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Corporate Tax Burdens in the Southern States: A Comparison

INTRODUCTION

State and local taxes and tax policy are among the more important considerations in decisions to locate, expand or continue a business operation. When the essential factors, such as labor, raw materials, transportation and access to markets, are equal, state and local taxes can tip the scales. Businesses also stress the importance of tax stability, predictability and ease of administration. Frequent changes or threats of change in a state's tax policies make it difficult for businesses to plan with any certainty.

Unfortunately, Louisiana is generally regarded as having one of the worst business tax climates in the country. At the same time, Louisiana is often portrayed as a low tax state. In recent years, the state has been ranked from 44th to 46th in the nation in total taxes per capita. However, generalizing about tax burdens from such data can be misleading. The state's very low per-capita income and the favorable property tax treatment on homes results in lower-than-average total tax payments by individual taxpayers, thus leaving businesses to take up the slack. Not only does Louisiana's tax structure treat business and individual taxpayers differently, but it also bears more heavily on some types of businesses than others.

Although a bit dated, a 1997 study by the Institute on Taxation and Economic Policy (ITEP) ranked Louisiana 10th in the nation in the share of total state and local taxes paid by business. In contrast, Louisiana ranked 41st in total state and local taxes per capita that year. However, these broad comparisons tell little about the relative tax burdens the states would place on a specific firm.

This analysis uses hypothetical firms to compare the corporate tax structure and major tax incentives offered in each of 12 southern states: Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas and Virginia. It is an expanded update of a 1994 PAR report.

The hypothetical firms used in this analysis are assumed to be registered as traditional "C" corporations. The relative tax burdens would likely differ for firms registered as partnerships, "S" corporations or limited liability companies (LLCs), but a detailed comparison of these forms of business was beyond the scope of this analysis.

A full discussion of the methodology and findings of this study can be found on PAR's website (www.la-par.org). Included are the balance sheets and income statements for the hypothetical firms; the tax calculations for each hypothetical firm, for each state and for the urban, suburban and rural areas; the tax rates used; the tax calculations for the incentive comparison; and a description of the incentives applied.

Tax Burden Comparisons

The first part of the analysis compares the 2000 tax burden for each of 14 hypothetical firms. Balance sheets and income statements for these firms were designed to isolate specific tax policy issues and illustrate differences in state tax structures. Seven of the 14 firms were examined in the 1994 analysis and the other seven were designed to represent firms in the industry clusters targeted by the Department of Economic Development (DED). All firms were assumed to be ongoing concerns no longer eligible for temporary tax incentives. Tax burdens were calculated for the largest urban areas and for typical suburban and rural locations in each state. The suburban area taxes are used for this summary discussion as they generally appear to be more representative of the states' tax structures as a whole.

Using hypothetical firms provides a useful comparison of state tax laws, but does not capture all the subtleties of tax administration and tax planning that can greatly alter a real firm's tax payments. (For example, if one state's inventory tax is high, a firm might store its inventory in a lower-tax state.) However, obtaining comparable tax data on real firms for 12 states is not a realistic option.

TABLE 1
Louisiana State and Local Tax Burden as a Percentage of the Southern Average
(Rank #1=highest)

Louisiana Firm	1993 Taxes		2000 Taxes	
	Percent of Average	11-State Rank	Percent of Average	12-State Rank
Average Manufacturer	126%	1	122%	2
Capital-Intensive Manufacturer	133%	1	134%	3
Labor-Intensive Manufacturer	119%	3	104%	5
No-Profit Manufacturer	142%	2	136%	2
High-Debt Manufacturer	127%	1	124%	2
Retail Firm	106%	5	97%	7
Wholesale Firm	107%	4	93%	8
Cluster Firms				
Pulp & Paper	–	–	136%	1
Chemical	–	–	132%	1
Fabricated Metal	–	–	121%	2
Electrical	–	–	117%	2
Shipbuilding	–	–	102%	6
Scientific Instruments	–	–	112%	3
Water Transportation	–	–	135%	2

State/Local Tax Burdens, 1993 and 2000

Table 1 compares Louisiana's state and local tax burdens in 2000 to the 1993 tax burdens from PAR's earlier analysis. Louisiana has apparently improved its position somewhat relative to the southern states. However, both studies show higher than southern average state/local tax burdens for each of the hypothetical Louisiana manufacturing firms, with taxes on the capital-intensive manufacturer fully one-third higher than the southern average. Both studies show retail and wholesale firm taxes close to the southern average.

Several changes in methodology from the earlier study may account for some of the differences from 1993 to 2000. Specific location taxes replaced statewide averages and Virginia, a low-tax state, was added. However, the major difference was that the phase-in of the inventory tax credit was only 40% implemented in 1993. With the credit fully phased in, the tax burden on those firms with relatively large inventories–the labor-intensive manufacturer, wholesale firm and retail firm–fell sharply relative to the southern average. The capital-intensive manufacturer, with relatively little inventory, saw little change in its relative tax burden although its ranking improved–from first highest to third.

Cluster Firms

The DED has designated nine industry clusters for special development efforts, however each includes a wide range of firms. PAR selected a hypothetical firm from each of seven manufacturing clusters to compare tax burdens. (See Table 1.) The tax burdens differed according to where the firm falls on the labor-intensive to capital-intensive continuum.

If a conclusion can be drawn from the cluster-firm data, it might be that Louisiana's basic tax structure is not well suited, in the long run, to some of the targeted industries. The most labor-intensive of these firms, shipbuilding, would have been taxed at about

TABLE 2
Ranking by State and Local Tax Burden
(Rank #1=highest)

State	Average Manufacturer	Capital-Intensive Manufacturer	Labor-Intensive Manufacturer	Wholesale Firm	Retail Firm
Texas	1	2	1	1	1
LOUISIANA	**2**	**3**	**5**	**8**	**7**
Florida	3	1	7	6	5
Mississippi	4	5	2	2	2
Georgia	5	6	3	3	3
Oklahoma	6	7	4	4	4
South Carolina	7	4	10	11	11
North Carolina	8	9	8	7	8
Arkansas	9	10	6	5	6
Tennessee	10	8	9	9	9
Alabama	11	11	12	12	12
Virginia	12	12	11	10	10

the southern average. However, the taxes on the other firms examined would have all exceeded the southern average by 12% to 35%. (NOTE: in this comparison the Louisiana taxes do not include the industrial tax exemption and other incentives that might help to initially attract such firms.)

Southern State Rankings

Table 2 shows the relative state/local tax burden rankings of the 12 southern states for five hypothetical firms. Texas is generally the highest tax state with Florida, Mississippi and Louisiana vying for next highest. Alabama and Virginia have the consistently lowest tax burdens for the firms examined.

Because of the major role capital-intensive firms play in Louisiana's economy, it is interesting to see how the different state tax structures favor or disfavor the capital-intensive manufacturer as compared to other types of business firms. The tax systems in Arkansas, Georgia, Mississippi and Oklahoma tend to favor the capital-intensive manufacturer while Florida, Louisiana and South Carolina tend to disfavor them relative to the other types of firms.

Comparing Louisiana's Major Taxes

Why do Louisiana's state/local tax burdens on the hypothetical manufacturing firms rank so high? As shown in Table 3, the property tax, sales tax and franchise tax on these firms all exceed the southern averages. The primary factor, however, is the sales tax on manufacturing machinery and equipment (MM&E). This, together with high sales tax rates, results in sales taxes for the Louisiana manufacturing firms that are three times the southern average, more or less, depending on the type of firm. The capital-intensive firm is particularly vulnerable. Louisiana is one of only two southern states that do not exempt or significantly reduce sales taxes on replacement purchases of MM&E.

Louisiana's inventory tax credit, which has been fully phased in since 1995, makes a tax-by-tax comparison with other states extremely complicated. Louisiana firms pay the property tax on inventories and receive a credit first against their income tax liability and then against their corporate franchise tax liability. Any remaining credit is refunded by the state. As a result, roughly a third of the property tax paid becomes a deduction from the firm's income and franchise tax liabilities. For most of the hypothetical firms, the credit eliminates all or nearly all of the income tax.

TABLE 3
Louisiana Taxes as a Percentage of the Southern Average

				Before Inventory Tax Credit is Deducted		After Inventory Tax Credit is Deducted [1]			
Louisiana Firm	Total State/Local	Property Tax [2]	Sales Tax	Income Tax	Franchise Tax	Income Tax	Franchise Tax	Federal Income Tax	Total Tax
Average Manufacturer	122%	133%	304%	100%	203%	6%	203%	100%	108%
Capital-Intensive Manufacturer	134%	120%	359%	99%	200%	34%	200%	98%	114%
Labor-Intensive Manufacturer	104%	158%	251%	101%	202%	0%	48%	101%	102%
No-Profit Manufacturer	136%	134%	305%	0%	278%	0%	0%	0%	136%
High-Debt Manufacturer	124%	134%	305%	100%	219%	6%	219%	100%	108%
Retail Firm	97%	152%	108%	100%	223%	0%	7%	101%	99%
Wholesale Firm	93%	158%	100%	100%	198%	0%	100%	101%	99%

1. The inventory tax credit is shown deducted first from the income tax and then from the franchise tax.
2. The property tax figure includes the tax paid on inventory.

Table 3 shows the total property taxes paid (including inventory taxes) as a percentage of the southern average. The income and franchise taxes are shown before and after the inventory tax credit is taken.

Before the inventory tax credit is taken, the Louisiana income tax liability for each of the hypothetical firms is essentially at the southern average. And, the Louisiana franchise tax is nearly twice that of the next highest state. Texas, the only southern state without an income tax, has a franchise tax nearly two and one-half times Louisiana's. However, the Texas franchise tax is not really comparable. It actually functions as an income tax–80% of the taxpayers pay it based on their net income.

Louisiana's tax structure is unsympathetic to a firm that does not show a profit. The Louisiana state/local tax burden for the "average" manufacturer making a normal profit is 22% above the southern average, but when it breaks even, the gap grows to 36%. The firm would pay no income tax but its combined property and franchise taxes would still be the fifth highest in the south. The primary problem, however, is the very high sales taxes on MM&E replacement. Of course the ailing firm could forego these taxes by not making the replacements, but this would only further hurt its competitiveness.

When the "average" manufacturer's balance sheet is tweaked to show a higher proportion of debt and less capital stock, the Louisiana firm is placed at a slight disadvantage. The shift from stock to debt does not change the Louisiana taxes on the "high-debt" firm but it lowers the tax in most other states. Only Louisiana and Oklahoma include debt in the franchise tax base. In most states, more debt and less stock means a lower franchise tax bill. The relative impact in this example is small because the franchise tax is less than 12% of the state/local tax burden.

Table 3 also illustrates how federal taxes serve to partially offset differences in state/local

TABLE 4
Louisiana Tax Burdens as a Percentage of the Southern Average
Three Scenarios

Louisiana Firm	Current Tax Structure	Scenario 1: Remove State Sales Tax on MM&E	Scenario 2: Remove State and Local Sales Taxes on MM&E	Scenario 3: Remove State and Local Sales Taxes on MM&E and Debt From Franchise Tax	
	State/Local	State/Local	State/Local	State/Local	State/Local/ Federal
Average Manufacturer	122%	111%	98%	94%	98%
Capital-Intensive Manufacturer	134%	119%	102%	99%	99%
Labor-Intensive Manufacturer	104%	98%	91%	86%	97%
Retail Firm	97%	97%	97%	90%	98%
Wholesale Firm	93%	93%	93%	87%	98%

taxes. This is because much of the state and local tax burden is deductible for federal tax purposes. For each additional $1 in property and state income taxes paid, the firm typically saves 34 cents in federal taxes (about 32 cents in Louisiana because federal taxes are deductible for state income tax purposes). However, sales tax paid on equipment can only be expensed against federal taxes over the life of the equipment.

The Impact of Potential Tax Changes

PAR calculated, for each hypothetical firm, the impact of removing the state sales tax on MM&E, removing the state and local sales tax on MM&E and additionally removing debt from the franchise tax base. Table 4 summarizes the results for five of the firms.

The potential tax changes would significantly reduce the tax burdens on Louisiana manufacturing firms. The wholesale and retail firms would only be affected by the removal of debt from the franchise tax base. The final column shows the offsetting impact of federal taxes. While the firms' state and local tax burdens would be dramatically improved, their total tax burdens would be reduced to just slightly below average.

Comparing Taxes and Tax Incentives For a Start-Up Manufacturing Firm

The second part of this analysis calculates the total start-up taxes paid in each state by a hypothetical "average" manufacturing firm. Table 5 shows the combined total of all major state and local taxes paid in the first 10 years of operation and the combined total of the major tax incentives that might be given in each state in a competitive situation. The table then shows the amount of start-up sales tax paid on building materials, machinery and equipment and any incentives that might apply to these sales taxes. The final column shows the net combined tax burden for the start-up and first ten years of operation.

Selecting the incentives to apply in each state is a somewhat subjective exercise. Most of the incentives are discretionary and often are negotiated by the state and/or local governments. In addition, the incentives are often variable, depending on the firm's investment, payroll, average wages, employee characteristics, location and other factors.

The hypothetical average manufacturing firm is assumed to have invested $5.6 million in plant and equipment ($4,840,000 in building materials, machinery and equipment) and created 100 new jobs paying an average of $35,000 per year (annual payroll of $3.5 million.) The firm earns $1 million annually before taxes, after the first year, and ends the 10-year period with $10 million in assets.

Table 5 presents the Louisiana tax burden with three scenarios. The first applies the ten-year industrial property tax exemption alone, which a bona fide manufacturer is essentially guaranteed. In addition, however, the firm would almost certainly be able to obtain the enterprise zone (EZ) incentives (a $2,500 per job credit and a rebate of start-up sales taxes–the 4% state sales tax and an assumed 1% local tax rebate) **or** the Quality Jobs incentive (5% of payroll annually for 10 years), whichever is higher. These are shown as alternatives two and three. Clearly, the Quality Jobs incentive would be selected, which, in this case, would exceed the total state and local tax liabilities and provide a sizeable cash rebate. A more capital-intensive firm might find the EZ incentives better if its start-up sales taxes on MM&E were large enough.

Similar quality jobs programs in South Carolina, Oklahoma and Arkansas would cover all of the firm's tax liabilities for the first 10 years. These programs are not true tax incentives, but actually cash rebates paid as a percentage of the firm's new payroll. The remaining states show a large range of potential net tax burdens. Texas has the highest tax burden, even after its generous tax incentives are applied. However, several of the higher tax states, including

Texas and Florida, could further sweeten the deal if local governments used their full authority.

Unique among these states is Virginia, which levies low taxes to begin with and offers no general tax incentives. Each of the other states has at least two or three generally applicable tax incentives at its disposal. Most states also have a number of other incentives for limited or targeted purposes.

It is difficult to generalize from this limited comparison, however it does illustrate the range of state incentive packages. It also demonstrates the importance of incentives in offsetting Louisiana's otherwise high tax structure. Louisiana has the third highest 10-year tax total before any incentives are applied, in this case, but its start-up sales taxes far exceed those of any other state due to the heavy sales taxes on MM&E.

The Louisiana firm's net start-up, 10-year tax burden ranks second highest in this comparison with only the industrial tax exemption applied. With the EZ incentives added, it ranks about midway among the 12 southern states. The quality jobs incentive can, in effect, create a negative tax situation for the hypothetical firm.

TABLE 5
Ten-Year State and Local Start-up Taxes on an Average Manufacturing Firm, With Available Tax Incentives

State	10-Year Taxes With No Incentives	Tax Incentives[b]	Start-up Sales Taxes	Start-up Sales Tax Incentives	Net Total State/Local 10-Year Taxes & Start-up Sales Tax	Louisiana Rank
Louisiana (No Enterprise Zone)	**1,781,954[a]**	**($696,612)**	**$411,400**	**$ 0**	**$1,497,739**	**2**
Louisiana (Enterprise Zone)	**1,781,954[a]**	**(946,612)**	**411,400**	**(242,000)**	**1,005,742**	**6**
Louisiana Quality Jobs	**1,781,954[a]**	**(2,446,612)**	**411,400**	**0**	**(252,258)**	**12**
Florida	1,961,213	(384,007)	97,200	(97,200)	1,577,206	
Georgia	1,669,531	(470,600)	113,400	(113,400)	1,312,331	
Texas	2,332,141	(1,196,436)	133,650	0	1,269,355	
Virginia	1,134,125	0	68,400	0	1,202,525	
Mississippi	1,712,924	(714,890)	161,700	(64,050)	1,095,684	
North Carolina	1,364,155	(493,630)	99,440	0	969,965	
Tennessee	1,417,160	(612,015)	133,650	0	938,795	
Alabama	1,025,424	(622,239)	238,275	(210,000)	476,460	
Oklahoma	1,525,410	(1,676,475)	129,600	0	(21,465)	
South Carolina	1,595,609	(1,831,181)	97,200	0	(138,372)	
Arkansas	1,375,715	(1,530,000)	115,425	(115,425)	(154,285)	

a. Does not include 10-year industrial tax exemption.
b. Includes cash rebate programs for Arkansas, Oklahoma and South Carolina.

Conclusion

The comparison of state tax structures as they apply to ongoing firms indicates once again the need for serious tax reform in Louisiana. While the inventory tax credit has apparently made some improvement, Louisiana's corporate tax burden on manufacturing firms remains relatively high among the southern states. To offset this tax structure, the state has adopted increasingly generous incentives in an effort to lure new firms.

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Major Tax Policy Implications

Inventory Tax Credit

The 1994 PAR report warned against efforts by some to halt the phasing-in of the inventory tax credit. It indicated that the credit could reduce the total tax burden for labor-intensive manufacturers to about the southern average and bring wholesale and retail firms slightly below the average. Current comparisons indicate that those predictions were correct and show significant reductions in the relative tax burdens of each of the hypothetical firms examined, although some still remain high.

Sales Tax on MM&E

The sales tax on the initial and replacement purchase of MM&E continues to be out of line with the practice in other states. The elimination or reduction of this tax, or its impact, would accomplish several desirable objectives. It would significantly reduce the cost of start-ups and expansion or modernization, particularly for capital-intensive firms. An incentive offered at the point of investment is much more meaningful to a start-up firm, which typically begins operations in the "red." Also, this incentive would give the firm an immediate $1 benefit for each $1 in taxes foregone, whereas most later $1 tax breaks require the firm to pass on up to 34 cents to the federal government.

Corporation Franchise Tax

The state's franchise tax remains out of line with other states. The franchise tax could be lowered to about the southern average by cutting the tax rate in half or by removing debt from the tax base. Removing debt would benefit most firms but particularly start-ups, high-debt firms and firms which cannot easily raise capital by issuing stock.

Industrial Property Tax Exemption

The 10-year industrial tax exemption remains one of the more significant tax incentives in the south. It is unique in that its nearly automatic application makes it essentially a part of Louisiana's tax structure. Even with this exemption, Louisiana's start-up tax burden is easily equaled or undercut (substantially in some cases) by other southern states when they apply their generally available discretionary tax incentives.

Tax Reform

The need to revise the entire state and local tax structure to provide an equitable, productive and stable revenue stream to finance governmental operations remains of paramount importance.

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