taxanalysts the SALT effect

Credits and Incentives Are Inevitable — Accept It

by Brian Strahle

Do you ever feel like you're living in the movie *Groundhog Day*, reliving the same day over and over? From a state tax policy perspective, it seems like states' use of credits and incentives to entice businesses receives constant scrutiny. The problem with the criticism of incentives is that it is both unnecessary and counterproductive. Credits and incentives are a permanent part of state politics and economic development strategy because of state tax sovereignty. The independent power of each state to tax and spend according to its local economy creates competition. Competition between the states for tax revenue and investment by businesses is by design. Credits and incentives are inevitable.

The Redistribution of Wealth

David Cay Johnston recently provided convincing evidence that New York business tax credits are simply giveaways to wealthy corporations at the expense of lower-income taxpayers, which he described as the "upward redistribution of wealth by the states to businesses."[1] If that's true, would incentives receive as much criticism if they went to start-up, entrepreneurial activity rather than big business? It appears that opponents of incentives and big business would welcome that, but if big business can't meet the return on investment (jobs and facilities), how could small business?

Opponents argue that evidence shows states aren't receiving the expected benefits of providing incentives to businesses. If that's true, why do they continue to offer incentives like the $8.7 billion in tax breaks Washington state approved for Boeing and other aerospace companies last month? Why is Missouri considering approving tax cuts totaling $1.7 billion, also geared toward Boeing and other aerospace firms? According to Citizens for Tax Justice, those companies don't always need tax cuts. Over the past decade, Boeing paid no state income taxes on $35 billion in pretax U.S. profits. So why is Missouri offering tax cuts? According to Gov. Jay Nixon (D), it's to entice Boeing to produce its 777X commercial aircraft there. The answer is competition.

The Threat of Competition

Over the past year, Oregon has used the carrot of "tax certainty" to make deals with two *Fortune* 500 companies, Nike and Intel (note there are only two *Fortune* 500 companies in Oregon **[Brian, Intel is headquartered in California, does this edit work?]**). The incentive is not a package, but simply the ability to use the single-sales-factor apportionment method for at least five years and up to 30 years. The deal was made by Gov. John Kitzhaber (D) along with the director of the Oregon Business Development Department and the director of the Department of Revenue under legislation (HB 4200) signed into law in December 2012. A qualifying investment is one in which a company creates at least 500 jobs and $150 million in capital investment over five years. The period in which a qualifying investment contract can be entered into started December 14, 2012, and ends January 1, 2014. The investment requirements and time period strongly suggest that the legislation was passed to benefit Nike and Intel, even though it says a qualifying contract may be entered into with any taxpayer.

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Before HB 4200 was signed, Nike apparently threatened to expand outside Oregon.[2] The mere threat of competition moved Oregon to act. The interesting thing about the Intel deal is that the

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[1]Johnston, "Billions of Tax Dollars Later, No New Jobs for New York," *State Tax Notes*, Dec. 9, 2013, p. 609.

[2]Tim Christie, "Threats From Nike Preceded Single-Sales-Factor Bill," *State Tax Notes*, Feb. 18, 2013, p. 470.

company has invested $25 billion in Oregon since 1974. Perhaps Intel would have invested or expanded in Oregon without receiving tax certainty, but if the allowance of an apportionment method guarantees that Oregon will receive more significant capital investment from Intel, isn't it worth it?

In the credits and incentives arena, allowing a company to use the single-sales-factor apportionment method seems negligible when you consider that some states require all companies to use that method. What's strange is that Oregon used single-sales-factor apportionment as a bargaining tool. Instead of changing the legislation so that all taxpayers could use single-sales-factor apportionment, the legislature decided to pass legislation that allows the governor to pick and choose which companies can use that method. Is that fair to the non-*Fortune* 500 companies in Oregon?

Icing on the Cake

Johnston mentions a 143-page study by Marilyn M. Rubin of John Jay College and Donald J. Boyd, the former director of the Rockefeller Institute of Government State and Local Government Finance research group. The study was prepared for the New York State Tax Reform and Fairness Commission created by Gov. Andrew Cuomo (D), but its findings apply to all 50 states.

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According to Rubin and Boyd, credits and incentives conflict with the traditional principles of tax policy because taxes aren't supposed to influence economic behavior — individuals and businesses are supposed to make decisions based on economic merit rather than tax implications. Rubin and Boyd argue that business tax incentives violate that principle by encouraging more of a particular activity than private markets would undertake absent the incentives.

However, that is not always true. Companies usually contemplate major investments in facilities or people for business reasons. The decision of where to make that investment hinges on several factors, such as access to resources and location of customers. For most companies, incentives aren't the cake, but the icing on it.

State and local tax experts and government leaders recently met in Morocco to discuss the expansion of decentralization and increased competition among governments.[3] Those attending the International Tax Dialogue Global Conference discussed challenges facing their tax systems and how to better define relationships among a country's tax authorities.

According to government officials, tax competition caused by decentralization can be good. In countries like Switzerland, localities use direct elections to set tax rates. The tax base is constant across the nation, which creates standardization and uniformity — something the Multistate Tax Commission and similar organizations seek. However, despite Switzerland's uniformity, its localities still compete by having a mix of tax rates and services that are attractive to residents and businesses, making the country an example of how competition among localities or states is inevitable.

Conclusion

I recently wrote that states should continue to use credits and incentives to encourage companies to "reshore" their operations to the United States.[4] I admit that Johnston's article gave me pause. I do believe a standard, flat system of taxation that doesn't pick winners and losers or redistribute wealth would be fairer. However, the system of credits and incentives, lobbying, and negotiation appears to feed on itself — meaning that for the cycle to end, states or businesses must decide to stop or simply say no. If states continue determining their own tax bases, rates, and administrative processes, standardization is unlikely and competition between jurisdictions for business will continue. We should learn from *Groundhog Day* and stop reliving the credits and incentives tug-of-war. ✰

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[3]David Sawyer, "SALT Experts Tout U.S. Model of Subnational Tax Cooperation," *State Tax Notes*, Dec. 9, 2013, p. 583.

[4]Strahle, "'Reshoring' Should Inspire Favorable State Tax Policy," *State Tax Notes*, Dec. 9, 2013, p. 605.