Arkansas in the top ten. All states in the top 10 lowest tax burden states in 2007 were in the top 12 in 2006. See Table 2 on page 3.

TABLE 2. Comparison of Top Ten Lowest Tax Burden States, 2006 and 2007 Rankings

| | 2007 Rankings (FY 2005 data) | | 2006 Rankings (FY 2004 data) | |
|---------------------------------|------------------------------|------|------------------------------|------|
| | % | Rank | % | Rank |
| Delaware | 15.89% | 1 | 17.41% | 1 |
| Missouri | 17.45% | 2 | 21.36% | 3 |
| Tennessee | 18.00% | 3 | 21.72% | 4 |
| Minnesota | 18.07% | 4 | 21.08% | 2 |
| Connecticut | 18.08% | 5 | 21.97% | 6 |
| New Mexico | 18.11% | 6 | 22.62% | 7 |
| North Carolina | 18.15% | 7 | 21.84% | 5 |
| South Dakota | 18.42% | 8 | 22.94% | 8 |
| Ohio | 18.58% | 9 | 23.36% | 11 |
| Georgia | 18.93% | 10 | 23.65% | 12 |
| <i>Memo: U.S. State Average</i> | 24.2% | | 29.9% | |

Source: Anderson Economic Group LLC

States With Highest Tax Burdens. There was no change in which states had the highest tax burdens from the 2006 to 2007 rankings. Business taxes paid as a share of business profits declined between 2006 and 2007 for the group and the ordering of the states changed slightly, as shown in Table 3 on page 3.

TABLE 3. Comparison of Top Ten Highest Tax Burden States, 2006-2007 Rankings

| | 2007 Rankings (FY 2005 data) | | 2006 Rankings (FY 2004 data) | |
|----------------------|------------------------------|------|------------------------------|------|
| | % | Rank | % | Rank |
| North Dakota | 29.28% | 42 | 37.70% | 45 |
| Mississippi | 30.00% | 43 | 38.97% | 46 |
| District of Columbia | 30.48% | 44 | 35.23% | 42 |
| Hawaii | 30.56% | 45 | 35.68% | 43 |
| West Virginia | 31.50% | 46 | 37.37% | 44 |
| Alaska | 33.78% | 47 | 43.46% | 48 |
| New Hampshire | 34.92% | 48 | 42.49% | 47 |
| Maine | 37.72% | 49 | 48.15% | 50 |
| Vermont | 39.37% | 50 | 47.69% | 49 |
| Montana | 44.24% | 51 | 55.18% | 51 |

Source: Anderson Economic Group LLC

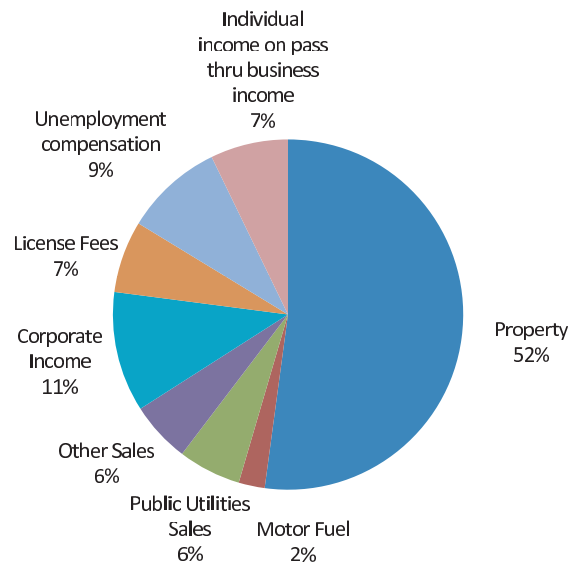
STATE AND LOCAL BUSINESS TAXES

In FY 2005, state and local governments reported total tax revenue of \$1.1 trillion. Businesses (as opposed to households) paid 35% of total state and local taxes. Most tax revenue from businesses came from property taxes. As shown in Figure 1 on page 4, revenue from property taxes made up 52% of all tax revenue from busi-

nesses. Revenue from corporate income taxes made up 11%, while the remaining share come from sales, unemployment compensation, license fees and individual taxes on pass-thru business income.

In FY 2005, businesses paid \$388.3 billion in state and local taxes. This is 7.3% more than they paid in FY 2004. Tax revenue in all categories except unemployment compensation increased between FY 2004 and FY 2005. The tax categories that experienced the largest increases include corporate income (27.9%), license fees (17.8%), and individual income taxes on pass-thru business income.

FIGURE 1. Share of Revenue by Type of State and Local Business Taxes, FY 2005



Source: Anderson Economic Group, LLC

TABLE 4. Change in Business Taxes Paid, FY 2004-FY 2005

| Business Tax Category | FY 2004 | FY 2005 | Change (%) |
|--|----------------------|----------------------|--------------|
| Property Tax | \$191,905,939 | \$202,419,895 | 5.5% |
| Motor Fuel Sales Tax | \$8,808,804 | \$9,387,218 | 6.6% |
| Public Utilities Sales Tax | \$21,426,576 | \$22,551,373 | 5.2% |
| Other Selective Sales Tax | \$20,877,962 | \$21,753,054 | 4.2% |
| Corporate Income | \$33,715,793 | \$43,137,967 | 27.9% |
| License Fees | \$23,181,855 | \$25,776,500 | 11.2% |
| Unemployment Compensation | \$38,361,503 | \$35,374,494 | -7.8% |
| Individual Income Tax on Pass-thru Business Income | <u>\$23,675,052</u> | <u>\$27,895,826</u> | <u>17.8%</u> |
| Total Taxes Paid by Businesses | \$361,953,484 | \$388,296,327 | 7.3% |

Base Data Source: U.S. Census of Governments State and Local Finance Survey, FY 2005

Source: Anderson Economic Group, LLC

Exhibit I. All Taxes Paid By Businesses as a Share of Business Profits Earned within the State

| Ranking | State | All Taxes Paid by Businesses as a % of Business Profits Earned within the State |
|---------|---------------------------|---|
| 1 | Delaware | 15.89% |
| 2 | Missouri | 17.45% |
| 3 | Tennessee | 18.00% |
| 4 | Minnesota | 18.07% |
| 5 | Connecticut | 18.08% |
| 6 | New Mexico | 18.11% |
| 7 | North Carolina | 18.15% |
| 8 | South Dakota | 18.42% |
| 9 | Ohio | 18.58% |
| 10 | Georgia | 18.93% |
| 11 | Louisiana | 18.96% |
| 12 | Utah | 19.02% |
| 13 | Colorado | 19.03% |
| 14 | Alabama | 19.33% |
| 15 | Arkansas | 19.62% |
| 16 | Massachusetts | 20.26% |
| 17 | Oklahoma | 20.73% |
| 18 | Kentucky | 20.76% |
| 19 | Virginia | 21.06% |
| 20 | Washington | 21.19% |
| 21 | Wisconsin | 21.22% |
| 22 | New York | 21.69% |
| 23 | Maryland | 21.74% |
| 24 | Pennsylvania | 21.84% |
| 25 | Nebraska | 22.08% |
| 26 | Michigan | 22.10% |
| 27 | Iowa | 22.17% |
| 28 | California | 22.92% |
| 29 | Texas | 23.44% |
| 30 | Indiana | 23.96% |
| | <i>U.S. State Average</i> | <i>24.2%</i> |
| 31 | Arizona | 24.31% |
| 32 | South Carolina | 24.61% |
| 33 | Oregon | 24.63% |
| 34 | Illinois | 24.80% |
| 35 | Kansas | 25.52% |
| 36 | Wyoming | 26.45% |
| 37 | New Jersey | 26.84% |
| 38 | Nevada | 26.93% |
| 39 | Rhode Island | 27.01% |
| 40 | Idaho | 27.53% |
| 41 | Florida | 28.37% |
| 42 | North Dakota | 29.28% |
| 43 | Mississippi | 30.00% |
| 44 | District of Columbia | 30.48% |
| 45 | Hawaii | 30.56% |
| 46 | West Virginia | 31.50% |
| 47 | Alaska | 33.78% |
| 48 | New Hampshire | 34.92% |
| 49 | Maine | 37.72% |
| 50 | Vermont | 39.37% |
| 51 | Montana | 44.24% |

Note: Data is from FY 2005

Source: AEG Estimate

METHODOLOGY

Taxes Paid by Businesses

The base data for AEG's estimate of taxes paid by businesses in each state come from the 2005 U.S. Census of Governments State and Local Finance survey. This source gives comparable tax and revenue data for all 50 states and the District of Columbia.

In order to construct our "total taxes paid by businesses" figure, we used tax data from six main tax categories:

1. Property
2. Sales and excise
3. License
4. Individual income
5. Corporate income
6. Unemployment contributions

For each of the above categories, we allocated some portion of tax revenue as paid by businesses using the following methodology.

Property taxes. The U.S. Census State and Local Government Finances survey reports state and local property taxes collected by state for fiscal year 1999-2000. The business share of property taxes paid in 2000 was calculated as the residual of total property taxes collected in 2000 less property taxes paid on owner-occupied units. We then applied the same fraction from the 2000 business share to property taxes collected in 2005. The Census of Housing (2000) provides an aggregate figure of taxes paid on owner-occupied units for each state. As other studies, such as Tannewald (2004) and COST (2005), have done, we treat taxes paid on rental housing as business taxes.

Motor fuel sales tax. The U.S. Census State and Local Government Finances Survey provides the sales tax from motor fuel sales in 2005. We allocated a portion of this tax as paid by businesses based each state's diesel fuel sales share of total diesel and gas sales. We assumed that companies, rather than households, purchase diesel and pay this tax. We obtained the diesel and motor gasoline fuel sales by state from the U.S. Energy Information Administration.

Public utilities tax. We allocated all of this category as tax paid by businesses.

Other Selective Sales tax. We split remaining selective sales taxes 50-50 between households and businesses.

Corporate income tax. The U.S. Census of Governments State and Local Finances reports this category for 2005. We allocated all revenue raised by taxes on corporate income to businesses.

License taxes. The U.S. Census State Government Finances survey provides license taxes by subcategory. We allocated amusement, corporation, public utility, and occupation and business license taxes to businesses. We allocated motor vehicle license taxes based on the same ratio of diesel to total fuel sales used to apportion

the motor fuel sales tax. We allocated to business the same portion of local license fees as used for state license fees.

Unemployment compensation. We allocated all of the unemployment compensation revenue reported by the U.S. Census to businesses.

Individual income tax on pass-through business income. In order to estimate the amount of individual taxes paid on pass-through business income, we turned to data provided by the Internal Revenue Service's Statistics of Income (SOI). We used returns data on net income less deficit reported in 2004 for partnerships, "S" Corporations, and sole proprietorships to determine the national profits for these types of firms. We allocated the national profits to states based on each state's share of proprietorship income, as reported by the Bureau of Economic Analysis (BEA). Proprietorship data reported by the BEA includes partnerships and "S" Corporation income in addition to income from sole proprietorships.

After allocating profits from these types of firms to each state, we calculated the appropriate tax rate for these profits. We calculated the average individual income tax rate by dividing each state's individual income tax revenue in 2005 by the state's adjusted gross income (AGI) from the SOI. We then created a weighted personal income tax rate that consisted of 1/3 the top individual tax rate and 2/3 the average tax rate. Individual income taxes on pass-through business income was thus profits from these firms times each state's weighted tax rate.

Business Profits Earned within Each State

One of our metrics in this study is business taxes as a share of state profits. For the denominator in this measure, we had to estimate total business profits earned within each state. We first had to determine national profits for different types of firms. We relied on tax return data from the IRS to determine profits in each industry in the United States. We used information published by the IRS to find out profits by major industries in 2004 for "C" corporations, "S" Corporations, partnerships, and sole proprietorships.

We allocated profits to each state using a two-factor approach. We first looked at each state's share of employment in each industry using the 2002 U.S. Economic Census. We allocated profits by industry to each state using each state's share of national payroll in that industry. A state's total profit is the sum of all the profits by industry in that state. Next, we allocated national profits to each state by each state industry's share of total GSP in 2004. The state's total profit was the sum of all industry profits in that state. Finally, we averaged the profits given by these two approaches to obtain each state's total profits.

Previous Year's Rankings and Detailed Methodology

The complete methodology of how we apportioned taxes to businesses can be found in Patrick L. Anderson and Caroline M. Sallee, *Benchmarking for Success: A Comparison of State Business Taxes*, Anderson Economic Group, 2006. This report is available at AEG's website: <http://www.AndersonEconomicGroup.com>.

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Visit AEG's website at: <http://www.AndersonEconomicGroup.com>.

ABOUT THE AUTHORS

Caroline M. Sallee. Ms. Sallee is a Consultant at Anderson Economic Group, working in the Public Policy, Fiscal, and Economic Analysis practice area. Ms. Sallee's background is in applied economics and public finance.

Ms. Sallee is the co-author of the 2006 report *Benchmarking for Success: A Comparison of State Business Taxes*. Ms. Sallee's recent work includes an economic impact assessment for Michigan's University Research Corridor (Michigan State University, University of Michigan, and Wayne State University), and an analysis of Michigan's Earned Income Tax Credit. Ms. Sallee holds a Masters degree in Public Policy from the Gerald R. Ford School of Public Policy at the University of Michigan and a Bachelor of Arts degree in economics and history from Augustana College.

Patrick L. Anderson. Mr. Anderson founded Anderson Economic Group in 1996, and serves as Principal and CEO of the company. In this role he has successfully directed projects for state governments, cities, counties, nonprofit organizations, and corporations in over half of the United States.

Mr. Anderson has written over ninety articles published in periodicals such as *The Wall Street Journal*, *The Detroit News*, *The Detroit Free Press*, *American Outlook*, *Crain's Detroit Business*; and monographs published by the Mackinac Center for Public Policy, The Economic Enterprise Foundation of Detroit, the Ethan Allen Institute in Vermont, and the Heartland Institute of Chicago. His book *Business Economics and Finance* was published by CRC Press in August 2004. His paper "Pocketbook Issues and Presidency," co-authored with Ilhan Geckil, was awarded the 2004 Mennis award for the best submitted paper to *Business Economics* by the National Association of Business Economics.

Mr. Anderson is a graduate of the University of Michigan, where he earned a Masters degree in Public Policy and a Bachelors degree in Political Science. He has been a member of the National Association for Business Economics since 1983.

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