

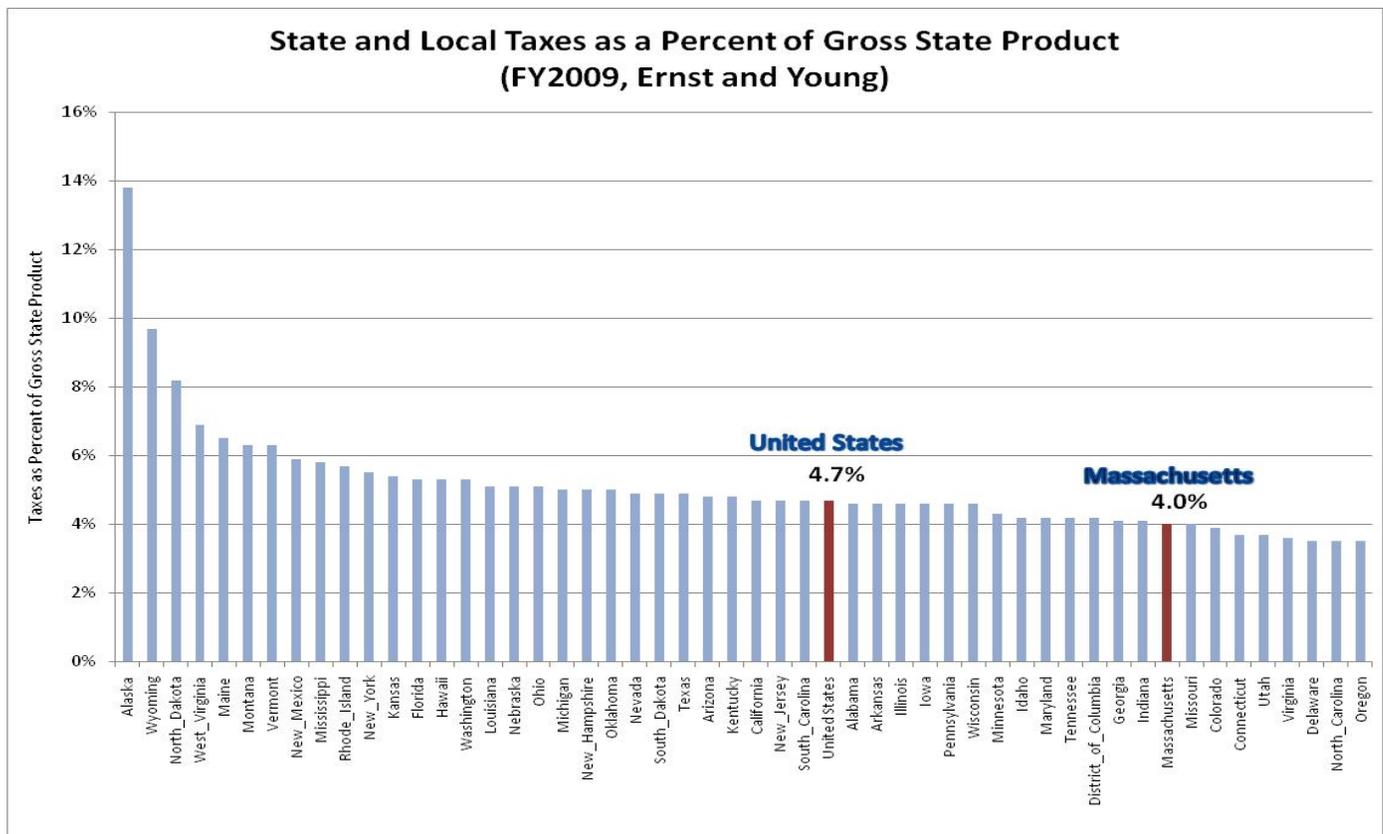
FACTS AT A GLANCE April 6, 2010

MA Business Taxes: How Our State Compares to the Nation

National studies have examined both the level of business taxation in Massachusetts and the “tax climate.” These studies have consistently found that the overall level of business taxation is significantly lower in Massachusetts than in most states.ⁱ An update of one prominent study, produced regularly by the Council on State Taxation (COST), ranks Massachusetts 43rd for its overall business tax level in Fiscal Year 2009, placing Massachusetts among the states with the lowest business taxes nationally. This *Facts at a Glance* examines this updated study and discusses the implications of its findings for Massachusetts.

HOW DOES THE OVERALL LEVEL OF TAXATION OF BUSINESSES IN MASSACHUSETTS COMPARE TO OTHER STATES?

The updated study was conducted by Ernst & Young for the Council on State Taxation (COST), a Washington, DC based trade association that represents over 600 multistate and multinational corporations.ⁱⁱ The study determined that, in FY 2009, business taxes accounted for a larger percentage of Gross State Product (GSP) in 42 other states than they did in Massachusetts. Had business taxes in Massachusetts (4.0 percent of GSP) consumed the same percentage of Gross State Product as the US average (4.7 percent of GSP), businesses would have contributed an additional \$2.3 billion in Massachusetts state and local revenues in FY 2009, according to Ernst and Young’s methodology.



Though overall business taxes in Massachusetts are significantly lower than the national average, Massachusetts receives an unusually large share of the tax revenue it does collect from businesses from the taxation of corporate income. Offsetting the relatively high corporate income tax levels, businesses in Massachusetts pay substantially less in sales taxes and excise and gross receipts taxes than do businesses in many other states (see table, below).

BUSINESS TAXES (Ernst and Young, FY2009)

	Massachusetts % of GDP	United States % of GDP
Property tax	1.7%	1.7%
Sales tax	0.5%	1.0%
Excise and gross receipts	0.2%	0.6%
Corporate income	0.6%	0.4%
Unemployment insurance	0.5%	0.2%
Individual income tax (on pass-through business income)	0.4%	0.3%
Licenses and other taxes	0.2%	0.5%
Total Business Taxes	4.0%	4.7%

WHY DOES TAX FOUNDATION RANK THE MASSACHUSETTS BUSINESS TAX CLIMATE AS BELOW AVERAGE WHEN THE LEVEL OF BUSINESS TAXES IS AMONG THE LOWEST IN THE NATION?

Another national study that has looked at business taxes is the Tax Foundation's State Business Tax Climate Index (SBTCI).ⁱⁱⁱ In this study Massachusetts ranks fairly low, with 35 states having a better "business tax climate." It is not surprising that this study finds something very different from the others, because it is measuring something very different. This study does not seek to measure the level of business taxation in each state (as does the study by Ernst & Young). Instead it measures the manner in which states tax businesses.^{iv} The authors of the study explain this clearly:

"The SBTCI does not measure business tax burdens. While it is unquestionably important how much revenue states collect in business taxes, the manner in which they extract tax revenue is also important. In other words, quite apart from whether a state's total business tax burden is higher than in other states, it can enact (and many states do) a set of business tax laws that cause great damage to the economy. The SBTCI does not allow states with poor business tax regimes to hide behind low business tax burdens.

"Good state tax systems levy low, flat rates on the broadest bases possible, and they treat all taxpayers the same. Variation in the tax treatment of different industries favors one economic activity or decision over another. The more riddled a tax system is with politically motivated preferences the less likely it is that business decisions will be made in response to market forces. The SBTCI rewards those states that apply these

principles in five important areas of taxation: major business taxes, individual income taxes, sales taxes, unemployment insurance taxes and property taxes.”^v

While business taxes in Massachusetts are low, the state’s tax system does not meet these criteria for a good tax system. The Massachusetts corporate tax system includes numerous special tax breaks for specific industries, such as mutual funds, manufacturing, and the motion picture industry. Tax policy analysts can agree or disagree with the Tax Foundation’s criteria for judging a tax system. It is important to recognize, however, that this study does not purport to compare the level of business taxation in different states.

ⁱ MassBudget, Facts At A Glance, March 2007: http://www.massbudget.org/file_storage/documents/BusinessTaxRanksUpdated.pdf

ⁱⁱ COST Report, FY2009: <http://www.cost.org/Page.aspx?id=69654>

ⁱⁱⁱ Kail M. Padgitt, 2010 *State Business Tax Climate Index*, Tax Foundation Background Paper No.59, September 2009: <http://www.taxfoundation.org/files/bp59.pdf>

^{iv} For instance, the Tax Foundation corporate tax index examines two sets of policies. One is measured by a rate sub-index consisting of the top tax rate, the level of taxable income at which the top rate kicks in, and the number of brackets. Because when Massachusetts cut business taxes during the 1990s it did so by creating special tax breaks rather than reducing the overall rate, the tax foundation appears not to count those cuts as improving the tax climate. The second sub-index relates to the tax base. (See *2010 State Business Tax Climate Index*, pgs 10-14):

<http://www.taxfoundation.org/files/bp59.pdf>

^v Kail Padgitt, Tax Foundation, September 2009: <http://www.taxfoundation.org/research/show/22658.html>