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## **The Truth About California's Business Tax Burden**

California's business tax burden is talked about a lot but most of the debate is based on rhetoric as opposed to empirical research. The business community and lawmakers from both parties, particularly the California Republican Party, have made repeated claims that California businesses are heavily overtaxed.

Furthermore, these critics claim that any additional efforts to close business tax loopholes or make the tax system more fair and equitable will cause businesses to flee the state. But a review of the empirical evidence suggest that California is a moderate to low taxed state, when compared with other states.

A classic study developed by Peat and Marwick also helps put California's state tax burden into perspective. The study found that state and local tax costs are generally less than 2% of the cost of doing business, and are often close to 1%. Thus, state and local taxes are a very minor consideration compared to virtually all other costs of doing business.

Furthermore, the value of tax breaks or differences in tax burden will about to a fraction of that amount, on the order of 0.2% (2 tenths of 1 percent) of the cost of doing business. These findings were confirmed in a study by the New York State Tax Commission.

The truth is that businesses consider a wide variety of factors when considering where to locate including proximity to markets, availability of labor, quality of schools, hospitals, transportation networks and other infrastructure, energy costs, workers' compensation costs and other costs of doing business.

But renewed calls from legislators and the business community for additional business tax incentives shows that the debate over California's business tax burden is still as heated as ever.

This paper seeks to provide a comprehensive review of studies done since the year 2000 which compare California's business tax burden with other states.

### **A Review of the Literature**

There have been several studies in recent years that compare local and state business tax burdens on a state by state basis. Studies were only examined that were released since the year 2000.

The most comprehensive of these studies were prepared by Ernst and Young for the Council on State Taxation (COST) in 2003 and 2008.

COST is a nonprofit trade association based in Washington, DC that was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce. Today it has an independent membership of more than 600 major corporations engaged in interstate and international business.

The 2003 study, titled “Total State and Local Business Taxes: A 50-State Study of Taxes Paid By Business in Fiscal 2003,” found that California’s total tax burden on business ranks average or below average when compared to the 50 other state for four measures of state and local business taxes in fiscal 2003.

**Measure of California Business Tax Burden  
Among 50 States (2003 COST Study)**

**California’s Rank**

|  |                   |
|--|-------------------|
| Business Share of All State and Local Taxes    | 32 <sup>nd</sup>  |
| Per Dollar of Private-Sector Economic Activity | 39 <sup>th</sup>  |
| Per Dollar of Capital Income                   | 42 <sup>nd</sup>  |
| Per Employee                                   | 15 <sup>th*</sup> |

*\*California tends to rank higher in tax per burden per employee because the state has one of the highest rates of productivity per employee when compared with other states.*

*Source: Prepared by Ernst & Young LLP for the Council on State Taxation (COST), which is an advisory committee to the Council of State Chambers of Commerce.*

The study includes property taxes, sales and excise taxes paid by business on their business purchases, gross receipts taxes (i.e. insurance companies), corporate income and franchise taxes, license taxes, and unemployment and workers’ compensation payroll taxes.

For the 2003 fiscal year, the study found that the national average for business taxes paid as a percentage of total local and state taxes was 42.6%.

California’s business tax burden was found to be 40% of all local and state taxes—2.6 percentage points below the national average. As the above chart indicates, the state ranked 32<sup>nd</sup> (with 1<sup>st</sup> representing the highest business tax burden and 50<sup>th</sup> representing the lowest business tax burden) in business share of taxes as a percentage of all state and local taxes.

Alaska ranked 1<sup>st</sup> with business share of taxes representing 77% of all state and local taxes. Maryland ranked 50<sup>th</sup> with business taxes representing 32% of all taxes.

California state ranked 39<sup>th</sup> in business taxes as a percentage of private-sector economic activity and 42<sup>nd</sup> in business taxes per dollar of capital income used in the state (i.e. plant, equipment, land, inventory, etc.). Business taxes in California were found to represent 4.4% of all private sector economic activity.

Alaska ranked 1<sup>st</sup> in terms of business taxes as a percentage of private sector economic activity (8.0%) and Oregon ranked 50<sup>th</sup> (3.4%).

When compared with neighboring states including Arizona, Idaho, Nevada, New Mexico, Oregon and Washington, California was found to have the lowest tax burden of every state per dollar of

private-sector economic activity except for Oregon, which received the lowest ranking of all 50 states (see chart on next page).

**2003 California Tax Burden Compared With Neighboring States**

| State      | Business Tax Burden as a % Of Economic Activity | Rank             |
|------------|---|------------------|
| Washington | 6.3%  | 7 <sup>th</sup>  |
| New Mexico | 5.9%  | 14 <sup>th</sup> |
| Arizona    | 5.3%  | 19 <sup>th</sup> |
| Nevada     | 4.7%  | 29 <sup>th</sup> |
| Idaho      | 4.6%  | 36 <sup>th</sup> |
| California | 4.4%  | 39 <sup>th</sup> |
| Oregon     | 3.4%  | 50 <sup>th</sup> |

*Source: Prepared by Ernst & Young LLP for the Council on State Taxation (COST), which is an advisory committee to the Council of State Chambers of Commerce.*

The 2007 COST study, titled “Total State and Local Business Taxes: 50-State Estimates for Fiscal Year 2007,” found similar results.

The 2007 study did not compute the business tax burden per dollar of capital income or per employee as the 2003 study did but did make calculations for the business tax burden as a share of total local and state taxes and as a percentage of private-sector economic activity.

For the 2007 fiscal year, the COST study found that the national average for business share of the local and state tax burden was 44.1%, which equated to an average of 5.0% of state private sector economic activity.

California was found to be slightly above the national average with California businesses paying 41.4% of all local and state taxes—three tenths of a percent above the national average. California’s business tax burden represented 4.7% of private sector economic activity—three tenths of a percent below the national average.

California ranked 35<sup>th</sup> highest in terms of its total business tax burden as a percentage of total local and state taxes (with 1<sup>st</sup> representing the highest business tax burden and 50<sup>th</sup> representing the lowest business tax burden). Alaska ranked 1<sup>st</sup> (80.8%) and Maryland ranked 51<sup>th</sup> (32.2%) for total business tax burden as a percentage of all state taxes (the District of Columbia was included in the 2007 COST study).

California ranked 32<sup>nd</sup> highest in terms of its business tax burden as a percentage of private sector economic activity. Alaska ranked 1<sup>st</sup> (11.6%) and Delaware ranked 51<sup>th</sup> (3.5%) for business tax burden as a percentage of private sector economic activity.

When compared with neighboring state’s including Arizona, Idaho, Nevada, New Mexico, Oregon and Washington, California’s business tax burden was found to be in the middle of the group (see chart on next page).

**2007 California Tax Burden Compared With Neighboring States**

| State      | Business Tax Burden as a % Of Economic Activity | Rank             |
|------------|---|------------------|
| Oregon     | 3.8%  | 49 <sup>th</sup> |
| Idaho      | 4.6%  | 35 <sup>th</sup> |
| California | 4.7%  | 32 <sup>th</sup> |
| Nevada     | 4.9%  | 29 <sup>rd</sup> |
| Arizona    | 5.1%  | 20 <sup>th</sup> |
| Washington | 5.8%  | 15 <sup>th</sup> |
| New Mexico | 6.3%  | 11 <sup>th</sup> |

*Source: Prepared by Ernst & Young LLP for the Council on State Taxation (COST), which is an advisory committee to the Council of State Chambers of Commerce.*

In 2004, Robert Tannenwald, an economist with the Federal Reserve Bank of Boston published a similar study in response to the COST study and other statistics on the business tax burden for the 2000 tax year. The study was published by the National Tax Association.

The study, titled “A (Not So Quick) and (Not Too Dirty) Way To Compare States In Terms of Business Tax Burden,” found that California’s business taxes as a share of total state tax burden was 42%, which ranked the state 33<sup>rd</sup> when compared with the other 50 states and the District of Columbia. Tannenwald found that California business taxes represented 4.6% of personal income, which ranked the state 27<sup>th</sup> highest. Lastly, the study found that California business taxes as a share of corporate profits were found to be 70.8%, which ranked the state 18<sup>th</sup> highest.

The Wisconsin Department of Revenue completed a series of studies comparing tax burdens in 10 industrial states including California. The 2004 study, titled “Corporate Tax Burden Comparison: Paper Industry,” found that California’s total tax burden ranked 9<sup>th</sup> out of the 10 industrial states that were looked at. (see chart on next page)

**Results of Corporate Tax Burden Comparison: Paper Industry (2004)**

| State          | Total State Tax Burden | Rank |
|----------------|------------------------|------|
| Georgia        | \$3.8 million          | 1    |
| North Carolina | \$3.3 million          | 2    |
| Ohio           | \$2.9 million          | 3    |
| Texas          | \$2.9 million          | 4    |
| Wisconsin      | \$2.7 million          | 5    |
| Illinois       | \$2.6 million          | 6    |
| Tennessee      | \$2.6 million          | 7    |
| Minnesota      | \$2.0 million          | 8    |
| California     | \$1.9 million          | 9    |
| Pennsylvania   | \$1.7 million          | 10   |

*Source: Wisconsin Dept. of Revenue*

The study examined the tax burden for a hypothetical paper manufacturing corporation. The study included the corporate income, franchise, property and sales taxes.

The states included in the comparison are California, Georgia, Illinois, Minnesota, North Carolina, Ohio, Pennsylvania, Tennessee, Texas and Wisconsin.

A 2005 study, titled “Corporate Tax Burden Comparison: Biotechnology Corporation,” used a similar methodology.

The 2005 study included only five states: California, Illinois, Massachusetts, Minnesota and Wisconsin. California was found to rank 5<sup>th</sup> out of all five states that were looked at.

**Results of Corporate Tax Burden Comparison: Biotechnology Corporation (2005)**

| State         | Total State Tax Burden | Rank |
|---------------|------------------------|------|
| Minnesota     | \$1,700,000            | 1    |
| Wisconsin     | \$927,000              | 2    |
| Illinois      | \$876,000              | 3    |
| Massachusetts | \$849,000              | 4    |
| California    | \$774,000              | 5    |

*Source: Wisconsin Dept. of Revenue*

A 2006 study, titled “Corporate Tax Burden Comparison: Plastics Industry,” looked at a hypothetical plastics products manufacturing corporation located in 15 industrial states. California’s tax burden was found to rank 4<sup>th</sup> highest. (see chart below)

**Results of Corporate Tax Burden Comparison: Plastics Industry (2006)**

| State          | Total State Tax Burden | Rank |
|----------------|------------------------|------|
| Indiana        | \$314,000              | 1    |
| New Jersey     | \$279,000              | 2    |
| Pennsylvania   | \$257,000              | 3    |
| California     | \$251,000              | 4    |
| Wisconsin      | \$235,000              | 5    |
| Minnesota      | \$234,374              | 6    |
| Ohio           | \$230,510              | 7    |
| North Carolina | \$216,909              | 8    |
| Texas          | \$200,076              | 9    |
| Georgia        | \$191,253              | 10   |
| Michigan       | \$173,000              | 11   |
| Virginia       | \$171,000              | 12   |
| New York       | \$163,000              | 13   |
| Iowa           | \$143,000              | 14   |
| Illinois       | \$137,000              | 15   |

*Source: Wisconsin Dept. of Revenue*

**Results of Corporate Tax Burden Comparison: Wood Products Industry (2006)**

| State          | Total State Tax Burden | Rank |
|----------------|------------------------|------|
| Indiana        | \$259,000              | 1    |
| Michigan       | \$232,000              | 2    |
| Georgia        | \$200,000              | 3    |
| Ohio           | \$170,000              | 4    |
| Wisconsin      | \$161,000              | 5    |
| Alabama        | \$156,000              | 6    |
| Minnesota      | \$152,000              | 7    |
| Iowa           | \$152,000              | 8    |
| North Carolina | \$150,000              | 9    |
| Washington     | \$143,000              | 10   |
| California     | \$141,200              | 11   |
| Illinois       | \$140,000              | 12   |
| Pennsylvania   | \$133,000              | 13   |
| Oregon         | \$109,000              | 14   |
| Virginia       | \$101,000              | 15   |

*Source: Wisconsin Dept. of Revenue*

Another 2006 study, titled “Corporate Tax Burden Comparison: Wood Products Industry,” did a comparison among 15 industrial states for a hypothetical wood manufacturing plant. (see chart above). The study found that California to rank 12 in terms of overall tax liability on the hypothetical plant.

The last study looked at in this literature review was completed by the Utah State Tax Commission. The study titled, “Western States’ Tax Burdens Fiscal Year 2002-2003,” was published in February of 2004. The study reviewed the business tax burden for the following seven states: Arizona, California, Colorado, Idaho, Oregon, Utah and Washington. It compared total local and state business taxes as a percentage of gross state product. The study found that California’s tax burden ranked 5<sup>th</sup> out of the seven states that were examined.

**Business Tax Burden for Selected Western States, FY 2002-03**

| State             | Business Tax Burden As A % of Gross State Product | Rank     |
|-------------------|---|----------|
| <b>Washington</b> | <b>4.07%</b>                                      | <b>1</b> |
| <b>Utah</b>       | <b>2.58%</b>                                      | <b>2</b> |
| <b>Idaho</b>      | <b>2.55%</b>                                      | <b>3</b> |
| <b>Arizona</b>    | <b>2.52%</b>                                      | <b>4</b> |
| <b>California</b> | <b>2.52%*</b>                                     | <b>5</b> |
| <b>Colorado</b>   | <b>2.51%</b>                                      | <b>6</b> |
| <b>Oregon</b>     | <b>1.78%</b>                                      | <b>7</b> |

*\*This figure is significantly lower than the 4.4% burden found by the COST study because the COST study was more inclusive in the types of taxes that were accounted for.*

*Source: Utah State Tax Commission*

## Conclusion

A comprehensive review of shows that California is in fact a moderately taxed state. A few studies placed California's business tax burden a bit higher than average but a majority of the studies revealed that California's business tax burden is in fact lower than average.

It must be noted that states tax businesses in different ways which means that that certain businesses may be over or under taxed relative to other businesses. State policymakers should carefully examine their business tax burdens to ensure that they do no unfairly discriminate against certain classes of businesses.

This paper did not examine the many studies that set up a business climate index to evaluate a state's competitiveness because experts have noted many problems and biases with these types of studies.

This paper sought to provide policymakers with the truth about California's business tax burden compared to other states.

There has been a lot of rhetoric used in public debate about California businesses being overtaxed. It has been argued that any effort to close tax loopholes or make California tax burden more equitable will cause businesses to migrate to other states. The evidence provided in this paper shows that there are relatively few states with a significantly lower business tax burden than California.

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