How Would a Corporate Income Tax Cut Hurt Virginia's Ability to Invest in the Future?

The Commonwealth Institute

There's more to a competitive business climate than just lower taxes

By Massey Whorley, Sara Okos, and Michael J. Cassidy

Letting big, profitable corporations skip out on support for the things that make Virginia one of the best states for business will undermine the commonwealth's ability to create jobs and boost the economy. A stronger future for Virginia requires businesses to invest, like the rest of us, in the key services that build the foundation for real economic growth – things like healthy families, an educated workforce, safe communities, and well-maintained roads.

Attorney General Ken Cuccinelli has proposed cutting the corporate income tax rate to 4 percent from 6 percent. But similar legislative proposals have been rejected in the past because of the large amount of resources they would drain from public services. Those proposals have ranged from cutting the tax for certain businesses to eliminating it for all businesses. All of these proposals would have reduced state revenues substantially – an important reason they have failed each time.

This analysis highlights the importance of Virginia's corporate income tax and the reasons why cutting it risks Virginia's economic potential.

Key state revenue source that only some businesses pay

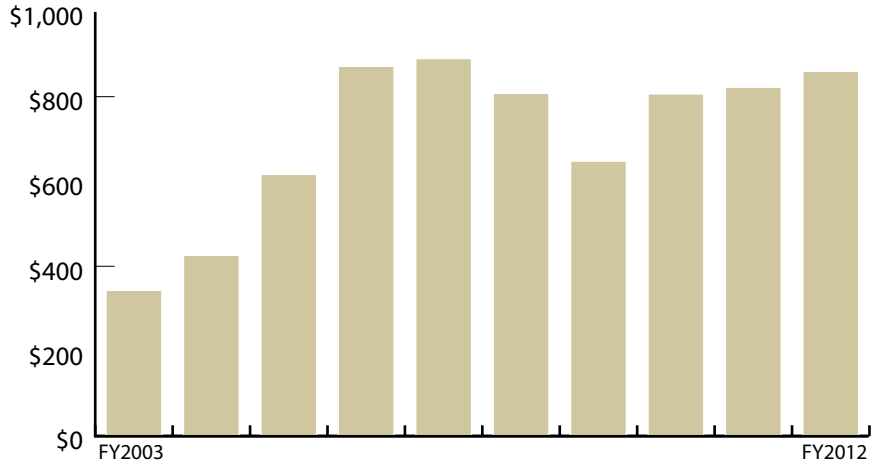
Virginia's corporate income tax is the third-largest source of revenue for the state's general fund, its main account for education, public safety and other services Virginians use every day. Over the past 10 years, corporate income taxes have generated over $700 million annually (see Figure 1), on average. They brought in roughly $860 million in 2012, which is a little more than what the state spends on local law enforcement, including state police, local sheriffs and jails, and Commonwealth's Attorneys.

FIGURE 1

Critical Collections

Virginia's Corporate Income Tax Revenues, Fiscal Year 2003- 2012

Corporate Tax Revenues (millions)



Source: Virginia Secretary of Finance.

But only one type of business, legally classified as "C corporations," pays the tax. And less than 10 percent of Virginia businesses are C corporations. Even within that subset, the majority of corporate income taxes are paid by an even smaller number of multistate and highly-profitable corporations. In fact, in 2012, nearly two-thirds of corporations in Virginia paid no corporate income taxes at all.

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Business climate is more than just taxes

While some argue that low corporate income taxes encourage businesses to locate or expand in a state, Virginia already has a highly competitive business environment, and the state's corporate income tax system does not detract from that. Virginia ranked No. 2 on the 2012 Forbes list of the best states for business, and No. 3 on a similar ranking by business news channel CNBC.

The legislature's own auditor concluded that Virginia's corporate tax system compares favorably to other states. Virginia's 6 percent corporate tax rate is one of the lowest in the country, according to the Joint Legislative Audit Review Committee's (JLARC)comprehensive 2010 study. Among the state's competitors, only one – Florida – has a lower rate.

But corporate taxes are not a make or break proposition for businesses. While companies do evaluate a state's taxes, they are a small part of a bigger package. Corporations make their location and investment decisions based on a range of critical business factors, such as access to markets, an educated workforce, and a sound transportation system. As shown in Figure 2, state and local taxes represent, on average, only 2 percent of the total cost of doing business.

Businesses need well-trained workers, good roads that allow them to bring their products to market, and safe, stable communities. These are the things that attract businesses and people to a state and allow it to thrive over the long-term. Cutting business taxes makes it harder to have these things, not easier.

Benefits from a cut flow out of state

Cutting the corporate income tax would reduce state revenues, diminish the services that benefit employers and most likely cost jobs in Virginia, while the benefits would flow mostly out of state.

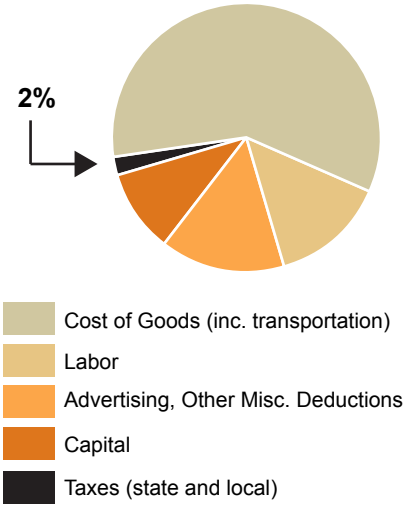
That's because many of the corporations that pay the tax are big, multi-state entities and will invest where it is most profitable for them to expand. Businesses would retain or invest about 75 percent of a Virginia tax reduction outside of the state, according to the 2010 JLARC study of the state's corporate income tax.

In addition, the corporate income tax is the only contribution that Virginia gets from out-of-state investors and shareholders who benefit from Virginia services like education, roads and bridges, public safety, and our legal system, which all help create a strong business environment and generate corporate profits. Without the corporate income tax, these out-of-state investors and shareholders would benefit from Virginia's strong business climate essentially at no cost because they don't live or work here.

FIGURE 2

A Small Cost of Doing Business

State & Local Taxes as a Share of the Cost of Doing Business in the U.S.



Source: IRS, All Active Corporate Income Tax Returns, 2005.

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Corporations pay less, people pay more

Reducing the corporate income tax rate for large, profitable corporations means Virginia will have to raise other taxes or make more cuts to important investments because we won't have the resources to pay for them.

If we pay for the tax cuts by reducing incomes for people right here in the commonwealth – by laying off teachers, cutting worker hours, or raising taxes on low-income people and the middle class, for example – then people will have less money to spend in their communities, and that will hurt the state's economy.

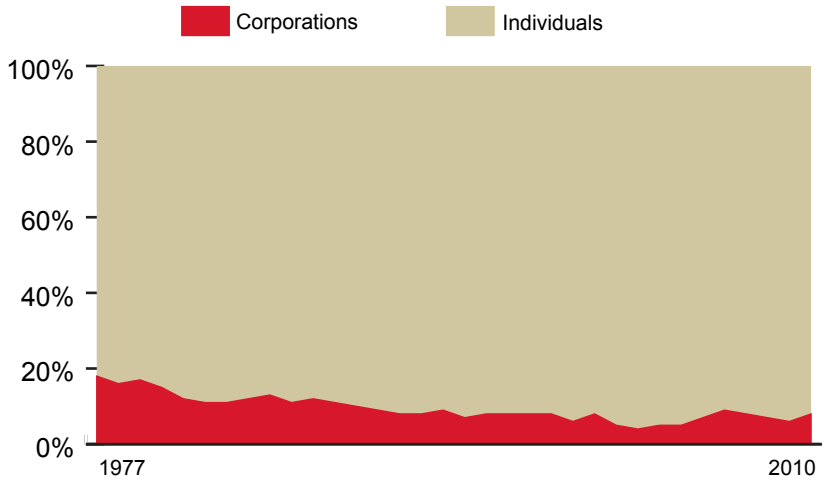
This would continue the trend of Virginians paying a growing share of total state income taxes, while the share paid by corporations has been declining. As shown in Figure 3, since the late 1970s the share of total income taxes paid by corporations has been cut by more than half (to roughly 8.4 percent in 2010 from 18.2 percent in 1977).

Cutting the corporate income tax would be dangerous for Virginia. It would deplete the resources we need for first-class schools and colleges, a sound transportation system, a healthy workforce and other things businesses look to when they are considering where to locate or expand. Bolstering Virginia's economy will require more investment in those services, not less.

FIGURE 3

Shrinking Share

Share of Total State Income Taxes Paid by Individuals vs. Corporations, 1977-2010



Source: TCI analysis of Tax Policy Center data.

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