



Washington Businesses Account for 58 Percent of State and Local Tax Collections

Briefly

- Nationally, business tax revenues were up 2.2 percent in 2014.
- Washington state's total effective business tax rate (TEBTR) rose to 5.4 percent in 2014.
- State and local governments tax Washington businesses an average of \$7,700 per employee.
- Washington has the sixth highest percentage of business taxation in the U.S.
- The tax-benefit ratio for businesses in this state is the ninth worst.
- The Tax Foundation rates Washington's tax climate as 12th best, due to the lack of an income tax.

Two highly regarded organizations released fifty-state comparisons related to taxes and business climate in the final quarter of 2015. The Council On State Taxation (COST) released its 2014 total state and local business taxes study (E&Y 2015), which was followed by the Tax Foundation's 2016 (predictive) state business tax climate ratings for overall business atmosphere in each state (Walczak et al. 2015).

Tax burden is a critical, though not the only, element in determining and comparing the business climate in states competing for those taxable entities. The COST study is relatively straightforward. It measures the burden borne by businesses through various tax mechanisms. The Tax Foundation uses a complex formula with over 100 variables to assess the economic impact of corporate and income taxes on businesses, as well as the effects of sales, property, and unemployment taxes.

Nationally, Business-Based Tax Revenues Are Up

First, a national snapshot from the COST study: Local business tax revenue is up

3.1 percent. Of total state and local taxes, business property tax revenues are up 3.2 percent and business-paid sales tax revenues are up 4.3 percent. Meanwhile, those in business filing a personal state income tax return produced 4.8 percent less revenue over the previous year. Overall, business tax revenue from all state and local sources contributed 2.2 percent more in fiscal year (FY) 2014 than in FY 2013.

Measuring Business Tax Levels Against Gross State Product and Employment Numbers

There are many ways to evaluate business tax levels and the climate for doing business in a state. One is to measure the total of state and local business tax revenues for a year against the total annual value of private sector production of goods and services, or gross state product (GSP). This measure of taxation levels is called the total effective business tax rate (TEBTR). The national average TEBTR is 4.6 percent. Washington state comes in higher with a TEBTR of 5.4 percent. (In FY 2013, Washington's TEBTR was 5.0 percent.)

Table 1: State and Local Business Tax Burdens

	Share of Private Sector GSP		State & Local Business Taxes		Share of All Taxes	
	Percent	Rank	FY 2014 Amount (Billions)	Change from FY 2013	Percent	Rank
North Dakota	11.5%	1	\$5.5	21.1%	74.0%	3
Alaska	8.9%	2	\$4.2	-29.5%	80.0%	1
Vermont	7.5%	3	\$1.9	3.5%	52.3%	13
Wyoming	7.3%	4	\$2.7	1.2%	74.9%	2
New Mexico	7.0%	5	\$4.9	5.8%	58.0%	6
Mississippi	6.5%	6	\$5.6	1.9%	52.5%	12
Hawaii	6.4%	7	\$3.8	1.7%	44.8%	29
Maine	6.4%	8	\$3.1	2.4%	47.8%	19
West Virginia	6.2%	9	\$3.8	0.5%	51.9%	14
New York	5.7%	10	\$69.0	2.5%	41.8%	35
Montana	5.4%	11	\$2.0	1.4%	50.0%	16
Nevada	5.4%	12	\$6.2	0.6%	53.0%	9
Washington	5.4%	13	\$19.5	3.7%	58.0%	7
Rhode Island	5.3%	14	\$2.5	0.4%	43.3%	32
Florida	5.2%	15	\$37.1	0.6%	52.6%	11
New Jersey	5.1%	16	\$24.9	2.8%	41.4%	37
Illinois	5.0%	17	\$33.1	0.0%	45.1%	28
Arizona	4.9%	18	\$11.8	-1.4%	50.6%	15
South Carolina	4.9%	19	\$7.6	2.5%	47.8%	20
Texas	4.9%	20	\$70.7	6.5%	62.6%	4
Kansas	4.7%	21	\$5.9	-0.3%	45.2%	27
Kentucky	4.7%	22	\$7.5	1.8%	46.2%	23
Oklahoma	4.7%	23	\$7.2	1.1%	49.8%	17
Minnesota	4.6%	24	\$13.0	3.1%	40.1%	42
South Dakota	4.6%	25	\$1.8	3.7%	59.8%	5
Idaho	4.5%	26	\$2.4	0.2%	44.6%	30
Iowa	4.5%	27	\$6.8	-0.8%	46.2%	24
Pennsylvania	4.5%	28	\$26.1	-0.6%	42.3%	34
Wisconsin	4.5%	29	\$11.4	1.9%	39.9%	44
Alabama	4.4%	30	\$7.1	0.0%	47.3%	21
California	4.4%	31	\$87.8	3.6%	40.4%	41
Delaware	4.4%	32	\$2.4	0.0%	57.9%	8
Arkansas	4.3%	33	\$4.5	3.3%	40.0%	43
Colorado	4.3%	34	\$11.3	2.4%	46.5%	22
Nebraska	4.3%	35	\$4.2	0.5%	45.9%	25
Tennessee	4.2%	36	\$11.0	-0.5%	52.9%	10
Massachusetts	4.1%	37	\$16.4	4.0%	39.1%	45
New Hampshire	4.1%	38	\$2.5	-2.2%	45.3%	26
Ohio	4.1%	39	\$20.8	3.7%	41.7%	36
Louisiana	4.0%	40	\$8.9	5.3%	49.8%	18
Georgia	3.8%	41	\$15.3	3.8%	43.5%	31
Maryland	3.8%	42	\$10.3	1.0%	31.3%	49
Utah	3.8%	43	\$4.5	1.1%	42.8%	33
Virginia	3.8%	44	\$14.2	0.0%	40.6%	39
Indiana	3.7%	45	\$10.6	1.5%	40.8%	38
Michigan	3.7%	46	\$14.4	0.3%	36.5%	48
Missouri	3.5%	47	\$8.7	1.5%	40.6%	40
North Carolina	3.5%	48	\$14.4	2.4%	38.8%	46
Connecticut	3.4%	49	\$7.7	1.1%	28.9%	50
Oregon	3.4%	50	\$6.3	2.7%	37.6%	47
United States	4.6%		\$688.7	2.2%	45.0%	

Source: COST

An alternative analysis, beneficial particularly when a state has an inordinately high GSP (which lowers TEBTR), is to look at total business tax revenues within a state against the number of private sector employees. Washington state's businesses pay \$7,700 in taxes per employee (the sixth highest in the country).

Washington State Businesses Pay 58 Percent of Taxes Collected

COST reports that revenue from the total of all state and local taxes paid by businesses in Washington state increased by 3.7 percent over 2013, the 9th largest increase among the fifty states. Washington businesses contributed over \$18 billion in taxes in FY 2014, now a full 58 percent of all state and local taxes paid in our state. *This is the sixth highest percentage of business taxation by a state and its localities in the U.S.* The national average for business tax revenue by state is 45 percent. Washington businesses are the source of 62 percent of all state tax revenues, and 52 percent of local taxes. These facts need to be considered when the question of regressivity and the Washington state tax system is discussed.

Four taxes generate over 80 percent of business tax revenues in Washington state. Comparing them to the national average for each (shown in brackets), the sales tax is the largest contributor at 33 percent [21 percent on average nationwide]; followed by the property tax, 23 percent [36 percent]; business and occupation (B&O) tax, 17 percent [9 percent]; and unemployment insurance tax, 7 percent [7 percent]. (Washington's B&O tax, a gross receipts tax, can only be compared to a few other states with gross receipts taxes. The national figure reflects a combining of both gross receipts and corporate income tax percentages across all the states.)

How Much Does Business Benefit from Taxes Paid?

Business tax revenues provide resources that may be used to provide services

which directly benefit businesses, and enhance the climate for economic growth in a state or region. Law enforcement and other first responders, judicial systems, and health departments have obvious value to businesses. Water, power, sewer, and garbage services are necessary. Transportation funding and the mobility of goods and services are critical for any economy. The COST study uses a methodology originating with the Federal Reserve Bank of Chicago to assign value from government services that benefit businesses as measured against tax revenues paid. Washington state is tied for the tenth worst tax-benefit ratio, paying \$4.64 for every dollar of benefit, a ratio rounded to 4.7 to 1.

This calculation does not include education spending as a direct benefit. Education spending comprises a significant percentage of the taxes paid by business in each state, at a national average of 41 percent of state and local tax revenues. Imputing direct value to business from the full measure of this sizable outlay is particularly difficult. A highly trained employee can add significant value to a business, but the market wage for this worker is higher as well. Spending tax dollars on state-subsidized advanced degrees may result in a gifted student finding a job in another state. The funding of elementary education does not see a financial return for many years.

Yet education funding can add tangible value to businesses. Courses of study in the STEM (science, technology, engineering and math) cluster, accounting, or marketing give future employees the skills many businesses need. Because the direct value of an education system is hard to quantify, COST produces two more statistics imputing 25 percent and 50 percent of education costs as a value to statewide business communities. This causes the tax paid to value received ratios to fall for every state. With a 25 percent allocation, Washington's ratio is 2.6 to 1, the sixth worst in the country. When 50 percent of education expenditures are allocated to business as a benefit, the

ratio becomes 1.8 to 1, the nation's fifth worst.

Tax Foundation Rates Washington's Business Climate the 12th Best

Despite the preceding woeful statistics, the Tax Foundation gives the business climate in Washington state high marks, rating it 12th out of the fifty states. (See Table 2 on page 4.) How can that be? The answer can be summarized in three words: "No income tax." In fact, of the ten best states for tax climate according to the Tax Foundation study, seven (beginning with No. 1 Wyoming) have no personal or corporate income tax. In contrast, the bottom three states in the report, California, New York, and New Jersey, possess comparatively high income tax rates.

The Tax Foundation tax climate study looks at the broad categories of income, sales, property, and unemployment taxes through the lens of 114 individual measurements of the tax situation in each state. These statistics are weighted in the following fashion:

- Individual income tax, 33.2 percent
- Sales tax, 22.3 percent
- Corporate tax, 18.5 percent
- Property tax, 14.8 percent
- Unemployment insurance tax, 11.3 percent

Over 50 percent of the rating is determined by income taxes or the lack thereof. Washington has neither a personal nor a corporate income tax. However, the Tax Foundation treats the B&O tax paid by C corporations as a form of corporate income tax and the B&O tax paid by sole proprietors, partnerships and S corporations as a form of personal income tax. Thus, Washington becomes 28th in corporate income tax ratings and sixth for individual income taxes. Washington state's high sales tax rate is ranked 45th, while our property and unemployment tax rates are given the mid-

Table 2: Tax Foundation National Rankings, by Tax

	Overall	Corporate Tax	Individual Income Tax	Sales Tax	Unemployment Insurance Tax	Property Tax
Wyoming	1	1	1	12	30	36
South Dakota	2	1	1	34	40	22
Alaska	3	30	1	5	21	21
Florida	4	17	1	17	3	20
Nevada	5	4	1	39	42	7
Montana	6	23	20	3	18	9
New Hampshire	7	48	9	2	44	43
Indiana	8	20	11	11	14	5
Utah	9	5	12	16	19	2
Texas	10	41	6	37	15	34
Oregon	11	37	31	4	27	10
Washington	12	28	6	45	23	24
Michigan	13	11	15	7	48	26
Delaware	14	50	33	1	4	15
North Carolina	15	7	14	31	11	32
Tennessee	16	18	8	46	25	37
Missouri	17	3	28	23	12	8
Colorado	18	15	16	44	33	12
Idaho	19	24	23	20	45	4
Mississippi	20	13	21	28	8	35
West Virginia	21	21	25	21	22	16
Kansas	22	40	18	32	10	19
Illinois	23	36	10	33	39	45
Arizona	24	22	19	49	9	6
Massachusetts	25	39	13	18	47	46
North Dakota	26	14	35	22	16	3
Nebraska	27	31	24	26	2	39
Kentucky	28	29	30	9	46	23
Alabama	29	25	22	41	26	17
Virginia	30	6	39	6	38	29
Hawaii	31	10	37	14	24	14
Pennsylvania	32	47	17	25	50	38
Oklahoma	33	8	40	38	1	18
Maine	34	45	26	10	41	41
New Mexico	35	27	34	48	7	1
South Carolina	36	16	41	19	35	25
Louisiana	37	38	27	50	5	28
Arkansas	38	42	29	43	43	27
Georgia	39	9	42	35	37	31
Iowa	40	49	32	24	34	40
Maryland	41	19	45	8	28	42
Ohio	42	26	47	30	6	11
Wisconsin	43	32	43	13	36	33
Connecticut	44	33	36	29	20	49
Rhode Island	45	34	38	27	49	44
Vermont	46	44	44	15	17	48
Minnesota	47	46	46	36	29	30
California	48	35	50	40	13	13
New York	49	12	49	42	32	47
New Jersey	50	43	48	47	31	50

Note: A rank of 1 is best, 50 is worst. Rankings do not average to the total. States without a tax rank equally as 1. The report shows tax systems as of July 1, 2015 (the beginning of Fiscal Year 2016).

Source: Tax Foundation.

dle rankings of 23rd and 24th, respectively. But that individual tax ranking of sixth is weighted as one-third of the total, causing our state to rank 12th overall in this survey.

Is the Level of Business Taxation Central to Evaluating Business Climate?

The COST study is relatively straightforward and does not assign a comparative ranking to the fifty states for business climate overall. Conversely, the Tax Foundation's index uses a large number of indicators to assess the business climate in each state, assigning rankings correlated most heavily to personal income tax levels, while looking secondarily to corporate, sales, property, and unemployment tax rates. But is taxation a valid surrogate for, or at least a key indicator of, the health of the business climate within a state?

In asserting that taxation is not a primary driver in assessing a business climate, some point to states like California that have a relatively high tax burden and still boast a robust business environment (at least in some sectors). Having large markets for goods, a plethora of universities focused on R&D, proximity to investment funds, and nice weather can all be significantly beneficial to a business climate.

The Tax Foundation study's authors focus on the competition between states to land businesses, where specific tax incentives or overall rates are obvious factors. They rightly point out that a characteristic of today's business marketplace is mobility—of capital and labor. They argue that other factors affecting a business's location, such as education, healthcare, or transportation systems, can take decades to modify, while changes to the tax climate of a state can literally occur overnight.

Although businesses operate in the global economy and the competition to attract job creators is worldwide, the Tax Foundation authors point to a U.S. De-

partment of Labor study (BLS 2013) to show that a state is more likely to lose a job to another state than to competing governments overseas. There are many factors that affect where a business might relocate—proximity to markets, infrastructure, workforce experience and education levels, regulatory climate, and “quality of life,” to name a few.

But tax climate is a major element of this competition, as evidenced by the regular deals featuring tax incentives that states strike with coveted employers. As the COST study shows, Washington has a high business tax burden relative to other states, businesses here don’t get as much value for their taxes as in most other states, and Washington’s tax collections are particularly dependent on business taxes. Those negative elements in Washington state’s business tax climate are mitigated to some degree by the lack of an income tax.

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