



# Fiscal Policy

# MEMORANDUM

TO: Friends, Members, Indiana Fiscal Policy Institute

FROM: Earl M. Ryan, President

SUBJECT: State Tax Rankings

DATE: January 31, 1991

The January 28-February 3, 1991 edition of the Indianapolis Business Journal ran a Viewpoint column concerning the poor showing of Indiana in several recent rankings of business tax burden. Unfortunately, a table that constituted an integral part of the article was omitted by the IBJ. To remedy that situation, we are reprinting the article together with the missing table, which appears on the other side.

## VIEWPOINT

### Business tax rankings are not kind to Indiana

BY EARL M. RYAN

As this is being written, a great media debate is winding down: whether the University of Colorado or Georgia Tech is No. 1 in college football. This is a weighty question, no doubt, and the intensity of the arguments indicates the importance attached to the national rankings. The appearance of a team in the wire-service polls serves to confirm its status among the elite in the sport. This, in turn, may mean greater exposure on television and more success in the struggle to recruit talented players.

Sports rankings are not, however, the only rankings that generate interest. Although it is far less glamorous than college-football competition, the competition among states to attract economic enterprises is a higher-stakes game, one in which political leaders generally feel that they must participate. States without especially attractive weather, geography or natural resources are locked into an intense and often costly struggle to make up for their lack of natural advantages. The desire to be in the economic top 10 explains numerous public-policy choices in state government.

State policymakers may not be able to do anything about the weather (a fact for which we should probably be grateful), but they can determine the composition and level of state and local taxes. Although controversy rages



According to Earl Ryan, president of the Indiana Fiscal Policy Institute, the state's business-tax burden may be hurting economic-development efforts.

over the significance of a state's tax structure in business-location decisions, it is evident that enough decision-makers, both in and out of government, believe that it matters. It evidently matters so much that in most states, decisions on tax policy now involve not only revenue considerations, but also economic-development concerns.

This fact has led to a minor growth industry, the production of comparisons of state and local tax burdens. Such rankings fall generally into two categories: those based on total tax collections, either per capita or in relation to personal income; and those that attempt to apply provisions of each state's tax law to the circumstances of particular individuals or firms.

Neither approach is satisfactory for all purposes. The comparisons based on total collections blur the widely varying effects of the tax system on different taxpayers, while the taxpayer-specific calculations may have very limited relevance to a broad cross-section of individuals or firms. And of

course, neither can replace taxpayers' own computations.

Not surprisingly, the two approaches can produce very different perceptions of the tax climate. Based on collections for fiscal 1988-89 (the last year for which comparable figures are available), the U.S. Bureau of the Census ranks Indiana 33rd among the 50 states and the District of Columbia in per-capita state and local tax collections, and 35th in taxes per \$1,000 of personal income. The Census Bureau does not distinguish between taxes on business and taxes on individuals. The rankings cited here include all state and local taxes.

It may well be that taxes on individuals heavily affect economic development in a state. Most large corporations have faced difficulties in trying to attract competent employees to areas with high personal-income or residential-property taxes.

It is taxes directly on business, however, that normally excite the interest of those making locational decisions. "Business taxes" is not

a term with a precise definition. In addition to what we normally consider to be business taxes (corporate income, franchise, business property), businesses also pay sales taxes, motor-fuel taxes and other fees that are usually thought of as taxes on individuals. This ambiguity, however, has not deterred the widespread preparation of tax rankings.

When the taxes compared are limited to those that have an initial effect on business, a different picture of Indiana's tax climate emerges. Two recent studies of business taxes in several states place Indiana at the top in terms of corporate-tax burden. These studies echo a similar analysis done in 1987 in Pennsylvania.

The three studies employed essentially the same methodology. Hypothetical balance sheets and income statements were developed for a small group of firms thought to be representative of different industrial or commercial categories. The principal taxes in each state were then applied and the results compiled. The rankings derived from these results are shown in the accompanying table.

The reasons noted by the studies for Indiana's high ranking are the inclusion of inventory in the base of the property tax and the presence of the corporate gross income tax.

The results of studies of this kind may be affected by three factors:

■ The selection of states may produce a list that is not terribly relevant to every state on the list.

■ The taxes selected may leave out a significant portion of the tax burden on a business. General sales taxes, for instance, may not be included because they are often not considered to be business taxes.

■ Because actual taxes paid by a firm are the result of complex laws, regulations and accounting practices, the opportunities for error or distortion are numerous in a study that tries to apply the tax laws in several states to diverse hypothetical taxpayers.

Regardless of these potential problems, new state tax rankings are certain to be produced. If they continue to represent Indiana as they have in recent studies, a perception of Indiana business taxes as an economic minus will develop.

It would not be surprising if Indiana's poor showing were partly a result of the methodology of the rankings themselves. At the same time, such negative ratings should caution policymakers that the Indiana tax structure is sending signals that they may not want to have sent.

**Indianapolis  
Business  
Journal**

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## Summary of Comparisons of Business Taxes Selected Studies

### Pennsylvania Economy League 1987

- |           |          |
|-----------|----------|
| 1. W. Va. | 7. Pa.   |
| 2. Ind.   | 8. N.J.  |
| 3. Ohio   | 9. N.C.  |
| 4. N.Y.   | 10. Ill. |
| 5. Mass.  | 11. Md.  |
| 6. Ga.    | 12. Va.  |

*Pennsylvania Economy League,  
Taxes Paid By Industry, 1987*

*Prepared for the*

*Pennsylvania MILRITE Council,  
Harrisburg, PA, January 1987*

### Wisconsin Dept. of Revenue 1990

- |           |             |
|-----------|-------------|
| 1. Ind.   | 10. Miss.   |
| 2. La.    | 11. Tenn.   |
| 3. Ariz.  | 12. Ga.     |
| 4. Minn.  | 13. Colo.   |
| 5. Mich.  | 14. N.C.    |
| 5. Calif. | 15. Mass.   |
| 7. Ohio   | 16. Ill.    |
| 8. Tex.   | 17. Wisc.   |
| 9. N.Y.   | 18. Iowa    |
|           | 19. Alabama |

*Wisconsin Dept. of Research  
and Analysis, Corporate Tax  
Climate. A Comparison of  
Nineteen State, Madison, WI,  
November 1990*

### Texas Research League 1990 \*

- |           |           |
|-----------|-----------|
| 1. Ind.   | 10. Ill.  |
| 2. La.    | 11. N.J.  |
| 3. Ohio   | 12. Wisc. |
| 4. Ga.    | 13. Fla.  |
| 5. Pa.    | 14. Tex.  |
| 6. Mich.  | 15. N.C.  |
| 7. Calif. | 16. Okla. |
| 8. N.Y.   | 17. Ark.  |
| 9. Mass.  | 18. N.M.  |

*Texas Research League,  
Comparing Texas' Corporate  
Taxes, Austin, TX,  
November 1990*

*\* Composite ranking by Indiana Fiscal Policy Institute  
based on separate industry calculations in original study.*



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