

Competitive Position of District Businesses, Employers, and Employees vs. Maryland and Virginia

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Members of the Working Group:

My name is Joseph Henchman, and I'm vice president for state projects at the Tax Foundation, which is a non-profit organization based here in the city. I'm grateful for the opportunity to speak to you today on the District's business competitiveness.

First, a general caveat: lots of things matter for individual and business location decisions. My specialty is tax policy, which certainly matters, but so does labor policy. So does housing prices. So does weather. So does wages. So does the quantity and quality of government services. So does roads, transit, and airports.

A weakness in one area can be made up by a strength in the other. Something that was once a strength but is no longer can continue to play a role because not everyone reacts quickly to changing circumstances. Similarly, a weakness turned into a strength can have different time horizons for effectiveness: a major education reform might take a generation to have its effects felt, while changes to business policies can have more immediate effects.

I'd like to start by reviewing three reports my organization puts out, ranking the states on tax policy. I'll also then highlight several reports by other organizations that look at other competitiveness factors. I can't speak to the methodology or veracity of these other studies, other than to say I hear them come up over and over as I testify in state capitols across the country. Unfortunately, the vast majority of these reports do not include the District of Columbia. I'm not sure what steps are appropriate to appeal this omission, although many of the organizations that produce them have offices in the District.

Report	What It Measures	D.C. Rank	Virginia Rank	Maryland Rank
<i>State-Local Tax Burdens</i> (Tax Foundation), FY 12	Percent of income paid by residents in state and local taxes	10 (10.6%)	27 (9.3%)	7 (10.9%)
<i>State Business Tax Climate Index</i> (Tax Foundation)	Overall tax structure (1=best, 50=worst)	47	33	42
	Corporate tax component	31	6	21
	Individual income tax component	43	40	46
	Sales and excise tax component	33	11	14
	Unemployment insurance tax component	27	39	26
	Property tax component	47	28	42
<i>Location Matters</i> (Tax Foundation/KPMG, 2015)	Tax cost of hypothetical businesses			
	Corporate headquarters	34 (14.9%)	12 (12.0%)	17 (12.6%)
	R&D facility	49 (17.9%)	35 (13.5%)	10 (7.9%)
	Retail store	37 (18.4%)	16 (14.1%)	32 (16.4%)
<i>Business Taxes as a Share of All Taxes</i> (COST/EY 2014)	Business taxes paid per employee	\$7,200 (4.8%)	\$4,800 (3.8%)	\$5,000 (3.8%)
<i>Shipment Migration State-to-State</i> (United Van Lines, 2015)	Desire to live there (measured by percent of moving vans going inbound compared to going outbound)	8 (57% inbound)	29 (47% inbound)	40 (45% inbound)
<i>Best States for Credit Conditions</i> (CardRatings, 2015)	Average credit scores, foreclosure rates, credit card delinquency rate, unemployment rate, bankruptcy rate	Not in Top or Bottom 10	Not in Top or Bottom 10	Bottom 10
<i>Burden of Licensing Requirements</i> (Institute for Justice, 2012)	Fees, days of training, and number of exams required to get a license for a low-income occupation (1=heavy burden, 51=light burden)	23	8	10

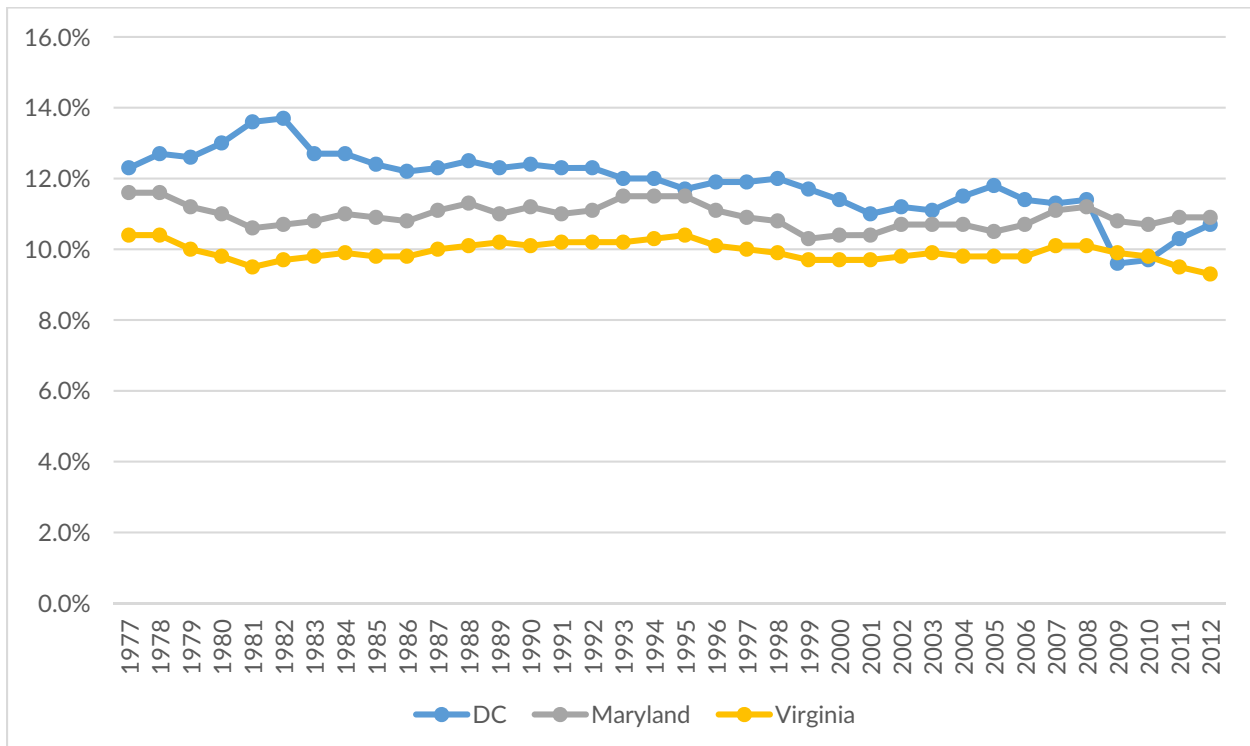
State-Local Tax Burdens (Tax Foundation)

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This report totals the portion of total state income that goes to state and local taxes.

In FY 2012, the most recent year with comparable data across the states, D.C. residents paid 10.6 percent of their income in state-local taxes. This is the 10th highest of the 50 states, above the U.S. average of 9.9 percent, and above Virginia (9.3%, 27th) but below Maryland (10.9%, 7th). D.C. tax burdens were more impacted by the 2008 recession and aftermath than Maryland or Virginia, although they have been bouncing back.

The report calculates the figure back to 1977. In that time, Maryland has stayed within a narrow band, never going below 10.4% and not going above 11.6%. Virginia's band is even narrower: between 9.3% and 10.4%; interestingly, this means Virginia's tax burden at its highest has never been higher than Maryland's at its lowest, at least for the last forty years. D.C.'s trend is a gradual decline, from 13.0% in 1978, falling below 12% in the mid-1990s, below 11% beginning in 2009.



State Business Tax Climate Index (Tax Foundation)

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This report measures how each state's tax laws affect economic performance, taking into account structural complexity and neutrality, both in tax rates and tax bases. The report compiles 115 variables in five areas of taxation, using laws in effect as of July 1 of each year. The 2017 *State Business Tax Climate Index*, released September 28, 2016, compares the states as their laws were on July 1, 2016. It thus does not include all elements of the D.C. tax reform package passed several years ago, which are still phasing in (we note this on page 7 of our report).

D.C. ranks better than Virginia in the area of unemployment insurance tax, and better than Maryland in the area of individual income tax. D.C. ranks below both states in the areas of corporate income tax, sales and excise taxes, and property tax. However, we project D.C. will move above Maryland on the corporate income tax component once the last pieces of the D.C. tax reform package come into effect.

All of these taxes matter for business climate, in different ways:

- Corporate taxes are applied to the largest businesses who are often major employers, and directly impact the scope of their activities in a state and the wages they pay.
- Most small businesses are organized not as corporations but as pass-through businesses like S corporations or LLCs, and thus pay their taxes through the individual income tax code, and a complex or burdensome individual income tax affects them.
- Businesses collect the vast majority of sales taxes, and if a state taxes business-to-business transactions (as D.C. does), they directly pay part of it as well and pass those costs forward in the form of lower wages, higher prices, or lower shareholder returns.
- Unemployment insurance tax costs are spread among solvent businesses to pay for the costs of involuntary unemployment by struggling businesses, and states that do this poorly (overly tax successful businesses to overly subsidize struggling businesses) impact the economy.
- Finally, property taxes are often paid by businesses, and taxes on individual property and wealth can impact investment decisions.

Over the course of our report, D.C. has generally ranked in the 40s, while Maryland fell heavily in 2009 (from the mid-20s to the 40s) after a series of tax increases. Virginia has also fallen (from the teens to the 30s). In some respects, D.C.'s business climate is improving while Maryland and Virginia are making theirs less competitive relative to other states, although a crossover has not happened.

Location Matters (Tax Foundation)

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Location Matters (Tax Foundation, 2015)	Tax cost of hypothetical businesses			
	Corporate headquarters	34 (14.9%)	12 (12.0%)	17 (12.6%)
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This report compares the tax costs that would be paid by hypothetical model firms in each state. We produced the report in collaboration with accounting firm KPMG, and included all business-related taxes (income, property, sales, and unemployment insurance). We used the law as it stood on April 1, 2014 for this 2015 report.

We modeled D.C. for three of the firm types (corporate headquarters, research & development facility, and retail store) but not for other firm types (manufacturing facilities, distribution centers, or call centers). For most states we calculated tax costs twice, with the second calculation including any available tax incentives. D.C. does not significant tax incentives so we did not do this calculation for D.C. The comparisons above do not account for tax incentives, which would be most relevant for new businesses; most states phase out incentives for mature businesses.

In all cases, the businesses located in D.C. would face a higher tax bill than identical businesses in Maryland or Virginia. Key reasons are D.C.'s throwback rule and high rates. It is important to note that the D.C. tax reform package would change these results, as it lowers corporate and individual tax rates. The report used the 9.4 percent business tax rate as it stood in 2014.

Reports that do not include the District of Columbia. The top four are most cited:

- *Small Business Policy Index* by the Small Business & Entrepreneurship Council (Virginia is 15, Maryland is 40). The report uses 50 measures in tax, regulatory, spending, and performance.
- *Best and Worst States for Business* by Forbes (Virginia is 7, Maryland is 33). This report reviews business costs, labor supply, regulatory environment, economic climate, growth prospects, and quality of life.
- *Best and Worst States for Business* by Chief Executive Magazine (Virginia is 12, Maryland is 43). This report is based on a survey of over 500 CEOs.
- *Top States for Business* by CNBC (Virginia is 13, Maryland is 30). This report reviews measures of workforce, cost of doing business, infrastructure, the economy, quality of life, technology and innovation, education, business friendliness, cost of living, and access to capital.
- *Best and Worst States for Business* by 24/7 Wall Street (Virginia is 10, Maryland is 18). This report reviews economic conditions, business costs, state infrastructure, the availability and skill level of the workforce, quality of life, regulations, technology and innovation, and cost of living.
- *Top States to Retire* by Kiplinger's (neither Virginia nor Maryland is in the top 10 or bottom 15 states). This report reviews taxes on retirees, cost of living, average health care costs, economic health, health of the elderly population, household incomes, and poverty rates.
- *Kauffman Indexes* by the Kauffman Foundation:
 - Startup activity (Virginia is 17, Maryland is 13)
 - Small business activity (Virginia is 16, Maryland is 13)
 - Growth of business activity (Virginia is 1, Maryland is 2)
- *State Competitiveness Index* by the Beacon Hill Institute (Virginia is 12, Maryland is 29). This report includes measures of fiscal policy, security, infrastructure, human resources, technology, business incubation, openness, and environmental policy.
- *State of American Well-Being Rankings* by Gallup (Virginia is 17, Maryland is 34). This report includes 2.3 million surveys on levels of well-being, measured by purpose, social, financial, community, and physical well-being.
- *Trust in State Government* by Gallup (Virginia is 16, Maryland is 44)
- *Enterprising States* by the U.S. Chamber of Commerce (Virginia is top ten in 6 categories; Maryland is top ten in 6 categories). This report compares economic performance, transportation and trade, innovation and entrepreneurship, business climate, talent pipeline, and high-tech performance.
- *Lawsuit Climate* by the U.S. Chamber of Commerce (Virginia is 11, Maryland is 28). This report looks at tort liability systems, using surveys of corporate general counsels.
- *Freedom in the 50 States* by the Cato Institute (Virginia is 21, Maryland is 46). This report looks at fiscal, personal, and regulatory policy.
- *How Prepared are the 50 States for the Next Recession?* by the Mercatus Center (Virginia is "unprepared" and Maryland is "well prepared"). This report reviews the status of state rainy day funds and ending balances.
- *Best and Worst Drivers* from Bankrate. Virginia has 47th best drivers, Maryland 34th.