

spotlight

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THE TRUE COST OF STATE AND LOCAL TAXES

How to understand the business tax burden study

KEY FACTS: • **The Council on State Taxation (COST) estimate of tax burdens is widely misunderstood.**

• **The COST study does not measure the cost of government or the competitiveness of North Carolina's business tax climate.**

• **The COST study shows business taxes in the state as a share of all private sector activity in the state.**

• **Compared to other states, North Carolina taxes individuals more than it taxes businesses.**

• **North Carolina regularly ranks as one of the worst business tax climates in the country according to the Tax Foundation.**

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Each year, the Council on State Taxation (COST) releases a 50-state estimate of total state and local business taxes for the preceding fiscal year.¹ The report measures the tax burden on businesses as a share of private-sector state gross domestic product (GSP). North Carolina regularly has one of the lowest tax burdens in this study, leading some to misunderstand what that means and claim that taxes are not a problem for North Carolina businesses.

In 2004, the COST report did not include personal income taxes paid on pass-through income from S-Corporations and sole proprietorships. Roy Cordato, vice president of research and resident scholar at the John Locke Foundation, pointed out this problem, among others, in a Spotlight report that year.² The current COST study addresses the pass-through income issue but is still easily misinterpreted.

What the COST study does *not* say

- The study does not say what a typical business pays in taxes. The typical business likely pays a higher tax rate, much higher than what the study indicates. Private sector GSP includes nonprofit businesses that pay no income or sales tax (e.g., universities, hospitals, and the state's largest health

200 W. Morgan, #200
Raleigh, NC 27601
phone: 919-828-3876
fax: 919-821-5117
www.johnlocke.org

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insurance company), and businesses such as Goodyear and Google that receive partial tax exemption.

- The study does not say, as many politicians over the years have suggested, anything about whether North Carolina “offers an attractive business climate.”
- The study does not say anything about the competitiveness of North Carolina’s tax system.
- The study does not say, as one legislator wrote in 2007: “North Carolina ties three other states with state and local taxes making up the *lowest* percentage of their GSP” (emphasis in the original).

What the COST study *does* say

- States can tax their citizens directly through the individual income tax or sales tax, or indirectly through taxes on businesses. North Carolina state and local governments collect \$31.8 billion in taxes, 62 percent of that from non-business sources. North Carolina’s reliance on individual taxation results in a lower effective tax rate on businesses.

Conclusions

Unlike the E&Y/COST study, the Tax Foundation’s State Business Tax Climate Index (SBTCI) is specifically designed to measure the competitiveness of a state’s business tax structure. According to the FY2010 study, North Carolina had the 39th best business tax climate.³

Joseph Coletti is Director of Health and Fiscal Policy Studies at the John Locke Foundation.

End Notes

1. Council on State Taxation, FY2009 Business Tax Study, <http://www.cost.org/Page.aspx?id=69654>.
2. Roy Cordato, “The Tax Study That Isn’t: NC taxes are *not* among friendliest to business,” John Locke Foundation *Spotlight* No. 240, February 20, 2004, <http://www.johnlocke.org/spotlights/2004022082.html>.
3. Tax Foundation, State Business Tax Climate Index, <http://taxfoundation.org/taxdata/topic/90.html>.