



Briefing Paper

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This paper is the first in a special series of occasional papers from the Keystone Research Center that will examine economic development policy issues in Pennsylvania.

Are Business Taxes Really High in Pennsylvania?

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Summary

Contrary to conventional wisdom, the total amount in taxes that Pennsylvania businesses pay to state and local governments is not high when compared with other states.

- Even before the most recent spate of tax cutting, in only 23 states did business pay a smaller share of all taxes than in Pennsylvania.
- Based on 1995 data, Pennsylvania businesses paid \$940 per capita in state and local taxes, 17th highest out of the 50 states but less than the \$962 average for all states.
- A 1999 study found that, for typical manufacturing firms, Pennsylvania had the second lowest business taxes in a group of 10 mid-Atlantic and southeastern states.
- In 2001, Pennsylvania's ranking based on a subset of business taxes that are relatively high in the Commonwealth dropped from fifth highest to 15th highest, according to Census Bureau data.

The impression that Pennsylvania has high business taxes has been created, in part, by recent studies sponsored by business organizations. When making comparisons between business tax burdens in Pennsylvania and other states, these studies have failed to consider all taxes businesses pay. Specifically, the studies have ignored property and sales taxes. Table 1 provides a point-by-point discussion of the claims in the most recent business-sponsored study.

Whatever the level of Pennsylvania business taxes, research shows that low business taxes are not the key to rapid job growth. One reason is that lower taxes can deprive states of revenues necessary to invest in educational and infrastructural services that help attract or expand businesses.

Pennsylvania does need tax reform, but the reforms the state needs must be consistent with a 21st century economic development strategy. Such a strategy must be “business friendly,” but must also expand economic opportunity for workers and support strong communities. Tax reform must not be informed simply by the special interest pleading of business associations.

The Keystone Research Center recommends that the General Assembly in cooperation with the next governor establish a 21st Century Pennsylvania Tax Commission to develop recommendations for a much-needed comprehensive overhaul of the Pennsylvania tax system focused on:

- Eliminating inequities in business taxes;
- Shifting educational funding to the state level so that all communities have adequate resources for a high quality education, and to stabilize communities that now face the double whammy of high local taxes but insufficient school funding;
- Ensuring adequate investment in early childhood education, higher education, and lifelong career learning-- public goods that benefit firms in general as well as workers;
- Using green taxes to create incentives for environmentally sustainable development; and
- Exploring other ways to make Pennsylvania’s tax system more progressive at both an individual and community level.

Significantly, while it takes a different position than this paper on the current reality of Pennsylvania business taxation, a recent Pennsylvania Economy League (PEL) study also recommends a systemic updating of the Pennsylvania tax system to fit today’s economic realities.

The Received Wisdom: Business Taxes in Pennsylvania Are Too High

The conventional wisdom in Harrisburg is that Pennsylvania imposes high taxes on business. This view has been rooted in a series of studies published by the Pennsylvania Economy League, the most recent sponsored by various business organizations.¹

In its most recent study, based on a comparison of what it calls “widely applied state business taxes,”² PEL finds that Pennsylvania ranks fifth highest of all the states in terms of tax collections per employee. Pennsylvania collections in 2000 were said to equal \$613.17 per employee compared to the national average of \$388.18.

PEL finds that Pennsylvania’s overall rank in terms of state business tax collections per employee was fifth highest in 2000. Despite the recent cuts in Pennsylvania business taxes, PEL finds Pennsylvania’s rank in 2000 to be essentially unchanged from fifth highest in the 1997-1999 period and seventh highest in 1996 (Table 2).

At first glance, the PEL study appears plausible. For the years 1996 to 2000 (Table 2 shows two of these years), U.S. Census Bureau state-level data on two major categories of business taxes is consistent with PEL’s 2001 report. In 2001, Pennsylvania’s business tax ranking based on these taxes (according to the Census Bureau) dropped to 15th from fifth. (Year-to-year state rankings fluctuate, in part because the corporate taxes included in Table 1 do not vary a lot across states. It will take additional years of data to see if the 2001 shift is permanent.)



Table 1. An Evaluation of Pennsylvania Economy League (PEL) Claims	
<i>What the PEL 2001 Study Says*</i>	<i>What the Available Evidence Indicates</i>
<p>“...from 1996 to 2000, ...[PA] shows at best a national ranking of 7th highest business tax burden, at worst the 4th highest business tax burden.” (p. v)</p>	<ul style="list-style-type: none"> • Estimating all taxes paid by business, Pennsylvania’s business tax burden in 1995 was 17th on a per capita basis and 27th based on the share of total taxes paid by business (Table 3). • PEL study includes business taxes that are relatively high in Pennsylvania but leaves out property taxes on business, which are relatively low in Pennsylvania. (It also leaves out sales taxes.) • Even considering only business taxes that are relatively high in PA, recent tax cuts dropped PA’s per capita ranking to 15th in 2001 (Table 2).
<p>PA relies “more heavily on business taxes than any of the other ten states that compete closely with Pennsylvania” (p. v.)</p>	<ul style="list-style-type: none"> • Counting all taxes, PA per capita taxes on business were lower in 1995 than in seven of the 10 states that PEL study says compete closely with PA (Table 4). • Pennsylvania per capita taxes on business were 7 percent lower than the average for the 10 competitor states. • Pennsylvania’s taxes on business as a share of all taxes were sixth lowest -- right in the middle – in this group of 11 states.
<p>“Pennsylvania’s Corporate Net Income (CNI) tax rate of 9.99% ranks as the third highest in the nation and remains substantially higher than the national average rate of 7%” (p. iii.)</p>	<ul style="list-style-type: none"> • At least two fifths of the state’s corporate taxpayers are Subchapter S corporations or other entities exempt from the CNI (footnote 9) • At most one in five PA corporations actually pays CNI tax each year (footnote 9). • The 2.8 percent tax on the net income of S corporations is lower in Pennsylvania than in any of 11 other states examined by the PA. Department of Revenue in 1994. In these states, the highest rate paid on S corporation income averaged 7 percent, nearly three times the Pennsylvania rate. ** • PA is in the middle of the pack in terms of total business taxes.
<p>“Pennsylvania is one of just 18 states that tax corporate worth in addition to corporate income via the Capital Stock and Franchise Tax.” (p. i.)</p>	<ul style="list-style-type: none"> • The Capital Stock and Franchise Tax (CSFT) includes an exemption for assets engaged in manufacturing and for selected other assets. • The high level of Pennsylvania’s CSFT is offset by low property taxes on business. • Pennsylvania is in the middle of the pack in terms of total business taxes.
<p>“Pennsylvania’s effective tax burden on capital is not just the highest among these 18 states, but it is extraordinarily heavy in comparison to our competitors.” (p. i.)</p>	<ul style="list-style-type: none"> • While a high proportion of the CSFT is actually based on income, rather than capital, revenue from both parts of the tax is included in PEL’s ranking. Most other taxes in the ranking are imposed strictly on capital. • PEL’s statement may or may not be true, but its study does not provide evidence to support the statement. • PA is in the middle of the pack in terms of total business taxes.

* All claims in column 1 are from Pennsylvania Economy League, *A Comparative Analysis of Major State Business Taxes in Pennsylvania and Other States* (Harrisburg: PEL, 2001).

** Pennsylvania Department of Revenue, *Comparative Tax Burdens: What the Pennsylvania Economy League Didn’t Tell You* (Harrisburg: DOR, 1994), p. 8.



The most serious limitation in the most recent PEL study is that it fails to consider property and sales taxes. These two categories account for over half the total state and local taxes paid by businesses in many states. PEL acknowledges (p. 3) that its data “does not fully account for the business tax burden in each state.” PEL does not fully acknowledge the impact that this omission has on its conclusions. By including in its study only the specific taxes on which Pennsylvania’s tax burden ranks high among states, the PEL study endorses a skewed impression of the overall tax burden on Pennsylvania businesses. The explanation given for these omissions is that “Business taxes levied at the local level are most notably absent for practical reasons.” Local taxes include property taxes.

Are Business Taxes Really High in Pennsylvania?

To overcome the limits of the PEL study, we rely on other sources that use two different methods of comparing state and local business taxes across states.

- One approach, most similar to PEL’s, is to add up all major taxes that business pays, including property and sales taxes, and compare this total across states, controlling for the size of the state.
- The second approach is to calculate what a group of hypothetical business would actually pay in taxes if they operated in each state. This second approach mirrors analysis by companies and consultants when factoring tax burdens into site location decision. (Numerous studies by PEL from the 1970s through the early 1990s have used this methodology.³)

Estimated by either method, overall tax burdens on Pennsylvania businesses cannot fairly be called high. They appear, in fact, to be among the lowest in the Mid-Atlantic region.

The Tax Burden by Comparing All Taxes Paid by Business in a State. As PEL implies, gathering data on property (and sales) taxes paid by business is no easy task. A 1997 Institute on Taxation and Economic Policy (ITEP) study did attempt the difficult task of estimating consistent data on all state and local taxes paid by

Table 2. State Business Taxes Excluding Property and Sales Taxes: A Comparison Of Pennsylvania Economy League and U.S. Census Bureau Data (rank: 1=highest tax; 50=lowest tax)				
	<i>PEL 2001 Study</i>		<i>U.S. Census Bureau Data</i>	
	<i>Total Major State Business Taxes* Per Employee</i>	<i>Ranking Out of 50 states</i>	<i>Major State Business Taxes (Excluding Property and Sales Taxes)** Per Capita</i>	<i>Ranking Out of 50 States</i>
1995			\$227.27	3
1998	\$584.22	4	\$221.28	4
2000	\$613.17	5	\$218.81	5
2001			\$186.90	15

*Includes Corporate Net Income Tax, Financial Institutions Tax, Capital Stock and Franchise Tax, and Insurance Premiums Tax.

**Includes Corporate Net Income Taxes plus what Census Bureau labels Corporate License Taxes (which include Stock and Franchise Taxes).

Sources: Keystone Research Center (KRC), based on Pennsylvania Economy League (PEL), *A Comparative Analysis of Major State Business Taxes in Pennsylvania and Other States* (Harrisburg: PEL, 2001); and based on U.S. Census Bureau data on line at www.census.gov/govs/www/statetax.html.



business in 1995.⁴ (Appendix A briefly describes how ITEP estimates business taxes.) As well as the published ITEP study, we rely here on underlying data that ITEP shared with the Keystone Research Center and that ITEP used to generate its 1997 report.

According to ITEP, the business share of all state and local taxes ranged from a high of 88 percent in Alaska to a low of 26 percent in Maryland. At 38.4 percent, Pennsylvania ranked 27th out of 50 states based on the share of taxes paid by business. (Pennsylvania ranked 15th highest based on the share of taxes paid by households.) Based on per capita taxes paid by business, Pennsylvania had the 17th highest taxes. Pennsylvania’s \$940 per capita business taxes were \$22 below the \$962 per capita average for all 50 states. Ranked by either the share of taxes paid by business or per capita business taxes, Pennsylvania was near the middle of its six neighboring states (Table 3 and Figure 1).

The main reason that ITEP found Pennsylvania’s overall business tax ranking in 1995 to be near the middle of all states was low property taxes. At \$244, Pennsylvania’s per capita business property taxes were \$163 below the average for all states. This offset the fact that an aggregate of Pennsylvania’s corporate taxes that includes the CNI tax and the CSFT was \$177 above the average of all states. (In 1995, ITEP, similar to PEL, and to the Census Bureau until 2001, found that Pennsylvania had the third highest per capita taxes in this aggregate of corporate taxes that included primarily the CNI tax and the CSFT.)

Since Pennsylvania has cut state-level business tax burdens since the 1997 ITEP study, an up-to-date ranking might show Pennsylvania now to have relatively lower total taxes on business.⁵

We can also use ITEP’s 1995 figures to examine taxes paid by business in Pennsylvania and in 10 states that PEL identified as competitor states. Table 4 and Figures 2 and 3 show the results.

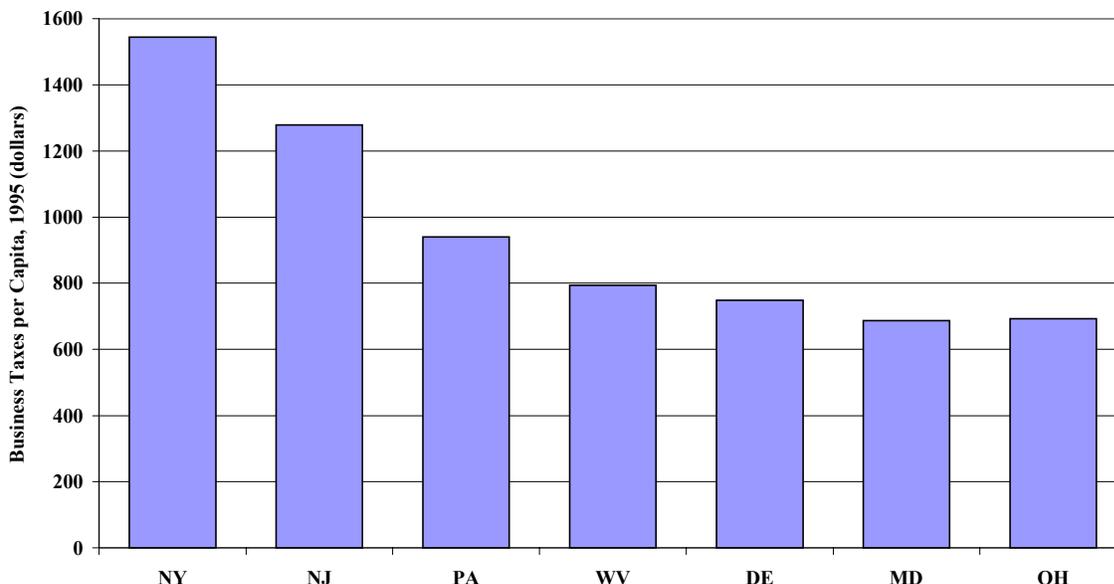
- Pennsylvania’s per capita business taxes are eighth lowest out of the group of 11 states.

<i>State</i>	<i>Per Capita Business Taxes (dollars)</i>	<i>Rank out of 50 states based on Per Capita Business Taxes</i>	<i>Share of Taxes Paid by Business (percent)</i>	<i>Rank out of 50 states based on share of taxes paid by business</i>
New York	1544	2	41.4	18
New Jersey	1278	5	37.6	30
Pennsylvania	940	17	38.4	27
West Virginia	793	31	44.2	12
Delaware	748	36	39.4	23
Maryland	687	42	25.6	50
Ohio	693	41	32.7	46

Sources: Institute on Taxation and Economic Policy (ITEP), *The Business Share of State and Local Taxes* (Washington, D.C.: ITEP, 1997), Table 1 and Table A4; and KRC, based on data provided by ITEP.



Figure 1. Taxes Per Capita Paid by Business in Pennsylvania and Neighboring States



Source: Table 3.

- Pennsylvania’s per capita business taxes are 7 percent lower than the average for the other 10 states.
- Pennsylvania’s business share of taxes is 6th lowest out of the group of 11 states – right in the middle.

The Tax Burden By Comparing Hypothetical Businesses. A second way to compare business taxes is to consider what representative businesses would pay in taxes if they operated in each of a comparison group of states. A 1999 study of this type by the Barents Group found that Pennsylvania taxes manufacturers at the second lowest level in a group of 10 mid-Atlantic and southeastern states (Table 5 and Figure 4).⁶ (Maryland had the lowest share of business taxes among all 50 states in the ITEP study.) Pennsylvania taxes were 28 percent lower than the 10-state average.

According to the Barents study, Pennsylvania levies lower property taxes on manufacturers than any other state studied. One reason is that Pennsylvania, unlike many other states, does not impose local property taxes on business inventories and equipment.

A limitation of the Barents study is that the methodology requires examining what property taxes are in a single “representative” community, in this case Westmoreland County. Since the ITEP study also finds that property taxes on business in Pennsylvania are low, we can have more confidence that the low property taxes in Westmoreland County would generalize to the rest of Pennsylvania.⁷

No recently published representative firm study compares tax burdens on non-manufacturing firms in Pennsylvania and competitor states. An unpublished study did recently benchmark Pennsylvania business taxes in five



Table 4. Taxes Paid by Business in Pennsylvania and 10 Other States PEL Identifies As Competitor States (rank: 1=highest tax; 50=lowest tax)				
	<i>Business Taxes Per Capita (dollars)</i>	<i>Rank Out of All 50 States, Business Taxes Per Capita</i>	<i>Business Share of Taxes (percent)</i>	<i>Rank Out of All 50 States, Business Share of All Taxes</i>
New York	1544	2	41.4	18
New Jersey	1278	5	37.6	30
Illinois	1257	7	46.2	7
Indiana	1041	11	45.5	9
Michigan	1010	14	41.8	17
Florida	1021	12	46.6	5
Massachusetts	1015	13	35.6	39
Pennsylvania	940	17	38.4	27
Ohio	693	41	32.7	46
Virginia	653	45	30.7	49
North Carolina	641	46	31.7	47

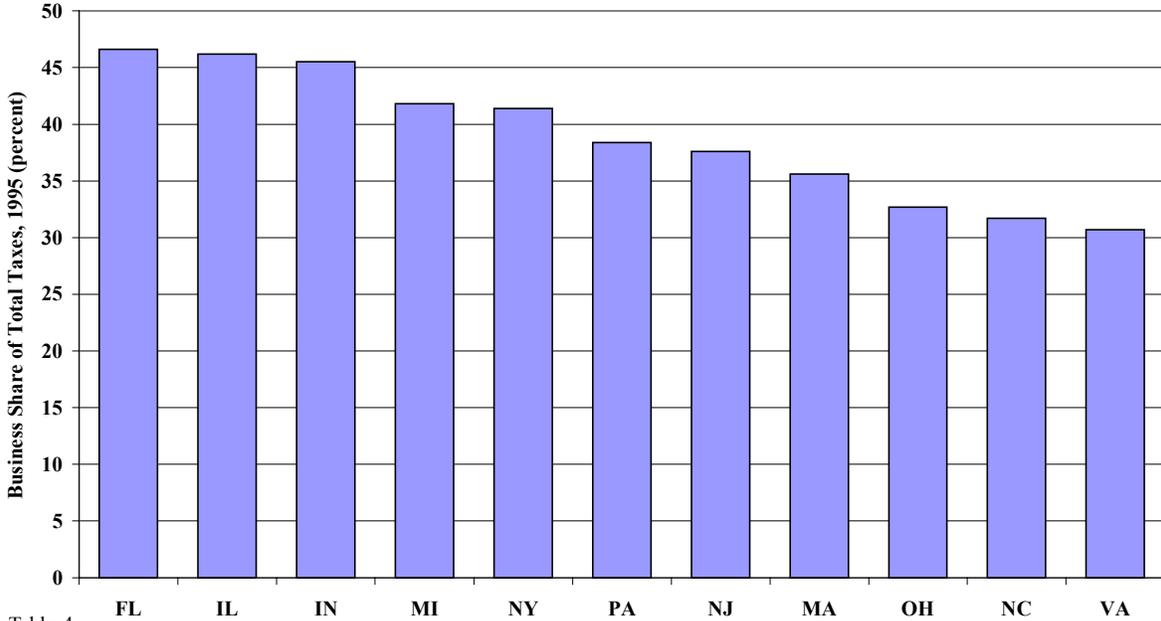
Source: KRC, based on data provided by ITEP.

Figure 2. Business Taxes Per Capita Lower in PA than in Most of PEL's "Competitor" States



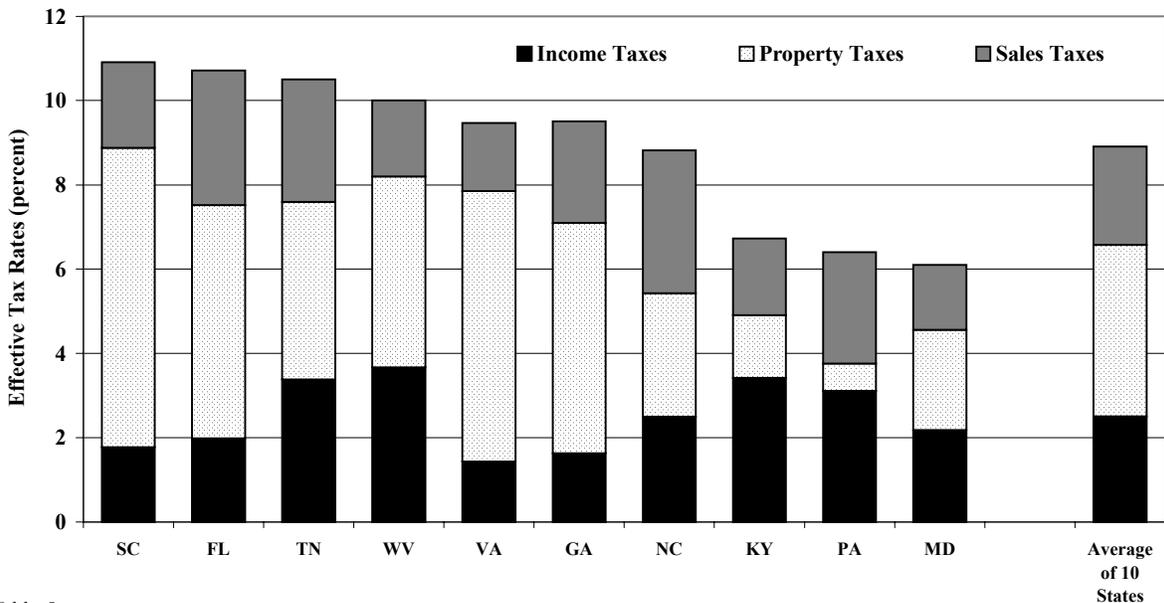
Source: Table 4.

Figure 3. Business Share of Taxes in Pennsylvania in the Middle of PEL's "Competitor" States



Source: Table 4.

Figure 4. Pennsylvania Has Second Lowest Manufacturing Tax Burden in 10 Mid-Atlantic and Southeastern States



Source: Table 5.



non-manufacturing industries (and several manufacturing industries).⁸ It found Pennsylvania to have the third highest business tax rate of 13 states, 19 percent above the 13-state average. This study, however, assumed that all Pennsylvania corporations pay the Corporate Net Income tax of 9.99 percent, whereas at least two fifth of Pennsylvania corporations are not subject to this tax (and two thirds of the remaining 60 percent of corporations reported a zero CNI liability in recent years).⁹ This unpublished study was also written prior to the beginning of the phase-out of the CSFT tax and prior to the introduction of an exemption from the sales and use tax for businesses that purchase computer services.

Business Taxes and Job Creation

One underlying assumption that drives enthusiasm for business tax cutting is that lower business taxes lead to greater job creation. While we do not review in detail the research literature on this topic, it is important to point out that research does not support the conventional assumption that lower business taxes necessarily lead to job growth.

To be fair, PEL itself does not take a strong position on this issue in its 2001 report.

- It acknowledges (p. 1) that this issue has been the subject of debate and academic inquiry for many years and has not produced a consensus.
- It also summarizes (p. 1) the conclusion of site selection consultant Robert Ady that “taxes are not

Table 5. Effective Tax Rates (ETRs)* on Typical Manufacturing Businesses in PA and Nine Mid-Atlantic and Southeast States
(average of ETRs in 10 manufacturing industries)
(rank: 1=highest taxes, 10=lowest)

	All Taxes		Sales Taxes		Property Taxes		Income Taxes	
	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank
South Carolina	10.86	1	2.03	6	7.11	1	1.77	8
Florida	10.71	2	3.19	2	5.53	3	1.99	7
Tennessee	10.51	3	2.9	3	4.22	6	3.38	3
West Virginia	9.99	4	1.8	8	4.53	5	3.67	1
Virginia	9.47	5	1.62	9	6.42	2	1.43	10
Georgia	9.24	6	2.41	5	5.47	4	1.63	9
North Carolina	8.82	7	3.39	1	2.93	7	2.5	5
Kentucky	6.73	8	1.82	7	1.49	9	3.42	2
Pennsylvania	6.40	9	2.64	4	0.65	10	3.11	4
Maryland	6.09	10	1.54	10	2.38	8	2.18	6
Region	8.88		2.33		4.07		2.51	

* The ETR reflects the difference between pre-tax and after-tax rates of return. If, for example, the pre-tax rate of return is 10 percent and the after-tax rate of return is 9 percent, the ETR will be 10 percent – i.e., the difference between the two rates of return as a percent of the pre-tax rate of return.

Source: Nancy Cook, Gang Shao, and Andrew Phillips, “Analysis of State and Local Business Tax Systems,” *State Tax Notes*, September 8, 1999.

relatively important when compared with other cost factors such as labor, transportation, and utility and occupancy costs.”

- PEL concludes (also p. 1) with the cautious statement that “majority opinion does favor some level of tax impact both on business decisions and overall growth at the state level.”

Even the conclusion that lower taxes has at least some positive impact on growth is open to question. Tim Bartik, the researcher that PEL cites as having produced the most notable research on the link between business taxes and growth himself concludes that low business taxes are probably not an effective economic development strategy.¹⁰ A central reason is that the benefits of lower taxes must be offset by reductions in services valuable to business.¹¹ Bartik suggests that states choose the tax/service combination they prefer – higher taxes and higher services or lower taxes and lower services – based on factors other than an expectation that one or the other will generate higher economic growth.

A 21st Century Tax Strategy

As best can be determined from available evidence, Pennsylvania business taxes are not high overall. Simply cutting business taxes is not an effective route to growth and good jobs -- Pennsylvanian's recent poor job creation record and mediocre wage growth performance suggest as much.¹² In spite of this evidence, Pennsylvania continues to cut business taxes sharply.

At present, Pennsylvania is scheduled to phase out the Capital Stock and Franchise Tax by the year 2009. In 2002, the tax is scheduled to drop to 6.49 mills (\$6.49 per \$1,000), down from 12.75 mills in 1997. For the 2001-02 fiscal year now ending, the revenue from the CSFT is projected to equal \$917 million. Next year, the tax is projected to raise \$997.5 million.¹³

The CSFT phase-out passed without any consideration of whether the state would end up unable to fund its schools, expand quality pre-school programs, buttress it's underfunded community colleges, or invest in other public goods of importance to businesses making expansion and location decisions. Keystone Research Center wrote two years ago that “Phasing out [the CSFT] without creating an alternative source of revenue is a time bomb for the state's next Governor. Only unexpectedly rapid growth will prevent the cut from derailing investments in education or in reducing worker insecurity...”¹⁴ The economic stall since 2000 makes this observation even more relevant.

To his credit, Governor Schweiker in his budget proposed a partial delay in the phase out of the CSFT tax. He proposed spreading the drop from 7.49 mills to 6.49 mills over 2002 and 2003, and postponing the full phase-out until 2010. In light of the severity of the current budget situation, and the inadequately considered original plan, a partial delay is insufficient. Pennsylvania legislators should halt the phase out until a more forward-looking tax package can be developed.

Proposing a halt in the phase out does not mean that Pennsylvania's current business tax structure is, in any sense, perfect.

In fact, Pennsylvania's business taxes, while low overall, do impose inequities on business. Businesses that compete with each other are not subjected to similar tax burdens. Some companies pay the CSFT tax; some companies do not. Some companies pay the CNI of 9.9 percent; some companies instead pay 2.8 percent. At

minimum, both the CSFT and CNI tax should have fewer exemptions and a lower rate, a combination that could maintain current revenues without unduly burdening any particular company.

Proposing a halt in the phase out of the CSFT does not mean, either, that high business taxes are the favored public policy. A case can be made for lower taxes on corporate profits and capital IF adequate revenues can be collected in other ways to meet the state's development needs.

To help Pennsylvania achieve a more comprehensive and forward-looking approach to tax policy, the legislature should establish a 21st Century Tax Commission. This Commission could develop recommendation on how the state can establish a tax system that promotes high-wage, high-skill economic development rather than low-wage, low-skill development. Such development, and such a tax system, would be friendly to business, as it should be; but it would also be friendly to workers and to communities.

Significantly, while it takes a different position than this paper on the current reality of Pennsylvania business taxation, PEL also recommends a systemic updating of the Pennsylvania tax system to fit the today's economic realities. According to PEL (*A Comparative Analysis*, p. vi),

...perhaps the most important conclusion of this study is that Pennsylvania would benefit from a broader examination of the overall tax structure including both state and local taxes. This analysis would serve as the basis for systemic change rather than relying on the incremental approach applied over the past 50 years. This is a tall order for such a complicated and ingrained issues, however, if Pennsylvania wants to be competitive in the coming years, it must take the first step to ensure that our tax system is appropriate for the new economic order.

A 21st century Pennsylvania tax system must:

- consider the combined impact of state and local tax burdens;
- be equitable across and within all categories of taxpayers, including business;
- give all public schools the state funds they need for a high quality education (for reasons of fairness, to produce a skilled future work force, and to slow the decline of older communities);
- raise other revenues adequate to meet the early educational and skill needs of the work force, to finance transportation (including mass transit) and infrastructure, and to adequately fund social programs;
- attract and grow high-wage, high-skill businesses and their workers;
- promote environmentally sustainable development; and
- counteract the rise of inequality across individuals and communities in Pennsylvania.

ENDNOTES

¹ Pennsylvania Economy League, *A Comparative Analysis of Major State Business Taxes in Pennsylvania and Other States* (Harrisburg: PEL, 2001). On line at www.pelcapital.org/reports/RptBizTax2000.pdf. See also, "Improving Pennsylvania's Business Climate: A Comparative Analysis of State Business Taxes," *Capital Perspective*, October 1999. The most recent study was completed with the support of the Business Climate Coalition, a group of Pennsylvania's leading business associations formed to advocate cuts in Pennsylvania state business taxes. Coalition members include the Greater Pittsburgh Chamber of Commerce, Pennsylvania Business Roundtable, Pennsylvania Chamber of Business and Industry, Pennsylvania Manufacturers' Association, and Pittsburgh High Technology Council.

² The 2001 PEL study, an update of its 1999 study, bases its findings on "... only the most widely applied state business taxes including those levied on corporate net income, capital, insurance premiums, and financial institutions." (p. iii) The two most important taxes included in the PEL analysis are the Corporate Net Income tax, now 9.9 percent, and the Capital Stock and Franchise Tax (CSFT), a corporate tax imposed on a combination of net income and a company's net worth. The CSFT tax fell to 7.49 mills in 2001 (\$7.49 per \$1,000), down from a peak of 13 mills in 1991 and 12.75 mills over the 1992-1997 period. Certain corporate assets are exempt from the CSFT tax, including assets engaged in producing a manufactured article within Pennsylvania, computer software development, research or development activities, and air or water pollution control efforts. For additional information, see Appendix A and Pennsylvania Department of Revenue (PDR), *The Tax Compendium 2001* (Harrisburg: PDR, 2001), pp. 4-5.

³ See, for example, PEL, *Taxes Paid by Industry, 1994* (Harrisburg: PEL, 1994). This study found Pennsylvania's tax burden to be 19 percent above a 12-state average in manufacturing and between 11 and 36 percent higher in three service industries. According to the Pennsylvania Department of Revenue, correcting mathematical errors in the PEL study led to the conclusion that Pennsylvania had an 8 percent advantage over the 12-state average in manufacturing and a five to 11 percent disadvantage in the three service industries. Further re-estimation of the business tax burden by the Department of Revenue (taking into account the existence of large numbers of S corporation not liable for the CNI) led to the conclusion that Pennsylvania had a business tax burden in manufacturing 18 percent below the 12-state average and a 3 to 8 percent disadvantage in the three service industries. See Pennsylvania Department of Revenue, *Comparative Tax Burdens: What the Pennsylvania Economy League Didn't Tell You* (Harrisburg: PDR, 1994).

⁴ Institute on Taxation and Economic Policy (ITEP), *The Business Share of State and Local Taxes* (Washington, D.C.: ITEP, 1997).

⁵ Simply substituting for ITEP's 1995 estimates of major business taxes (not including sales and property taxes) the most comparable 2001 Census Bureau data (this most comparable data turns out to be an aggregate of Corporate Net Income taxes plus corporate license taxes) moves Pennsylvania's business tax ranking to 30th on a per capita basis instead of 17th. This substitution moves Pennsylvania's ranking based on the business share of total taxes to 38th (from 27th). Since we have no way of updating the other taxes in ITEP's model, including some taxes that may have gone up on business in Pennsylvania (e.g., local property taxes), we do not report this partial updating in the text.

⁶ Nancy Cook, Gang Shao, and Andrew Phillips, "Analysis of State and Local Business Tax Systems," *State Tax Notes*, September 8, 1999.

⁷ In picking a community in each state, Barents seeks to find one in which local property taxes are similar to the average for the state (see Appendix A). A Minnesota study also found that while Pennsylvania has relatively high property taxes for residences, it has relatively low property taxes for businesses. Minnesota Taxpayers Association, *50-State Property Tax Comparison Study* (Minneapolis, MN: June, 1996).

⁸ Barents Group, *Pennsylvania Tax Blueprint Project: Phase One- Benchmarking*, unpublished study for the Pennsylvania Tax Blueprint Project, 1996.



⁹ According to the Pennsylvania Department of Revenue, 222,491 corporations were liable for the Capital Stock and Franchise Tax in 1997. Only 135,379, or 60 percent of 222,491, were liable for the Corporate Net Income Tax in the same year, from which we infer that 40 percent of the 222,491 were Subchapter S corporations or other types of corporations that are not liable for the CNI. In addition, of the 135,379 liable for the CNI in 1997, only 45,589 actually paid corporate net income tax. In sum, only roughly one out of five Pennsylvania corporations (45,589 of 222,491) paid any CNI in 1997. Data in this footnote are from Pennsylvania Department of Revenue, *The Statistical Supplement for Pennsylvania Tax Compendium: Fiscal Year 2000-01* (Harrisburg: PDR Bureau of Research, 2002), p. 10.

¹⁰ Timothy J. Bartik, *Growing State Economies: How Taxes and Public Services Affect Private-Sector Performance* (Washington, D.C.: Economic Policy Institute, 1996).

¹¹ See also Robert G. Lynch, *Do State and Local Tax Incentives Work?* (Washington, D.C.: Economic Policy Institute: 1996.)

¹² For data on wage and benefit trends and some analysis of job growth, see David H Bradley and Stephen A. Herzenberg, *The State of Working Pennsylvania 2001* (Harrisburg: Keystone Research Center, 2001); on line at www.keystoneresearch.org.

¹³ Commonwealth of Pennsylvania, *Governor's Executive Budget 2002-03* (Harrisburg: Office of the Governor, 2001), p. C-18.

¹⁴ Stephen A. Herzenberg and Howard Wial, *Steal This Agenda: A Blueprint for a Better Pennsylvania* (Harrisburg: Keystone Research Center, 2000), p. 27; on line at www.keystoneresearch.org.

APPENDIX A. SOURCES OF TAX DATA AND TAX DEFINITIONS

SOURCES

Pennsylvania Department of Revenue

The Pennsylvania Department of Revenue provides comprehensive data on taxes collected in the Commonwealth. *The Pennsylvania Tax Compendium* details Pennsylvania's revenue sources, including the Corporate Net Income Tax (CNI) and the Capital Stock and Franchise Tax (CSFT). *The Statistical Supplement for the Pennsylvania Tax Compendium* includes information on revenue by source, tax by business type, and the distribution of tax liability. The Compendium and the Supplement are available on line at http://www.revenue.state.pa.us/revenue/lib/revenue/2001_tax_compendium.pdf and http://www.revenue.state.pa.us/revenue/lib/revenue//2000-01_Stat_Supplement.pdf.

U.S. Census Bureau

The U.S. Census Bureau is the most widely accepted source of comparable state business tax collections data. The majority of data from the Census are gathered directly from state revenue agencies. The Census Bureau edits and tabulates data collected from the state level in order to provide consistent, comparable tax data. The tax figures presented in Census data are net of refunds.

Census Bureau data presented in the last two columns of Table 2 include corporation taxes and corporation net income taxes (see definitions below) and are available online at <http://www.census.gov/govs/statetax/01staxss.xls>. The two taxes used to generate the last two columns of Table 2 are defined below.

Corporation License Taxes

Includes: Franchise license taxes; organization, filing and entrance fees; taxes on property measured by amount of corporate stock, debt, or other basis besides assessed value of property; and other licenses applicable with few, specified exceptions to all corporations.

Excludes: Taxes on corporations based on value of property, on net income (report at Corporation Net Income Taxes), or on gross receipts from sales, other than at minor rates; and taxes distinctively imposed on particular kinds of businesses, such as public utilities, insurance companies, etc. (report at appropriate Selective Sales Tax).

Corporation Net Income Taxes

Includes: Taxes on corporations and unincorporated businesses (when taxed separately from individual income), measured by net income, whether on corporations in general or on specific kinds of corporations, such as financial institutions.

Excludes: Income taxes on gross income or receipts of corporations (report at Sales and Gross Receipts Taxes); and combined corporation and individual income taxes not separable by type. Notes: Although such

taxes may be called "license" or "franchise" taxes, they are classified in this category if measured by net income.

For complete descriptions of tax categories in the U.S. Census Bureau's tax data, see http://www.census.gov/govs/www/class_ch7_tax.html.

For a discussion of the sources of U.S. Census Bureau data, see the technical documentation online at <http://www.census.gov/govs/www/stateloctechdoc.html>.

Institute on Taxation and Economic Policy (ITEP)

Data presented in Tables 3 and 4 are from the Institute on Taxation and Economic Policy (ITEP). The ITEP model consists of three elements – residential data, business data, and visitor data. In estimating the business share of state and local taxes, ITEP uses a forty-nine sector input-output model for each state to create a business tax model. Models were based on data from the U.S. Commerce Department, a stratified random sample of federal tax returns, and the 1990 Public Use Microdata Sample (PUMS) of census records. To derive business property taxes, ITEP first computed residential property taxes from the residential database. The business property tax estimate was then computed as the residual of total property tax collections minus residential property taxes. Details on ITEP's tax models is available online at [and](http://www.ctj.org/itep/model.htm), in progressively more detail, at [and http://www.ctj.org/itep/model.htm](http://www.ctj.org/itep/model.htm).

Barents Group

Data in Table 5 are from Barents Group (formerly the Policy Economics Group of KPMG). Barents Group developed the Business Tax Competitiveness Model (BTCM) to estimate business taxes facing firms in different locations. The BTCM model incorporates federal, state, and local taxes, thus allowing for more complete comparisons than models that use only business taxes. At the core of the BTCM model is a "representative firm" that is derived by using Internal Revenue Service (IRS) Corporation Source Book data, input-output data from the Bureau of Economic Analysis (BEA), and other publicly available data. The BTCM computes tax liabilities based on 57 depreciable asset classes and 40 operating cost categories. The model then estimates tax rates for four state and local business taxes – corporate income tax, corporate franchise tax, property tax, and sales and use tax on business purchases. Specific locations for representative firms are based on two criteria – a local property tax rate near the statewide average and the plausibility of business site location. For information on Barents Group, see http://kpmgconsulting.com/go/barents_test/statelocal/businesstaxmodel.html.

DEFINITIONS

The CNI tax and the CSFT tax are two of the main state business taxes in Pennsylvania. The following definitions of these two taxes are from the Pennsylvania Department of Revenue, The Tax Compendium (Harrisburg: PDR Bureau of Research, 2001).

Corporate Net Income Tax

Domestic and foreign corporations are required to pay the corporate net income tax (CNI) for the privilege of conducting business, carrying on activities, having capital or property employed or used in Pennsylvania, or



owning property in Pennsylvania. Exempt businesses include building and loan associations, banks, savings institutions, trust companies, insurance and surety companies, and nonprofit corporations. Business income is apportioned on the basis of property, payroll, and sales factors within and without Pennsylvania. The apportionment formula is 60 percent sales, 20 percent payroll, and 20 percent property. The current rate is 9.99 percent.

Capital Stock and Franchise Tax

The CSFT tax is levied on corporations with capital stock, joint-stock associations, limited liability companies, business trusts and other companies conducting business within Pennsylvania. Exemptions include nonprofit and family farm corporations. To determine the portion of capital stock value attributable to Pennsylvania and thus to Pennsylvania taxation, corporations subject to this tax are allowed to choose between a single “exempt assets” factor and a three-factor apportionment. Corporations may use the exempt assets factor to exclude certain nontaxable assets. A statutory exemption exists for assets engaged in producing a manufactured article within Pennsylvania, specified processing operations, including computer software development, research or development activities, and air or water pollution control efforts. A corporation also receives an exemption for intangible assets to the extent that they are directly used in an exempt activity.