

THE FISCAL NOTE

An Examination of Tax and Fiscal Matters
 By the Arizona Free Enterprise Club

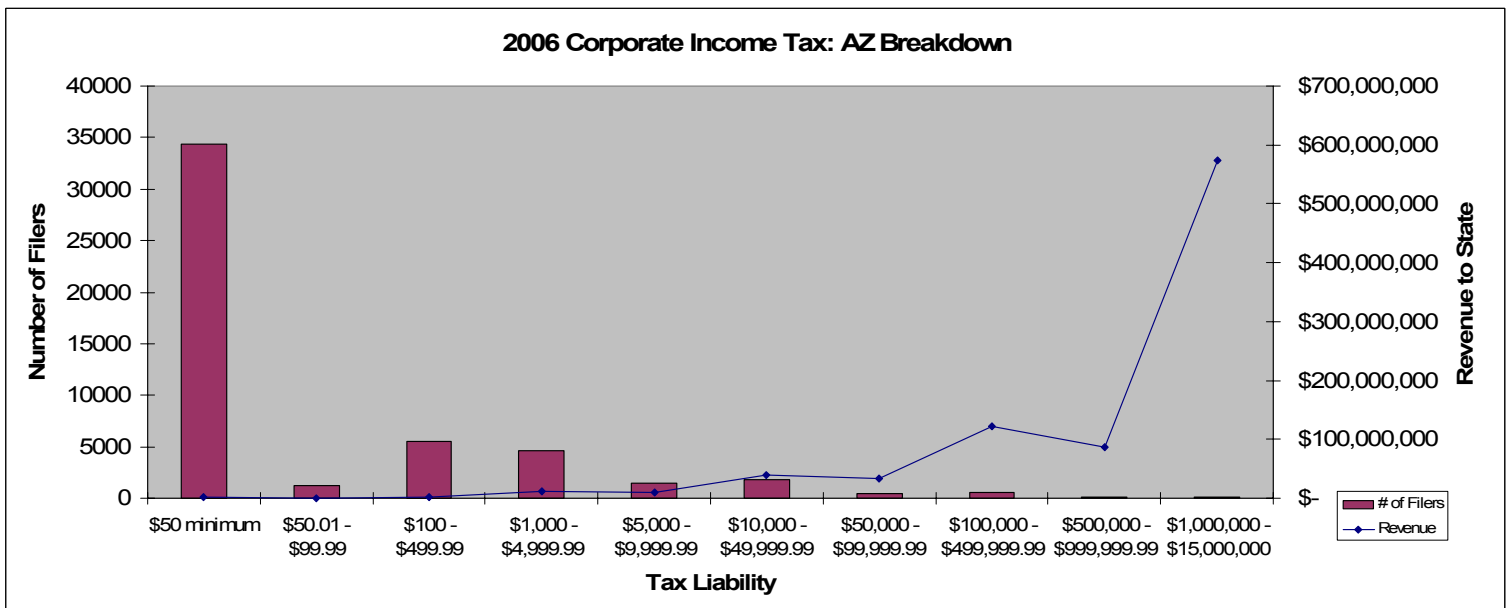
Monday, November 23, 2009

Grow Jobs: Cut the Corporate Income Tax

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.

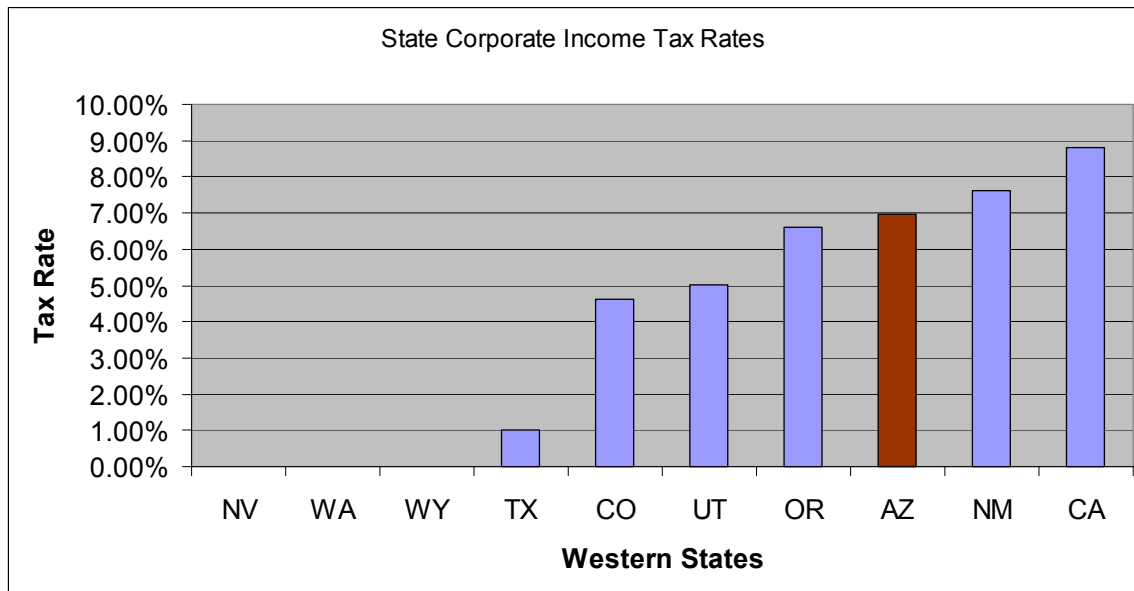
Background: Arizona taxes corporate income at 6.968 percent. This is 54 percent higher than what most Arizona businesses pay under the individual income tax system. According to NFIB, approximately 75 percent of businesses pay taxes under the individual income tax system, of which the top rate is 4.54 percent.

Very few companies shoulder Arizona's corporate income tax burden. There were 50,000 corporate income taxpayers in 2006 (most recent data) with a liability of \$820 million¹. Because businesses with less than \$50 in taxable income only pay \$50 in corporate income taxes, an astonishing 68 percent of the filers (34,000) contributed only .2 percent of the total revenue (\$1.7 million). The remaining \$818 million is therefore shouldered by only 16,000 companies. See chart below. Not surprisingly, 146 of these companies contributed \$575 million in corporate income taxes (65% of the total liability). That equates to a \$3.9 million tax bill for each company.



¹ 2006 Corporate Income Tax figures from Department of Revenue

What would a cut in corporate income taxes accomplish? 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. Arizona's corporate income tax rate is a disincentive. Arizona has the third-highest corporate income tax rate in the western U.S. (see chart below). From a profit-and-loss and balance sheet perspective, it makes more sense to be headquartered in Las Vegas, Denver, or Dallas than it does Phoenix. Reducing the state's corporate income tax rate makes Arizona a better business option.



A more competitive corporate income tax rate would 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 change to Arizona law offers corporate income tax credits to lure certain out-of-state companies to locate in Arizona. Compelling current Arizona taxpayers to subsidize new taxpayers is bad public policy. The tax code should not favor one industry over another.

Finally, 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, high corporate taxes ultimately hurt workers².

“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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The Arizona Free Enterprise Club is a 501(c)(4) advocacy group not affiliated with any other organization. The mission of the AZFEC is to advance policies that promote a strong and vibrant Arizona economy. For more information visit www.azfec.org or call 602-346-5061.

² NCPA: The Case for Corporate Income Tax Cuts, Brief No. 633, September 29, 2008