

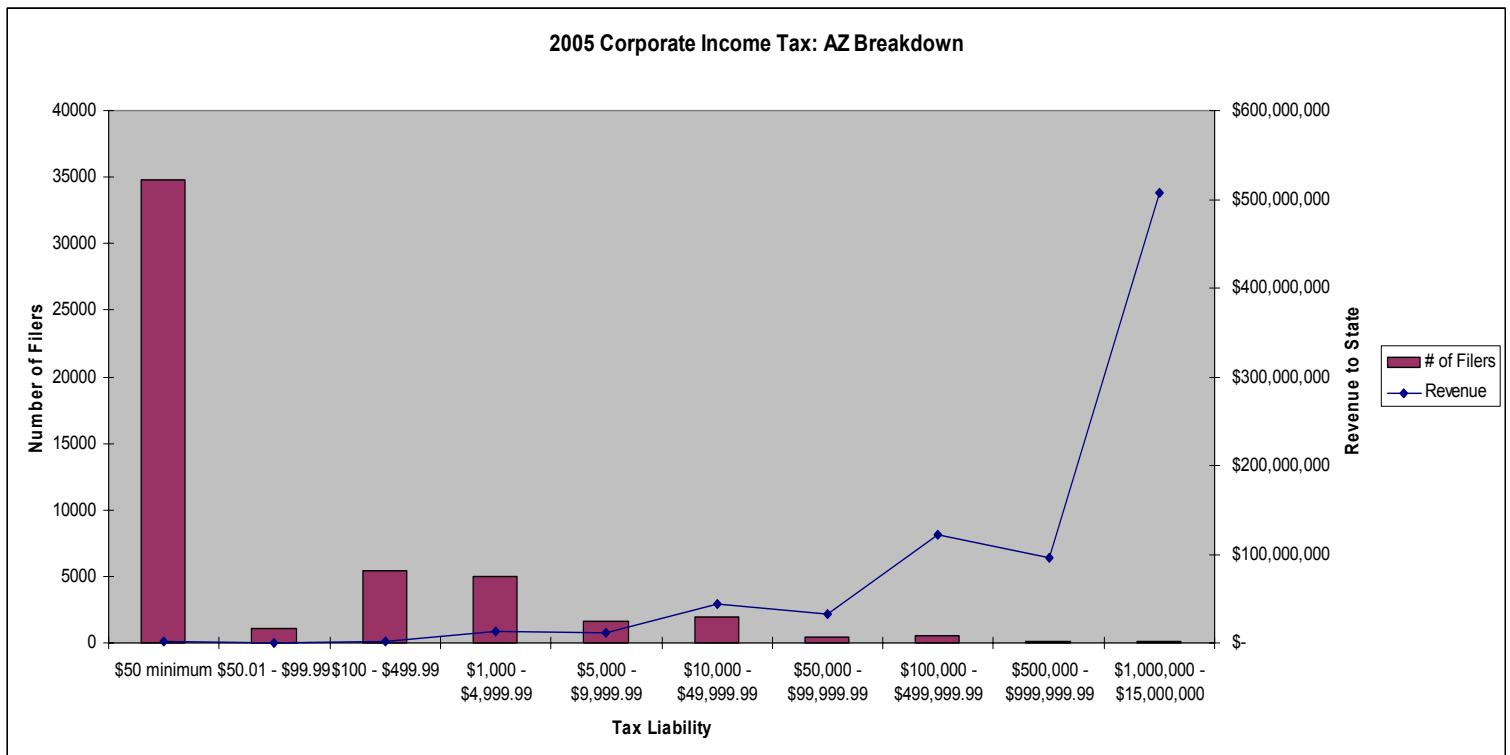
State Corporate Income Tax Cut

**Arizona Free Enterprise Club Recommendation:** Arizona should tax corporate income at 4.54 percent, which is the top state tax rate paid by individuals, limited liability companies, and subchapter S corporations.

**Background:** Arizona taxes corporate income at 6.968 percent. This is 35 percent higher than what most Arizona businesses pay under the individual income tax system. According to NFIB, approximately 75 percent of businesses pay taxes under the individual income tax system, of which the top rate is 4.54 percent.

Very few companies shoulder Arizona’s corporate income tax burden. There were 51,000 corporate income taxpayers in 2005 (most recent data) with a liability of \$828 million<sup>1</sup>. Because businesses with less than \$50 in taxable income only pay \$50 in corporate income taxes, an astonishing 68 percent of the filers (35,000) contributed only .2 percent of the total revenue (\$1.7 million). The remaining \$826 million is therefore shouldered by only 16,300 companies. See Chart A. Amazingly, 134 of these companies contributed \$506.8 million in corporate income taxes (61.2% of the total liability). That’s a \$3.8 million tax bill for each company.

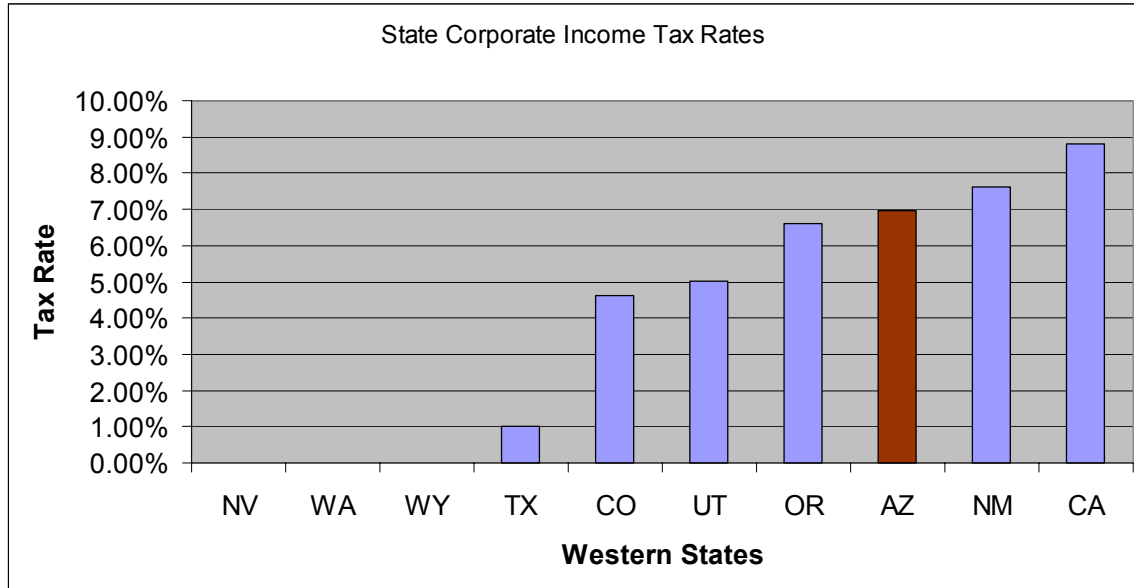
Chart A – Breakdown of AZ Corporate Income Taxpayers



<sup>1</sup> 2005 Corporate Income Tax figures from Department of Revenue

**What would a cut in corporate income taxes accomplish?** First, because many corporations carry out numerous activities in different states, there is an incentive for companies to structure their activities to minimize their tax burdens. But is Arizona’s corporate income tax a disincentive? The answer is yes. Arizona has the third-highest corporate income tax rate in the western U.S. (see Chart B). From a corporate tax perspective, it would make more sense to be headquartered in Las Vegas or Denver. Lowering the state’s corporate income tax rate would make Arizona a better economic choice.

Chart B



Second, having a more competitive corporate income tax rate should reduce the political desire to offer tax subsidies, credits, and other incentive packages. These packages often seek to reduce (or eliminate) the tax burden for a few select companies. This is a great deal for the businesses (and their lobbyists), but it’s a bad deal for those who must foot the rest of the bill.

For example, a recent GPEC proposal seeks to offer transferable corporate income tax credits to companies who fit certain criteria for the manufacturing of renewable energy components. This tax credit could give these businesses an effective tax rate of zero. However, these businesses still utilize the services covered by everyone else’s taxes. As a matter of tax fairness, if a zero tax rate is good for some, it should be good for all.

Third, high taxes increase the cost of capital. There are countless papers that demonstrate the negative consequences high corporate taxes have on job growth, investment, and wages. According to the National Center for Policy Analysis:

- Workers bear slightly more than 70 percent of the burden of high corporate taxes in the form of reduced wages, estimates the Congressional Budget Office.

- A \$1 increase in corporate taxes tends to reduce real median wages by 92 cents, concludes an Oxford University study.
- A 1 percentage-point increase in corporate tax rates is associated with nearly a 1 percent drop in wage rates, according to an American Enterprise Institute (AEI) study.

Economists caution that people ultimately pay taxes, not corporations. Thus, corporate tax hikes unintentionally hurt workers<sup>2</sup>.

*“The ultimate payers of the corporate tax are those individuals who have some stake in the company on which the tax is levied. If you own corporate equities, if you work for a corporation or if you buy goods and services from a corporation, you pay part of the corporate income tax. The corporate tax leads to lower returns on capital, lower wages or higher prices — and, most likely, a combination of all three.”*

Gregory Mankiw, professor of economics at Harvard

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<sup>2</sup> The Case for Corporate Income Tax Cuts, Brief No. 633, September 29, 2008