



Washington State Businesses Pay 58 Percent of State and Local Taxes

Briefly

- The percentage of Washington's private sector gross state product paid in business taxes was 5.5 percent; in 40 other states the percentage paid in taxes was lower.
- State businesses paid an average of \$7,600 per employee in taxes; in 45 other states, businesses paid less per employee.
- Washington businesses pay almost 58 percent of all state and local taxes.
- Washington had the eighth highest growth rate of business tax revenues, 4.5 percent, from fiscal year 2014 to fiscal year 2015.
- The Tax Foundation says Washington has the 17th best tax climate for business.
- For tax burden comparisons across states, the Tax Foundation classifies B&O taxes paid by sole proprietors, S corporations and other pass-through entities as personal income taxes and B&O taxes paid by C corporations as corporate income taxes.
- The Tax Foundation rates Washington state sixth best for personal income taxes, 48th for corporate income taxes, 49th for sales taxes, 27th for property taxes, and 18th for unemployment insurance taxes.
- Changing tax rates is one of the quickest ways for government to affect the business climate.
- States are in competition with each other for economic growth: tax policy is a key weapon states deploy in this competition.

At the beginning of this critical legislative year, we examine the most recent versions of the 50-state comparative tax climate reports from the Council on State Taxation (COST) and the Tax Foundation.

COST

The COST report, which was prepared by the Quantitative Economics and Statistics practice of Ernst & Young LLP, presents three metrics comparing the level of state and local business taxation across the 50 states in fiscal year (FY) 2015. The first of these metrics is the *total effective business tax rate* (TEBTR). TEBTR gauges taxes paid by businesses against the total annual value of private sector pro-

duction of goods and services within the state, or gross state product (GSP). The TEBTR for Washington state is 5.5 percent. Forty states have lower TEBTRs, indicating lesser business tax burdens. The national average for TEBTR is 4.6 percent.

The second metric gauges taxes paid by businesses against the number of jobs provided by business. Washington's businesses paid \$7,600 in state and local business taxes per employee in FY 2015. In only four states did businesses pay more. Nationally, businesses paid an average of \$5,800 per employee.

The third metric accounts for taxes paid by businesses against the total amount

COST Business Tax Burdens, Fiscal Year 2015

	TEBTR		Tax/Employee		Business Share	
	Value	Rank	Value	Rank	Value	Rank
Alabama	4.5%	24	\$4,600	39	47.4%	21
Alaska	3.5%	48	\$6,000	17	61.0%	4
Arizona	4.9%	17	\$5,300	26	50.3%	15
Arkansas	4.4%	31	\$4,600	39	40.6%	37
California	4.5%	24	\$6,500	12	39.8%	41
Colorado	4.4%	31	\$5,600	19	45.8%	24
Connecticut	3.5%	48	\$5,300	26	28.7%	50
Delaware	4.5%	24	\$7,100	9	58.6%	6
Florida	4.9%	17	\$5,100	31	51.6%	13
Georgia	3.7%	43	\$4,300	44	42.8%	31
Hawaii	6.1%	8	\$7,200	8	42.6%	33
Idaho	4.5%	24	\$4,500	42	43.1%	30
Illinois	4.8%	19	\$6,200	13	44.7%	28
Indiana	3.6%	44	\$4,100	46	40.4%	39
Iowa	4.5%	24	\$5,100	31	45.0%	26
Kansas	5.1%	14	\$5,600	19	47.5%	20
Kentucky	4.7%	21	\$4,800	35	45.2%	25
Louisiana	4.1%	37	\$5,300	26	48.8%	17
Maine	6.7%	5	\$6,200	13	47.2%	22
Maryland	3.8%	41	\$4,900	33	29.9%	49
Massachusetts	4.1%	37	\$5,400	22	38.5%	45
Michigan	3.6%	44	\$4,000	48	35.7%	48
Minnesota	4.5%	24	\$5,400	22	39.3%	44
Mississippi	6.4%	6	\$6,200	13	51.8%	12
Missouri	3.6%	44	\$3,800	50	40.3%	40
Montana	5.4%	11	\$5,500	21	48.6%	18
Nebraska	4.4%	31	\$5,200	30	46.2%	23
Nevada	5.4%	11	\$5,900	18	53.6%	9
New Hampshire	4.2%	36	\$4,700	37	44.9%	27
New Jersey	5.1%	14	\$7,400	6	40.8%	36
New Mexico	7.1%	4	\$8,000	4	57.7%	8
New York	5.8%	9	\$9,100	3	41.6%	34
North Carolina	3.5%	48	\$4,100	46	37.4%	46
North Dakota	9.9%	1	\$13,300	1	71.5%	2
Ohio	4.0%	39	\$4,500	42	39.4%	43
Oklahoma	4.6%	23	\$5,400	22	49.1%	16
Oregon	3.6%	44	\$4,300	44	37.2%	47
Pennsylvania	4.5%	24	\$5,300	26	41.5%	35
Rhode Island	5.4%	11	\$6,200	13	43.3%	29
South Carolina	5.0%	16	\$4,900	33	47.9%	19
South Dakota	4.7%	21	\$5,400	22	59.5%	5
Tennessee	4.3%	35	\$4,600	39	53.0%	10
Texas	4.8%	19	\$6,800	10	61.5%	3
Utah	3.8%	41	\$4,000	48	42.8%	31
Vermont	7.7%	3	\$7,400	6	52.7%	11
Virginia	4.0%	39	\$4,800	35	40.5%	38
Washington	5.5%	10	\$7,600	5	57.8%	7
West Virginia	6.3%	7	\$6,800	10	50.8%	14
Wisconsin	4.4%	31	\$4,700	37	39.5%	42
Wyoming	8.1%	2	\$12,300	2	74.3%	1
Dist. of Columbia	5.0%		\$7,400		54.4%	
United States	4.6%		\$5,800		44.1%	

of taxes collected by the state and its local governments. Washington state businesses were found to have paid 57.8 percent of all state and local taxes collected in FY 2015. In only six states did businesses contribute a greater share of total taxes. Washington businesses paid a higher share of state taxes (61.5 percent) than of local taxes (51.7 percent).

State and local business tax revenues grew in 43 states, with only seven showing a decline in revenues. Washington state business tax revenues grew by 4.5 percent, the eighth highest growth rate in the country. Nationally, business taxes grew by 1.9 percent.

Taxes provide benefits to businesses in the form of law enforcement, judicial systems, infrastructure, and other government services. Education spending, which is around one-third of all state and local spending nationally, can benefit businesses in direct and indirect ways. Directly, public funds can pay for STEM (science, technology, engineering and math) courses and job training that improve the quality of the workforce. Indirectly, it is in the general interest of the business community to have educated, upwardly mobile consumers with rising income levels adding to the stability and prosperity of the community.

COST uses a methodology developed by the Federal Reserve Bank of Chicago to gauge taxes paid by businesses against government services that benefit businesses. Washington state is tied with three states for the 24th best tax-benefit ratio, paying \$3.4 in state and local tax dollars for every dollar of benefit. This compares to a national average of \$3.1. These initial calculations do not consider education as a direct benefit to business. COST produces two more statistics that attempt to measure this factor, imputing alternately 25 percent and 50 percent of education spending as a direct value to businesses statewide. With a 25 percent factor, Washington's tax-benefit ratio is \$2.0, tied with three states for 36th best. When 50 percent of education expendi-

Tax Foundation Tax Climate Ranks, July 1, 2016

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

tures are allocated as a value to business, Washington's ratio is \$1.4, tied with five states for 38th best.

The Tax Foundation

The numbers from COST clearly show that Washington state and local governments remain heavily reliant on revenue from businesses in Washington, at a higher level than most other states. Meanwhile, the recent study from the Tax Foundation shows that our unorthodox tax system, much criticized for lacking an income tax, is a competitive advantage for just that reason.

The Tax Foundation uses a complex formulation of over 100 variables to arrive at an overall tax rating for each state. Ratings by state for corporate and individual income tax, property tax, sales tax, and unemployment insurance tax are building blocks for the final number. Fifty percent of the overall ranking is determined by income tax levels. In Washington state, which has no income tax per se, the Tax Foundation makes an adjustment and considers B&O tax paid by C corporations as a form of corporate income tax. And it treats the B&O tax paid by sole proprietors, partners, and S corporations as a personal income tax.

Of the ten states getting top marks for overall tax climate in the Tax Foundation report, only two use all three of the major forms of state and local tax: income, property and sales. Those two states, Indiana and Utah, have tax systems characterized by "low rates on broad bases." Their various taxes spread the burden broadly across economic sectors, allowing for lower rates in an increased pool of taxpayers. The remaining top ten states lack either a tax on income (Wyoming, South Dakota, Alaska, Florida, Nevada), or a tax on sales (Montana, New Hampshire, Oregon).

The Tax Foundation rates Washington state 49th best (second worst) for sales taxes, 27th for property taxes, and 18th for unemployment insurance taxes. But since income tax indicators receive 50

percent weight in this study, the results for Washington state are more favorable than might be expected. The B&O adjustments described above yielded a ranking of 48th for corporate income taxes, and sixth for personal income taxes. The result is an overall tax climate rating of 17th best in the country, up one notch from last year, using this year's methodology.

Comment

So how important is taxation in evaluating a state's business climate? The Tax Foundation points out that taxation is one area of policy where changes can be felt overnight. Education and infrastructure initiatives, for example, may take a decade to show tangible results. Business taxation can directly affect other business climate indicators as well, such as a skilled workforce. Coveted employees in the high-tech sector, who are paying state income tax somewhere else, have been persuaded to move to Washington state to benefit from the lower tax exposure.

The 50 states are in aggressive competition with each other for quality employers and jobs. News headlines frequently depict a competition between the states and overseas locations for factories, etc. But according to the Tax Foundation, citing a Bureau of Labor Statistics study

in 2012, a state is more likely to lose an employer to another state than to another country. A state tax code change can yield an immediate comparative advantage that may be decisive.

States and localities must strike the balance between funding needed government services and creating the types and levels of tax obligations that are competitive and cause minimal economic dislocation. This ongoing tension is often the source of heated controversy. It will be front and center once again in the legislative session now underway in Olympia.

References

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