Ensuring Funding for Public Pensions:

A Guide to Raising Revenues and Closing Tax Loopholes

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Executive summary

Following a dramatic widening in the gap between their asset valuations and their funding obligations in the years around the Great Recession, most state pension plans have emerged in better shape than they were a decade ago. Improved equity market performance along with reforms enacted by pension plan administrators have helped close the funding gap. In addition, state governments have become more conscientious about making their employer pension contributions.

Still, 10 years after the start of economic recovery, many pension plans remain weak, and even some of the stronger ones will face challenges over the next decade. The national economy is expected to slow over the next 10 years, moderating the growth in equity returns and valuations and slowing the growth in income and consumption, which are the primary drivers of state tax revenue. Beyond the slowing economic outlook, state tax structures have revealed trends over the last decade that indicate that state tax revenues are growing more slowly than the overall economy.

This paper focuses on that last point: the relative decline of state tax revenues as a share of economic growth. It finds that part of the relative decline is attributable to a structural decay in the base of consumption taxes over time as a diminishing share of consumer spending goes to items subject to the state sales tax base. Another part of the revenue decline is the result of the shifting to greater state reliance on inelastic consumption taxes and away from elastic income taxes.

The paper concludes with nine guidelines for sustainable tax revenues:

1. Keep what you have.
2. Be very skeptical of tax incentives and special breaks.
3. Reverse previous tax cuts.
4. Increase reliance on personal income tax.
5. Minimize dependence on sales and other consumption taxes.
6. Avoid income-to-sales tax swaps.
7. Be leery of exotic revenue sources.
8. Conduct comprehensive and ongoing reviews of tax expenditures.
9. Sunset all tax breaks.

Introduction

Several recent reports have concluded that, for the nation as a whole, public pensions are in better shape than they have been for the last several years. The reports find that reforms have been made and funding levels have improved, and while several states remain in dire situations, the outlook for the sustainability of pensions has improved. Some of these reports are summarized below.

> Under low or moderate asset return assumptions and in aggregate for the U.S. as a whole, pension debt can be stabilized with relatively moderate fiscal adjustments[1] . . . Our results suggest there is no imminent 'crisis' for most pension plans. . . . Overall, of course, there is significant heterogeneity across plans, with some plans requiring large contribution increases to achieve stability.
>
> Brookings Institute, July 2019

> Since [the] Great Recession, the eight states with the best-funded retirement systems rebounded and were, on average, 95% funded by 2017. Conversely, the 20 states with the lowest-funded pension plans saw the financial position of their systems decline steadily from 76% funded in 2007 to 56% in 2017. [2]
>
> Pew Charitable Foundation, June 2019

> Although states have a history of making adjustments to their workforce retirement programs, changes to public pension plan design and financing have never been more numerous or significant than in the years following the Great Recession. Since 2009, nearly every state passed meaningful reform to one, or more, of its pension plans. However, due to differing plan designs, budgets, and legal frameworks across the country there was no single solution; instead, each state met its challenges with tailored changes specific to its unique circumstances. [3]
>
> National Association of State Retirement Administrators, June 2019

This improved pension situation has occurred over a decade of exceptionally strong economic growth, including having the longest period of uninterrupted growth in output in modern history. The period from 2009 to 2019 saw job growth averaging 190,000 a month, an unemployment rate falling from 10 percent of the workforce to 3.7 percent, and a stock market quadrupling in value. Remarkably, interest rates remained near historic lows throughout the decade, and inflation was nonexistent. However, in all probability, the economic circumstances that drove the decade-long economic expansion and concurrent improvement in the aggregate pension situation are not likely to be repeated.

The most recent 10-year period began as the nation was just emerging from a devastating financial recession. The stock market had experienced a 50 percent decline between October 2007 and March 2009, and a significant part of the price run-up simply reflected a market returning to normal. The Great Recession also left an army of unemployed or underemployed workers willing and available to be employed for relatively low wages. In addition, the early decade was boosted by a $787 billion stimulus package under President Obama and toward its end by a $1.9 trillion tax cut under President Trump.

While the economy of mid-2019 is operating at full capacity, the outlook for the coming decade is for a significant slowdown. Looking beyond the current headline economic issues relating to tariffs, monetary policy, Brexit, and so forth, factors such as an aging population, ever-increasing globalization, and structural inequality serve to weigh down growth. The Congressional Budget Office's outlook for long-term growth in the national economy shows a slowing from an average annual rate of 2.3% over the period from 2010 to 2018 to a more modest 1.7% from 2019 to 2029.[4]

A significant policy measure influencing the anticipated slowdown comprises the recent federal tax cuts and spending measures that were financed via the federal deficit. The tax cuts from the 2017 Tax Cut and Jobs Act added nearly $2 trillion to the federal deficit over the coming decade. The added fiscal burden of those large deficits and the massive increase in the national debt will probably preclude any similar future fiscal measures to stimulate the economy, short of an outright national emergency.*

Finally, at some point during the coming decade, another recession is likely to befall the economy. When that happens, the states' ability to meet their financial commitments, such as public pensions, will depend on those states having sufficient revenues to fulfill these commitments. When tax revenues tighten, as they do in recessions, the competition for general fund dollars will become even more intense, and public pensions will face greater challenges in obtaining the funding to meet any budgetary gaps.

At least partially as a result of the 2008 recession, many states fell behind on post-recession funding commitments, especially for big-ticket items, such as public education. Together, public education and higher education comprise around 60% of a typical state budget. The need for funding for Medicaid and other healthcare spending, such as insurance for state workers, will continue to rise. While it is widely agreed that the national infrastructure is deeply in need of repair, most states have not begun to seriously address those needs.

Meeting future pension plan obligations and commitments to other public services will be much easier if states have an adequate and growing tax revenue structure. The remainder of this report examines some of the drivers behind state tax growth in the past and makes some observations and recommendations for the future.

Slowing Growth In Tax Revenue Collections

From the end of the Great Recession in mid-2009 to the last quarter of 2018, the real (inflation-adjusted) personal income of Americans rose 24%.[5] However, real tax revenues collected by the states were only 13.4 above where they were during the third quarter of 2008, their pre-recession peak. Despite the robust general economy and strong private-sector job growth, state government employment is still 58,000 jobs, or about 1%, below its pre-recession peak in August 2008.[6]

A report by the Pew Charitable Foundation found the following:

Even though total state tax revenue recovered nearly six years ago from its losses in the downturn, many states are still dealing with fallout from the tough choices they had to make to fill budget holes during the recession, including recent strikes by teachers who went years without pay raises, higher tuition at public universities, complaints from local governments living with less state aid, mounting repair bills for public infrastructure, and smaller state workforces. State policymakers also feel pressure to replenish rainy day funds for the next inevitable downturn, even while their budgets are squeezed by higher health care costs and unfunded pension liabilities.[7]

* Federal debt as a share of GDP rose from 52% in June 2009 to 78% in June 2019, a 50% increase.

The Pew report identified 10 ways that states still face the legacy of the Great Recession. After adjusting for inflation:

1. States missed out on at least $283 billion in tax revenue.

2. Nearly half of states are spending less than before the recession.

3. States' funding for higher education is down 13%.

4. States' funding for K-12 education is down in 29 states.

5. States' investment in infrastructure as a percent of GDP is at its lowest level in more than fifty years.

6. States' aid to local governments still down in most states.

7. State governments' workforce (non-education) is 132,000 jobs (-4.5%) below its peak.

8. Nineteen states have smaller reserve funds than they did in 2007. Ten states have less than one week's worth of operating funds.

9. Medicaid spending growth limits states' budget flexibility. Spending rose from 14% in 2007 to 17% in 2016. (Preliminary data indicates that spending increased in 2017 and 2018 as well).

10. State pension funding gap reached new highs.

Pew Charitable Foundation

If this slow growth in state tax revenues reflects an enduring downward shift that will extend beyond this current recovery, that would have very disturbing implications for public pensions and other services that depend on state government resources. Future budgets would be even more constrained than they are currently, and the battles for diminishing tax dollars would be even more challenging.

Understanding the cause of the slowdown should help in planning strategies for the future. For example, it matters whether the cause is organic and stems from trends and developments in the economy or if it is the consequence of deliberate policy decisions. In other words, did the slowdown happen to us, or did we cause it to happen?

Addressing this question, David Sjoquist at the University of Georgia examined the long-term trends in the three major sources of state revenues: individual income taxes, general sales taxes, and corporate income tax.[8] These three broad categories of taxes represent the overwhelming majority of state tax revenues.

The appendix of this report contains four charts from Sjoquist's research showing the long-term trends in state taxes as a percent of personal income over the period from 1972 to 2017. *

Total state taxes. Chart A in the appendix shows the national total for state tax collections since 1972. The data show that, for most of that 45-year period, state revenue collections have claimed an above-average share of personal income. The exceptions were in the years around the 1982 recession, 2001 recession, and 2008 recession. The recessions of 1982 and 2001 were followed by recoveries in tax shares. The 2008 recession, which officially extended from December 2007 to June 2009, was much deeper and lasted much longer and was followed by a brief uptick in 2011 and then a return to below-average income share in the following four years.

Personal income taxes. Chart B in the appendix shows the history of personal income tax, the largest source of state taxes, currently representing 41.9% of total revenues. Personal income tax rose steadily from 1972 to 2001. Then,

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* The other broad categories of tax revenues are license (motor vehicle, operators, business, and occupational license) comprising 6% of the total revenue, other (which includes severance, stock transfer, and estate taxes) at 3% of revenue, and property at 2%. The percentages vary widely by state, with some states having no income taxes, some having no sales taxes, and two, Alaska and Wyoming, having neither.

it dropped sharply, largely in response to 9/11 and the broad economic slowdown that followed. However, instead of returning to a steady upward path seen in the earlier recovery period, the years after the 2001 recession saw an erratic up-and-down pattern that, on average, produced a period of flat growth relative to income.

General sales tax. General sales tax, shown on Chart C of the appendix, paints a much starker picture of the recent past. Except for a three-year downturn associated with the 1981 recession, sales taxes had risen significantly between 1972 and 1994, rising from just over 1.8% of income to almost 2.2%. However, after 1994, sales taxes began a long slide downward and, by 2017, were back down to the level last seen in 1973.

One explanation of the up-then-down shape of the sales tax trend is that, in the earlier years leading up to the peak, many states were increasing sales tax rates. In 1972, the average sales tax rate for the 45 states imposing a sales tax was 3.7%. In 1994, the year of the peak on the sales tax chart, that average rate had risen to 5.16%, a 40% increase. However, from 1995 to 2010, the average rate went up only slightly to 5.56%, and in 2017 to 5.67%, a 10% increase.

These rate changes roughly correlated with the sales tax pattern but do not fully explain it. For one, the increase in the average rate from 1972 to 1994 should have been larger. The increase between 1972 and 1994 was approximately 40%, while the sales tax share of income over that period increased by only 20%. This suggests that the underlying tax base was shrinking even before the tax share started to decline after 1994. The notion that the base is shrinking is further indicated by the decline in sales tax share of income after 1994, a period in which the average tax rate actually increased slightly. [9]

The most likely cause of the shrinkage of the sales tax base is the increasing share of consumer spending that goes to services. The typical state sales tax base is focused on consumer goods and excludes most types of services. The share of consumer spending that went toward services in 1972 was 51.4%. By 2017, the service share had risen to 67.9%. Alternatively, the nonservice share of spending (i.e., the sales tax base) declined from 48.6% in 1972 to 32.2% in 2017, a one-third reduction.

The sales tax base has also been affected by the rapid increase in online sales over the last decade. In 2017, the US Government Accountability Office estimated that, together, state and local governments could gain between $8 billion and $13 billion if states were given authority to require sales tax collection from all remote sellers. This amount is about 2% to 4% of total state and local government general sales and gross receipt tax revenues in 2017.[10] A 2018 Supreme Court decision regarding the South Dakota v. Mayfair case found that states had the right to collect sales tax from out-of-state sellers even if those sellers had no physical presence in the state and ordered large vendors to begin collecting and remitting those taxes. This decision will certainly help slow future decline in the sales tax base but will not halt it.

Corporate income tax. The trends in the corporate income tax are shown in Chart D in the appendix. In addition to state policy changes, state corporate income revenues fluctuate with swings in the state, national, and global economy and with policy developments. That said, the general direction of corporate tax revenue has been downward since 1976, the year of the last major tax overhaul prior to 2007. The corporate tax share of income peaked that year at 6% but has remained just above or below 3% since 2010.

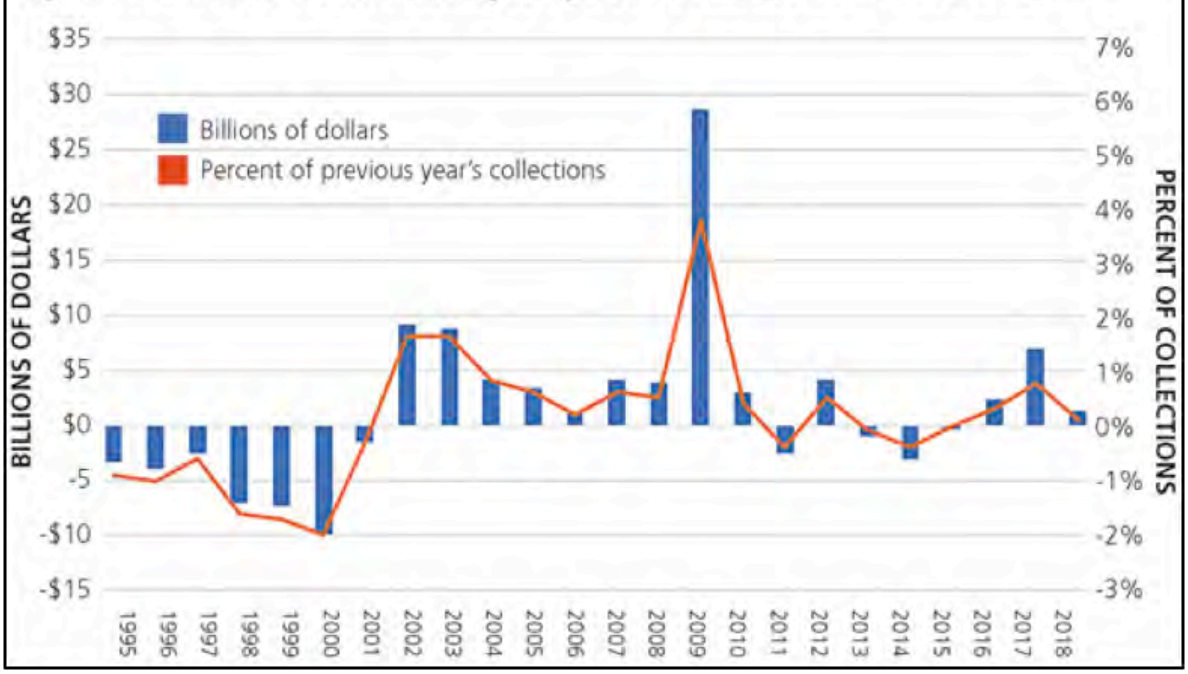
The reasons for the decline are many and vary from state to state. One factor is that most states closely tie their corporate tax base to the federal tax base, and changes in federal taxes are incorporated almost automatically into state tax systems. In addition, corporate tax incentives and other business-related tax breaks have also contributed to the declining corporate tax share. While there appears to be broad popular support for increasing corporate taxes, competition among the states for business locations and jobs makes increasing these taxes extremely difficult.

Legislated Tax Changes

Part of the declining share of state tax revenues as a share of income is attributable to legislated tax changes. These are intentional policy decisions to change tax legislation in ways that increase or decrease revenues. The National Council of State Legislatures (NCSL) compiles each state's estimate of the increase or decrease in revenue over the previous year's collections that are attributable to legislated tax changes. The chart below in Figure 1 shows that states cut taxes each year from 1995 to 2000, a period of strong economic growth with the GDP growth averaging 4.3%. Most of these cuts affected personal income taxes. Then, the nation experienced a recession in 2001, followed by six years in which the GDP growth averaged a weak 2.7%. Over the period from 2001 to 2009, states enacted tax increases, mostly sales taxes. The Great Recession of 2008 and 2009 knocked the bottom out of state revenues, and in 2010, the first year of recovery, there were large increases in numerous taxes and fees. Since then, legislated tax changes have been small, and the enacted changes tended to be sales tax increases.

The slowdown in tax revenue growth relative to the growth in the economy since 2010 is in part due to intentional policy decisions to cut tax rates and to expand the use of tax credits and tax incentives, such as targeted tax breaks intended to attract businesses. The NCSL found that between 2008 and 2015, 14 states reduced personal income tax rates, and cuts were frequently paired with increases in consumption taxes. In addition, 14 states increased sales taxes over the same period.

Fig. 1. 2018 Net State Tax Changes by Year of Enactment, 1995-2018



Source: National Council of State Legislatures, 2018 State Tax Actions, December 2018.

Figure 1. Net Tax Changes by Year of Enactment, 1995-2018.

It is important to note that the tax changes in this chart only reflect the net revenue increase or decrease estimated for the year of enactment and do not reflect the effects of these changes in subsequent years. How these changes might affect tax collections over time is addressed in the next section.

State Tax Elasticities

In addition to legislated cuts in taxes, the other major cause for the slowdown in revenues as a share of personal income is a decline in the elasticities of the various taxes and of the overall state tax system. Elasticities are the year-to-year changes in revenue collections that are not the result of legislated changes in tax rates or bases.

A 2006 study by Donald Bruce, William Fox, and M.H. Tuttle calculated the long-run elasticities of general sales tax and personal income tax, the two major sources of state general revenue.[11] They found that the elasticity of personal income tax was over double the elasticity of the general sales tax (Figure 2).

Southern Economic Journal Long-Run Elasticities of Tax Revenue US Average	
Personal Income	1.83
General Sales	0.81

Figure 2. US average long-run elasticities of tax revenue estimated in 2006.

A 2008 study by Alison Felix of the Federal Reserve Bank of Kansas City found similar results for general sales taxes and personal income taxes in an analysis that also included selective sales taxes and corporate income taxes.[12] This study found that corporate income taxes grew at a rate of 0.53, only about half as fast as the growth in the economy (Figure 3). Selective sales tax grew much slower still, at 0.23.

Federal Reserve Bank of Kansas City Long-Run Elasticities of Tax Revenue US Average	
Personal Income	2.03
General Sales	0.92
Corporate Income	0.53
Selective Sales	0.23

Figure 3. US average long-run elasticities of tax revenue estimated in 2008.

Finally, a 2009 report by the Kansas Division of the Budget showed even lower elasticities.[13] In particular, the sales tax elasticity was only 0.2, and the selective sales elasticity was 0.1, barely growing at all (Figure 4). The total general fund taxes had an elasticity of 0.9, meaning that each year revenues will grow slower than the economy.

Kansas Tax Shares and Elasticities General Fund Average, 2003-2009	Elasticity	Share
TOTAL GENERAL FUND TAXES	0.9	100%
Personal Income Tax	1.6	40%
Sales Tax	0.2	39%
Selective Sales	0.1	12%
Corporate Income Tax *(1998-2009)*	0.4	5%
License Taxes *(No estimate)*	--	4%

Figure 4. General fund average for Kansas tax shares and elasticities, estimated in 2010.

Each of these studies found personal income tax to be the only major tax with an elasticity greater than 1.0, while all other taxes grew more slowly than the growth in income. Having a larger share of personal income taxes in a state basket of taxes leads to a rising share of total taxes to income and having a larger share of sales or other taxes leads to a lower share of tax growth to income.

An analysis by the National Education Association of each state's revenue growth relative to income for the years 2008 and 2009 found that only 11 states had an overall general fund tax elasticity of 1.0 or higher. * Of those 11 states, seven were states that received a large share of their total revenue from energy severance taxes and whose revenues were supported by the then-booming energy market. For example, in order, the first, second, and third states were Alaska, North Dakota, and Wyoming. All are states with small populations and very large and then-growing energy sectors.

At the other end of the elasticity scale, the five states with the lowest elasticity (elasticities below 0.82) were states with no personal income tax. Other than Alaska and Wyoming, which receive around 80% and 50%, respectively, of their taxes directly from energy production taxes, no other states with no personal income taxes were in the top 32 states ranked by elasticity. The average tax elasticity for the five states with no personal income tax was 0.78.

The chart below, figure 5, uses elasticities of 1.8 for personal income, 0.8 for general sales tax, and 0.2 for other taxes to illustrate the implications for a hypothetical state's total general fund elasticity under different distributions of tax shares. In the first instance, personal income taxes and general sales taxes are both assumed to comprise 40% of total taxes, and other taxes are 20%. Next, the personal income share is lowered to 20% and general sales taxes raised to 60%, with other taxes unchanged. Finally, the personal income tax share is set to zero, general sales taxes to 80%, and again no change in other taxes.

Under these assumed tax-share distributions and elasticities, a state relying on 40% each of personal income and general sales taxes and 20% of other taxes would have a total general fund elasticity of 1.14. If the income tax share is 20% and the sales tax share is 60%, the total general fund would have an elasticity of 0.94. Finally, zero reliance on personal income tax and 80% reliance on sales taxes would result in a total general fund elasticity of 0.74. Interestingly,

How the composition of taxes effects General Fund elasticity

Tax Shares:	40%, 40%, 20%			20%, 60%, 20%			0%, 80%, 20%		
	a	b	a x b	a	b	a x b	a	b	a x b
	Tax Share	Tax Elasticity	General Fund	Tax Share	Tax Elasticity	General Fund	Tax Share	Tax Elasticity	General Fund
Personal Income	40%	1.8	0.72	20%	1.8	0.36	0%	1.8	0.00
General Sales	40%	0.8	0.32	60%	0.8	0.48	80%	0.8	0.64
Other	20%	0.5	0.10	20%	0.5	0.10	20%	0.5	0.10
TOTAL ELASTICITY			**1.14**			**0.94**			**0.74**

Figure 5. How the composition of taxes effects general fund elasticity.

* Author's analysis of data from the National Association of State Budget Officers.

this hypothetical finding of an elasticity of 0.74 in the zero personal income tax scenario is remarkably close to the finding of 0.78 for the five states with no income tax in the previously mentioned analysis.*

These findings on elasticity and this illustration show that the decades-long shift by states away from income-based taxes and toward consumption taxes is a major contributor to the revenue growth slowdown. This decline has dire implications for state pensions, both directly and indirectly. In the most direct sense, it means there is simply less money to support public needs, such as pensions.

Some guidelines for sustainable tax revenues

1. **Keep what you have.** A simple starting point in protecting future tax revenues is to keep those revenue sources currently in place. Avoid tax cuts and other legislative actions that reduce tax revenues.

   The revenues from the current tax structure should represent a floor for future revenues. Cuts in taxes lower the revenue floor, and cuts in elastic taxes, namely individual income tax, reduce the year-to-year growth rate of the overall tax system.

2. **Be very skeptical of tax incentives and special breaks.** This especially includes tax cuts and tax incentives that are often offered in the name of attracting businesses and jobs. Numerous experts say such cuts do not work as advertised. **

3. **Reverse previous tax cuts.** Major tax increases are never easy, but the easiest tax to raise is probably one that was recently cut. The voters are already familiar with the tax, and unless it was extremely unpopular, they will recall that the world did not collapse when the tax was in effect. For example, in 2017, legislators in Kansas handily reversed Governor Brownback's disastrous tax cuts of five years earlier. It does not always work (see New Jersey's experience in 2019) but probably has better odds than typical "new tax" alternatives.

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* There are nine states with no income tax. The five low-elasticity states are Washington, Tennessee, Nevada, New Hampshire, and South Dakota. Two others, Alaska and Wyoming, are technically high elasticity, but obtain most of their revenue from energy taxes. The remaining two are Florida and Nevada, both of which benefit extensively from tourism-related revenue.

** For example, Therese McGuire stated, "Those who argue for business-friendly tax cuts usually leave out a crucial part of the fiscal equation: cutting taxes means less revenue to spend on public investment. There is plenty of evidence that investment drives growth in local economies." McGuire concluded, "Every company wants educated workers, a well-functioning transportation system, dependable utilities, and so on. Cities and states that invest in themselves are attractive places to do business."18

In addition, William Gale, Kim Ruben, and Aaron Krupkin, writing in the National Tax Journal, stated: "We show that marginal tax rates generally have no impact on employment and statistically significant but economically small effects on the rate of firm formation."19

The Upjohn Institute for Employment Research conducted a major study of economic development incentives and found that the typical public costs and benefits of business tax incentives are "almost the same size." "However, of the jobs created, only a modest proportion involves the employment of local residents." In addition, the costs of incentives may lead state and local governments to neglect public services, which can have large economic costs and reduce residents' future wages.

Finally, in a 2019 survey of recent economic literature on state fiscal policy published in the Journal of Economic Surveys, Dan Rickman and Hongbo Wang concluded that "state and local tax fiscal policy is not predictably a major driver of economic growth in the U.S., particularly in more recent decades. There does not appear to be any economic benefit from deviating greatly from other states in the structure of state and local fiscal policy."20

4. **Increase personal income tax.** Personal income tax, alone among all the major taxes, has the capability to grow at least as fast as the growth in the income of state residents. In terms of fairness, it is the only tax that imposes at least as large a burden on millionaires as on schoolteachers, firefighters, and social workers.
5. **Minimize dependence on sales and other consumption taxes.** Sales taxes are regressive (they fall harder on low-income taxpayers than those with higher incomes), and their revenues tend to diminish over time. To maintain sales tax revenues, states have had to continually raise the nominal sales tax rate. As rates rise to high levels, sales taxes encounter increasingly stronger taxpayer resistance.
6. **Avoid income-to-sales tax swaps.** Numerous states have swapped some portion of their income taxes for sales taxes, and some have proposed a full income-to-sales swap. From a public policy standpoint, this is a foolish tradeoff. It involves giving up revenues from the only major tax that is both progressive and elastic and substituting a tax that is both inelastic and regressive. The inevitable result is a slowdown in total revenue growth. In addition, middle and lower-income residents end up paying an increasing share of revenues. While some politicians might see these results as positive features, for advocates of good government, it is clearly a fatal flaw.
7. **Be leery of exotic revenue sources.** Revenues from sources such as casinos, racetracks, riverboats, sports betting, and cannabis sales are enticing because they appear to be voluntary taxes. However, they come at a cost. For one, they often end up displacing existing revenues. The introduction of an exotic new tax likely makes it harder to raise or otherwise expand existing, more traditional tax sources. After lotteries were first introduced in the 1980s, states encountered much greater resistance to raising traditional taxes. For another, the revenues from these sources tend to fluctuate widely year to year and deteriorate over time as the novelty fades and as competition from other states and other activities increases. In addition, revenue sources such as lotteries, gaming, and cannabis frequently have high administrative costs for advertising and promotion, monitoring and enforcement, and so on. They may also have high social costs. For example, states often allocate a significant portion of gaming revenues to treat gambling addiction.
8. **Conduct comprehensive and ongoing reviews of tax expenditures.** Tax expenditures are the budgetary costs of all items that would be taxed were it not for special provisions in the law. While many of these tax expenditures may serve a good public purpose, many others may be outdated, poorly targeted, or otherwise ineffective. Dollars saved from eliminating needless tax expenditures are just as spendable as dollars raised from new taxes.
9. **Sunset all tax breaks.** Require that all tax breaks expire after some set period, preferably a fairly short period. Renewal of the tax break would then require affirmative legislative action. Applicants would have to demonstrate success in achieving carefully predetermined and clearly measurable performance measures.

Following these suggested guidelines will not guarantee flourishing state revenues and adequate funding for pensions or other public services. Rather, they are good stewardship measures that will make state tax systems stronger, more resilient, and fairer for both current and future taxpayers. In practice, they would be a significant step toward improving the fiscal health of states and enhancing their capacity to provide adequate levels of public services.

II. Public Pensions Deserve More: A Toolkit for Challenging Corporate Loopholes and Subsidies

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Introduction

This toolkit for pension advocates is intended to create an environment in which tough fiscal times compel states to close tax loopholes and end irresponsible corporate subsidies first before cutting back on state services or cutting retirement. As a matter of good tax policy, states should end loopholes and subsidies first to provide fair, stable, and adequate funding for the public services their citizens need. With the tools provided here, pension advocates can gather elusive tax and subsidy information, evaluate their state's positions on subsidies and loopholes, create community awareness, and finally develop policy initiatives to end loopholes and subsidies.

The toolkit contains:

- an introduction to tax loophole and subsidy concepts,
- instruments to gather initial tax data to use in public campaigns,
- state-specific information on loopholes and additional revenue measures,
- meaningful and specific reforms to close loopholes and end subsidies, and
- a training deck of slides to deliver the message to employee and community groups.

Don't worry – you are not alone

- Have you ever asked yourself why budgets are being cut and why retirement is under attack, when learning that many of our largest corporations are paying less in taxes than you and your family pay?
- Have you wondered why we don't close the loopholes that allow corporations to pay very little or nothing at all in taxes before cutting pensions for many of our most dedicated public servants?
- If you have asked yourself these questions, you are not alone: Recent polling data show that two-thirds of voters believe that states should close tax loopholes first before considering any cuts in public services.
- Corporate tax loopholes allow corporations to avoid their responsibility of paying their fair share of taxes, even though they count on the very things that those tax dollars pay for in order to do business in a state: roads and bridges for transportation, law enforcement systems for security of both real and intellectual property, and schools to provide the skilled and creative employees they seek.
- How is it that General Electric paid no federal income taxes in 2010, despite earning profits in the United States of over $5 billion? The answer is tax loopholes. Loopholes exist at the federal and state level. We must focus our efforts on the state and local loopholes and subsidies because public pensions are paid for in large part by those state and local tax dollars.

What is a tax loophole?

Tax loopholes are provisions in the tax law or the lack thereof that allow corporations to avoid taxes. Loopholes, by definition, are not intended to provide lower taxes or no taxes; instead, an unintended or unexpected use of the tax law by corporations to avoid taxes makes them a loophole. More plainly, corporations may be following the letter of the law when they avoid taxes with loopholes, but they are not following the spirit of the law that makes it their responsibility to pay their fair share. Most people believe that corporations should pay their fair share because they are doing business in a given jurisdiction and using public services like police, fire, roads, and schools. For example, General Electric paid no taxes from 2008 to 2015, despite large US profits.[1] How could that be? The answer is a tax loophole.

General Electric works all over the world, and under the law, its profits are not taxed as long as GE says that they are reinvested abroad. GE is just one of a number of major corporate tax avoiders. Five companies – AT&T, Wells Fargo, J.P. Morgan Chase, Verizon, and IBM – enjoyed more than $130 billion in tax breaks during the same eight-year period. [2] A 2008 study by the Government Accountability Office shows that two out of three US corporations paid no federal income taxes in the last decade or so. [3]

How many types of tax loopholes are there?

Tax loopholes generally fall into four categories:

1. Federal loopholes that allow US multinational corporations to use the law to avoid paying taxes. These include perpetual deferral of profits in tax havens and transfer pricing.
2. Federal tax expenditures and subsidies to corporations. These include subsidies to specific industries, such as oil and gas and drug companies.
3. State tax loopholes that allow multistate and multinational companies to avoid tax responsibility. These include lack of combined reporting, passive investment companies, "nowhere income," and others discussed below.
4. State and local tax subsidies given in the name of so-called economic development. Years of lax corporate accountability and disclosure have resulted in little information on how much revenue is lost due to these tax loopholes, tax subsidies, and tax expenditures. Although information is hard to come by, The New York Times estimated in 2012 that state and local governments were granting more than $80 billion in direct subsidies every year. [4]

Which loopholes or subsidies are most important for pension advocates?

Because the majority of funding for public pensions comes from state and local sources, the most important loopholes and subsidies are the ones granted at the state and local level. Even if the total amount of revenue raised by closing a loophole is not significant, the closing of loopholes has political value. Polling data show that two-thirds of voters believe that we should close tax loopholes first to properly fund public services.

Are there any success stories? Yes. Efforts to close tax loopholes began in early 2000 in Alabama by asking a few questions about revenue from the state department of revenue. One question was "How many of the 150 largest companies in Alabama paid no taxes in the last three years?" The finding was astonishing. About 50% of the largest for-profit companies in Alabama had paid zero taxes. This allowed policy advocates to build momentum to close certain tax loopholes, the same loopholes these companies were using to avoid paying their fair share.

Similar questions were used in Mississippi and Louisiana to gather the same data. The findings were even more astonishing. In all, 103 of the 130 largest corporations in Mississippi had paid zero taxes in the last three years. In Louisiana, 99 companies out of 150 paid nothing.

The media coverage, engagement of members and communities, and reaction from key legislators were very encouraging. Mississippi immediately hired two additional auditors and assessed corporations for back taxes. In Louisiana, there is a new process to evaluate subsidies that gives local governments more input in the awards. As a result, a number of local jurisdictions denied subsidies when they came up for renewal, and there have been several local campaigns to end subsidies to Louisiana's old friend, the oil and gas industry.

Who's not paying? How do you find out?

In every state, there are restrictions on the disclosure of individual taxpayer information, including a taxpayer's returns or any information on those returns. Sometimes these laws impose criminal liability on employees of the respective taxing authorities for any disclosure. This makes most tax authorities very careful when evaluating information requests and prevents direct access to tax returns for even research purposes. However, there is a way to know who is not paying. Most states allow exceptions for disclosure of statistical information that is not linked to individual taxpayers. Below is a list of six simple questions that can be asked of the revenue department in any state. These questions have been carefully drafted to request appropriate information that is not barred by anti-disclosure laws. It may also be a good idea to have a friendly legislator or statewide elected official to formally request this information by asking them to submit the questions on their official letterhead. This has produced faster and more complete responses from some states. See the questions below.

Sample Questions: Letter to obtain statistical information on state corporate income tax from your state revenue department or fiscal officer

Dear Revenue Department:

As a means of gaining statistical information on our state's system of taxation and on the tax obligation of corporations that do business in [Name of STATE], could you answer the following five questions?

1. As measured by payroll withholding, of our state's 150 largest for-profit employers, how many paid zero state corporate income tax in the four most recent tax years for which you have complete data?
2. For C corporations that reported over $50 million in total income to the IRS, how many paid zero state corporate income tax for the four most recent tax years for which you have complete data? Please provide the same information for companies that reported over $100 million, over $250 million, and over $1 billion to the IRS. (For each income category and for each year, could you provide the actual number of companies in the income category and the actual number of companies that paid zero? Could you also provide the total dollar amount of income reported in each category for each year, on which no income tax was paid? For example, in 2016, of the 500 companies making over $250 million, 40% or 200 companies paid no state income tax. In 2016, those same 200 companies made more than $60 billion in total income and did not pay state corporate income tax.)
3. Of all corporations (C-Corps or LLCs taxed as corporations) doing business in [STATE], what percentage paid no state corporate income tax for the four most recent tax years for which you have complete data? For example, in 2015, out of the 35,000 corporations doing business in the state, 17,000 companies paid zero state income tax.
4. Of all the corporations (C-Corps or LLCs taxed as corporations) doing business in [STATE] that reported income to the IRS, what percentage paid no state corporate income tax for the four most recent tax years for which you have complete data?
5. What percentage of total state income taxes was contributed by C Corporations and LLCs taxed as corporations for the four most recent tax years for which you have complete data?
6. Are there any direct causes, other than the economy, that have caused a drop in corporate income tax in this state? In other words, do corporate loopholes or any changes in the taxing statutes exist that may have reduced corporate income tax collections? Has total corporate income declined in a relative sense to cause a decline in corporate income tax collections?

If you or your staff has any questions regarding this request, please do not hesitate to contact me.

Sincerely,

If your state does not seem likely to respond to these requests, inform them that other states have regularly responded to these exact requests. See Appendix C for actual responses from Alabama, Mississippi, and Louisiana. While states are allowed to give statistical information to researchers and the public regarding general tax matters and revenue trends, they cannot disclose the corporate identities that accompany those statistics.

You may be wondering how to identify the companies paying zero. The Institute of Taxation and Economic Policy (ITEP) has done excellent work to identify companies that continue to pay no taxes year after year. In a recent report, ITEP found that 100 of the 258 evaluated companies (39% of them) paid zero or less in federal income taxes in at least one year from 2008 to 2015. [5]In a joint report with the Center for Tax Justice, ITEP also identified 68 corporations that paid no state taxes to any state in at least one year from 2008 to 2010. [6] Some of these tax dodgers include General Electric, Dupont, International Paper, Corning, Boeing, Comcast, ConAgra Foods, American Express, and Campbell Soup. With the tax data from the state and a list of these names, pension advocates can prove that loopholes are affecting pension funding, and they can also point to some of the wealthiest corporations in the world as culprits. This makes a powerful policy argument and puts policy makers on notice that pensions are a priority and that they deserve more.

Three common loopholes to close

Many states have not closed the three most common loopholes. When working through this toolkit, you may want to start with the following:

1. The throwback rule

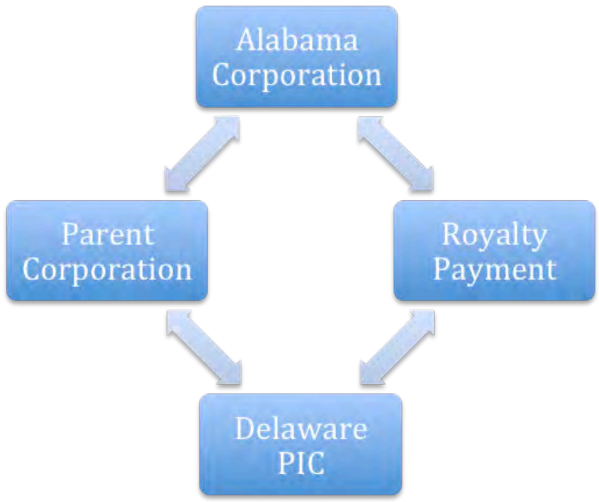
Some companies cannot be taxed in every state because the level of business they are conducting in that state does not rise to the level that can be taxed. As a result, those companies sometimes assign income to the states under the threshold, thus creating "nowhere" income. In other words, this income cannot be taxed by any state because it was reportedly earned in a state that has no taxing authority over that company. Enacting the "throwback rule" ensures that profits earned in a state in which a corporation may not be subjected to an income tax are taxed instead by its home state.

2. The passive investment companies loophole

Many major corporations have implemented a corporate income tax avoidance strategy that is based on transferring ownership of the corporation's trademarks and patents to a subsidiary corporation located in a state that does not tax royalties, interest, or similar types of intangible income. They call these related companies passive investment companies (PICs), and these companies can escape taxation by making payments to themselves. For example, the state corporation makes a royalty payment to the Delaware PIC, and, because there is no income tax in Delaware, that payment escapes tax. The Delaware PIC then makes a payment back to the parent company and finally all the way back to the state corporation. These payments are for the sole purpose of avoiding tax, and all of these payments escape taxes through the PIC loophole.

3. Expanding the definition of business income

The definition of "business income" has provided aggressive corporations with an enormous loophole they have used to deny many states their fair share of tax on billions of dollars' worth of corporate profits. Business income is traditionally defined as income that is generated from a company's core business and is generally taxed where it is earned. This definition excludes mergers and acquisitions and sales of divisions, equipment, and so forth. As one might imagine, an enormous amount of income is generated by these activities. This income is defined as nonbusiness income and is generally taxed where a business is located or in its headquarters' state. This definition becomes a



loophole because most businesses are located in nontax states, like Delaware, or even overseas, making their nonbusiness income tax-free. Expanding the definition of business income to capture certain types of nonbusiness income would close this loophole.

The pinnacle of loophole-closing

There is a comprehensive way to nullify artificial income-shifting strategies used by corporations: mandatory "combined reporting." If a state requires combined reporting, all related corporations that are operated as a single business enterprise, any part of which is being conducted in the state, are essentially treated as one taxpayer for deciding which state receives the tax. If all businesses are included in one enterprise, then all the income is subject to tax in a state, rather than escaping the tax through income shifting to related companies in nontax states.

Does my state have these loopholes?

See Appendix A for a list of these loopholes in each state. For an excellent example of a model of combined reporting legislation, see "Multistate Tax Commission Proposed Model Statute for Combined Reporting," July 29, 2011.

What is economic development?

Economic development occurs when the government actively provides assistance to private enterprise. They intervene in the free market by providing direct payments, infrastructure improvements, tax deductions or credits, and even public relations or marketing campaigns. The rationale for governments placing certain companies at a distinct advantage over others is growing the economy. Therefore, it is referred to as economic development, when it is actually a government subsidy of a certain private industry. Policy makers that support subsidies claim that these payments create jobs that help the community and make the political class popular. Most states have a full infrastructure of economic developers and quasi-governmental development agencies that reach from the top at the state level all the way down to local governments. This infrastructure serves to encourage companies to take large subsidies to locate in that area.

What are subsidies and how do they work?

Corporate subsidies are cash, tax breaks, and in-kind benefits given to companies to offset the costs of opening or expanding a new facility. Subsidies take many forms from reduced tax rates and cash grants to cheap loans, to name a few. Good Jobs First, [7] a research and policy center based in Washington, D.C., identifies some of the most common subsidies as follows.

Tax abatements reduce or eliminate the taxes a company pays to state and/or local governments. Commonly used abatements include property tax abatements, sales tax exemptions, and inventory tax abatements.

Tax credits reduce or eliminate state corporate income taxes by allowing a company to deduct a certain percentage of a specific kind of expense dollar for dollar from what it would normally owe. Examples include credits for spending on research and development and new equipment and for employing hard-to-hire workers.

Industrial revenue bonds (IRBs) reduce the cost of borrowing money. When local governments issue bonds, the interest on the bonds is tax-free. Companies obtain what amounts to a low-interest loan.

Infrastructure assistance lessens the price of construction by shifting the cost of improvements or expansion of roads, sewers, water lines, and other utilities to local governments. Improvements may be made on the project site (e.g., bulldozing existing structures or preparing land) or off-site (e.g., adding a stoplight to reroute traffic or rebuilding a bridge to accommodate heavy trucks).

Grants are subsidies given as cash to companies. Usually, grants must be used for a specific purpose, such as worker training. Some states and cities award grants for general use.

Land-price write-downs reduce the cost of purchasing land. A development authority (the quasi-governmental arm of state or local development departments) typically buys the land and then transfers it to a private developer for a price below the authority's acquisition cost. The local government may also pick up the tab for the exercise of eminent domain, demolition and clearance, or environmental cleanup.

Tax-increment financing uses the property tax collected on the increased property value of a new development (and in some places, the newly generated sales tax) to pay for infrastructure, land acquisition, or other costs of the development.

Enterprise zones (a.k.a. empowerment zones or by state-specific names, such as Michigan's Renaissance Zones or New York's Empire Zones) are geographically designated, economically depressed areas in which companies can obtain multiple subsidies (usually property tax abatements, inventory tax exemptions, and various corporate income tax breaks, including employment tax credits).

How are subsidies awarded?

More often than not, subsidies are awarded without adequate transparency and sometimes without any transparency. Almost without fail, a subsidy deal comes with a public relations campaign and a political announcement. Residents rarely have much input into the subsidy deal, including the amount of the subsidy or what that company has to do to earn it. Oddly, a government announcement of a large subsidy package is often the first official word the public hears about a development project.

Good Jobs First advises that "without binding, enforceable commitments in these areas, communities too often find they are left out of the benefits a development brings. Companies often cite their good intentions and protest that their word is enough, but reality shows otherwise. There are hundreds of scandals involving subsidy abuse among corporations: companies that pocketed millions in tax abatements and then moved to another state; companies that received subsidies for job creation but created no jobs, or even laid people off." [8]

If subsidies can't be ended, how can companies be held more accountable?

Subsidies create problems for communities in two primary ways. First, when they are not evaluated up front with a cost-benefit analysis, and second, when, after they are awarded, they are not monitored throughout the term for compliance. Some reforms that could be implemented for additional accountability include the following.

Disclosure laws. Transparency is key to accountability. Whether it is by executive order or legislation, states should require reports from companies who have applied or have been granted subsidies. These reports should include public access to information and records, including the names of companies that have applied for subsidies, the amounts of the subsidies, whether these companies are in compliance, and finally, what enforcement actions have been taken to ensure compliance.

Clawback (or recapture) provisions. Every subsidy agreement should stipulate that, if a company does not comply with the terms of its agreement (for instance, creating the promised number of jobs or paying certain wages), it must refund all or a portion of the subsidy it received.

Job quality standards. Every subsidy agreement should require subsidized companies to pay a regional living wage, provide a good benefits package, and comply with any other state-specific or regionally acceptable job standards.

Increasing accountability in the subsidy approval process. Governments should hold mandatory public hearings and require votes on subsidies by elected officials.

Negotiating community benefits agreements. Contracts between developers and community coalitions should lay out a set of tangible benefits that development will create to meet the needs of residents.

How can I research subsidies in my area?

There are some valuable resources available to researchers on the Good Jobs First website (goodjobsfirst.org), including tutorials on subsidies, how to research corporations in general, and most importantly for subsidy research, the Subsidy Tracker. This tool catalogs some key information for each subsidy, such as company name, when awarded, amount of subsidy, and type of subsidy. If you visit the Subsidy Tracker, you will be able to search for particular subsidies by company name, type of subsidy, and state, county, or city. This tool will get you started, but additional follow up will be necessary to find subsidies that are in the process of being granted.

Learning about subsidies before they are officially awarded is not an easy job. It takes time and dedication, but if your state has a policy group that is willing to assist in this project, it has the potential of transforming the way subsidies are awarded in your state. Specific details of a particular subsidy are sometimes hard to come by because, without transparency laws, the state may take the position that the information is not public, at least until the deal is signed. This obviously makes accountability measures difficult to impose.

Additionally, often, no central source for subsidy data exists even within a particular city or state, so researching most deals involves contacting an array of government agencies. Surprisingly, a good initial source for subsidy details is the local or regional newspaper, which sometimes lists the people and companies involved, the subsidies awarded, and the job creation projections. After the local news coverage, the real work begins in contacting government departments and agencies that handle the subsidy negotiations and implementation. If you are able to obtain basic details and can force a public meeting or town hall related to the subsidy, you are on your way. Shining the light on the details is the best weapon against irresponsible subsidies.

What about additional revenue options in my state?

In addition to closing loopholes and ending or limiting subsidies, several revenue measures exist that states can enact to invest in pension stability. These range from technical changes, such as limiting loss reporting for corporations, to direct tax increases, such as raising cigarette and alcohol taxes. Review Appendix B for a complete list of revenue measures available in your state.

Conclusions and takeaways

Funding public pensions in a responsible and adequate way is vital to communities and their citizens. It is also the fulfillment of the promise that states make to their public servants. Many times, policy makers maintain that they would invest in public pensions if only they had more resources. This toolkit gives public pension advocates the means to fight for more investment in public pensions through closing corporate loopholes and ending irresponsible corporate subsidies. This will not be accomplished overnight, but with some dedication and perseverance, pension advocates can persuade policy makers to choose pensions over corporate loopholes and subsidies. This toolkit allows advocates to shift the arguments against funding from "we don't have the resources" to "we are choosing to subsidize wealthy corporations over public servants." The latter is an argument pension advocates can wage and win.

Appendix A

States that Could Raise Revenue by Enacting Throwback Rules, Closing the PIC Loophole, and Broadening the Definition of Business Income

State	Enact Throwback Rule	Nullify PICs	Broaden Business Income Definition
Alabama			x
Alaska			x
Arizona	x		x
Arkansas		x	x
California			x
Colorado			x
Connecticut	x		Possibly
Delaware	x	x	Possibly
Dist. of Columbia		x	x
Florida	x	x	
Georgia	x	x	Possibly
Hawaii			x
Idaho			x
Illinois			x
Indiana		x	x
Iowa	x	x	x
Kansas			x
Kentucky	x	x	x
Louisiana	x	x	x
Maine			Possibly
Maryland	x	x	Possibly
Massachusetts	x		Possibly
Minnesota	x		
Mississippi			x
Missouri		x	x
Montana			x
Nebraska	x		Possibly
New Hampshire			Possibly
New Jersey			x
New Mexico		x	x
New York	x	x	x
North Carolina	x		
North Dakota			x
Ohio	x		x

State	Enact Throwback Rule	Nullify PICs	Broaden Business Income Definition
Oklahoma		x	Possibly
Oregon			x
Pennsylvania	x	x	
Rhode Island	x	x	Possibly
South Carolina	x	x	Possibly
Tennessee	x	x	x
Texas		x	
Utah			x
Vermont		x	Possibly
Virginia	x	x	Possibly
West Virginia		x	x
Wisconsin		x	x

Appendix B

Selected revenue options for states to bring more funding to pensions

1. Raise sales tax on luxury goods and/or income tax rates on high earners
2. Broaden the sales tax base
3. Extend sales tax to Internet downloads
4. Reduce vendor compensation in sales tax
5. Add a new top bracket to income tax
6. Scale back or delay tax expenditures
7. Decouple from the federal domestic production deduction
8. Enact combined reporting
9. Establish a corporate minimum tax of $250 or more
10. Decouple from the cancellation of debt income (CODI) provision of the American Recovery and Reinvestment Act of 2009 (ARRA)
11. Repeal net operating loss carrybacks
12. Establish $250 minimum tax on S corporations and LLCs
13. Restore estate tax
14. Tax tires
15. Tax air emissions
16. Tax soft drinks
17. Raise cigarette tax to the median of all states
18. Raise alcohol taxes
19. Tax the full rental value of hotels booked online
20. Strengthen Internet sales tax laws to increase collections
21. Phase down exemptions/deductions based on income
22. Reduce capital gains preference
23. Eliminate the deduction for federal taxes paid
24. Taxable benefit recapture
25. Require withholding of personal income tax liability of individual owners of pass-through entities
    (S corporations, limited liability companies, general partnerships, and limited partnerships)

Selected Revenue Options For States

State	1. Raise sales/ income tax rate	2. Broaden sales tax base to tax services	3. Extend sales tax to Internet downloads	4. Reduce vendor compensation in sales tax	5. Add new top bracket to personal income tax (* = recent increases)	6. Scale back or delay tax expenditures
Alabama	x	x		x	x	x
Alaska						x
Arizona	x	x		x	x	x
Arkansas	x	x	x	x	x	x
California	x	x	x		x*	x
Colorado	x	x	x	x		x
Connecticut	x	x	x		x*	x
Delaware	x				x	x
District of Columbia	x	x			x	x
Florida	x	x	x	x		x
Georgia	x	x	x	x	x	x
Hawaii	x				x*	x
Idaho	x	x			x	x
Illinois	x	x	x	x		x
Indiana	x	x		x	x	x
Iowa	x	x	x		x	x
Kansas	x	x	x		x	x
Kentucky	x	x		x	x	x
Louisiana	x	x		x	x	x
Maine	x	x			x	x
Maryland	x	x	x	x	x*	x
Mass	x	x	x			x
Michigan	x	x	x	x		x
Minnesota	x	x	x		x	x
Mississippi	x	x		x	x	x
Missouri	x	x	x	x	x	x
Montana	x				x	x
Nebraska	x	x		x	x	x
Nevada	x	x	x	x		x
New Hampshire						x
New Jersey	x	x			x*	x
New Mexico	x				x	x
New York	x	x	x	x	x*	x

Selected Revenue Options For States (continued)

State	1. Raise sales/ income tax rate	2. Broaden sales tax base to tax services	3. Extend sales tax to Internet downloads	4. Reduce vendor compensation in sales tax	5. Add new top bracket to personal income tax (* = recent increases)	6. Scale back or delay tax expenditures
North Carolina	x	x	x		x*	x
North Dakota	x	x	x	x	x	x
Ohio	x	x	x	x	x	x
Oklahoma	x	x	x	x	x	x
Oregon	x				x*	x
Pennsylvania	x	x	x	x		x
Rhode Island	x	x	x		x	x
South Carolina	x	x	x	x	x	x
South Dakota	x					x
Tennessee	x	x				x
Texas	x	x		x		x
Utah	x	x		x	x	x
Vermont	x	x			x	x
Virginia	x	x	x	x	x	x
Washington	x	x				x
West Virginia	x	x			x	x
Wisconsin	x	x		x	x*	x
Wyoming	x	x				x

x = revenue option is available for the state.

Selected Revenue Options For States (continued)

State	7. Decouple from federal domestic production deduction	8. Enact combined reporting	9. Establish a corporate minimum tax of $250 or more	10. Decouple from CODI provision of ARRA	11. Repeal net operating loss carrybacks	12. Establish $250 min. tax on S Corps & LLCs	13. Restore estate tax
Alabama	x	x	X	x		x	
Alaska	x		x	x	x	x	x
Arizona	x		x	x		x	x
Arkansas		x	x	x		x	x
California				x			
Colorado	x		x	x		x	x
Connecticut		x					
Delaware	x	x	x	x	x	x	
District of Columbia			x	x		x	
Florida	x	x	x			x	
Georgia		x	x	x	x	x	x
Hawaii			x	x	x	x	x
Idaho	x		x	x	x	x	x
Illinois	x		x	x		x	
Indiana		x	x		x	x	x
Iowa	x	x	x	x	x	x	x
Kansas	x		x	x		x	x
Kentucky	x	x	x	x		x	x
Louisiana	x	x	x	x	x	x	x
Maine			x	x		x	
Maryland		x	x		x		
Mass				x			
Michigan	x		x	x	x	x	x
Minnesota			x			x	
Mississippi		x	x	x	x	x	x
Missouri	x	x	x	x	x	x	x
Montana	x		x	x	x	x	x
Nebraska	x		x	x		x	x
Nevada						x	
New Hampshire			x	x		x	x
New Jersey	x	x					
New Mexico	x	x	x	x		x	x
New York			x	x	x	x	

Selected Revenue Options For States (continued)

State	7. Decouple from federal domestic production deduction	8. Enact combined reporting	9. Establish a corporate minimum tax of $250 or more	10. Decouple from CODI provision of ARRA	11. Repeal net operating loss carrybacks	12. Establish $250 min. tax on S Corps & LLCs	13. Restore estate tax
North Carolina		x	x	x		x	
North Dakota			x	x		x	x
Ohio			x		x	x	x
Oklahoma	x	x	x	x	x	x	x
Oregon			x	x		x	
Penn	x	x	x	x		x	
Rhode Island	x	x					
South Carolina		x	x	x		x	x
South Dakota			x			x	x
Tennessee		x	x	x		x	x
Texas			x			x	x
Utah	x		x	x	x	x	x
Vermont	x			x			
Virginia	x	x	x	x	x	x	x
Washington			x			x	
West Virginia			x	x	x	x	x
Wisconsin			x	x		x	x
Wyoming			x			x	

x = revenue option is available for the state.

Selected Revenue Options For States (continued)

State	14. Tire disposal tax	15. Tax air emissions	16. Soft drink excise tax	17. Raise alcohol taxes (x = tax collections per capita < median)	18. Raise cigarette tax to US median	19. Tax full rental rate of hotels booked online	20. Strengthen Internet sales tax
Alabama		x	x		x	x	
Alaska	x		x				
Arizona		x	x	x		x	x
Arkansas		x			x	x	
California			x	x	x		
Colorado			x	x	x	x	x
Conn	x	x	x	x		x	
Delaware	x	x	x			x	
District of Columbia	x	x	x	dk	dk	x	x
Florida	x	x	x		x	x	x
Georgia	x	x	x		x	x	x
Hawaii	x	x	x			x	
Idaho		x	x	x	x	x	
Illinois			x	x	x	x	
Indiana		x	x	x	x	x	
Iowa	x	x	x	x		x	
Kansas		x	x		x	x	
Kentucky		x	x		x	x	
Louisiana		x	x	x	x	x	X
Maine			x			x	X
Maryland		x	x	x		x	X
Mass	x	x	x	x		x	X
Michigan	x		x	x		x	x
Minnesota	x	x	x	x		x	
Mississippi		x	x	x	x	x	x
Missouri		x	x	x	x	x	x
Montana	x	x	x			x	
Nebraska		x	x		x	x	x
Nevada		x	x		x		x
New Hampshire	x	x	x	x		x	

Selected Revenue Options For States (continued)

State	14. Tire disposal tax	15. Tax air emissions	16. Soft drink excise tax	17. Raise alcohol taxes (x = tax collections per capita < median)	18. Raise cigarette tax to US median	19. Tax full rental rate of hotels booked online	20. Strengthen Internet sales tax
New Jersey	x		x	x		x	
New Mexico		x	x		x	x	x
New York		x	x	x		x	
North Carolina		x	x		x	x	x
North Dakota	x	x	x	x	x	x	
Ohio			x	x		x	x
Oklahoma			x			x	
Oregon	x	x	x	x		x	
Penn		x	x			x	
Rhode Island		x	x			x	
South Carolina		x	x		x	x	
South Dakota	x		x			x	
Tennessee	x	x			x	x	x
Texas		x	x			x	
Utah		x	x		x	x	
Vermont	x		x			x	
Virginia		x	x		x	x	
Washington		x				x	
West Virginia	x	x		x	x	x	
Wisconsin	x		x	x		x	x
Wyoming	x		x	x	x	x	

x = revenue option is available for the state.

Selected Revenue Options For States (continued)

State	21. Phase down exemptions/ deductions based on income	22. Reduce capital gains preference (* recent change)	23. Eliminate deductions for federal taxes paid	24. Taxable benefit recapture	25. Require PIT withholding by S Corps (S), LLCs, Gen'l partnerships (GP), Ltd part. (LP)
Alabama	partial		x	x	
Alaska					
Arizona	x			x	S, LLC, GP
Arkansas	x	x		x	S
California	x			x	
Colorado					
Connecticut	partial			x	S, LLC
Delaware	x			x	S
District of Columbia	x			x	S, LLC, GP, LP
Florida					
Georgia	x			x	
Hawaii	partial	x		x	LLC, GP, LP
Idaho	partial			x	S, LLC, GP, LP
Illinois	x				S, LLC, GP, LP
Indiana	x				
Iowa	x		x	x	S, LLC, GP, LP
Kansas	x			x	S
Kentucky	x			x	
Louisiana	x		x	x	S, GP, LP
Maine	x			x	LLC, LP
Maryland	x			x	
Massachusetts	x				LLC, GP, LP
Michigan	x				LP
Minnesota				x	S, LLC, GP, LP
Mississippi	x			x	S, LLC, GP, LP
Missouri	partial		partial	x	
Montana	x	x	partial	x	
Nebraska					
Nevada					
New Hampshire					
New Jersey	x			x	S, LLC, GP
New Mexico		x		x	LLC, GP
New York	x				S

Selected Revenue Options For States (continued)

State	21. Phase down exemptions/ deductions based on income	22. Reduce capital gains preference (* recent change)	23. Eliminate deductions for federal taxes paid	24. Taxable benefit recapture	25. Require PIT withholding by S Corps (S), LLCs, Gen'l partnerships (GP), Ltd part. (LP)
North Carolina	x			x	S, LLC, GP, LP
North Dakota		x		x	
Ohio	x			x	
Oklahoma	x			x	S, GP
Oregon	x		partial	x	LLC, GP
Pennsylvania	N/A				
Rhode Island	x			x	LLC, GP, LP
South Carolina		x		x	
South Dakota					
Tennessee					
Texas					
Utah				x	S, LLC, GP, LP
Vermont		x*		x	
Virginia	x			x	LLC
Washington					
West Virginia	x			x	S, LLC, GP, LP
Wisconsin	partial	x*		x	
Wyoming				x	

x = revenue option is available for the state.

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Appendix C

State Responses

The Mississippi Legislature

Joint Committee on Performance Evaluation and Expenditure Review

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The following is an assistance memo prepared by the PEER Committee staff in response to a specific legislative request. It is not a report of the PEER Committee, nor does it represent the individual or collective views of the PEER Committee members. A legislative assistance memo is the PEER staff's best efforts to answer the questions posed within the time frame allowed and with the information sources available. Unless prior approval has been given, this memo will be distributed only to the requesting legislator(s) named below.

TO: Representative Cecil Brown
FROM: Max Arinder MKA
SUBJECT: Mississippi Corporate Income Tax
DATE: January 18, 2011

As you requested, PEER staff sought information on a series of questions regarding corporate income tax rates in Mississippi.

Responses to Specific Questions Regarding Corporate Income Tax Rates

Please note that the Department of Revenue did not provide responses to questions 2 and 4, citing provisions of federal Internal Revenue Code 6103 (d), which allows the use of federal tax information for tax administration purposes only.

1. *As measured by payroll withholding, of our state's 150 largest for-profit employers, how many paid zero state corporate income tax in calendar years 2006, 2007, 2008 and 2009?*

   In 2006, the Department of Revenue only recorded information for the top 130 for-profit employers, but of these 130 employers, ninety-one did not pay state corporate income tax. In 2007, 2008, and 2009, 103 of the 150 largest for-profit employers paid zero state corporate income tax.

2. *Of these 150 companies that reported over $5 million in total income to the Internal Revenue Service (IRS), how many paid zero state corporate income tax for calendar years 2006, 2007, 2008 and 2009? Please provide the same information for companies that reported over $10 million and over $25 million to the IRS. (For each income category and for each year above, please provide the actual number of companies in the income category and the actual number of companies that paid zero state corporate income tax. Also, please provide the total dollar amount of income reported in each category for each year on which no income tax was paid. For example in 2006, of the 500 companies making over $25 million, 40% or 200 companies paid no state income tax. In 2006, those*

1

200 companies made more than $600 million in total income and did not pay state corporate income tax.)

The Mississippi Department of Revenue receives federal tax information under Internal Revenue Code 6103(d), which allows the use of information for tax administration purposes only. The IRC does not permit state tax agencies to furnish federal tax information to other state agencies, tax or non-tax, or to political subdivisions, for any purpose, including tax administration, absent explicit legislative authority. Therefore, the Department of Revenue was unable to provide any information based on amounts reported to the Internal Revenue Service.

3. *Of all corporations doing business in Mississippi, what percentage paid no state corporate income tax for calendar years 2006, 2007, 2008 and 2009?*

   In calendar years 2006, 2007, and 2008, 80% of corporations doing business in Mississippi paid no state corporate income tax. In 2009, 81% of corporations paid zero state income tax.

   Note that of the corporations paying zero state income tax, some corporations may have made no profit and thus owe no tax.

4. *Of all the corporations doing business in Mississippi that reported income to the IRS, what percentage paid no state corporate income tax for calendar years 2006, 2007, 2008 and 2009?*

   Please refer to the answer to number 2 above.

5. *What percentage of total state income taxes was contributed by C Corporations and by limited liability entities (LLEs) for the 2006, 2007, 2008 and 2009 tax years?*

   In 2006, C Corporations contributed 85% of state income taxes, and LLEs contributed 0.37% of state income taxes. In 2007, contributions were 81% and 0.38% respectively. In 2008, contributions were 91% and 0.37%, and in 2009, 79% of state income taxes were paid by C Corporations, and 0.28% were paid by LLEs. The remaining corporate collections were comprised of payments from composite returns filed by S Corporations and some insurance companies.

Additional Information Regarding Corporate Taxes

Corporate income tax revenues may be reduced by a variety of Mississippi programs that offer incentives to companies, allowing them to apply credits to decrease their tax liability. The Jobs Tax Credit, Skills Training Tax Credit, and the Broadband Technology Tax Credit are examples of many programs that allow a business to take a credit of up to 50% of income tax liability in a given year. The Growth and Prosperity Program allows companies that create jobs in counties with high unemployment and poverty rates to have full exemption from all state income taxes.

State corporate income tax rates differ considerably from state to state. Some states, such as Nevada and South Dakota, have a 0% corporate income tax rate, while others such as Iowa and Pennsylvania have 9%+. Mississippi's 3%, 4%, and 5% rates are lower than many other states' rates; Mississippi ranks 13th among all states in an index of FY 2011 corporate tax rates. This ranking means that Mississippi has the 13th most favorable tax system for businesses. Other southern state rankings are as follows: Arkansas— 40th, Alabama— 24th, Louisiana— 19th, Tennessee— 11th, and Georgia— 8th.

Should you need further assistance, please feel free to contact Ted Booth or me at (601) 359-1226.

Louisiana Responses

1. As measured by payroll withholding, of our state's 150 largest for-profit employers, how many paid zero state corporate income tax in the four most recent tax years for which you have complete data?

   For C corporations that reported over $50 million in total income to the IRS, how many paid zero state corporate income tax for the four most recent tax years for which you have complete data? Please provide the same information for companies that reported over $100 million, over $250 million, and over $1 billion to the IRS. (For each income category and for each year, could you provide the actual number of companies in the income category and the actual number of companies that paid zero? Could you also provide the total dollar amount of income reported in each category for each year in which no income tax was paid? For example, in 2015, of the 500 companies making over $250 million, 40% or 200 companies paid no state income tax. In 2015, those same 200 companies made more than $60 billion in total income and did not pay state corporate income tax.)

Top 150 withholding taxpayers

Calendar Year	Number of the 150 top withholding taxpayers with $0 tax after nonrefundable credits	Percentage with $0 tax after nonrefundable credits
2013	101	67.33%
2014	111	74.00%
2015	117	78.00%
2016	102	68.00%

Taxpayers whose LA Income Tax after Nonrefundable Credits is zero by Reported Federal Taxable Income

Gross Revenue of > $50 million to $100 million

Tax Year	Federal Taxable Income as Reported to LDR	Number of Returns	Federal Taxable Income for taxpayers with $0 tax after nonrefundable credits	Number of Returns with $0 tax after nonrefundable credits	Total Income on Which No Tax was Paid
2012	$45,779,068,822	656	$1,553,776,291	21	$248,457,041
2013	$47,127,723,943	676	$1,600,546,903	24	$108,117,245
2014	$52,454,752,261	737	$1,503,607,387	21	$239,463,723
2015	$51,937,610,012	734	$701,417,602	8	$353,778
Summary	**$197,299,155,038**	**2,803**	**$5,359,348,183**	**74**	**$596,391,787**

Gross Revenue of > $100 million to $250 million

Tax Year	Federal Taxable Income as Reported to LDR	Number of Returns	Federal Taxable Income for taxpayers with $0 tax after nonrefundable credits	Number of Returns with $0 tax after nonrefundable credits	Total Income on Which No Tax was Paid
2012	$91,139,134,531	583	$4,365,416,124	27	$91,608,717
2013	$88,376,913,333	559	$3,822,965,008	24	$226,317,829
2014	$89,180,842,968	564	$2,793,262,446	17	$190,410,969
2015	$92,642,627,358	591	$4,908,764,298	451	$1,136,000,325
Summary	**$361,339,518,190**	**2,297**	**$15,890,407,876**	**519**	**$1,644,337,840**

Gross Revenue > $250 million to $1 Billion

Tax Year	Federal Taxable Income as Reported to LDR	Number of Returns	Federal Taxable Income for taxpayers with $0 tax after nonrefundable credits	Number of Returns with $0 tax after nonrefundable credits	Total Income on Which No Tax was Paid
2012	$158,196,257,933	335	$ 10,395,683,267	19	$124,797,691
2013	$175,771,267,775	372	$ 14,195,569,153	28	$371,876,597
2014	$198,765,233,689	425	$ 7,411,578,401	14	$566,511,775
2015	$183,384,055,365	393	$ 4,901,172,129	9	$138,338,062
Summary	**$716,116,814,762**	**1,525**	**$ 36,904,002,950**	**70**	**$1,201,524,125**

Gross Revenue > $1 Billion

Tax Year	Federal Taxable Income as Reported to LDR	Number of Returns	Federal Taxable Income for taxpayers with $0 tax after nonrefundable credits	Number of Returns with $0 tax after nonrefundable credits	Total Income on Which No Tax was Paid
2012	$2,211,356,234,087	1,047	$32,487,360,200	8	$67,553,902
2013	$634,732,157,056	1,061	$37,577,812,592	13	$694,357,077
2014	$732,683,631,408	1,130	$23,766,553,451	8	$415,602,533
2015	$754,646,049,460	1,131	$40,318,737,969	4	-$43,564,908
Summary	**$ 4,333,418,072,011**	**4,369**	**$134,150,464,212**	**33**	**$1,133,948,604**

The Louisiana Department of Revenue (LDR) does not have information pertaining to what was reported to the IRS. Taxpayers were grouped by federal taxable income as reported to LDR by the taxpayer. Whether a company paid state corporation income tax was determined by tax liability after applying nonrefundable credits. Total income on which no tax was paid is the sum of the Louisiana net income before loss adjustments and federal income tax deduction for those corporations whose tax liability is zero after applying refundable credits.

2. Of all corporations (C-Corps or LLCs taxed as corporations) doing business in Louisiana, what percentage paid no state corporate income tax for the four most recent tax years for which you have complete data? For example, in 2015, out of the 35,000 corporations doing business in the state, 17,000 companies paid zero state income tax.

Percentage of Corporations that Pay No Income Tax After Applying Nonrefundable Credits

Tax Year	Number of Returns	Number of Returns with $0 tax after nonrefundable credits	Percentage of Returns with $0 tax after nonrefundable credits
2012	130,684	109,238	83.59%
2013	129,636	107,711	83.09%
2014	127,689	104,479	81.82%
2015	125,539	99,942	79.61%
Summary	**513,548**	**421,370**	

3. Of all the corporations (C-Corps or LLCs taxed as corporations) doing business in Louisiana that reported income to the IRS, what percentage paid no state corporate income tax for the four most recent tax years for which you have complete data?

Percentage of Corporations with Reported Federal Taxable Income that Pay No Income Tax After Applying Nonrefundable Credits

Tax Year	Number of Returns with Reported Federal Taxable Income greater than $0	Number of Returns with $0 tax after nonrefundable credits	Percentage of Returns with $0 tax after nonrefundable credits
2012	66,541	46,844	70.40%
2013	67,759	47,724	70.43%
2014	69,419	48,669	70.11%
2015	67,817	46,657	68.80%
Summary	**271,536**	**189,894**	

4. What percentage of total state income taxes was contributed by C corporations and LLCs taxed as corporations for the four most recent tax years for which you have complete data?

Percentage of Total Tax Paid by Type of Corporate Filer

Document Version	Income Tax After Nonrefundable Credits	Percentage of Total Tax	Type Filer
2012	$432,710,051	80.2204%	Income and Franchise
2012	$621	0.0001%	Franchise Only
2012	$106,370,344	19.7201%	Income Only
2012	$43,762	0.0081%	Other
2012	$276,741	0.0513%	Non Profit
2012-Total	$539,401,519	100.0000%	
2013	$411,563,266	82.5092%	Income and Franchise
2013	$23,627	0.0047%	Franchise Only
2013	$86,308,382	17.3029%	Income Only
2013	$121,485	0.0244%	Other
2013	$792,040	0.1588%	Non Profit
2013-Total	$498,808,800	100.0000%	
2014	$521,062,729	75.8052%	Income and Franchise
2014	$15,481	0.0023%	Franchise Only
2014	$165,561,580	24.0862%	Income Only
2014	$306,932	0.0447%	Other
2014	$423,579	0.0616%	Non Profit
2014-Total	$687,370,301	100.0000%	
2015	$453,388,257	73.0109%	Income and Franchise
2015	$36,263	0.0058%	Franchise Only
2015	$166,807,202	26.8616%	Income Only
2015	$341,048	0.0549%	Other
2015	$414,231	0.0667%	Non Profit
2015-Total	$620,987,001	100.0000%	

Alabama Responses

1. What percentage of total state taxes was contributed by corporations and LLCs for the 2008, 2009, 2010, and 2011 tax years?

Our office does not have data that will allow us to break down certain taxes into amounts paid by individuals and amounts paid by businesses. Examples of taxes for which data is unavailable are property tax, sales tax, and utility tax. Income tax data is available by type of taxpayer, but it is not available by tax years; however, for fiscal years 2008 through 2011, corporations paid, on average, 12.4% of income taxes collected by the state, and individuals paid 87.6%.

FY 2008	individuals 86.7%	corporations 13.3%
FY 2009	individuals 86.1%	corporations 13.9%
FY 2010	individuals 87.4%	corporations 12.6%
FY 2011	individuals 90.1%	corporations 9.9%

2. Of all the corporations doing business in Alabama, what percentage of corporations paid no corporate income tax for tax years 2007, 2008, 2009, and 2010?

The Department provided data on tax years 2007, 2008, and 2009 to our office. No information was available for tax year 2010. For the purposes of this project, we defined "tax year" to mean taxable years beginning on or after December 15th of one year and before December 15th of the following next year.

	2007	2008	2009
Corporations doing business in Alabama	27,202	24,673	36,165
Corporations that paid no income tax to AL	17,683	16,588	25,541
Percentage	65.01%	67.23%	70.62%

3. Of all the corporations doing business in Alabama that reported income to the IRS ("federal government"), what percentage paid no corporate income tax to Alabama for tax years 2007, 2008, 2009, and 2010?

No data is available for 2010. For this question, we determined that taxpayers who had a positive federal taxable income as reported on their Alabama income tax return would be deemed to have "reported income to the IRS."

	2007	2008	2009
Corporations that reported income to IRS	11,973	9,939	13,592
Corporations that paid no income tax to AL	3,111	2,659	3,979
Percentage	25.98%	26.75%	29.27%

4. Of the companies that reported over $5 million in total income, how many companies paid zero corporate income taxes for tax years 2007, 2008, 2009, and 2010? Over $10 million? Over $25 million? (i.e., 500 companies reported $5 million in total income, and 200 or 40% of the companies paid no state income taxes.)

No data is available for tax year 2010. We used federal taxable income as reported on the Alabama return to determine the taxpayers with more than $5 million, $10 million, or $25 million in income. The answer to this question is in the chart below.

	2007	2008	2009
Corporations with over $5 Million Federal Taxable Income	2858	2354	3303
of the companies, how many paid zero to Alabama.	854	726	1125
Percentage	29.88%	30.84%	34.06%
Corporations with over $10 Million Federal Taxable Income	2152	1766	2502
of the companies, how many paid zero to Alabama.	626	533	802
Percentage	29.09%	30.18%	32.05%
Corporations with over $25 Million Federal Taxable Income	1352	1093	1519
of the companies, how many paid zero to Alabama.	380	320	494
Percentage	28.11%	29.28%	32.52%

5. As measured by payroll withholding of Alabama's 150 largest for-profit employers who are subject to the corporate income tax, how many paid zero corporate income tax in tax years 2007, 2008, 2009, and 2010? How many of those companies paying zero corporate income tax reported income in tax years 2007, 2008, 2009, and 2010? How many of those companies paid tax to the IRS ("federal government")?

No data is available for tax year 2010. The answer to this question is in the chart below.

	2007	2008	2009
Corporations subject to tax	150	150	150
Corporations that paid no tax	65	58	83
Percentage	43.33%	38.67%	55.33%
	2007	2008	2009
Corporations that reported income	65	59	83
Corporations that paid no tax	16	23	26
Percentage	24.62%	8.98%	31.33%
	2007	2008	2009
Corporations that paid tax to IRS	65	59	83
Corporations that paid no tax		24	25
Percentage	36.92%	42.37%	13.25%

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