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Corporate Tax Rates Do Not Drive Business Decisions
Rate Cuts Could Impede Economic Growth

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While some policymakers advocate cutting Missouri's corporate income tax as a way to revitalize the state's still-struggling economy, such a move would have little-to-no impact on business expansion or hiring, and is likely to backfire by reducing resources for schools, transportation and other things that businesses cite as bigger concerns.

Corporate income tax rates play a negligible role in business decisions, most research shows. In fact, Missouri already has one of the lowest corporate tax rates in the nation, so it is unlikely cutting it further would have any impact.

State corporate income tax cuts don't result in economic growth for four main reasons:

- State and local taxes comprise a very small portion of the cost of doing business and, as a result, are much less important to business location and investment decisions than factors such as a skilled workforce and efficient transportation. Income taxes represent only **one-fifth of one percent of business costs in Missouri.**
- Business owners can deduct state taxes from the federal taxes they owe, so a cut at the state level would be offset by a bump in their federal taxes.
- Part of the benefit of any state tax cut is likely to be passed on to out-of-state shareholders, who will spend the money where they live, not in Missouri.
- Businesses need customers to thrive, but a cut in the corporate income tax does nothing to address that need. Without an increase in customers for new or expanded services or products, businesses are unlikely to increase investment.

Certainly, with unemployment still hovering above pre-recession levels,[i] job growth should be a priority for Missouri lawmakers. But investing more in education, health care, transportation and other ingredients of a strong economy would have a bigger impact than a corporate income tax cut, which would only drain resources from those priorities.

State Taxes Have Little Influence on Business Decisions

Businesses rely on a variety of factors when making investment, relocation, or expansion decisions. These include the availability of skilled and educated workers, labor costs,

access to transportation and other services, the quality of life in an area and factors that are specific to the nature of the business. While a state's tax policy may be a consideration if all other influencing factors were equal, normally that is not the case.

In addition, since Missouri must balance its budget each year, any state tax cuts would require a corresponding tax increase somewhere else or a reduction in public services to cover their cost. That could result in a decrease in economic activity – the exact opposite of what lawmakers hope to achieve.

State and Local Taxes Comprise a Very Small Portion of Business Costs

State tax rates have little influence on business decisions simply because they comprise a very small portion of total business costs. Missouri's effective corporate tax rate already ranks as one of the lowest in the nation: only six states have a lower effective rate, according to the Missouri Department of Economic Development. While state law sets the corporate income tax rate at 6.25 percent of net taxable income earned by a business in Missouri, the state allows a 50 percent deduction for federal income tax payments, which can reduce the effective tax rate to 5.2 percent.

Missouri is also the only state that allows companies to choose the formula that is used to calculate their income taxes so they can pay the lesser of two possible amounts. They can pick a three-factor formula, based on sales, property and payroll, or a single-factor formula, based only on sales. [ii]

Among the 50 states, Missouri ranked near the bottom – 44th – in state corporate tax collections per capita in 2010.[iii] **If state tax policy is a primary factor in motivating business investment, then Missouri should already rank as one of the best states in economic growth.**

A comparison of economic indicators – including unemployment, median income, and concentration of Fortune 500 companies – with state corporate tax rates shows no relationship between the two. As shown in the table below:

- The average unemployment rate is virtually identical in states with the highest corporate tax rates and states that do not levy corporate income tax.
- States with relatively high corporate tax rates have a higher average median income than states that do not levy corporate income tax.
- The average number of Fortune 500 companies located in states with high corporate tax rates surpasses that of states that do not levy a corporate income tax.

State Corporate Tax Rates Compared with Economic Indicators				
State	**Corporate Income Tax Rate**	**Unemployment Rate December 2012**[iv]	**Median Income 3 year average 2009 - 2011**[v]	**# of Fortune 500 Companies**[vi]
Missouri	6.25%	6.7	$48,058	10
States with High Corporate Income Tax Rates				
Iowa	6% – 12% graduated rate	4.9	$51,322	3
Pennsylvania	9.99%	7.9	$50,087	23
Minnesota	9.8%	5.5	$56,869	19
Illinois	9.5%	8.7	$52,801	32
Alaska	1% - 9.4% graduated rate	6.6	$60,566	0
Average of High Rate States		**6.72**	**$54,329**	**15.4**
States With No or Low Corporate Income Tax Rates				
Nevada	0	10.2	$51,263	4
South Dakota	0	4.4	$47,353	0
Texas	(franchise tax only)	6.1	$49,195	52
Washington	0	7.6	$59,370	8
Wyoming	0	4.9	$54,458	0
Average		**6.64**	**$50,527**	**12.8**

In terms of overall business costs, state and local taxes represent just 1.8 percent of the total, on average, in all 50 states, according to one recent study that summarized voluminous economic research and found, at most, a weak relationship between state and local tax levels and state economic growth. Corporate income taxes alone make up a tiny 0.17 percent of the cost. The largest costs influencing businesses were labor for the service industry and building space for manufacturing and warehousing businesses, according to the study.

Differences in state corporate income tax levels have little or no impact on interstate differences in economic performance, according to numerous recent studies that have applied rigorous statistical analysis to the issue. These include:

- A 2012 study that looked at the impact of state personal and corporate income tax policies on relative rates of entrepreneurship among the states and found "no evidence of an economically significant effect of state tax [policy] portfolios on entrepreneurial activity. . ."[vii]

- A 2011 study that looked at the factors contributing to relative rates of growth in state per capita personal income between 1947 and 1997[viii] concluded that corporate income tax levels did not have a statistically significant negative effect on economic growth, and that frequently, they showed a statistically significant positive impact.

- Another 2011 study found that "although individual tax rates . . . appear to" have an impact on relative rates of economic growth, "corporate tax rates. . . do not in our estimates. This may indicate that such policies are not linked to growth or, alternatively, that businesses are accomplished at finding effective ways of reducing the burden of these policies."[ix]

- A 2007 study concluded that "The top [state corporate income tax] rate does not have a statistically identifiable effect on private-sector economic activity."[x]

- A 2003 study that examined the impact of state corporate income tax policy on relative rates of business investment in states between 1983 and 1996 found that the relationship appeared "unlikely to become economically significant."[xi]

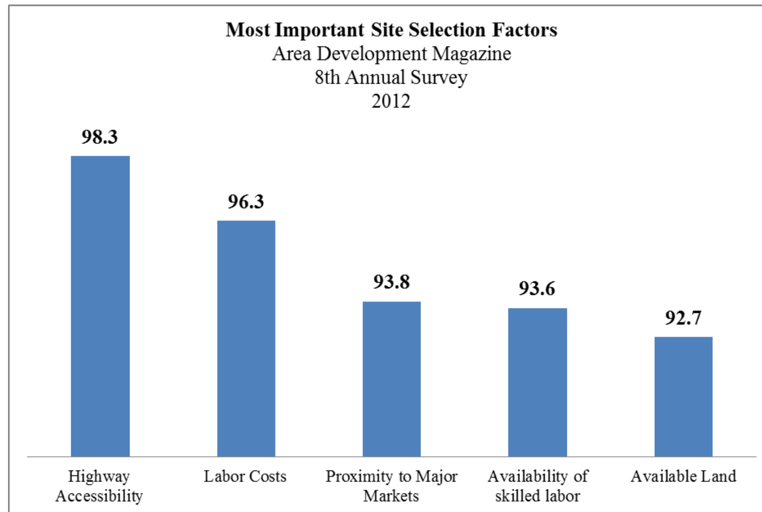
It appears that only a couple of studies have concluded that interstate differences in corporate taxes do affect relative rates of economic growth, including a 2003 study that found the "the [state] corporate income tax has a [statistically] significant negative impact on employment,"[xii] and a 2007 study that found a one percent increase in a state's corporate tax rate would decrease, on average, the share of foreign direct investment by one percent, all other things being equal.[xiii]

But overall, the statistical research that has been conducted to date suggests that interstate differences in state corporate income tax levels has, *at most*, a *very* small impact on relative state economic performance.

Another major analysis of studies of state and local tax policy and economic activity found that the most important factors influencing business investments include:

- the cost and quality of the labor market,
- proximity to customers,
- quality transportation networks and other infrastructure, and
- access to raw materials and supplies.[xiv]

Those conclusions jibe with a survey of **consultants who help businesses determine new or expanded site locations (see chart below).** [xv]



The state corporate tax rate did not even rank within the top ten selection factors. The survey also found that the quality of public schools was the number one factor among quality-of-life indicators that business consultants consider when recommending a location.

Given the substantial risk that the loss in revenue could lead to inadequate state investments in education, roads, and public safety that are critical for businesses, the proposal to cut state corporate income taxes in the name of boosting Missouri's economy is misguided and should be rejected.

Depleting the value of a federal tax deduction

Since businesses can deduct state taxes from their federal corporate income tax, a portion of every dollar in state corporate tax reductions would result in a higher federal corporate tax bill**.** In fact, as much as 35 percent of the value of a state tax reduction could be offset by an increase in federal taxes.[xvi]

In addition, a portion of state corporate tax reductions would go to shareholders living in other states, depleting the benefit for Missouri.[xvii]

Increased Business Activity Requires Increased Demand

State tax reductions will only increase local investment by companies ***if*** the business has a corresponding increase in *demand* for that production. "In the absence of increased demand for output now or in the future, corporations will simply pocket a tax cut as a windfall increase in their retained earnings rather than spend it," according to the Center on Budget and Policy Priorities.[xviii]

An Educated Workforce and Quality Infrastructure Matter: State Budget Reductions Hurt Economic Activity

Like all other states except Vermont, Missouri's state budget must be balanced. As a result, reductions in the state corporate income tax would require either a corresponding increase in another tax, such as the individual income tax or sales tax, or cuts in state services to make up for the lost revenue . Business tax cuts may backfire if they lead to a deterioration of public safety, transportation and other services to business, economists warn. Conversely, tax increases may boost job creation if they significantly improve public services to business.[xix]

Although Missouri's state corporate income tax is only a small portion of business costs, it adds up to a significant portion of Missouri's budget. A 50 percent reduction in the corporate income tax and a similar reduction in the individual income tax paid on business income would reduce Missouri's general revenue by $589 million[xx] – an amount equivalent to one-fifth of the state funding provided to local school districts or nearly three-fourths of what Missouri provided to all public colleges and universities last year.

A state corporate tax reduction is likely to result in reduced funding for education and other services that businesses consider important, making Missouri less attractive for business investment. These services have already been harmed by spending cuts in recent years. For example, funding for the Missouri Department of Transportation (MODOT) is on track to fall by $1.4 billion by 2016, reducing investments in road and highway repairs and construction.[xxi] Cuts in education funding have resulted in 2,500 fewer K-12 teachers and steep tuition increases for public college and university students.[xxii] These reductions make the state less attractive for business investment by diminishing the education system and infrastructure that businesses need to be successful.

State tax reductions that result in less state spending could increase costs for businesses. Companies may be forced to spend more of their own money educating and training their workers, providing health services for employees and their families, securing their workplaces, and repairing infrastructure.[xxiii]

[i] United States Department of Labor, Bureau of Labor Statistics, Local Area Unemployment Statistics
[ii] Missouri Department of Revenue
[iiiii] United States Census Bureau
[iv] United States Department of Labor, Bureau of Labor Statistics, Local Area Unemployment
[v] State Median Incomes 3-year-average (2009-2011) US Census Bureau, American Community Survey, Annual Social and Economic Supplement
[vi] CNN Money: Annual Ranking of America's Largest Companies, 2012
[vii] Donald Bruce and John Deskins, "Can State Tax Policies Be Used to Promote Entrepreneurial Activity?" *Small Business Economics*, Volume 38, Number 4, 2012
[viii] James Alm and Janet Rogers, "Do State Fiscal Policies Affect State Economic Growth?" *Public Finance Review*, July 2011.
[ix] Brian Goff, Alex Lebedinsky, Stephen Lile, "A Matched Pairs Analysis of State Growth Differences," *Contemporary Economic Policy*, 2011.
[x] Donald Bruce, John Deskins, and William F. Fox, "On the Extent, Growth, and Efficiency Consequences of State Business Tax Planning," in Alan J. Auerbach, James R. Hines, Jr., and Joel Slemrod, Editors, *Taxing Corporate Income in the 21st Century*, Cambridge University Press, 2007.
[xi] Sanjay Gupta and Mary Ann Hofman, "The Effect of State Income Tax Apportionment and Tax Incentives on New Capital Expenditures," *Journal of the American Taxation Association*, 2003
[xii] J. William Harden and William H. Hoyt, "Do States Choose Their Mix of Taxes to Minimize Employment Losses?" *National Tax Journal*, March 2003.
[xiii] Claudio A. Agostini, "The Impact of State Corporate Taxes on FDI Location," *Public Finance Review*, May 2007.
[xiv] Robert Lynch, PH.D., "Rethinking Growth Strategies," 2004, published by the Economic Policy Institute
[xv] Area Development Magazine, "8th Annual Consultants Survey", 2012
[xvi] Robert Lynch, PH.D., "Rethinking Growth Strategies", 2004, published by the Economic Policy Institute
[xvii] See Timothy J. Bartik, "Solving the Problems of Economic Development Incentives," *Growth and Change,* Spring 2005 and Michael Mazerov, "Cutting State Corporate Income Taxes Is Unlikely to Create Many Jobs," September 2010, Center on Budget & Policy Priorities
[xviii] Michael Mazerov, "Cutting State Corporate Income Taxes Is Unlikely to Create Many Jobs," September 2010, Center on Budget & Policy Priorities
[xix]Peter Fisher, Ph. D., Greg LeRoy and Philip Mattera, "Selling Snake Oil to the States," November 2012, jointly released by the Iowa Policy Project and Good Jobs First
[xx] Missouri Budget Project estimate
[xxi] See Kruckemeyer and Blouin, "Stabilizing Missouri's Highway Funding," Missouri Budget Project, August 2012
[xxii] See "Cutting to the Chase: What Multi-Year Budget Reductions Mean for Missourians," September 2012, Missouri Budget Project
[xxiii] Robert Lynch, PH.D., "Rethinking Growth Strategies," 2004, published by the Economic Policy Institute