Business Taxation, Burden Shifting and Economic Development

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Background

- Study in early 2004 by Illinois Chamber claiming that Illinois was driving business out of the state by its high business tax burden.
- Feeling that the chamber study painted an oversimplified and fundamentally distorted picture of business taxation in Illinois

Findings

- There is no such thing as a neutral tax. Taxes impact every business differently.
- Combined state and local taxes actually borne by business comes in at less than 1% of business costs and less than 1.5% of Illinois state product.

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- Taxation is just a small piece of the economic development policy.
- In addition, taxes fund many of the services vital to economic development strategies in Illinois and other states.

Issues Surrounding Tax Burden/Incidence Research

- Imperfect data makes for imperfect research
- Tax rates are not the bottom line. Profits are.
- Cutting taxes means cutting public services
- Do businesses really move across state lines for small savings in taxes?
- Who bears the cost of taxation? In other words, do taxes stick where they hit?

Proposed Methodology

- Review of Texas and Minnesota studies
- General approach: Obtain data by industry from DoR. Use out-of-state export shares from data obtained from the REMI model for Illinois to determine the degree to which a tax is actually borne by the firms paying it.

Income Tax Methodology

- Subtract the refund fund.
- Sum tax payments by 2 digit SIC, then match each industry with their export share.
- Then, multiply tax collections for each industry by the export share to determine the amount of taxation that applies to out-of-state businesses.
- Conclude that these taxes can not be passed on, and constitute the amount of tax borne by Illinois business
- Similar methodology for Franchise tax

Sales Tax Methodology

- Using the REMI model, base estimates on an input-output methodology designed to determine the share of sales taxes paid by consumers and businesses.
- Estimate the degree to which businesses can pass on taxes incurred on their own purchases.

Property Tax Methodology

- Assume that firms who compete in international markets are more likely to absorb the majority of the cost of property taxes, while firms whose business is essentially local may be able to pass on a greater portion of this tax.
- Businesses could only be expected to pass on the proportion of property tax levied on buildings and improvements.

Utility Tax Methodology

- Separate residential and business share.
- Then use an input-output matrix to obtain business linkage and export share for 2-digit SIC codes to determine the degree to which businesses can pass on the cost of utility taxation.

Motor Fuel Tax Methodology

- Employ method similar to estimating the sales tax burden.
- Obtain forward and backward linkages for transportation-oriented industries.
- Then weight these by export shares, to determine the extent to which the costs of taxation could be passed on.

Conclusion

- Obviously tax burden studies do not represent tax incidence. How do we as a profession move ahead to bridge the methodological differences and research gaps?
- Since many companies do not pay corporate income tax – should we consider the concept of fairness relevant? If so, how should it be measured?

Research Ideas

- Consensus on methodology to measure tax incidence – how do we move forward?
- Micro-Data Studies of Employment and Taxation. Place taxes in the context of other factors that influence relocation and expansion/contraction
- What is the impact of zero corporate tax liability on business behavior

Research Ideas Cont'd

- Economic Impact – Cost/Benefit Analyses
- How to model Costs/Benefits – revenue estimate before or after incidence?
- Put services back in the equation.
- Define the tipping point at which firms actually change their behavior