

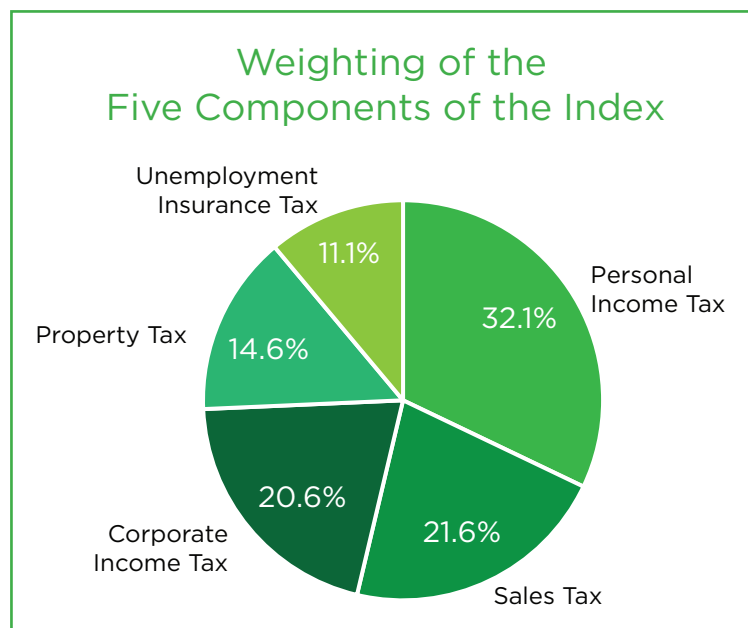
FLORIDA'S BUSINESS TAX CLIMATE JUDGED TO BE THE NATION'S 5TH BEST

A new report by the Tax Foundation evaluates the tax structures of the 50 states and compares them relative to their effect on each state's business climate. The *2015 Business Tax Climate Index* looks at five major tax areas: corporate income taxes, personal income taxes, sales taxes, property taxes and unemployment insurance taxes. The *Index* evaluates more than 100 variables in these areas to develop scores for each state ranging from 0 (worst) to 10 (best).

Instead of simply comparing how much in taxes each state collects, the report gauges how states structure their tax systems. Generally, the *Index* favors states that have simple tax structures with low rates and broad bases.

The five tax categories are weighted differently (see chart below). The more variation between state scores, the greater the weight of that category. The report points to evidence that shows that states with the best tax systems will be the most competitive in attracting business investment and fostering economic growth. The report offers the findings to provide a roadmap for improving these tax systems.

Florida fares well in the *Index*, receiving a score of 6.91, which is the 5th best in the nation. Wyoming is the highest-ranked state with a score of 7.58. The lowest score belongs to New Jersey at 3.43. The other states in the top five are South Dakota, Nevada, and Alaska.



Vermont, Minnesota, California, and New York round out the bottom five. Texas, the state to which Florida's economic development efforts are often compared, ranks 10th.

Florida's ranking can be largely attributed to the fact it has no personal income tax. States that do not have one of the major taxes generally receive a score of 10 for that tax and the personal income tax is the most heavily weighted of the five tax categories. All of the top five ranked states do not impose at least one of the major taxes. Florida receives relatively high scores in each of the five components, as its lowest ranking is 16th (property taxes). Relative to other states, Florida certainly has an attractive tax climate for business, but there are some areas where the report may overstate that attractiveness.

Components of the Index

Corporate Income Taxes

Florida Rank: 14 Score 5.42

These taxes, which include gross business receipts taxes that exist in some states, account for 20.6 percent of the *Index's* total score for each state. The report rates Florida as having the 14th best corporate income tax system in the nation, receiving a score of 5.47. Florida's single, relatively low (5.5 percent) tax rate is the most attractive aspect of the tax. Other states' rates go as high as 12 percent (Iowa). Florida also receives good marks for its conformity to the federal Internal Revenue Code, generous net operating loss (NOL) carry forward provisions, and the absence of a "throwback" rule. Not allowing the carry back of NOL and the existence of an Alternative Minimum Tax are viewed as negatives. Perhaps surprisingly, the existence of tax credits such as investment, job, and research and development credits are viewed as a negative. The Tax Foundation states that "tax credits complicate the tax system, narrow the tax base, drive up tax rates for companies that do not qualify, distort the free market, and often fail to achieve economic growth." While Florida offers all three of the credits listed, the pervasiveness of these credits among the other states mitigates its negative impact on its score.

Personal Income Taxes *Florida Rank: 1 (tie) Score 10.0*

These taxes are the most heavily weighted factor in the Index, comprising almost a third (32.1 percent) of the *Index's* total score for each state. All though it is a tax on “personal” income, this tax is becoming more and more important to business climate because sole proprietorships, Sub Chapter S, partnerships, and limited liability companies (LLCs) report their income through the individual income tax code.

The Index generally gives high marks to states that have flat, low tax rates with few deductions and exemptions. Complex, multiple-rate systems score poorly. Top tax rates range from a high of 13.3 percent (California), to a low of 3.07 percent (Pennsylvania).

The perfect 10 Florida receives for not having personal income tax is the main reason for its high overall *Index* ranking. While there are seven states without a personal income tax (Alaska, Florida, Nevada, South Dakota, Texas, and Washington), only five states get a 10. Texas and Washington do not recognize Sub S and LLCs for personal income tax treatment, so they are downgraded slightly. Tennessee and New Hampshire only tax interest and dividends (not wages) so they score highly as well.

Sales Taxes *Florida Rank: 12 Score 5.17*

Sales taxes comprise 21.6 percent of the *Index's* total score for each state, and include both state and local levies (using a weighted statewide average). Also included in this section are excise taxes on gasoline, diesel, cigarettes, beer, and spirits. Low rates, broad bases, and minimum sales taxation of business inputs are factors that lead to a high score. Taxing business inputs is a form of pyramiding, resulting in double taxation and economic distortions.

Florida ranks 12th, with a score 5.17. Although it has a relatively high state sales tax rate (6 percent), the inclusion of local taxes for all of the states brings Florida's comparative rate down. Florida has a weighted average state and local sales tax rate of 6.63 percent, which is only the 29th highest rate in the nation. Still, with 21 states having a lower rate than Florida, its rank of 12 is a bit surprising, especially

when you consider that the state's excise taxes are relatively high. Florida's taxes on gasoline and diesel are among the top five in the nation, and its alcoholic beverage taxes (especially on beer) are above average.

Florida is given high marks for non-taxation of business inputs (including agricultural and manufacturing inputs), most services, and software; however, it does not appear that other taxed inputs and other high excise taxes in Florida (which directly affect businesses) are considered. For instance: electricity used by businesses is subject to the sales tax at a higher rate of 7 percent; utilities are subject to a gross receipts tax; and Florida has a very high communications services tax (2nd highest nationally). All told, Florida collects more taxes per capita on utilities than any other state. Commercial leases are also subject to the sales tax in Florida, which is rare nationally.

Property Taxes *Florida Rank: 16 Score 5.45*

Property taxes comprise 14.6 percent of a state's total score. The relatively low weighting of this tax is somewhat surprising since it is estimated that property taxes account for 36.1 percent of all taxes paid by American businesses.¹ The *Index* is mostly a reflection of tax rates, which are measured by collections per capita and as a percentage of personal income. States are marked down if they have other "wealth taxes" such as taxes on capital stock, estates, inheritances, intangible property, and real estate transfers.

This is another area where Florida's ranking of 16th seems to be a bit generous. Florida's property taxes are slightly higher than average, as there are 28 states with lower collections. Moreover, from a business perspective, property taxes are even higher than that. While there are other states that tax businesses relatively higher than residents, such comparisons are difficult.

Florida's property tax system, due to large homestead exemptions and the Save Our Homes (SOH) provisions in the state constitution, shifts the tax burden from homestead to non-homestead property. The impact of SOH can be immense. It removed \$422 billion in taxable value from homestead property in 2007, and while that differential fell considerably during a rare period of decreasing property value

¹ Council On State Taxation, "Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2013," prepared by Ernst & Young LLP, August 2014.

from 2009 to 2013, the SOH differential is now rising again as values have begun to rise.²

Florida's property tax also applies to business tangible personal property (TPP). The *Index* does not directly consider TPP taxes, due to data availability constraints, but it does note that states are moving away from them. In 2011, a Florida TaxWatch task force recommended that Florida set a goal of eliminating TPP taxes³.

Florida received points for not having taxes on capital stock, estates, inheritances, intangible property, and inventories, but only a minority of states levy those taxes. However, Florida is one of 34 states that levy real estate transfer taxes, and it collects far more per capita than any other state – almost five times the national average.

Unemployment Insurance Taxes *Florida Rank: 3 Score: 5.97*

Besides the personal income tax, Unemployment Insurance (UI) taxes are the component of the *Index* where Florida ranks the highest, at 3rd. UI taxes account for 11.1 percent of the *Index's* total score for each state, and are evaluated based on the rate structure and the tax base.

UI is a joint federal and state program where taxes paid by employers finance benefits for workers recently unemployed. All states have UI taxes and the systems tend to be complex. Although UI benefits can help sustain an economy during times of increasing unemployment by providing spending money to laid-off workers, the *Index* report notes the “shut-down effect” of UI taxes: struggling businesses lay off employees to survive, but the layoffs result in higher UI taxes, which can cause businesses to fail sooner.

UI taxes rates are based on a schedule of tax rates. The rate a particular business pays is dependent on its experience rating; more layoffs mean higher taxes. Florida's rate ranges from 0.59 percent to 5.40 percent. Florida's maximum rate is tied with five other states for the lowest in the nation.

² Florida Ad Valorem Estimating Conference, Conference Package, August 1, 2014

³ Florida TaxWatch. “Report and Recommendations of the Florida Tangible Personal Property Tax Task Force” November 2011. In 2012, a proposed constitution amendment was placed on the ballot that would have exempted TTP if the assessed value was less than \$50,000 and allowed local governments to provide additional TPP exemptions. The amendment was not approved by the voters.

The country's highest maximum rate is 12.9 percent (Arkansas). Florida also has a low wage base of \$8,000, which is the amount of each employee's salary that is taxed.

California and Arizona have the lowest wage base (\$7,000), and Washington has the highest (\$41,300). The combination of low rates and a small tax base result in relatively low UI taxes for Florida businesses.

Current State Tax Reform Efforts

Florida's *Business Tax Climate Index* ranking has held constant at 5th since 2012. It would be difficult for Florida to improve its ranking, because three of the four states ranked higher do not levy two of the major taxes; however, the heavy advantage the *Index's* ranking gives to not having a corporate or personal income tax also means Florida is likely to stay near the top of the rankings.

Florida has made some changes to its tax structure in recent years, but certainly nothing that could be considered transformative. The Legislature has reduced some taxes, the biggest cut being the rollback of motor vehicle fees from last session. The others have mostly been smaller sales tax exemptions and holidays, measures unlikely to impact the tax climate rankings. The expanded sales tax exemption for manufacturing machinery and equipment from 2013 and the increases in the corporate income tax exemption from 2011 and 2012 are certainly beneficial to businesses.

However, other states are making changes to their tax systems that are improving their tax climate. North Carolina improved its ranking from 44th to 16th in the new index, thanks to a comprehensive tax reform effort. The state changed its personal income tax structure from a multi-bracket system with a top rate of 7.75 percent to a single rate of 5.8 percent with a standard deduction of \$7,500. The corporate income tax rate also fell from 6.9 percent to 6.0 percent. It will drop to 5.0 percent next year and has a trigger mechanism based on revenue growth that could take it as low as 3.0 percent. The state also improved the simplicity and equity of its sales tax system by prohibiting local governments from setting their own tax bases.

Several states (including New York, Nebraska, and West Virginia) reduced their corporate income tax (CIT) rate or made other CIT improvements. Kansas, Nebraska and North Dakota all improved their personal income tax systems, and Wisconsin enacted CIT and property tax reforms.

There was only one tax change cited as having a negative impact on a state's ranking: Maine's sales tax increase from 5.0 percent to 5.5 percent.

The Tax Foundation report also cites many states with recent and proposed changes that are not yet reflected in the current rankings but are expected to improve future scores. North Carolina, Arizona, Illinois, Indiana, New Mexico, New York, and Rhode Island are in the process of reducing corporate income tax rates. New York, a perennial bottom-dweller in tax rankings, is projected to see its corporate income tax ranking improve to 4th (best among the states that impose the tax) when its CIT changes are fully phased-in. Illinois, Indiana, and Missouri are reducing personal income taxes. Kansas plans to completely phase-out its corporate and personal income taxes by applying any additional general fund receipts over 2 percent growth from the previous year toward rate reduction.

Conclusion

As they say, "beauty is in the eye of the beholder." There are many measures of taxes and business climates. A March 2011 Florida TaxWatch report, *State Competitiveness Indices & Rankings: What National Rankings Tell Us about Florida's Competitiveness*, examined tax, business climate, and competitiveness rankings from seven different organizations and found that Florida's ranking ranged from 5th to 28th.

Many factors impact a state's attractiveness to business investment, such as workforce, education, infrastructure, access to raw materials, and quality of life. But taxes do matter, and as the *Index* points out, tax reform can often be accomplished much faster than significant improvements in areas such as education, healthcare, and transportation.

The Tax Foundation's *2015 Business Tax Climate Index* is a very interesting and useful publication. It is probably the most comprehensive and detailed look at state tax structures available and does a good job with the very difficult task of

trying to create apples to apples comparisons. Still, there are instances where one could argue the *Index* overstates the quality of Florida's business tax environment, particularly in the areas of property and sales taxes. A recent report by the Council on State Taxation⁴ estimates that 53.3 percent of Florida's total state and local taxes are paid by businesses, the 10th highest percentage in the nation. The report also estimates that Florida's effective business tax rate (total state and local taxes divided by gross state product) of 5.5 percent is the nation's 11th highest.

It is likely that most states would find something to quibble with in the *Index*; however, the bottom line of the *Index* is largely unassailable: the premise that simple tax structures with low rates, broad bases and the avoidance of taxing business inputs are preferable.

Tax competition among the states is a reality, but the Tax Foundation also warns against the common practice of trying to lure businesses through special incentives and tax credits, instead of broad-based tax reform.

The *Index* does highlight many of the strengths and weaknesses of Florida's tax structure. Hopefully, Florida's elected officials will work to truly reform our tax system by exploring ideas such as reducing or eliminating the sales tax on commercial leases, reducing the communications services tax, addressing the inequities of the property tax system, eliminating the tangible personal property tax, and collecting sales and use taxes on internet purchases.

⁴ Council On State Taxation, "Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2013," prepared by Ernst & Young LLP, August 2014.

2015 Tax Foundation Business Tax Climate Rankings as of July 1, 2014

	Individual Tax Ranking						
	Overall Rank	Overall Score	Corporate Income	Personal Income	Sales	Unemploy. Insurance	Property
Wyoming	1	7.58	1	1	13	34	35
South Dakota	2	7.50	1	1	35	41	18
Nevada	3	7.46	1	1	39	43	9
Alaska	4	7.22	30	1	5	24	32
Florida	5	6.91	14	1	12	3	16
Montana	6	6.21	18	20	3	18	8
New Hampshire	7	6.01	48	9	2	44	43
Indiana	8	5.96	22	10	10	7	5
Utah	9	5.91	5	12	19	22	4
Texas	10	5.80	39	6	36	15	36
Washington	11	5.79	28	6	46	19	23
Oregon	12	5.74	36	31	4	30	15
Michigan	13	5.64	10	14	7	47	27
Delaware	14	5.53	50	33	1	2	13
Tennessee	15	5.48	15	8	47	26	37
North Carolina	16	5.44	25	15	33	11	29
Missouri	17	5.41	4	29	29	12	7
Mississippi	18	5.29	11	21	28	8	33
Idaho	19	5.27	21	24	22	46	3
Colorado	20	5.27	12	16	43	35	22
West Virginia	21	5.19	17	26	25	23	25
Kansas	22	5.17	38	18	30	9	28
Arizona	23	5.12	24	19	49	4	6
Massachusetts	24	5.08	37	13	21	48	45
North Dakota	25	5.08	19	36	20	16	2
Kentucky	26	5.04	29	30	11	45	17
Virginia	27	5.03	6	39	6	37	26
Alabama	28	5.02	27	23	41	25	10
Nebraska	29	5.02	31	25	27	13	39
Hawaii	30	5.00	9	37	15	28	12
Illinois	31	4.96	47	11	34	38	44
Oklahoma	32	4.91	7	40	38	1	11
Maine	33	4.89	45	22	9	42	40
Pennsylvania	34	4.89	46	17	24	50	42
Louisiana	35	4.83	23	27	50	6	24
Georgia	36	4.78	8	42	17	36	30
South Carolina	37	4.76	13	41	18	40	21
New Mexico	38	4.75	35	35	45	10	1
Arkansas	39	4.68	40	28	44	39	19
Maryland	40	4.50	16	45	8	21	41
Iowa	41	4.50	49	32	23	33	38
Connecticut	42	4.47	32	34	31	20	49
Wisconsin	43	4.46	33	43	14	27	31
Ohio	44	4.41	26	47	32	5	20
Rhode Island	45	4.14	43	38	26	49	47
Vermont	46	4.11	42	44	16	17	48
Minnesota	47	4.07	44	46	37	29	34
California	48	3.77	34	50	42	14	14
New York	49	3.62	20	49	40	31	46
New Jersey	50	3.43	41	48	48	32	50

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As an independent, nonpartisan, nonprofit taxpayer research institute and government watchdog, it is the mission of Florida TaxWatch to provide the citizens of Florida and public officials with high quality, independent research and analysis of issues related to state and local government taxation, expenditures, policies, and programs. Florida TaxWatch works to improve the productivity and accountability of Florida government. Its research recommends productivity enhancements and explains the statewide impact of fiscal and economic policies and practices on citizens and businesses.

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