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Analysis: Do Business-Friendly Tax Climates Yield The Most Jobs?

POSTED BY [MIKE MACIAG](#) | OCTOBER 10, 2013

The Tax Foundation published its annual State Business Tax Climate Index study on Wednesday, ranking the most and least friendly states for companies to do business.

As in years past, [the release](#) generated no shortage of media attention. The index serves as a benchmark for comparison and is often cited by elected officials, whether they're on the campaign trail or looking to [lure companies](#) from other states.

In highlighting its rankings, the Tax Foundation calls on lawmakers to improve business tax climates to make their states more competitive.

But do states with higher business tax climate scores actually boast stronger job markets?

While business taxes do factor into the equation to an extent, a review of the most recent economic data shows no correlation between states rated higher and those with better employment indicators. In fact, some of the lowest-ranked states weathered the recession quite well.

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The Tax Foundation study compares more than 100 variables across five major areas of taxation: business taxes, individual income taxes, sales taxes, unemployment insurance rates and property taxes.

The top three states netting the highest scores were Wyoming, South Dakota and Nevada, all of which levy no individual income or corporate tax. The next two states on the list – Alaska and Florida – also impose no individual income tax.

Rounding out the least-competitive states were New York (50th), New Jersey (49th) and California (48th).

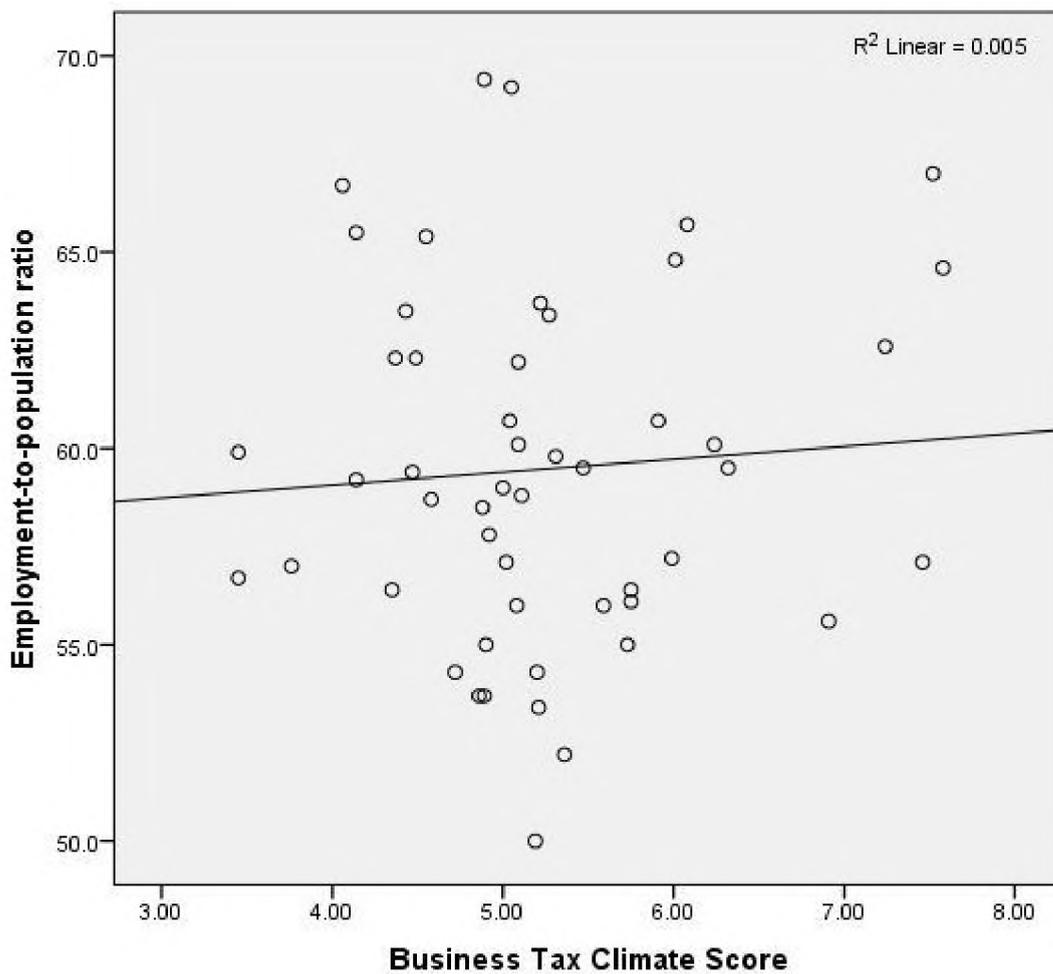
The following excerpt from the [study](#) underscores the group's key argument:

"When a state imposes higher taxes than a neighboring state, businesses will cross the border to some extent. Therefore, states with more competitive tax systems score well in the Index because they are best suited to generate economic growth."

From a quick review of states near the top of the list, it's clear that they benefit from other economic advantages on top of favorable tax rates. States like Wyoming (#1) and Alaska (#4) depend heavily on the energy sector for their employment bases. By contrast, states slapped with lower scores in the report lack vast oil reserves and larger shares of jobs in the agriculture industry, which similarly held up well in recent years.

Even with these caveats, there's no notable correlation between state's Business Tax Climate Index scores and their unemployment rates.

Plotting the most recent state employment-to-population ratios and Tax Foundation scores further reveals no relationship:



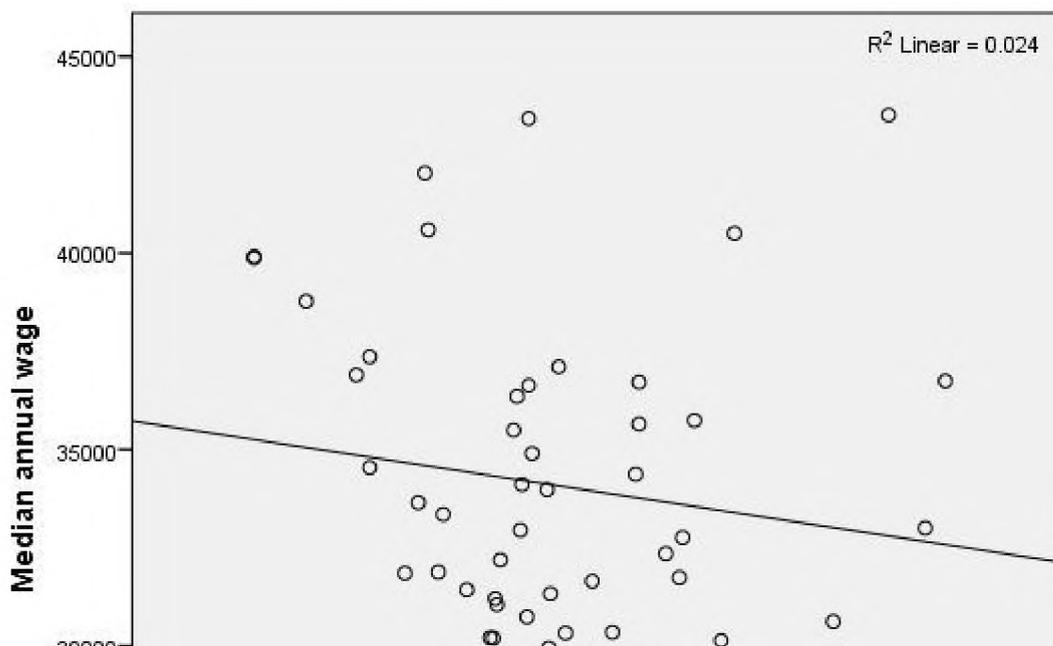
A few of the Tax Foundation's lowest ranked states are actually among the strongest performing in terms of current employment indicators.

The report singled out Minnesota, for example, because the state enacted policy changes said to have hurt competitiveness, particularly a retroactive individual income tax rate hike. Accordingly, the state fell three slots from last year's report to the 47th worst in country.

To the contrary, Minnesota's job market is quite strong. As of August, its unemployment rate stood at 5.1 percent – tenth lowest of any state. Elsewhere, it stacks up even better against other states. Its employment-to-population ratio is 66.7 percent, fourth best nationally.

Vermont's business tax climate similarly rates poorly in the report. With its above-average income taxes and higher property tax rates, the state ranks 45th nationally. Jobs data, though, paints a different picture: Its August jobless rate was fifth lowest and the employment-to-population ratio was a similarly-impressive sixth highest of any state.

It's also worth examining the varying wages paid to each state's workforce. States scoring lower in the Tax Foundation study, in fact, tended to record slightly higher [median annual wages](#):



(NOTE: Median wages represent [2012 figures](#) from the Labor Department's Occupational Employment Statistics data. Cost-of-living isn't considered in wage data, and several states with high wages have a higher cost of living).

Of course, there are countless other variables we could also factor in here.

Because many taxes are applied entirely differently from state to state, assessing competitiveness presents a challenge – a fact acknowledged in the report.

The Tax Foundation ranks each variable relative to other states. Components with greater variability of each state's score from the mean (such as individual income tax) are weighted more heavily.

In a [report](#) critical of the Tax Foundation and similar business climate rankings, liberal watchdog group Good Jobs First cited this aspect of the methodology as a flaw: "The net effect of overweighting for variability is to make taxes look more important in location decisions than they really are," the group stated.

Perhaps the most notable caution worth considering, which Good Jobs First also points out, is that the Tax Foundation's index doesn't resemble the total taxes businesses end up paying in many states.

The nonprofit trade association Council on State Taxation (COST) tallied the combined total effective business tax rate levied by state and local governments in its [business tax burden study](#), computing taxes as a percentage of the private-sector gross state product (GSP).

Excluding severance taxes collected in a few states, the effective business tax rate ranged from 3.3 percent of GSP in North Carolina to 7.3 percent of GSP in Vermont.

When ranked by COST's effective business tax rate, many states performed far better (or worse) than their Tax Foundation rankings would indicate.

The following table illustrates some of the variation, showing the lowest ten ranked states in the Tax Foundation study and COST's total effective business tax rate as a percentage of GSP (minus severance taxes) for fiscal year 2012:

State	Tax Foundation Business Tax Climate Index Rank	Tax Foundation Business Tax Climate Score	Total Effective Business Tax Rate % of GSP	Effective Business Tax Rank (Lower % ranked higher)
New York	50	3.45	6.23%	48
New Jersey	49	3.45	4.78%	27
California	48	3.76	4.53%	20
Minnesota	47	4.06	4.55%	21
Rhode Island	46	4.14	5.15%	39
Vermont	45	4.14	7.26%	51
North Carolina	44	4.35	3.31%	1
Wisconsin	43	4.43	4.45%	19
Connecticut	42	4.47	3.61%	4
Maryland	41	4.49	3.96%	9

The total state and local effective business tax rate for the U.S. came in at 4.8 percent.

Here's another table showing the Tax Foundation's overall business tax climate rankings, along with the most recent state economic data compiled by *Governing*:

Select State:

State	Business Tax Climate Rank	BTC Score	Labor Force Participation (%)	Employment-to-population Ratio (%)	Unemployment Rate	Me An W
Wyoming	1	7.58	67.7	64.6	4.6	\$36,74
South Dakota	2	7.52	69.7	67	3.8	\$29,09
Nevada	3	7.46	63.1	57.1	9.5	\$33,00
Alaska	4	7.24	67	62.6	6.5	\$43,51
Florida	5	6.91	59.8	55.6	7	\$30,62
Washington	6	6.32	63.9	59.5	7	\$40,50
Montana	7	6.24	63.5	60.1	5.3	\$30,14
New Hampshire	8	6.08	69.1	65.7	5	\$35,74
Utah	9	6.01	68	64.8	4.7	\$32,76
Indiana	10	5.99	62.3	57.2	8.1	\$31,74
Texas	11	5.91	64.9	60.7	6.4	\$32,35
Oregon	12	5.75	61.4	56.4	8.1	\$35,65
Delaware	13	5.75	60.5	56.1	7.3	\$36,71
Michigan	14	5.73	60.4	55	9	\$34,37
Tennessee	15	5.59	61.2	56	8.5	\$30,35
Missouri	16	5.47	64.1	59.5	7.2	\$31,65
Mississippi	17	5.36	57	52.2	8.5	\$27,82
Idaho	18	5.31	64.1	59.8	6.8	\$30,33
Colorado	19	5.27	68.2	63.4	7	\$37,10
Kansas	20	5.22	67.7	63.7	5.9	\$31,33
Alabama	21	5.21	57	53.4	6.3	\$29,95
Arizona	22	5.2	59.2	54.3	8.3	\$33,98
West Virginia	23	5.19	53.3	50	6.3	\$28,55
Pennsylvania	24	5.11	63.7	58.8	7.7	\$34,90
Massachusetts	25	5.09	64.8	60.1	7.2	\$43,42
Virginia	26	5.09	66	62.2	5.8	\$36,63
Kentucky	27	5.08	61.2	56	8.4	\$30,74
North Dakota	28	5.05	71.4	69.2	3	\$34,11
Maine	29	5.04	65.3	60.7	7	\$32,95
Hawaii	30	5.02	59.6	57.1	4.3	\$36,35
Illinois	31	5	65	59	9.2	\$35,49
Georgia	32	4.92	63.4	57.8	8.7	\$32,19
Louisiana	33	4.9	59.2	55	7	\$31,05
Nebraska	34	4.89	72.5	69.4	4.2	\$31,21
Arkansas	35	4.89	58	53.7	7.4	\$28,69
Oklahoma	36	4.88	61.8	58.5	5.3	\$30,20
South Carolina	37	4.86	58.5	53.7	8.1	\$30,21
New Mexico	38	4.72	58.3	54.3	6.8	\$31,43
Ohio	39	4.58	63.3	58.7	7.3	\$33,35
Iowa	40	4.55	68.7	65.4	4.9	\$31,88
Maryland	41	4.49	67	62.3	7	\$40,59
Connecticut	42	4.47	64.6	59.4	8.1	\$42,03
Wisconsin	43	4.43	68	63.5	6.7	\$33,65
D.C.	44	4.37	68.2	62.3	8.7	\$61,96
North Carolina	44	4.35	61.8	56.4	8.7	\$31,85
Vermont	45	4.14	68.6	65.5	4.6	\$34,54
Rhode Island	46	4.14	65.1	59.2	9.1	\$37,36
Minnesota	47	4.06	70.3	66.7	5.1	\$36,90
California	48	3.76	62.5	57	8.9	\$38,77
New Jersey	49	3.45	65.4	59.9	8.5	\$39,87
New York	50	3.45	61.3	56.7	7.6	\$39,91

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State unemployment rates, employment-to-population ratios and labor force participation rates were compiled from U.S. Bureau of Labor Statistics preliminary data for August 2013. Median annual wages obtained from the 2012 BLS Occupational Employment Statistics program.

Tax Foundation Reveals Scant Link Between Taxes And Prosperity

By Matthew Yglesias

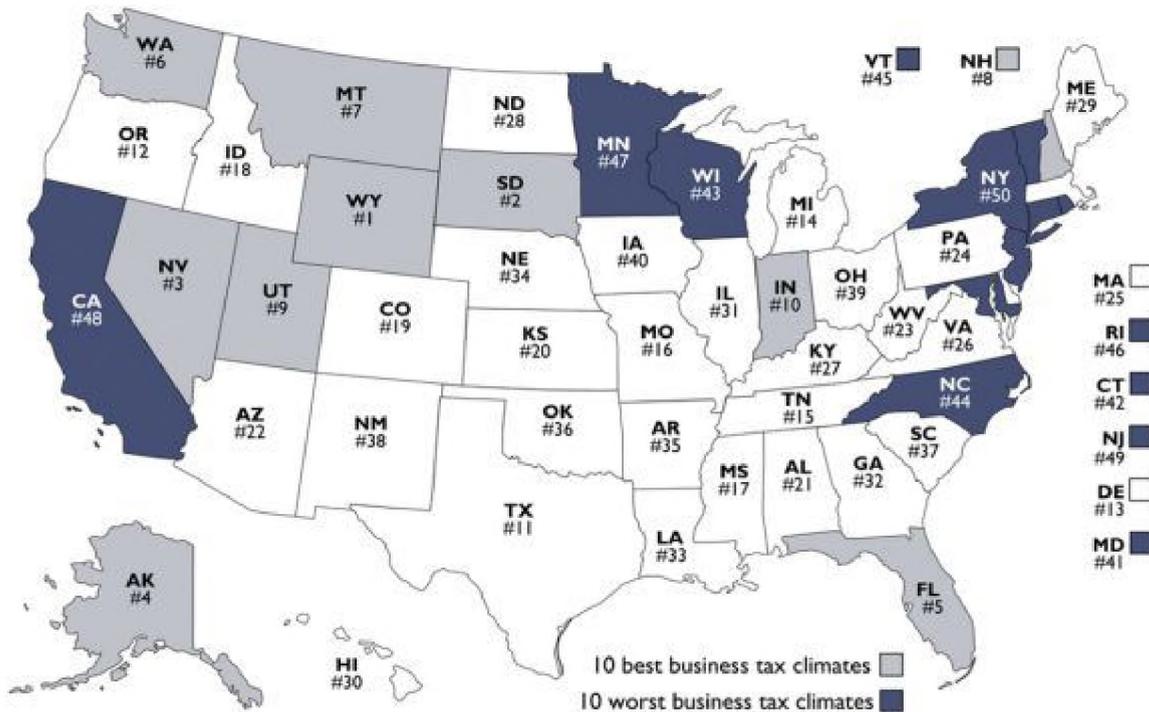


Fred Richard and Prince Albert I of Monaco pose after bagging a bear on a hunt outside Yellowstone National Park in September 1913.

Photo by Jack Richard Photograph Collection/Buffalo Bill Center of the West via Getty Images

Another day, another weird map from a libertarian group that seems designed to debunk libertarianism. Last time it was **strange assertions about freedom**, today it's the Tax Foundation explaining why there are **no successful businesses in California or New York**:

2014 State Business Tax Climate Index



Note: Published October 9, 2013.
Source: State Business Tax Climate Index

taxfoundation.org/maps

Now it would be a little silly to say that relatively high business tax rates are the *cause* of California and New York's success as the pillars of America's very successful high-tech, finance, and media industries. But this map seems to provide strong support for the hypothesis that policymakers seeking to create a prosperous local economy shouldn't sweat the business tax rate too much.

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Note that it's not just sunny California or hip New York that end up in the bottom 10 here—**low-unemployment, high-wage** Minnesota is almost as "bad" as those states. Maryland, New Jersey, and Connecticut are **three out of the four states** with the highest median household income. The fourth is Alaska, whose "discover tons of oil" economic development strategy is hard to replicate.

Matthew Yglesias is **Slate's** business and economics correspondent. He is the author of *The Rent Is Too Damn High*.

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