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TAX CHANGE FOR MULTISTATE CORPORATIONS:

A Measure that Would Harm Critical State Investments and Fail to Help Economy

BY CEDRIC D. JOHNSON, POLICY ANALYST

A proposed change in the way North Carolina taxes multistate corporations would not achieve its goal of boosting investment and job creation in the state, but instead result in additional revenue losses that would further threaten critical investments in education, roads, and other services that are the foundation of future economic growth.

The change being considered by state lawmakers would provide a tax cut to only certain corporations and with no guarantee of job creation. It would reduce revenue available for public investments by $90 million in the fiscal year that starts July 1, 2014. This loss would come on top of the nearly $440 million in lost revenue over that year resulting from the tax plan passed last year and likely result in further cuts to public schools, health care, and other important investments that also contribute to the success and viability of corporations.[1]

Corporations doing business in North Carolina pay state income tax on the portion of their nationwide profits that they earn in the state. To determine that portion, the state uses a formula based on three things: a corporation's property, payroll and sales in North Carolina – with sales factored in more heavily.[2] State lawmakers are considering a shift to a formula that would consider only the sales component. Under this formula, known as single sales factor (SSF), a multistate corporation making 10 percent of its sales to North Carolina customers would pay North Carolina corporate income tax on 10 percent of its nationwide profit.

Proponents of SSF claim that such a change will improve the state's business climate by making expansion of property and payroll in the state more attractive to businesses. Other states that have adopted an SSF formula based on this premise have not seen this happen, however, and there is no reason to believe that North Carolina will experience a different outcome.

State lawmakers should reject a single sales factor formula and instead focus on creating a fairer corporate income tax by closing existing loopholes that gives preferential treatment to some businesses at the expense of others.

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Here are four reasons why North Carolina ***should not*** shift to an SSF apportionment formula:

- **The single sales factor is not an effective economic development tool and is unlikely to spur job creation**

  Proponents of SSF often claim that it will spur job creation and economic growth by encouraging businesses to increase their investments in manufacturing plants and other buildings and add more workers to their payrolls. The experience of other states that have adopted SSF, however, shows that such a claim is not supported by real-world evidence. Manufacturers are the prime beneficiary of SSF because they tend to sell most of their products outside of the few states in which they typically produce them. And yet, of the eight states that had an SSF formula in effect from 2003 through 2012, six were below the average of all states in retaining manufacturing jobs; only two were above average. (See table in Appendix) SSF proponents also fail to acknowledge that it is a double-edged sword for economic development that could just as easily cost jobs rather than encourage their creation. Some out-of-state corporations will pay more taxes as a result of SSF, and these companies could decide to eliminate jobs in the state to escape their income tax obligation here.

  It should be no surprise that states adopting SSF have little to show for it. All state and local taxes combined represent no more than 3 to 4 percent of total expenses for the average corporation, and the corporate income tax is less than 10 percent of that already tiny fraction. Making a marginal change in corporate tax policy will have no significant bearing on where corporations invest or create jobs; those decisions will be determined by business fundamentals like the availability of skilled workers and the costs of energy and transportation.

- **The single sales factor will not benefit North Carolina businesses with little or no out-of-state sales, putting them at a competitive disadvantage**

  Because SSF disregards a corporation's in-state property holdings and payroll size in determining its taxes, it disproportionately favors corporations with a high quantity of out-of-state sales. The larger the percentage of a business' sales that occur out of state, the larger the tax savings under an SSF formula. This means that smaller North Carolina firms, which are less likely to be taxable in other states, are not able to profit from this change, while their significantly larger, multistate competitors are.

  Only around 8 percent of North Carolina businesses are taxable corporations to begin with, and the vast majority of those are unlikely to benefit from SSF because they make all their sales within the state.[3] Most of the revenue collected from North Carolina's corporate income tax over the years has come from a very small number of corporations. In 2009, for example, more than half (54 percent) of total corporate income taxes came from less than 3 percent of all corporations that filed incomes tax returns. Nearly all the benefits of SSF are likely to be concentrated in this tiny share of North Carolina businesses.

  The tax plan passed last year does little to rid the state's tax code of costly corporate tax loopholes. Meanwhile, the tax plan cuts the corporate income tax rate to 6 percent for 2014 from 6.9 percent. By 2015, the corporate income tax rate is cut to 5 percent and could go as low as 3 percent in subsequent years if revenue targets are met. The actual corporate income tax rate paid by profitable corporations, however, is much lower than the statutory rate. Between 2008 and 2012, nine major corporations headquartered in North Carolina paid an average state income tax rate of just 3.7 percent on more than $51 billion in profits earned.[4] (See table in Appendix) This is the case for many other profitable multistate corporations that are not headquartered but operate in North Carolina.[5]

- **The single sales factor will further reduce revenue for public investments that promote economic growth**

  A shift to SSF in North Carolina would cost about $90 million in forgone revenue, according to estimates by the General Assembly's Fiscal Research Division.[6] The cost could be much greater in the long run because corporations that would actually pay more under SSF can restructure their operations to keep that from happening.

  This estimated revenue loss as a result of shifting to a SSF would be in addition to the huge revenue loss resulting from the tax changes the state adopted in 2013, which will reduce annual revenue by more than $650 million when they are fully implemented.[7] The revenue loss is likely to be even higher than that estimate, since the corporate income tax rate will be cut again if certain revenue collection levels are met.

- **If some corporations pay less, other North Carolinians will end up paying more**

  Since it is legally required to balance its budget, North Carolina will likely not reap any short-term economic benefits from shifting to an SSF because every dollar given away in a tax cut through this change has to be made up with either a tax increase on another business or individual or with a cut to state services – or some combination of both. So, at best, any benefit from a tax cut will be offset dollar for dollar, and result in no net economic gain in the short-term.

  North Carolina is still investing less in vital public services than it did before the recession, including K-12 education, public universities, and economic development.[8] If the state continues to cut support for these public investments that promote opportunity and have been shown to boost the economy over the long haul, then North Carolina's economic future will be bleak.[9]

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1 Cedric D. Johnson, "Final Tax Plan Falls Far Short of True Tax Reform," BTC Report, NC Budget and Tax Center, Raleigh, NC, August 2013.

2 North Carolina currently gives a double weight to the sales component of the three factors – property payroll, and sales – used in determining the amount of state income taxes corporations pay.

3 Johnson, Cedric D., "Cutting Corporate Income Taxes Won't Be an Economic Boon for North Carolina," BTC Brief, NC Budget and Tax Center, Raleigh, April 2013.

4 The nine multistate corporations headquartered in North Carolina include: Duke Energy; Progress Energy; BB&T Corp.; VF, Family Dollar Stores; Lowe's; Laboratory Corp. of America; Ruddick; and Sonic Automotive. State income taxes paid by corporations are based on analysis conducted by the Institute on Taxation and Economic Policy and Citizens for Tax Justice.

5 For example, from 2008 to 2012 International Paper earned $2.81 billion in profits and paid an effective tax rate of -0.8 percent for total state income taxes across all states – meaning the company received a tax refund. Merck earned $20.2 billion in profits over this time period and paid an effective tax rate of -0.7 percent in total state incomes taxes across all states. This tax information is based on analysis conducted by the Institute on Taxation and Economic Policy and Citizens for Tax Justice.

6 "Corporate Income and Franchise Tax Apportionment: Single Sales Factor & Market Based Sourcing," Jonathan Tart, Fiscal Research Division. Presentation to North Carolina Revenue Laws Committee. February 11, 2014.

7 See endnote 2.

8 Mitchell, Tazra, "The 2013-15 Fiscal Year Final Budget: Putting North Carolina on a Path to Mediocrity," BTC Report, NC Budget and Tax Center, Raleigh, August 2013.

9 Thompson, Jess, "Prioritizing Approaches to Economic Development in New England: Skills, Infrastructure, and Tax Incentives," Political Economic Research Institute, University of Massachusetts, 2010.

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APPENDIX:

Single Sales Factor Fails to Boost Employment in Other States

Percent Change in Manufacturing Employment, Dec. 2002 – Dec. 2012
In States with Corporate Income Taxes (data not seasonally-adjusted)
States with Single Sales Factor Formula in Effect Throughout Period in Bold

State	% Change	
North Dakota	8.10%	
Utah	4.90%	
Iowa	**-5.20%**	SSF
Kansas	-8.20%	
Nebraska	**-8.30%**	SSF
Oklahoma	-9.00%	
Montana	-9.10%	
Hawaii	-9.30%	
Louisiana	-10.80%	
Alaska	-11.50%	
Idaho	-12.10%	
Arizona	-12.20%	
Minnesota	-12.40%	
Wisconsin	-13.10%	
Oregon	-13.60%	
Colorado	-16.50%	
Vermont	-16.50%	
Kentucky	-16.70%	
Indiana	-16.70%	
Alabama	-19.30%	
New Mexico	-20.60%	
New Hampshire	-20.60%	

State	% Change	
Connecticut	**-20.70%**	SSF
Illinois	**-21.40%**	SSF
South Carolina	-21.70%	
California	-21.80%	
Missouri	**-22.90%**	SSF
Georgia	-23.00%	
Pennsylvania	-23.60%	
Maine	**-23.90%**	SSF
Mississippi	-24.30%	
Florida	-24.80%	
Tennessee	-25.20%	
Arkansas	-26.40%	
West Virginia	-26.60%	
Massachusetts	**-26.60%**	SSF
Virginia	-26.80%	
Delaware	-29.00%	
New York	-29.10%	
North Carolina	-29.30%	
Maryland	**-29.90%**	SSF
New Jersey	-31.20%	
Rhode Island	-34.10%	

SOURCE: Center on Budget and Policy Priorities analysis of Bureau of Labor Statistics employment data.

State Income Tax Rate and Profits for Nine Major Corporations Headquartered in North Carolina (2008 – 2012)

	2008 - 2012	
Corporation	**Total Profits (million $)**	5-yr tax rate
BB&T Corp.	$10,507	2.0%
Duke Energy	$9,141	1.3%
Family Dollar Stores	$2,653	4.2%
Laboratory Corp. of America	$4,215	5.1%
Lowe's	$15,602	4.8%
Progress Energy	$4,990	1.4%
Ruddick	$808	5.4%
Sonic Automotive	$404	5.5%
VF	$2,956	3.5%

SOURCE: Institute on Taxation and Economic Policy and Citizens for Tax Justice