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2010 State Business Tax Climate Index

An Executive Summary

By
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Introduction

The Tax Foundation presents the 2010 version of the State Business Tax Climate Index (SBTCI) as a tool for lawmakers, the media, and individuals alike to gauge how their states tax systems compare. Policymakers can then use the SBTCI to pinpoint changes to their tax systems that will explicitly improve their states' standing in relation to competing states.

How much states collect in taxes is critical, but how they take it is also important. In other words, quite apart from whether a state's total tax burden is higher than in other states, it can enact (and many states do) a set of tax laws that cause great damage to the economy.

The modern market is characterized by mobile capital and labor. Therefore, companies will locate where they have the greatest competitive advantage. States with the best tax systems will have an advantage in attracting new businesses and generating economic and employment growth.

Although the market is now global, the Department of Labor reports that most mass job relocations are from one U.S. state to another rather than to an overseas location.[1] This means that state lawmakers must be aware of how their states' business climates stack up to others in their region and nationwide.

State lawmakers are always tempted to lure business with lucrative tax incentives and subsidies. This can be a dangerous proposition, as a case in Florida illustrates. In July of 2004 Florida lawmakers cried foul because a major credit card company announced it would close its Tampa call center, lay off 1,110 workers, and outsource those jobs to another company. The reason for the lawmakers' ire was that the company had been lured to Florida with a generous tax incentive package and had enjoyed nearly $3 million worth of tax breaks during the previous nine years.[2]

Lawmakers create these deals under the banner of job creation and economic development, but the truth is that if a state needs to offer such packages, it is most likely covering for a woeful business climate plagued by bad tax policy. A far more effective approach is to systematically improve the business tax climate for the long term. When assessing which changes to make, lawmakers need to remember these two rules:

1. Taxes matter to business. Taxes affect business decisions, job creation and retention, plant location, competitiveness, and the long-term health of a state's economy. Most importantly, taxes diminish profits. If taxes take a larger portion of profits, that cost is passed along to either consumers (through higher prices), workers (through lower wages or fewer jobs), or shareholders (through lower dividends or share value). Thus a state

1 U.S. Department of Labor, "Extended Mass Layoffs in the First Quarter of 2007," August 9, 2007, located at http://www.bls.gov/news.release/mslo.nr0.htm.

2 Dave Wasson, "Florida Lawmakers Slam Capital One's Layoff After Years of Tax Breaks," *Tax Analysts,*

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with lower tax costs will be more attractive to business investment, and more likely to experience economic growth.

2. States do not enact tax changes (increases or cuts) in a vacuum. Every tax law will in some way change a state's competitive position relative to its immediate neighbors, its geographic region, and even globally. Ultimately it will affect the state's national standing as a place to live and to do business. Entrepreneurial states can take advantage of the tax increases of their neighbors to lure businesses out of high-tax states.

Clearly, there are many non-tax factors that affect a state's business climate: its proximity to raw materials or transportation centers, its regulatory or legal structures, the quality of its education system and the skill of its workforce, not to mention the intangible perception of a state's "quality of life."[3] Some of these factors are, of course, outside of the control of elected officials. Montana lawmakers cannot change the fact that Montana's businesses have no immediate access to deepwater ports. Lawmakers do, however, have direct control over how friendly their tax systems are to business.

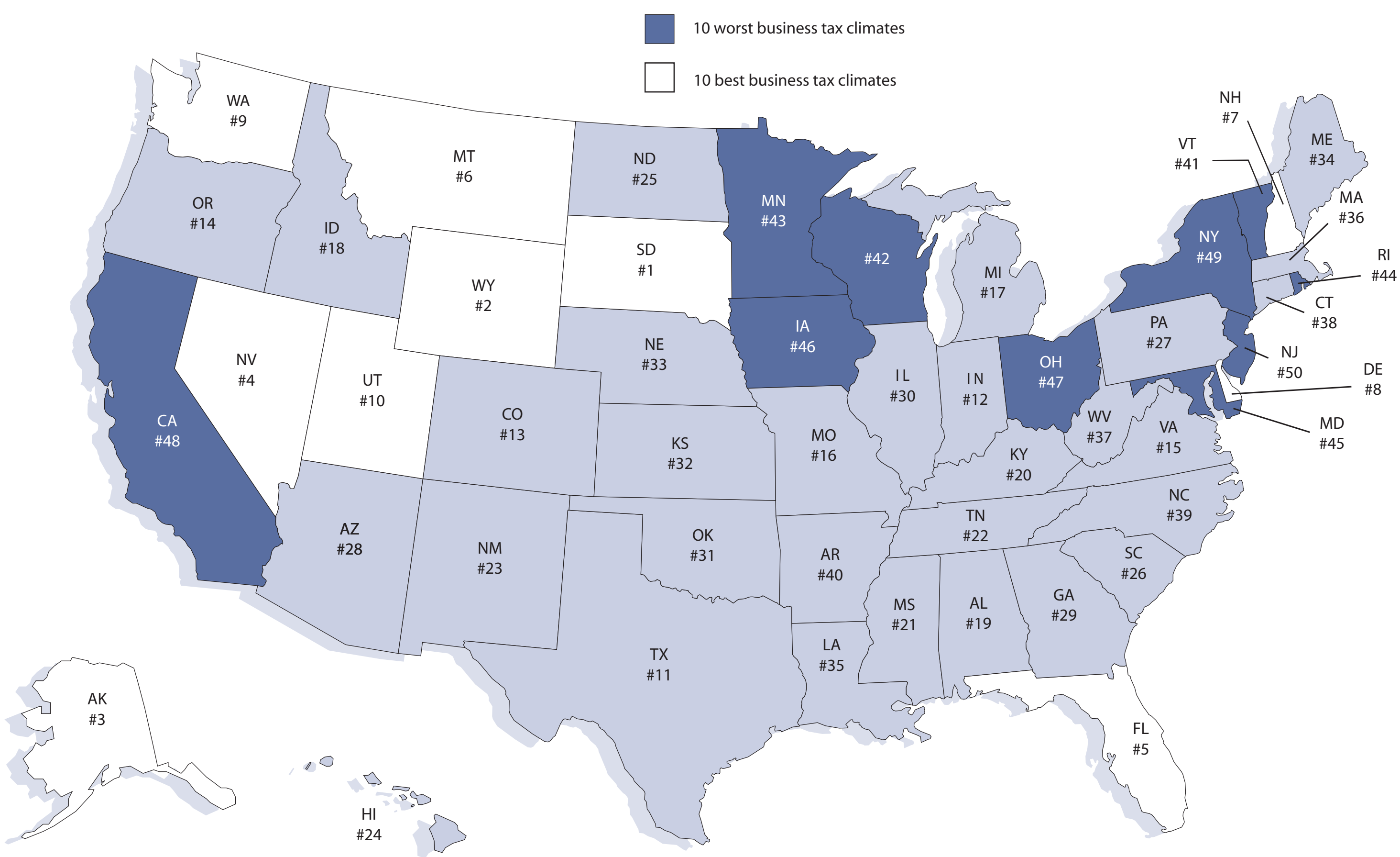
Purpose

The SBTCI is designed to measure the competitiveness of each state's tax system so lawmakers, the media and the public alike can gauge how their state compares to other states. They can also use the SBTCI to pinpoint specific changes that will increase the competitive standing of their state.

Good state tax systems levy low, flat rates on the broadest bases possible, and they treat all

Figure 1

State Business Tax Climate Index, Fiscal Year 2010



3 A trend in tax literature throughout the last two decades has been the increasing use of indexes to measure a state's general business climate. Recent examples include the Small Business & Entrepreneurship Council's "Small Business Survival Index 2007" and the Beacon Hill Institute's "State Competitiveness Report 2007." Such indexes even exist on the international level, including the Heritage Foundation's "2008 Index of Economic Freedom." Bittlingmayer, Eathington, Hall and Orazem (2005) find in their analysis of several business climate studies that a U.S. state's tax climate does affect its economic growth rate, and that several indexes are able to predict growth. In fact, they found, "The State Business Tax Climate Index explains growth consistently."

taxpayers the same. Variation in the tax treatment of different industries favors one economic activity or decision over another. The more riddled a tax system is with these politically motivated preferences the less likely it is that business decisions will be made in response to market forces. The SBTCI rewards those states that apply these principles in five important areas of taxation: individual income taxes, major business taxes, sales taxes, unemployment insurance taxes, and taxes on wealth or assets such as property.

How the State Business Tax Climate Index is Calculated

The SBTCI places 112 variables into five component indexes that each measure a different sector of a state's business tax climate. The five component indexes are the Corporate Tax Index, Individual Income Tax Index, Sales Tax Index, Unemployment Tax Index and Property Tax Index. The total score for each state is calculated based on the scores on each of the five component indexes.

Using the economic literature as our guide, we designed these five component indexes to score each state's business tax climate on a scale of zero (worst) to 10 (best). Each component index is devoted to a major area of state taxation and each has two equally weighted sub-indexes, some of which include several categories and variables under them.. The ranking of the states on each of the five major component indexes is presented in Table 2 on page 4.

Results of the 2010 State Business Tax Climate Index

The ten best states in the Tax Foundation's 2010 State Business Tax Climate Index are as follows:

1. South Dakota
2. Wyoming
3. Alaska
4. Nevada
5. Florida
6. Montana
7. New Hampshire
8. Delaware
9. Washington
10. Utah

The ten worst states are:

41. Vermont
42. Wisconsin
43. Minnesota
44. Rhode Island
45. Maryland
46. Iowa
47. Ohio
48. California
49. New York
50. New Jersey

Table 1
State Business Tax Climate Index, 2009 – 2010

	FY 2010 State Business Tax Climate Index		FY 2009 State Business Tax Climate Index		Change from 2009 to 2010	
State	Score	Rank	Score	Rank	Score	Rank
U.S.	5.00	–	5.00	–	0	–
Alabama	5.19	19	5.30	20	–0.11	1
Alaska	7.38	3	7.32	4	0.06	1
Arizona	5.01	28	5.25	24	–0.23	–4
Arkansas	4.61	40	4.87	35	–0.25	–5
California	3.89	48	4.14	48	–0.11	1
Colorado	5.63	13	5.89	13	–0.26	0
Connecticut	4.72	38	4.81	37	–0.09	–1
Delaware	5.98	8	6.01	10	–0.02	2
Florida	6.62	5	6.92	5	–0.30	0
Georgia	5.01	29	5.16	27	–0.15	–2
Hawaii	5.05	24	5.27	22	–0.22	–2
Idaho	5.21	18	5.10	29	0.11	11
Illinois	5.01	30	5.26	23	–0.26	–7
Indiana	5.67	12	5.88	14	–0.20	2
Iowa	4.23	46	4.35	44	–0.12	–2
Kansas	4.93	32	5.07	31	–0.14	–1
Kentucky	5.18	20	4.95	34	0.23	14
Louisiana	4.74	35	4.98	33	–0.24	–2
Maine	4.83	34	4.69	40	0.14	6
Maryland	4.26	45	4.31	45	–0.06	0
Massachusetts	4.73	36	4.99	32	–0.26	–4
Michigan	5.35	17	5.30	21	0.05	4
Minnesota	4.44	43	4.61	41	–0.18	–2
Mississippi	5.16	21	5.32	19	–0.16	–2
Missouri	5.37	16	5.57	16	–0.20	0
Montana	6.32	6	6.27	6	0.05	0
Nebraska	4.88	33	4.55	42	0.32	9
Nevada	7.05	4	7.37	3	–0.31	–1
New Hampshire	6.25	7	6.21	7	0.05	0
New Jersey	3.60	50	3.90	50	–0.30	0
New Mexico	5.06	23	5.17	26	–0.11	3
New York	3.66	49	4.00	49	–0.47	–2
North Carolina	4.66	39	4.74	39	–0.08	0
North Dakota	5.04	25	5.08	30	–0.04	5
Ohio	4.04	47	4.15	47	–0.08	1
Oklahoma	4.97	31	5.40	18	–0.43	–13
Oregon	5.59	14	6.04	8	–0.44	–6
Pennsylvania	5.03	27	5.14	28	–0.10	1
Rhode Island	4.33	44	4.18	46	0.15	2
South Carolina	5.03	26	5.21	25	–0.17	–1
South Dakota	7.42	1	7.50	2	–0.08	1
Tennessee	5.10	22	5.42	17	–0.32	–5
Texas	5.70	11	6.02	9	–0.32	–2
Utah	5.80	10	5.94	11	–0.14	1
Vermont	4.56	41	4.52	43	0.03	2
Virginia	5.53	15	5.70	15	–0.17	0
Washington	5.81	9	5.94	12	–0.13	3
West Virginia	4.73	37	4.86	36	–0.13	–1
Wisconsin	4.54	42	4.76	38	–0.22	–4
Wyoming	7.38	2	7.50	1	–0.12	–1
District of Columbia	4.72	–	4.53	–	0.20	–

Note: The higher the score, the more favorable a state's tax system is for business. All scores are for fiscal years.
Source: Tax Foundation

Tax competition is an unpleasant reality for state revenue and budget officials, but it is probably the most effective restraint on state and local taxes. When a state imposes higher taxes than a neighboring state, business will cross the border to some extent. Therefore states with more competitive tax systems score well in the SBTCI because they are best suited to generate economic growth.

Starting with the 2006 edition, the SBTCI has measured each state's business tax climate as it stands at the beginning of the standard state fiscal year, July 1. Therefore, this edition is the 2010 SBTCI and represents the tax climate in each state as of July 1, 2009, the first day of fiscal year 2010 for most states. Please view the full study on our website at **www.taxfoundation.org/files/bp59.pdf,** or, alternatively, call or write us for a free copy.

Table 2
Major Components of the State Business Tax Climate Index, FY 2010

State	Overall Rank	Corporate Tax Index Rank	Individual Income Tax Index Rank	Sales Tax Index Rank	Unemployment Insurance Tax Index Rank	Property Tax Index Rank
Alabama	19	23	17	25	16	17
Alaska	3	26	1	5	29	15
Arizona	28	22	23	46	2	4
Arkansas	40	39	34	43	17	20
California	48	34	48	48	14	13
Colorado	13	12	16	31	20	6
Connecticut	38	18	24	27	34	48
Delaware	8	49	35	1	13	7
Florida	5	15	1	32	3	22
Georgia	29	8	30	23	22	36
Hawaii	24	10	44	11	12	8
Idaho	18	17	29	12	48	3
Illinois	30	27	10	41	46	39
Indiana	12	21	11	20	11	12
Iowa	46	45	42	33	33	31
Kansas	32	40	21	24	6	32
Kentucky	20	42	32	7	36	19
Louisiana	35	19	25	47	8	24
Maine	34	43	40	6	40	41
Maryland	45	14	49	10	37	38
Massachusetts	36	47	14	26	49	45
Michigan	17	48	15	9	45	33
Minnesota	43	44	37	40	38	16
Mississippi	21	13	18	35	4	23
Missouri	16	5	27	16	7	18
Montana	6	16	22	3	21	10
Nebraska	33	35	31	17	15	34
Nevada	4	3	1	44	42	14
New Hampshire	7	50	9	2	39	40
New Jersey	50	41	47	38	25	50
New Mexico	23	32	19	42	19	1
New York	49	20	50	36	47	43
North Carolina	39	25	36	34	5	37
North Dakota	25	30	33	21	28	5
Ohio	47	38	46	37	10	49
Oklahoma	31	7	26	45	1	27
Oregon	14	31	45	4	30	9
Pennsylvania	27	37	13	29	41	42
Rhode Island	44	36	38	13	50	47
South Carolina	26	9	28	18	43	26
South Dakota	1	1	1	30	35	11
Tennessee	22	11	8	49	32	46
Texas	11	46	7	39	9	30
Utah	10	6	12	28	24	2
Vermont	41	28	41	14	18	44
Virginia	15	4	20	8	44	29
Washington	9	33	1	50	26	21
West Virginia	37	24	39	22	31	28
Wisconsin	42	29	43	19	23	25
Wyoming	2	1	1	15	27	35

Note: Rankings do not average across to total. States without a given tax rank equally as number 1.
Source: Tax Foundation

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