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BTC Brief

NC BUDGET & TAX CENTER

February 2011

Cutting the Corporate Tax Rate Unlikely to Boost Economy or Create Jobs

Timely, accessible, and credible analysis of state and local budget and tax issues

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KEY FINDINGS:

- **In her State of the State address, Governor Perdue proposed cutting the corporate tax rate by 2 percentage points from 6.9 to 4.9 percent.**
- **A 29 percent cut in the corporate income tax (from 6.9 to 4.9 percent) would result in just a 2.2 percent cut in overall business taxation and only a 0.04 percent reduction in total business costs.**
- **Cuts in the corporate tax rate are not targeted to businesses undertaking new investments, job creation or research and development. Thus, they do not generate the kind of new economic activity that is needed to create more jobs.**
- **Investments in education, transportation and public safety have been shown to result in improved economic outcomes.[1] When business tax cuts are proposed that will reduce available revenue to the state and require cuts to these critical public structures, the state's long-term economic growth and quality of life is compromised.**

IN HER STATE OF THE STATE ADDRESS, Gov. Beverly Perdue proposed cutting the corporate tax rate by 2 percentage points from 6.9 to 4.9 percent. As the state faces another significant budget shortfall in the first year of the next biennium of $2.7 billion, a further reduction of the state's available resources will not only be damaging to the state's public structures but in turn could undermine efforts to create jobs and build a stronger economy for North Carolina's future.

The proposed rate reduction on corporations comes at a time when North Carolina's revenues are at historic lows. In Fiscal Year 2011-2012, state tax revenues are likely to drop to 5 percent of the total state personal income, far lower than the historic average. And yet, corporate and personal incomes are recovering quickly in the state. As a result, North Carolina has been recognized nationally as being among the states leading the national economic recovery.[2]

For that economic recovery to be sustained and shared broadly, North Carolina must maintain a revenue system that adequately supports public services and is balanced across the traditional three-legged stool of collections from sales, personal income and corporate income. This is not only fiscally responsible, it reflects the important principle that everyone should contribute to the public structures that benefit them and their communities.

Corporate Taxes Support Public Structures

Corporations benefit from public structures—schools, universities and community colleges, roads, courts—and therefore it makes sense they contribute to their maintenance and improvement. Increasing evidence is available to suggest that it is, in fact, these public structures that greatly influence businesses decisions about where to locate and expand their operations.[3]

This makes sense. State and local taxes on businesses represent a small portion of the cost of doing business. On average for all states, corporate income taxes, sales taxes and local property taxes represent only about 1.8 percent of total business costs.[4] Furthermore, in North Carolina, the corporate income tax represents only 7.5 percent of all state and local business taxes.[5] That means that a 29-percent cut in the corporate income tax (from 6.9 to 4.9 percent), as proposed by the Governor, would result in just a 2.2 percent cut in overall business taxation and only a 0.04 percent reduction in total business costs. And due to the way in which state taxes can be deducted at the federal level, the business would be paying higher federal taxes as a result of the state change.

Due to balanced budget requirements at the state level, when business tax cuts are proposed, it is necessary for policymakers to either raise revenue some other way or cut public spending. Investments in education, transportation and public safety have been shown to result in improved economic outcomes.[6] When business tax cuts are proposed that will reduce available revenue to the state and require cuts to these critical public structures, the state's long-term economic growth and quality of life is compromised.

Corporate Taxes and the Economic Recovery

In the short term, corporate tax cuts are unlikely to provide the needed local boost to support the economic recovery and job creation. That is because, as research has found, the impact of tax cuts on corporate investment would not only be small but require years to fully take effect.[7] Additionally, businesses are likely to distribute these additional dollars to their shareholders who are often living out of state. Evidence has generally found that a 10-percent reduction in total state and local taxes paid by businesses is likely to boost economic output and jobs by *only* about 2 percent.[8] However, again, this does not account for the negative impact of the offsetting cuts to public structures that would be required to pay for such tax cuts.

The job creation goals of the Governor and other policymakers are important to the state's economic recovery. But investments to achieve that goal must be cost-effective in the immediate and long-term. Cuts in the corporate tax rate are not targeted to business undertaking new investments, job creation or research and development. Thus, they do not generate the kind of new economic activity that is needed to create more jobs.

Conclusion

North Carolina is facing a significant budget shortfall that policymakers have already stated will require significant cuts to critical public structures. Adding to that gap by reducing an important source of revenue from corporations is not sound fiscal policy. Now is the time to maintain our existing revenue streams and modernize our revenue system for the future. In so doing, there may be opportunities to consider lowering corporate tax rates alongside the elimination of certain corporate tax breaks, and implementation of combined reporting. But in the current fiscal crisis, the contributions that North Carolinians and businesses alike make to the state's public structures are essential to leading us out of the Great Recession and into better days.

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1 Fisher, Ronald. 1997. The Effects of State and Local Public Services on Economic Development. *New England Economic Review*. March/April: 53-67

2 *USA Today*, http://www.usatoday.com/money/economy/2009-02-06-new-jobs-growth-graphic_N.htm

3 Lynch, Robert G. 2004. Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development. Economic Policy Institute.

4 Fisher, Peter S. February 2011. Corporate Taxes and State Economic Growth. Iowa Fiscal Partnership.

5 Council on State Taxation. FY2009 Business Tax Burden Study. http://www.cost.org/Page.aspx?id=69654

6 Fisher, Ronald. 1997. The Effects of State and Local Public Services on Economic Development. *New England Economic Review*. March/April: 53-67

7 Mazerov, Michael. September 2010. Cutting State Corporate Income Taxes is Unlikely to Create Many Jobs. Center on Budget and Policy Priorities.

8 Mazerov, Michael. September 2010. Cutting State Corporate Income Taxes is Unlikely to Create Many Jobs. Center on Budget and Policy Priorities.

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