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POLICY brief

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TRENDS IN CORPORATE INCOME TAX RECEIPTS

Corporate income tax receipts have been an important source of tax revenue since the tax was officially created in 1909. Corporate taxes accounted for almost 12 percent of federal revenues in 1998 and 6.4 percent of state tax revenues in the same year. In Georgia, corporate income tax revenues are 6.4 percent of total net revenue in 1998--on par with the average state in the U.S. Corporate income tax revenues pall in comparison with personal income and sales tax revenues in the state. As a comparison, the Georgia personal income tax accounted for 48 percent of total net revenue in 1998 and the general sales and use tax was 36 percent of net total revenue collections.

Over the past two decades, the growth in Georgia state corporate tax receipts relative to other state revenue sources has faltered. With the exception of a slight rebound in 1993-95, the corporate tax as a percent of individual income tax receipts in Georgia declined from a high of 24.2 percent in 1985 to 14 percent in 1998. Compared to all state tax revenue, the corporate income tax has fallen from 9.5 percent in 1985 to the current level of 6.4 percent. The majority of the decline in importance as a state revenue source occurred from 1983-91. Since pulling out of the 1990-92 recession, state corporate tax revenues as a percent of total state taxes have stabilized at a rate between 6 and 7 percent. Relative to other states, Georgia's corporate income tax grew more slowly than the average state until the post-recession years.

Some might view these revenue patterns as significant--others may not be particularly concerned over these patterns. After all, the tax generates only about 6.4 percent of total revenue in the state – about one third more than the revenue loss due to the exemption of food from the sales tax base and less than the equivalent of a one cent increase in the sales tax. However, the tax is the third most important single revenue source in the state. Also, the corporate income tax does not simply play a revenue generating role. As a "tax on business" it is perceived to be a tax which is progressive in nature. In fact, whether the tax is progressive in nature or not is an open question.[1]

So long as the corporate tax exists, the question of why corporate tax receipts have slowed relative to other revenue

[1]In addition to its distribution and revenue roles, there are other reasons to levy a corporate income tax. These include the exportability of the tax (which lowers the tax burden of state residents) and the use of a tax as payment for services received by corporations. According to the benefits principle of taxation, taxes are payments for goods and services produced by the public sector. Businesses are consumers of roads, police protection, educational services and the like and as such businesses should pay for some part of these public goods.

Georgia State University

sources is important. The state government needs to know whether the pattern of corporate receipts is due to natural changes in the economy or due to federal and state policies. Such information will give the state more information for forecasting receipts as well as shed some light on the impact (cost) of federal and state policies such as tax rate changes and increased exemptions.

We examined the trends in state corporate tax receipts and possible explanations for these trends. We might think of the possible explanations as falling into three categories: legal tax avoidance (tax reforms and changes in laws governing incorporation and their impacts), economic changes, and other tax policy changes (tax credits and incentives).[2] What we find is that the changes in the economic base of Georgia are the most likely reason that state corporate tax receipts have declined in importance. Georgia's industry concentration is growing in sectors which do not pay an increasing share of federal corporate income taxes. This is due to the growth coming in industries which report smaller increases in taxable profits.

There are some other possible reasons for the trend in corporate tax revenue in the state including:

- A change in the form of incorporation by businesses ("disincorporation"). This means that due to tax policy and law changes, business entities can by-pass the corporate tax structure by passing income through to owners, shareholders, and partners who pay tax via the personal income tax structure.

- There have been some tax law changes which may contribute to the loss in corporate tax revenue in the state. In particular, the BEST legislation of 1994 and its expansion in 2000 offer a host of tax credits to corporations in the quest for economic development. Through 1997 the usage of these credits appears small, but anecdotal evidence suggests that firms are paying more attention to the credits and their usage may be on the rise.

- There are some other specific tax policy issues which plague the corporate income tax. The use of separate accounting encourages tax planning such that companies report as few taxable profits in Georgia as possible. A tax amnesty in late 1992 may have affected the growth of corporate tax revenues post recession and an expanded depreciation allowance in 1990-91 may have contributed to the same.

Many of the remaining questions--the extent of tax planning, the impact of differential tax rates among states, the effect of expanded credits, and the disincorporation hypothesis, can be more fully investigated with a panel of corporate taxpayers. Such analysis is necessary to quantify these potential changes so that we better understand what has happened to the corporate income tax in the state and what might happen in the future. Quantifying the costs of such avoidance behavior and the tax expenditures of the state government are important inputs in the development of a rational, long-term corporate income tax policy.

[2]We do not investigate tax evasion.

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