

BACKGROUND PAPER

October 2007, Number 57

2008 State Business Tax Climate Index An Executive Summary

By

Curtis S. Dubay and Chris Atkins

Introduction

The Tax Foundation presents the 2008 version of the State Business Tax Climate Index (SBTCI) as a tool for lawmakers, the media, and individuals alike to gauge how their states tax systems compare. Policymakers can then use the SBTCI to pinpoint changes to their tax systems that will explicitly improve their states' standing in relation to competing states.

How much states collect in taxes is critical, but how they take it is also important. In other words, quite apart from whether a state's total tax burden is higher than in other states, it can enact (and many states do) a set of tax laws that cause great damage to the economy.

The modern market is characterized by mobile capital and labor. Therefore, companies will locate where they have the greatest competitive advantage. States with the best tax systems will be most competitive in attracting new businesses and be the most effective at generating economic and employment growth.

Although the market is now global, the Department of Labor reports that most mass job relocations are from one U.S. state to another rather than to an overseas location.¹ This means that state lawmakers must be aware of how their states' business climates stack up to others in their region and nationwide.

State lawmakers are always tempted to lure business with lucrative tax incentives and sub-

sidies. This can be a dangerous proposition, as a case in Florida illustrates. In July of 2004 Florida lawmakers cried foul because a major credit card company announced it would close its Tampa call center, lay off 1,110 workers, and outsource those jobs to another company. The reason for the lawmakers' ire was that the company had been lured to Florida with a generous tax incentive package and had enjoyed nearly \$3 million worth of tax breaks during the previous nine years.²

Lawmakers create these deals under the banner of job creation and economic development, but the truth is that if a state needs to offer such packages, it is most likely covering for a woeful business climate plagued by bad tax policy. A far more effective approach is to systematically improve the business tax climate for the long term. When assessing which changes to make, lawmakers need to remember these two rules:

1. Taxes matter to business. Taxes affect business decisions, job creation and retention, plant location, competitiveness, and the long-term health of a state's economy. Most importantly, taxes diminish profits. If taxes take a larger portion of profits, that cost is passed along to either consumers (through higher prices), workers (through lower wages or fewer jobs), or shareholders (through lower dividends or share value).

¹ U.S. Department of Labor, "Extended Mass Layoffs in the First Quarter of 2007," August 9, 2007, located at <http://www.bls.gov/news.release/mslo.nr0.htm>.

² Dave Wasson, "Florida Lawmakers Slam Capital One's Layoff After Years of Tax Breaks," *Tax Analysts*, July 27, 2004.

Thus a state with lower tax costs will be more attractive to business investment, and more likely to experience economic growth.

- States do not enact tax changes (increases or cuts) in a vacuum. Every tax law will in some way change a state's competitive position relative to its immediate neighbors, its geographic region, and even globally. Ultimately it will affect the state's national standing as a place to live and to do business. Entrepreneurial states can take advantage of the tax increases of their neighbors to lure businesses out of high-tax states.

Clearly, there are many non-tax factors that affect a state's business climate: its proximity to raw materials or transportation centers, its regulatory or legal structures, the quality of its education system and the skill of its workforce, not to mention the intangible perception of a state's "quality of life."³ Some of these factors are, of course, outside of the control

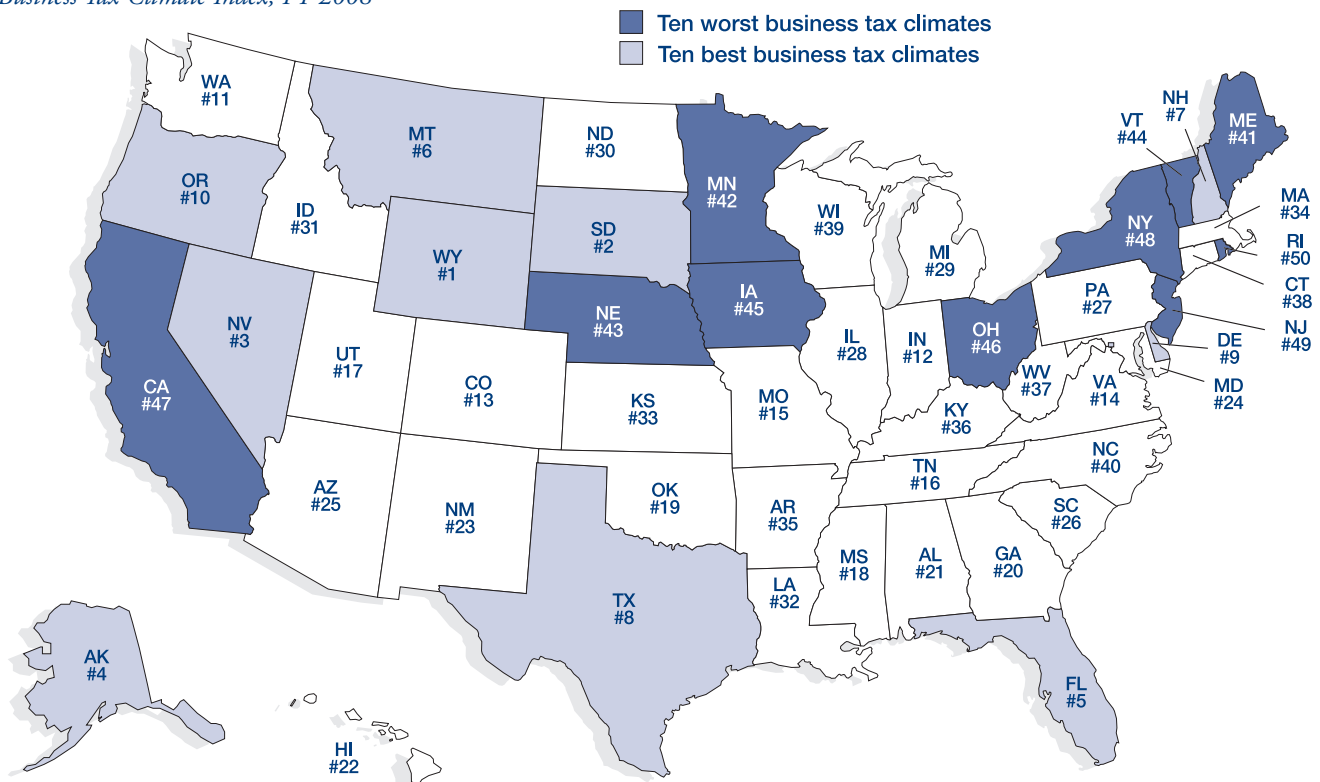
of elected officials. Montana lawmakers cannot change the fact that Montana's businesses have no immediate access to deepwater ports. Lawmakers do, however, have direct control over how friendly their tax systems are to business.

Purpose

The SBTCI is designed to measure the competitiveness of each state's tax system so lawmakers, the media and the public alike can gauge how their state compares to other states. They can also use the SBTCI to pinpoint specific changes that will increase the competitive standing of their state.

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 these politically motivated preferences the less likely

Figure 1
State Business Tax Climate Index, FY 2008



Source: Tax Foundation

³ A trend in tax literature throughout the 1990s has been the increasing use of indexes to measure a state's general business climate. These include the Center for Policy and Legal Studies' "Economic Freedom in America's 50 States: A 1999 Analysis" and the Beacon Hill Institute's "State Competitiveness Report 2001." Such indexes even exist on the international level, including the Heritage Foundation and *Wall Street Journal's* "2004 Index of Economic Freedom." Plaut and Pluta (1983) examined the use of business climate indexes as explanatory variables for business location movements. They found that such general indexes do have a significant explanatory power helping to explain, for example, why businesses have moved from the Northeast and Midwest towards the South and Southwest. In turn, they also found that high taxes have a negative effect on employment growth.

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: individual income taxes, major business taxes, sales taxes, unemployment insurance taxes, and taxes on wealth or assets such as property.

How the State Business Tax Climate Index is Calculated

The SBTCI places 113 variables into five component indexes that each measure a different sector of a state's business tax climate. The five component indexes are the Corporate Tax Index, Individual Income Tax Index, Sales Tax Index, Unemployment Tax Index and Property Tax Index. The total score for each state is calculated based on the scores on each of the five component indexes.

Using the economic literature as our guide, we designed these five component indexes to score each state's business tax climate on a scale of zero (worst) to 10 (best). Each component index is devoted to a major area of state taxation and each has two equally weighted sub-indexes, some of which include several categories and variables under them. Overall, there are 10 sub-indexes and 113 variables. The ranking of the states on each of the five major component indexes is presented in Table 2 on page 4.

Results of the 2008 State Business Tax Climate Index

The ten best states in the Tax Foundation's 2008 State Business Tax Climate Index are as follows:

- | | |
|-----------------|------------------|
| 1. Wyoming | 6. Montana |
| 2. South Dakota | 7. New Hampshire |
| 3. Nevada | 8. Texas |
| 4. Alaska | 9. Delaware |
| 5. Florida | 10. Oregon |

The ten worst states are:

- | | |
|---------------|------------------|
| 41. Maine | 46. Ohio |
| 42. Minnesota | 47. California |
| 43. Nebraska | 48. New York |
| 44. Vermont | 49. New Jersey |
| 45. Iowa | 50. Rhode Island |

Table 1
State Business Tax Climate Index, 2007 and 2008

State	FY 2008 State Business Tax Climate Index		FY 2007 State Business Tax Climate Index		Change from 2007 to 2008	
	Score	Rank	Score	Rank	Score	Rank
Alabama	5.37	21	5.37	21	0.00	0
Alaska	7.19	4	7.21	4	-0.02	0
Arizona	5.19	25	5.11	30	0.07	5
Arkansas	4.94	35	4.90	35	0.04	0
California	4.12	47	4.14	46	-0.03	-1
Colorado	5.89	13	5.82	13	0.07	0
Connecticut	4.89	38	4.77	39	0.13	1
Delaware	6.03	9	6.09	9	-0.06	0
Florida	7.03	5	6.83	5	0.20	0
Georgia	5.38	20	5.35	22	0.03	2
Hawaii	5.33	22	5.33	23	0.00	1
Idaho	5.06	31	5.21	26	-0.16	-5
Illinois	5.14	28	5.14	27	0.00	-1
Indiana	5.93	12	5.88	11	0.05	-1
Iowa	4.54	45	4.53	44	0.01	-1
Kansas	4.97	33	5.01	32	-0.04	-1
Kentucky	4.94	36	4.81	38	0.13	2
Louisiana	5.02	32	5.00	33	0.02	1
Maine	4.69	41	4.70	40	-0.02	-1
Maryland	5.25	24	5.12	28	0.13	4
Massachusetts	4.96	34	4.84	37	0.13	3
Michigan	5.13	29	5.12	29	0.00	0
Minnesota	4.60	42	4.63	42	-0.03	0
Mississippi	5.44	18	5.48	18	-0.04	0
Missouri	5.58	15	5.54	16	0.04	1
Montana	6.34	6	6.32	7	0.03	1
Nebraska	4.56	43	4.45	45	0.11	2
Nevada	7.35	3	7.31	3	0.04	0
New Hampshire	6.24	7	6.19	8	0.06	1
New Jersey	3.88	49	4.10	47	-0.23	-2
New Mexico	5.28	23	5.38	20	-0.10	-3
New York	4.11	48	4.08	48	0.03	0
North Carolina	4.73	40	4.70	41	0.04	1
North Dakota	5.08	30	5.11	31	-0.03	1
Ohio	4.14	46	3.93	49	0.21	3
Oklahoma	5.42	19	5.42	19	0.00	0
Oregon	5.98	10	6.01	10	-0.03	0
Pennsylvania	5.15	27	5.22	25	-0.06	-2
Rhode Island	3.78	50	3.67	50	0.11	0
South Carolina	5.18	26	5.26	24	-0.09	-2
South Dakota	7.46	2	7.51	2	-0.05	0
Tennessee	5.53	16	5.51	17	0.02	1
Texas	6.23	8	6.42	6	-0.19	-2
Utah	5.44	17	5.54	15	-0.10	-2
Vermont	4.54	44	4.54	43	0.00	-1
Virginia	5.69	14	5.59	14	0.10	0
Washington	5.95	11	5.83	12	0.12	1
West Virginia	4.90	37	4.98	34	-0.08	-3
Wisconsin	4.77	39	4.85	36	-0.08	-3
Wyoming	7.71	1	7.77	1	-0.06	0
District of Columbia	4.49	-	4.47	-	0.02	-

Note: The higher the score, the more favorable a state's tax system is for business. Scores from 2003 and 2004 are calendar year; from 2006 through 2008 they are fiscal year (July 1-June 30).

Source: Tax Foundation

Tax competition is an unpleasant reality for state revenue and budget officials, but it is probably the most effective restraint on state and local taxes. When a state imposes higher taxes than a neighboring state, business will cross the border to some extent. Therefore states with more competitive tax systems score well in the SBTCI because they are best suited to generate economic growth.

The first two editions of the SBTCI covered each state's tax climate as it existed in the calendar year starting January 1. For example, the 2004 SBTCI ranked each state as it entered calendar year 2004. Starting with the 2006 edition, the SBTCI has measured each state's business tax climate as it stands at the beginning of

the standard state fiscal year, July 1. Therefore, this edition is the 2008 SBTCI and represents the tax climate of each state as of July 1, 2007, the first day of fiscal year 2008 for most states. Please view the full study on our website at www.taxfoundation.org/files/bp57.pdf, or, alternatively, call or write us for a free copy.

Table 2
Major Components of the State Business Tax Climate Index, FY 2008

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

Note: States without a particular tax rank equally as number 1.

Source: Tax Foundation



BACKGROUND PAPER (ISSN 1527-0408) is published approximately four times a year. Each study explores an economic issue in depth, written by Foundation economists and guest scholars.

Single copy: FREE
Multiple copies: \$5 each

The Tax Foundation, a non-profit, non-partisan research and public education organization, has monitored tax and fiscal activities at all levels of government since 1937.

©2007 Tax Foundation

Editor and Communications Director, Bill Ahern
Copy Editor, Alicia Hansen

Tax Foundation
2001 L Street, NW, Suite 1050
Washington, DC 20006
ph. 202.464.6200
fx. 202.464.6201

www.TaxFoundation.org
TF@TaxFoundation.org