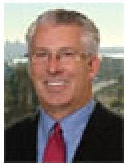

**Blake Christian**

## State Tax Burden

More taxing than you might think. SALT in the wound?

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*by Blake Christian, CPA/MBT*

Since federal corporate income tax rates are generally over four times higher than state income tax rates, tax advisors generally spend the majority of their planning and compliance time focused on reducing their federal tax burden. Too often, state income and franchise taxes are afterthoughts, particularly at compliance time.

The state and local tax (SALT) burdens can be fairly significant for taxpayers, particularly when adding in the sales tax, property taxes, city and county licenses and other fees and taxes. Since many of these taxes and fees are imposed without reference to a taxpayer's net income (or applied to a larger tax base), the combined SALT effective rates for certain states can average two thirds of the federal effective rate — and the trend in SALT tax rates continues to rise.

Large, publicly-traded companies will generally have a SALT Manager or similar position focused on these important tax issues; however, smaller companies seldom have resources devoted to SALT issues. Therefore, shifting a percentage of your planning and compliance hours to a company's SALT issues can make a significant impact on lowering your company's effective tax rates and increasing your cash flow and earnings per share.

It is fairly common for a taxpayer to have a higher state tax base than they do for federal purposes. This is due to more aggressive federal depreciation rates, expensing provisions, income exclusions and Net Operating Loss (NOL) provisions. Furthermore, because of state budget issues, it is fairly common for states to delay adoptions of federal tax breaks, but quickly adopt federal taxable income increases. Therefore, there is a certain "marginal rate creep" inherent in many state tax systems.

Many city, county income or license fees are tied to gross receipts, payroll or employee headcount; therefore, the effective SALT rates can be very high for companies with lower net margins.

### Number Speak

In a 2005 study conducted by University of Southern California professor, Charles W. Swenson: "Effective Tax Rates For The States: 1991–2002,"Swenson quantified that the average U.S. company's combined SALT burden increased from 18.16 percent in 1991 to 25.43 percent in 2002. The 2002 range of effective combined SALT rates ranged from a low of 7.89 percent in South Dakota to a high of 39.4 percent in Michigan.

Swenson's study further broke down the combined SALT burden by type of tax and leading the way was property taxes (37% combined state and local), corporate income tax at 30 percent, Occupation and Business Licenses at 19 percent and the balance a variety of other fees. ***Note:*** The aforementioned components are not marginal or effective rates, but the allocable percentages making up the combined SALT burden.

The lowest effective corporate income tax rates in 2002 were found in tax-exempt Nevada, Texas and Washington State. The highest effective tax rates were found in California (10.13%), Delaware (10.29 percent), West Virginia (13.0%), Michigan (17.01%) and a whopping 22.10 percent in New Hampshire.

In December of 2007, Supply Side Economics gurus Arthur Laffer and Stephen Moore released their annual state rankings of Economic Competitiveness based on 16 economic policy variables, including taxes, regulations, workforce, legal system, education, infrastructure, etc. As expected, there is a clear correlation between lower marginal rate states, competitive rankings and population patterns.

In the Laffer study, among the Top 10 rated states included: Utah, Arizona, South Dakota, Wyoming, Tennessee, Virginia, Colorado, Idaho and Texas. The bottom 10 rankings went to the following states: Vermont, New York, Rhode Island, Ohio, Kentucky, Hawaii, Maine, New Jersey, Illinois and California — most with higher than average overall SALT burdens.

The Laffer report concludes that absent changes in certain state's underlying tax structure, these states will continue to have lower than average business creation/retention and lower population growth rates.

Enough of the bad news. Virtually every state in the country has some form of state tax breaks in the form of income exclusions, sales tax exemptions, hiring and/or equipment tax credits, property tax breaks, training grants, "Tax Holidays," etc. These specialized tax benefits are rarely factored into state rate/competitiveness studies since these incentives are seldom available to every industry or in all geographic regions within a state.

While some of these special benefits are available to all industries and to all regions in a given state, in the majority of cases, the tax breaks are directed to only selected regions or industries within a given state.

Therefore, as a result of statutory complexities, lack of state promotion of these benefits and/or lack of taxpayer attention, many of these tax incentives are completely overlooked or grossly understated.

We consistently find that over 25 percent of businesses nationally have one or more facilities in a state or federal incentive zone, yet 90 percent of these eligible businesses overlook or materially understate these benefits.

These benefits can be very significant and in some cases can completely eliminate current year taxes, as well as taxes paid in years still open by statute. Since these are generally permanent tax savings; for public companies, this drop in effective rate can have a multiplier effect on their EPS (earnings per share) and stock price. For privately-held companies, these savings can also increase the business valuation and shareholder cash flow.

The following list illustrates the variety of tax breaks available to businesses operating in various states. Some programs are what are referred to as "statutory" or "non-pre-qualification" programs, which generally do not require the taxpayer to apply for the program benefits before starting operations. Some states, however, do require taxpayers to apply for the program benefits — either before starting operations or annually.

**State Enterprise Zone Programs**

While generally referred to as "Enterprise Zone" (EZ) programs, certain states may have their own unique program name (e.g. "Empire Zone" in New York, "Renaissance" program in Michigan, etc.).

These programs are generally designed around economically depressed areas to encourage companies to locate, remain and/or expand in a given region.

The tax incentive regions may be defined by city, county, census tracts or specific street ranges — which can present challenges to taxpayers attempting to access these benefits. A call to your local Economic Development department or Web search for your given jurisdiction will generally allow you to determin eligibility.

Over 40 states currently have some form of EZ benefits, which vary by state, but common features include: hiring credits (ranging from $500 to $13,000/year per "qualified" W-2 employee for workforce expansion); equipment credits for purchasing designated equipment; facility expansion benefits in the form of accelerated depreciation; expensing or credits; and possible training and other grants or lender benefits (CA, IL, IN) for financing such operations.

**Property Tax Relief**

In addition to potential property tax exemptions or rate reductions for operating in certain jurisdictions or being in a designated industry, 43 states also have some form of "tax increment financing" (TIF) programs, which generally allow taxpayers to either obtain subsidized funding for a project in a Redevelopment Area (RDA) or receive a lower tax base in return for revitalizing an economically depressed area. To obtain these benefits, a taxpayer must generally negotiate with the RDA prior to beginning the construction or rehab phase. State and/or federal rehabilitation credits and Low-Income Housing credits may also be available on such projects.

**Sales/Use Tax Exemptions**

State sales/use tax statutes are sprinkled with exemptions and credits for certain state jurisdictions or targeted/specialized industries.

Some cities and counties are also open to negotiate sales tax "holidays" for new businesses, whereby the city or other jurisdiction will either exempt taxable sales or rebate all or a portion of sales tax collected from the taxpayer.

**Other Benefits**

These state jurisdictions with employer tax incentives often are near or overlap with various federal programs such as: Empowerment Zones ($3,000 annual credit per "qualified" employee), Renewal Communities ($1,500), Indian Tribal Lands ($4,000) and Rural Renewal Communities ($2,400), which can offer additional overall savings.

It is fairly common for the federal, state and local agencies to also offer other resources to companies operating in these economically challenged areas. Free business counseling, employee training/screening, low-interest loans or outright grants are often offered in these regions — although some research may be required on the part of the company.

**Conclusion**

Companies that take the extra time to evaluate the available SALT benefits available to their various facilities will often gain immediate tax savings and significant refunds for prior years in certain states.

The permanent tax savings and cost reductions available under these programs can offer long-term competitive advantages in a challenging marketplace.

A thorough review of your current company or client facilities and available program benefits can yield positive results. And if you have no facilities in a state or federal incentive zone, when you are considering a move or expansion, you have 8,500 jurisdictions across the country that can generate tax breaks.

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