STATE CORPORATE TAXATION POLICIES

Comparative Analysis of New Jersey's Corporate Taxation Policy with Other Key States

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Executive Summary

New Jersey has a poor business tax climate which, combined with other State corporate tax policies, has detrimental effects on business investment and the decisions of businesses to locate in the State. According to the Tax Foundation's *2008 State Business Tax Climate Index*, New Jersey ranks 49th among the 50 states. The business climate is measured according to various state taxation polices, including the corporate income tax, property taxes, and sales and use taxes. While the business climate depends on multiple factors, the focus of this report is the corporate taxation policies of ten selected states, including New Jersey, Connecticut, Delaware, Georgia, Maryland, Massachusetts, New York, North Carolina, Pennsylvania, and Virginia. These states were selected because they are direct regional competitors and have more favorable business climates relative to New Jersey.

A comparative analysis of the corporate income taxation policies of the selected states was conducted to determine New Jersey's standing among the competitor states. The policy indicators used for comparison include: tax rate, minimum tax, base, pass-through-entities, definition of presence, apportionment formula, definition of business income, throwback rule, deductions for royalty payments to subsidiary companies, net operating loss, combined reporting, and tax incentives.

Compared to the selected states, New Jersey:

- Has the third highest tax rate;
- Has the highest minimum tax, with a top bracket of $2,000;
- Has a similar corporate income tax base and treatment of pass-through entities;
- Subjects corporations with both physical and economic presence to the corporate business tax, seen in the aggressive enforcement strategies;
- Has an apportionment formula that double-weights the sales factor, as with most other selected states;
- Is one of two states in the nation with a throwout rule;
- Does not allow corporations to deduct royalty payments to subsidiaries, as with most of the other selected states;
- Allows businesses to carry forward net operating losses for seven years, shorter than most of the selected states;
- Does not have a mandatory combined reporting policy; and,
- Has a very comprehensive tax incentive structure

Based on the comparative analysis and our interviews with tax experts, towards the goal of improving the State's business climate, we recommend the seven following reforms to New Jersey's corporate taxation policies:

1. **Reform the apportionment formula by increasing the weight on sales;**
2. **Do not pursue combined reporting;**
3. **Make tax incentives predictable and stable;**
4. **Eliminate the throwout rule by either adopting the throwback rule or not pursuing these policies;**
5. **Clearly define the business activities related to nexus;**
6. **Repeal the requirement for out-of-state corporations to pay minimum tax when soliciting orders in New Jersey; and,**
7. **Extend net operating loss.**

Certain state and local taxes are more significant to businesses in determining investment and location decisions when factors such as market access, workforce quality, cost of living, access to production inputs, and energy costs are comparable across states. By improving its business tax climate, New Jersey creates opportunities to increase business investments and employment opportunities in the State.

Section 1: Introduction

New Jersey's economic performance has declined in recent years in part because of its business tax climate. On behalf of and in cooperation with the New Jersey Policy Research Organization (NJPRO), a comparative analysis of the corporate income taxation policies of nine selected states was conducted to determine New Jersey's standing among competitor states in the region. The policy indicators used for comparison include: tax rate, minimum tax, base, pass-through-entities, definition of presence, apportionment formula, definition of business income, throwback rule, deductions for royalty payments to subsidiary companies, net operating loss, combined reporting, and tax incentives.

In recent years, New Jersey has experienced economic stagnation. In fact, several firms have found New Jersey's business environment too costly and have opted to move to other states. In June 2005, William Juliamo, a developer frustrated with environmental regulations, purchased a billboard in Pennsville that read[1]:

Welcome to New Jersey.
A Horrible Place to do Business.
D.E.P. Nightmare State.
Can Senator Corzine really do anything?

While extreme in tone, it is unfortunately indicative of some recent trends in the state.

James Hughes and Joseph Seneca of Rutgers University write in their quarterly economic publication, *Rutgers Regional Report*, "New Jersey now faces its most uncertain economic future since the Great Depression."[2] Hughes and Seneca explain how in the past, the State's economy has been very privileged, inventive, and affluent. Several studies confirm the dynamic character of the State's economic opportunities. For example, the Information Technology and Innovation Foundation's *2007 State New Economy Index: Benchmarking Economic Transition in the States*, ranks states on the following indicators: knowledge jobs, globalization, economic dynamism, transformation to a digital economy, and technological innovation capacity.[3] Based on their results, New Jersey ranked second in the nation.[4] The report goes on to describe New Jersey's efforts in fostering a high-tech economy that has the potential to be a leader in the emerging global economy.

Globalization, a weak business climate, and a high cost of doing business are undermining the economic prospects for the State. There has been a recent movement of jobs and a loss of industry. From 2000 to 2005, 98,900 manufacturing jobs were lost in the State.[5] Furthermore, private-sector growth has been very weak. From December 2006 to December 2007, New Jersey's private-sector employment growth rate was 0.1 percent, much less than the gains seen in New York and Pennsylvania of 1.2 percent and 0.6 percent, respectively.[6] Additionally, private sector employment growth in New Jersey continually lags behind the growth experienced in the nine other states used for comparison in this report.

Confidence in New Jersey's business climate has steadily eroded as well. A 2006 New Jersey Business & Industry Association (NJBIA) survey of 1,700 employers found that 51 percent expect economic conditions to worsen.[7] The survey found a general pessimism stemming from problems relating to economic weakness, business turnover, and financial instability. The survey concludes that New Jersey is at a 'critical tipping point.'[8]

Public policy has a dynamic influence on the operations and performance of business. New Jersey's ability to attract and retain business is vitally important. In a study published by the Small Business & Entrepreneurship Council's *11th Annual Small Business Survival Index*, New Jersey is the worst state to operate a small business based on regulation, soaring taxes, and other economic indicators. New Jersey received a score of 65.3, almost 29 percent higher than the national average of 50.7, where a lower score indicates a more favorable environment of investment and small business operation.[9]

Although New Jersey has the potential to return to its economic leader status, certain policies may be hindering its growth potential. To improve the likelihood that New Jersey will be able to compete regionally, attract businesses, and produce viable economic development, reforming its corporate income taxation is necessary.

The Tax Foundation's *2008 State Business Tax Climate Index,* based on an evaluation of states' corporate, individual, and property tax policies, ranks New Jersey as having the second worst business tax climate in the nation.[10] Governor Jon Corzine has established the Office of Economic Growth to revitalize the State's economic base, job growth, and business climate.[11] The challenge facing the State, however, is to identify reforms that maintain its corporate tax base, while simultaneously attracting business investment and growth.

National Corporate Income Tax Trends

Nationwide, state corporate income taxes as a share of state tax revenue have declined over the past three decades. Corporate tax revenues in the 44 states that tax businesses have declined from 10.2 percent of state tax revenue in 1979 to 6.5 percent in 2006.[12] One reason for this loss in corporate tax revenues relates to the way that businesses organize. For the past several decades, the majority of new businesses have organized as pass-through entities, such as partnerships, S-corporations, and limited liability companies (LLCs). Pass-through entities typically are not required to pay corporate business taxes; instead, earnings are taxed under the partners' individual income taxes.

Multi-state corporations conduct business in more than one state. Many states are initiating reforms specific to the taxation of multi-state corporations. These reforms include changing how corporations are taxed and the definition of the tax base either by taxing gross sales revenues or imposing a flat tax on revenues rather than profits. Some states have imposed combined reporting tax policies, treating the parent corporation and its subsidiaries as one corporation for the purposes of state income taxes. Currently, 16 states tax businesses on the basis of combined reporting and another six state governors have recommended the implementation of similar tax reforms.[13] New Jersey does not use combined reporting, although the New Jersey Division of Taxation has the ability to require combined reporting on a case-by-case basis.[14] To date, New Jersey has not required any corporation to file a combined report.

This report describes an analysis of the corporate income taxes in New Jersey compared to nine states in regional proximity. The goal of this analysis is two-fold: to better understand how corporate income tax policies in New Jersey contribute to its poor tax climate and to make recommendations that are likely to improve New Jersey's tax climate in ways that will help the state regain its competitiveness and stronger economic performance. The following sections will examine the factors that influence business location decisions, provide an overview of the taxes that impact businesses, and present recommendations for New Jersey's corporate income taxation policies.

Section 2: Factors Influencing Business Location Decisions

Analysts and economists have many differing opinions as to how important state taxation policies are in a business' decision to locate in a specific area. Firms consider a variety of factors when choosing a location to conduct business, including access to a quality workforce and other production inputs, access to a marketplace, energy costs, and preference of the CEO. These factors individually or in combination might carry more weight in the location decision than the amount of taxes the firm will incur. For example, New York City is ranked very unfavorably in the Tax Foundation's *2008 State Business Tax Climate Index*, yet businesses are still locating there in part because of the amenities and other benefits that are unique to New York City.

Small differences between jurisdictions in factors such as workforce quality may greatly offset large variations between jurisdictions' rate of taxation/tax incentives. Therefore, if a firm was making a decision between locating in either Los Angeles or Philadelphia, local taxes and incentives would probably not be the deciding factors for the firm. Even small differences between Los Angeles' and Philadelphia's workforce would likely serve to counterbalance the taxes or tax incentives of these locations.

The relative importance of tax and non-tax factors in a firm's location decision would change, however, if the firm was deciding between two locations within the same region, such as deciding between New York City and Northern New Jersey. Non-tax differences, such as in workforce quality, are likely to shrink with the closer geographic proximity of competing locations. More specifically, if a firm sees no significant differences between the major non-tax factors of the two locations, tax differentials will become more relevant in the firm's location decision. Businesses, in such cases, will move away from the less favorable taxation location and towards the more favorable taxation location.

Overall, some state and local taxes will matter more for some businesses location decisions when other non-tax factors (e.g., workforce quality) are comparable between or among location options. For example, it has been observed that for FIRE (Financial, Insurance and Real Estate) businesses the personal income tax rate is important to the firm's location decision.[15] But if a local or state government cuts services that are valuable to the business community, such as transportation and education spending, the jurisdiction might actually lose jobs as firms move to jurisdictions that spend more on these services.

For this reason, state policies that encourage the growth and development of employment sectors that are currently trending upwards in the United States such as professional, scientific and technical services industries will attract businesses demanding this type of labor.[16] By lobbying the state to fund basic research and development efforts, the business community positions the state for a central role in the next big industry growth trend. For example, in November of 2007, the State of Texas authorized a $3 billion research fund for basic cancer research.[17] This was a forward looking action by the State Legislature to make Texas the premier state for cancer and medical research in the nation. In Table 1 below, it is observed that Texas' employment growth rate in professional, scientific, and technical services was 3.1% while New Jersey's was only 1.7%.

*Table 1. Employment Growth in Chosen Sectors, United States, New Jersey and Texas**

	United States				New Jersey				Texas		
	March 2007	March 2008	% change		March 2007	March 2008	% change		March 2007	March 2008	% change
Professional, Scientific, and Technical Services	7,569.6	7,828.2	**3.4**		283.9	288.7	**1.7**		550.8	568.1	**3.1**
Education and Health Services	18,153	18,699	**3.0**		578.2	587.9	**1.7**		1,244.5	1,280.6	**2.9**

Source: U.S. Bureau of Labor Statistics * All numbers reported are seasonally adjusted, In Thousands

If all else is equal, the business tax climate can be a deciding factor for business location decisions, especially on a regional level. In these cases, a state's reputation can have a significant impact, even if the state has a favorable/unfavorable tax climate. Overall, the qualities businesses look for in a tax climate are stability, transparency, and efficiency. Business want a tax climate that has stability in the rate of taxation, transparency in how taxation and tax incentive programs are determined, and efficiency in the tax base and structure.

Section 3: Business Tax Overview

Taxes are one of the most apparent costs of doing business in the United States. Businesses pay taxes for the purchase of inputs, ownership of assets, earnings, and rights to do business.[18] Business taxation is an important source of revenue for state and local governments in the United States and New Jersey. In Fiscal Year 2006, businesses paid $554 billion in state and local taxes nationally, constituting 45 percent of total taxes collected by state and local governments. In New Jersey, businesses paid $18.7 billion, constituting 38 percent of total taxes collected by the New Jersey state government and local governments.

The distribution of business taxes in the United States and New Jersey is shown in Table 2:[19] Three key taxes comprise nearly 70 percent of state and local taxes paid by businesses both nationally and in New Jersey. These are: property taxes, sales and use taxes (including gross receipts taxes), and corporate income taxes.

*Table 2. State and Local Business Taxes in FY 2006 collected in the United States and New Jersey**

Business Tax	Payments (U.S.)	% of Total (U.S.)	Payments (N.J.)	% of Total (N.J.)
Property Taxes on Business Property	$ 204.8	37.0%	$ 7.5	40.1%
Sales and Use Tax on Business Inputs	124.7	22.5	2.7	14.4
Corporate Income Tax	51.8	9.4	2.9	15.5
Unemployment Insurance Tax	36.4	6.6	1.6	8.6
Excise Taxes	25.7	4.6	2.0	10.7
Individual Income Tax on Business Income	21.4	3.9	0.8	4.3
Licenses, Utility and Other Business Taxes	88.7	16	1.2	6.4
Total State and Local Business Taxes	**$553.7**	**100%**	**$18.7**	**100%**

Source: Ernst & Young, LLP *In billions of dollars

Property Tax

As real estate values have increased significantly in the past decade, property taxes have become a major concern to businesses because they increase operation costs and, as such, can significantly impact location decisions. Research shows that property taxes have a negative impact on business start-ups because property taxes are paid regardless of profit levels.[20] One study found that a ten percent increase in business property taxes decreases the number of new plant openings in a state by approximately one to two percent.[21] For this reason, property taxes can be expected to have a

more significant impact on business location decisions than profit-based taxes. Anecdotal evidence provided by tax experts interviewed as part of this study supported this conclusion.[22]

The effective tax rate of personal and real property for businesses and individuals is not available. The large number of local entities collecting property taxes makes data collection burdensome and beyond the scope of this paper. The Tax Foundation reports the level of property tax collection per capita for a state using the United States Census Bureau's property tax collection totals divided by state population.[23] Although this number includes both residential and business property tax payments, it gives taxpayers a sense of how much, in actual dollar terms, they pay in property taxes compared to taxpayers of other states. Property tax collections range from a high of $2,241 per capita in New Jersey to a low of $419 per capita in Alabama.[24] [For a more thorough discussion of property taxes' impact on businesses, see Appendix A].

Sales Tax

Levying a sales tax on business inputs and on final goods and services negatively impacts both businesses and consumers. Taxing business inputs results in tax pyramiding because the cost of the sales tax levied on the input becomes a part of the price of the good, and the final good is subject to a sales tax when sold to the consumer. Essentially, the consumer is taxed multiple times for the same purchase.[25] Businesses that must pay sales taxes on inputs end up charging higher prices or reducing workers' wages because of the added costs of conducting business. In fiscal year 2006, general sales taxes on business inputs totaled $124.7 billion, accounting for 22.5 percent of all state and local business taxes.[26] States that impose a sales tax on business inputs discourage economic activity and reduce the competitiveness of businesses located there, thereby dampening economic development by making the state a less attractive place to do business. Tax pyramiding encourages businesses to vertically integrate to avoid the sales tax, resulting in a greater potential for misallocation of economic resources and a violation of the principle of tax neutrality.[27]

Forty-five states and the District of Columbia have general sales taxes and approximately 7,600 counties and cities in 32 states levy local sales taxes.[28] Sales tax revenue for a state or locality depends on the sales tax rate and base defined by the taxing government authority. The sales tax base generally includes most tangible goods, some business inputs, and some services. Businesses pay a sales tax on inputs and collect the tax on final sales to consumers and remit payment to the state. Their role as tax collectors creates administrative costs for businesses. As of 2005, these collection costs were offset by laws in 29 states and the District of Columbia that allowed businesses to retain part of the tax collected.[29] [For a more detailed discussion on the sales tax and related issues, see Appendix B and D].

Corporate Income Tax

The corporate income tax is a tax on the profits of corporations. Rates of taxation vary from state to state. Only South Dakota, Nevada, Wyoming, and Washington do not have corporate income taxes. Of the states that do levy corporate income taxes, the rate of taxation varies from one percent to 12 percent, with Iowa having the highest rate.[30] In 1981, state corporate tax revenues made up 9.4 percent of total state tax revenue, but dropped to five percent in 2002.[31] This trend

occurred despite the fact that corporate profits as a share of national income rose between 1981 and 2002. In addition, state corporate income tax revenues as a share of corporate profits declined from 6.6 percent in 1980 to four percent in 2000. While state corporate tax revenues generally fell during this period, the corporate income tax in some states was stable or increased as percentage of state tax revenues.[32] By 2006 corporate income tax as a percentage of total state tax revenues had again increased to 9.4 percent.[33]

Contributing to the decline in state corporate revenues is the increasing number of businesses that are legally organizing as pass-through entities. Businesses that organize as S corporations, limited liability partnerships, and limited liability corporations, all of which are pass-through entities, are not subject to the corporate income tax. Instead, these businesses are taxed via the individual income tax. In 1996, approximately 50 percent of corporations were S corporations, comprising 11.5 percent of all corporate net income.[34] According to a 2004 Georgia State University study, *The Disappearing State Corporate Income Tax*, researchers found that, "much of the decline in state corporate income tax revenues is explained by economic factors (such as changes in industrial structure) and tax planning (such as changes in corporate form and apportionment factor management)."[35] Federal policy altering taxable income does not seem to be a causal factor. In the study, tax officials assert that state policy changes have not significantly affected state corporate income tax revenue.

Section 4: Comparative Analysis of New Jersey and Key States' Corporate Income Taxes

Businesses face a variety of corporate taxation issues that could affect locations decisions, payroll, number of employees, and the amount of tax due to a state. The following factors are significant components of the corporate income tax (CIT) structures in states: tax rate, minimum tax, base, pass-through-entities, definition of presence, apportionment formula, definition of business income, throwback rule, deductions for royalty payments to subsidiary companies, net operating loss, combined reporting, and tax incentives. Our analysis indicates that New Jersey's corporate income tax structure makes the state less competitive vis-à-vis comparison states (Connecticut, Delaware, Georgia, Maryland, Massachusetts, Pennsylvania, New York, North Carolina, and Virginia).

Tax Rate

As shown in Table 3, the range of CIT rates in these ten states is between six percent and 9.99 percent. Georgia and Virginia both have the lowest rate with six percent, whereas Pennsylvania has the highest tax rate with 9.99 percent. The three Southern states have the lowest relative rates. New Jersey has the third highest rate, surpassed only by Pennsylvania and Massachusetts, and is the only state with a graduated rate structure. Since, the cut off income level between the second bracket and the third bracket is very low ($100,000), the tax rate is effectively flat at nine percent.

Table 3. Broad Base Corporate Income Tax Rates

State	Rate
Georgia	6.0%
Virginia	6.0%
North Carolina	6.9%
Connecticut	7.5%
New York	7.5%
Maryland	8.25%
Delaware	8.7%
New Jersey	6.5% (net income≤$50,000) 7.5% ($50,000≤net income≤$100,000) 9.0% (net income>$100,000)
Massachusetts	9.5%
Pennsylvania	9.99%

Source: The Tax Foundation

Five out of ten states have corporate taxes based on measures other than net income, typically capital stock (see Table 4). Tax bases range from $1.5 per $1,000 in North Carolina to $3.89 per 1,000 in Pennsylvania. In North Carolina, Massachusetts, and Pennsylvania, these taxes are in addition to corporate income taxes. For Connecticut and New York, taxes on capital stock are an alternative to the corporate income tax.

Table 4. Corporate Taxes Based on Measures Other than Net Income

State	Rate	Additional/Alternative
North Carolina	$1.5 per $1,000 of the capital stock (capped at $75,000)	Additional
Connecticut	$3.1 per $1,000 of the capital base (capped at $1,000,000)	Alternative
New York	$1.78 per $1000 of the capital stock	Alternative
Massachusetts	$2.60 per $1,000 of a taxpayer's taxable tangible property or net worth	Additional
Pennsylvania	$3.89 per $1,000 of the capital stock (currently being phased out, will no longer be applied after 2010)	Additional

Sources: New York State Department of Taxation and Finance, Commonwealth of Pennsylvania, Department of Revenue, Commonwealth of Massachusetts, Department of Revenue, State of Connecticut, Department of Revenue Services, North Carolina Department of Revenue.

Minimum Tax

A minimum tax refers to the minimum amount of corporate income tax owed by a taxpaying entity. A State with a minimum tax may require that a taxpaying entity pay if they do not owe any tax. Thus the tax is based on the regular rate and taxable income resulting from a reporting loss in that particular year. A State may also impose a minimum tax based on a company's status, such as S corporations or those located out of state.

Minimum tax requirements vary greatly among states. Delaware, Georgia, Pennsylvania, Maryland, and Virginia do not impose a minimum tax. North Carolina institutes a minimum tax of $35.[36] Connecticut's minimum tax is fixed at $250 regardless of tax credits[37], while Massachusetts has a minimum tax of $456.[38]

In comparison, New Jersey and New York have much more complex minimum tax schemes. New York has two minimum taxes, a fixed-dollar minimum tax and an alternative minimum tax calculated as a percentage of taxable income. The fixed-dollar minimum tax graduates from a low of $325 for businesses with annual payrolls under $1 million to $1,500 for firms with payrolls over $6.25 million.

The New York corporate income tax involves four distinct taxes of which businesses are required to calculate their liability under each tax and pay the largest of the four. C corporations subject to the corporate income tax or franchise tax must pay 0.09 percent of subsidiary capital plus the great of the following:

- 7.5 percent of net income;
- 0.178 percent of capital (not to exceed $350,000);
- 2.5 percent of minimum taxable income; or,
- a fixed dollar minimum tax, ranging from $250 to $1,500 depending on payroll size.

Accordingly, a C corporation in New York may be subject to a minimum tax rate of 2.5 percent. New York defines its minimum tax base as entire net income "adjusted to reflect certain federal tax preference items and adjustments and state specific net operating loss (NOL) modifications."[39] New York has a separate, lower graduated tax rate for small C corporations with income under $290,000. The State imposes a fixed minimum tax of $800 for C corporations whose "gross property, receipts, and payroll are each less than $1000."[40] S corporations are subject to the same minimum tax as C corporations.[41]

New Jersey has several minimum taxes of $500, $750, $1,000, $1,500 and $2,000 depending on the amount of New Jersey gross receipts. The brackets are as follows:[42]

- $500 (if NJ gross receipts≤$100,000);
- $750 ($100,000≤NJ gross receipts≤$250,000);
- $1,000 ($250,000≤NJ gross receipts≤$500,000);
- $1,500 ($500,000≤NJ gross receipts≤$1,000,000); and,
- $2,000 (if NJ gross receipts≥$1,000,000).[43]

Base

Historically, businesses in the United States were structured as either sole proprieterships, partnerships, or corporations. In recent years, alternative business structures, such as S corporations and limited liability proprieterships and partnerships,[44] have become increasingly more common. A business' structure determines if it is included in the tax base. The general consensus from the literature and tax experts is that a broad tax base with a low tax rate is most conducive to creating a competitive climate for a state.

While the corporate income tax base varies by state, most states define their base as some combination of corporations, S corporations, and limited liability companies. Georgia, Virginia, and New York define their tax base as corporations and S corporations.[45] Connecticut's corporate business tax base includes corporations and limited liability companies.[46] Massachusetts' tax base includes corporations, limited liability companies, and S corporations.[47] Maryland and Delaware both include C corporations and any other business entity choosing to be taxed as a corporation in the base. New Jersey's corporate business tax base includes corporations, joint-stock companies or associations, business trusts, limited partnership associations, financial business corporations, and banking corporations.[48] Pennsylvania's tax base is defined as corporations, limited liability

companies, business trusts (classified as corporations for federal income tax purposes), and joint-stock associations.

Pass-Through Entities

Pass-through entities are entities, such as S corporations and limited liability partnerships, whose taxable income is passed through to the shareholders and partners.[49] Based on recent IRS statistics, between 2000 and 2004, the partnership population grew approximately 23 percent, while the number of S corporations in the U.S. grew about 21 percent.[50] As of 2005, there were approximately 2.5 million partnerships and 3.5 million S corporations in the country. A state reduces its competitive stance by imposing both a corporate income tax and personal income tax on pass through entities.

Each state defines how it will treat pass-through entitites for corporate income tax purposes. In New York, S corporations are subject to the personal income tax. In Connecticut, S corporations and partnerships owe income tax for each nonresident non-corporate member or when the member's share of the income derived from Connecticut is $1,000 or more.[51] In Massachusetts, sole proprietorships owe income tax on business profits and partnerships are taxed on the partner's share of the income.[52] Georgia's pass through entities are taxed at the individual level of the business owners.[53] Pass-through entities doing business in Virginia and that have taxable income derived from State sources are required to pay a withholding tax equal to five percent of their nonresident owners' shares of income from Virginia sources.[54] In Maryland, LLC's and S-corporations' tax rate for non-resident individual members is 6.75 percent and 8.25 percent for non-resident entity members. In Delaware, S-corporations' pay the individual tax rate of 5.95 percent. The partners/owners of S corporations are subject to the Pennsylvania personal income tax. However, an S corporation's net income that is subject to federal CIT (federal built-in-gains) is subject to the Pennsylvania Corporate Net Income Tax (CNIT).[55] In New Jersey, S corporations are subject to either the minimum tax (if net income ≤$100,000) or reduced rates (1.33 percent before June 30, 2006 and 0.67 percent for tax year 2007). This was phased out beginning June 30, 2007. Currently, the partners/owners of S corporations are subject to the personal income tax and are required to pay the minimum tax. However, an S corporation's entire net income that is subject to federal CIT is taxed at nine percent.[56]

In North Carolina, S Corporations are not subject to the corporate income tax but are subject to the individual income tax. A shareholder who is a resident of the State also takes into account their share of the S Corporation income not attributable to North Carolina when computing their individual income tax. An LLC is subject to income taxation as a partnership if classified as a partnership for federal income tax purposes or as a corporation if classified as a corporation for federal income tax purposes. An LLC classified as a C Corporation for federal income tax purposes is subject to the franchise tax, but all other LLCs are exempt. However, it is the intent of the law that the franchise tax applies equally to assets held by corporations and assets held by corporate-affiliated LLCs. Assets of a non-corporate LLC are attributed to a controlling corporation if the corporation or affiliate group of corporations own 50 percent or more of the assets. The Policy and Analysis Statistic Division of the North Carolina Department of Revenue cites this as a strategy to "avoid the possibility of corporations reducing their franchise tax by transferring assets to their LLC."[57]

Definition of Business Presence

The primary condition for a state to impose a corporate income tax on a business entity is the determination of nexus. Nexus is defined as the necessary physical and/or economic presence a corporation must have within a state to be mandated to pay taxes on business activities. As states have interpreted nexus in different ways, legal challenges have arisen.

Court cases, including *Geoffrey Inc v. South Carolina Tax Commission*, *MBNA America Bank v. Tax Commissioner of the State of West Virginia*, and *Lanco Inc. v. Director, New Jersey Division of Taxation,* have had significant implications for state business tax policies. These court decisions provide the opportunity for states to increase their corporate business tax revenues. Some states utilize combined reporting to prevent tax revenue losses due to payments made to parent companies. However, some court decisions may reduce the need to use this tax policy. [For a more in-depth summary of the landmark court cases, see Appendix E].

A majority of states analyzed adhere to the definition of presence found in the federal Interstate Income Tax Law. The law restricts a state from imposing a net income tax on income derived within its borders from interstate commerce if the only business activity of the company within the state consists of the solicitation of orders for sales of tangible personal property that are for shipment or delivery to somewhere outside the state.[58] Definition of presence in North Carolina, Georgia, Virginia, Pennsylvania, and Maryland adhere to the definition found in federal Public Law 86-272.

In Georgia, corporations that own property or do business in Georgia are subject to the corporate income tax.[59] In Virginia, every corporation that is incorporated under Virginia law, has registered with the State Corporation Commission for the privilege of conducting business in Virginia, or that receives income from Virginia sources must file a Virginia corporation income tax return. Delaware adheres to the definition of physical presence; a business must have either an employee or some property in the State. Connecticut defines presence as the ownership of real or tangible personal property within the State; compensation for services performed in the State or income from a business, trade, profession, or occupation carried on in the State; unemployment compensation received from the Connecticut Department of Labor; a trust or estate with income derived from or connected with Connecticut sources; or a nonqualified deferred compensation plan for services performed wholly within Connecticut.[60]

In Pennsylvania, a corporation is subject to the CNIT if it does business and carries on activities or has capital or property employed or used in the state. If a corporation's only interaction within Pennsylvania is solicitation to sell tangible personal property, it is not subject to the CNIT. However, the leasing, renting, licensing, or other disposition of tangible property, or transactions involving intangibles, such as franchises, patents, copyrights, trade marks, service marks and the like, or any other type of property are not protected under the federal Public Law 86-272.[61]

For New York State to impose a tax requirement on a business, the business must engage in business in New York, employ capital, own or lease property, or maintain an office in the state. Within this definition, 'engaging in business' is used in a comprehensive sense and includes all activities which occupy the time or labor of persons for profit. A corporation is subject to the New

York franchise tax if it engages in the above activities regardless of whether it is authorized to do business in New York.

Doing business in Massachusetts includes each and every act, power, right, privilege or immunity exercised in the Commonwealth, by virtue of the powers and privileges acquired by the nature of such organizations and the buying, selling or procuring of services or property. Interstate activities of solicitation orders for sales of tangible personal property filled by shipment or delivery from a point outside the State are excluded from Massachusetts' net income-based taxation.[62]

In New Jersey, the definition of presence and the issue of nexus are slightly more complicated. In New Jersey, a corporation is subject to the corporate business tax (CBT) under any of the following circumstances:

- Holding either authorization to do business in New Jersey or authorization from another state agency or department to engage in corporate activity in New Jersey;
- Deriving receipts from or engaging in contacts with New Jersey;
- Employing or owning capital in New Jersey;
- Employing or owning property in New Jersey; 04,
- Maintaining an office in New Jersey.

Even though New Jersey deems the mere solicitation of orders in the state to be doing business, the federal Public Law 86-272 does not hold these activities to corporate income tax requirements of a state. However, New Jersey requires corporations that engage in these types of activities to pay the minimum tax.[63] Tax experts agree that New Jersey's aggressive behavior in tax collection gives the state a bad reputation and could deter businesses from locating in the state as it signals that New Jersey is not business friendly. Moreover, these experts assert that most other states are aggressive only with financial institutions but operate within a legal framework and do not use enforcement personnel to gather back taxes.

Apportionment Formula

Corporate income tax apportionment is the formula that determines the taxable income of corporations that have nexus in more than one state. Apportionment rules were determined in the 1950s by the enactment of the Uniform Division of Income for Tax Purposes Act (UDITPA). According to this Act, the share of a corporation's taxable income that can be taxed by a state is calculated using three factors, also known as the 'three factor formula.' The three factors are:

- The percentage of a corporation's nationwide property that is located in the state;
- The percentage of a corporation's nationwide payroll paid to residents of the state; and
- The percentage of a corporation's nationwide sales made to residents of the state.

UDITPA requires calculating the share of a corporation's taxable income by taking the simple average of the above three percentages. The logic is that these three factors are a proxy of the extent to which a corporation is benefiting from a state's public services.[64] Before 1990, most states utilized a three factor formula. With globalization, the current trend among states has "been to

reduce or eliminate the property and payroll factors and emphasize sales, most typically through double weighting of sales."[65] By increasing the weight on sales, a state reduces the taxes of corporations that have a significant physical and employment base in that particular state. As a result, the state is effectively providing incentives to both retain in-state business and attract new development. However, some experts point out that by placing more weight on the sales factor, out-of-state companies face a higher tax burden.

Among the ten selected states, Delaware uses a three-factor, equally weighted apportionment formula which places the same weight on property, wages, and sales.[66]

Connecticut,[67] Massachusetts,[68] Maryland,[69] New Jersey, [70] North Carolina,[71] and Virginia[72] all use a double-weighted apportionment formula, which places 50 percent on sales, 25 percent on property, and 25 percent on payroll.

In North Carolina, for several other types of industries (construction contractor, securities dealer, a loan company or a corporation that receives more than 50 percent of its ordinary gross income from intangible property), apportionment is based only on the sales factor.[73]

In 2007, Pennsylvania increased the weight of the sales factor to 70 percent and decreased the weights of property and payroll factors to 15 percent each. In his Business Tax Reform Proposal, Governor Rendell recommended switching to a single sales factor formula.[74]

For tax year 2007, Georgia utilized an apportionment formula that placed 90 percent on sales, five percent on property, and five percent on payroll. Georgia phased in a single sales factor on January 1, 2008 and now places 100 percent on sales.[75] New York follows the same apportionment formula. Supporters of the plan argue that in-state companies, particularly manufacturing firms, will substantially benefit from the transition. Moreover, they point to evidence that increased employment will be one of the primary results of a single sales formula. For example, professors from the University of Chicago and University of North Carolina estimated the impact of single sales apportionment for New York if it adopted a single weighed sales factor in a report entitled, *The Economic Impact of Single Factor Sales Apportionment for the State of New York*. The report concluded that,

> increasing the weight on the sales factor has significant positive effects on in-state employment. In our estimation, switching to single factor sales will have a long-run impact of creating an additional 32,000 manufacturing jobs and 101,000 non-manufacturing jobs.[76]

Definition of Business Income

Business income is the portion of a corporation's income that is taxable in each state. Most often, business income means income from transactions and everyday activities of the corporation and income from the acquisition, management, and disposition of tangible and intangible property. Non-business income is typically taxed in the state where the corporation has its headquarters.[77] If business income is defined broadly within a state, then the corporation's income apportionable to that state will be higher. This will increase the tax liability of that corporation in the state.

Among the ten states, Connecticut, Maryland, and Virginia do not distinguish between business and non-business income and define all corporate income as apportionable. North Carolina and Pennsylvania specifically refer to the U.S. Constitution with the phrase "all income which is apportionable under the Constitution of the United States." These two states apply the standard defined by the Federal Supreme Court. According to the U.S. Supreme Court, states are free to include in apportionable income the profit associated with any asset that serves an 'operational function.' For example, the profit realized on the sale of a corporate subsidiary that was actively managed by the parent corporation at the time of sale can be defined as business income according to this standard.[78]

Delaware, Georgia, Massachusetts, New Jersey, and New York apply their own tests to define business income. They typically exclude income from investments not held, owned, or used in regular trade or business. In addition, Delaware does not define income from rents, royalties, interest, and gains on sales of tangible and real property as business income.

Throwback/Throwout Rule

Most states use an apportionment formula to determine a corporation's income allocable to the state. Sales to other states that are not taxable, due to lack of corporate income tax or insufficient nexus, can be 'thrown back' to the state of origin for tax purposes.[79] The throwback rule allows states to collect corporate income taxes on sales made in other states.

Of the ten states compared in this report, only New Jersey has a throwout rule. New York, North Carolina, Connecticut, Massachusetts, Georgia, Virginia, Maryland, and Delaware do not have a throwback rule. New Jersey enacted a throwout rule in 2002 and is one of only two states that utilize this policy, the other being West Virginia. However, the tax effect of the throwout rule on an affiliated or controlled group having $20 million or more in net income is capped at $5 million.[80]

Deductions for Royalty Payments to Subsidiary Companies

Many corporations use trademarks and patents from passive investment companies, a subsidiary company that is located in a different state from the corporation. Royalty payments and interest are submitted to the subsidiary company, which may be located in a state such Nevada that does not levy a corporate income tax.[81] Traditionally, the payments and interest are deductible expenses that reduce a company's taxable profits within a state. Some states have enacted laws to deny royalty deductions from gross income.

State laws that deny royalty deductions from gross income avoid court cases in which corporations contest whether it is legal for a state to tax a subsidiary company that is located in another state, although corporations have filed suit regarding the legality of the denial of royalty payments. In the past, some states permitted corporations to deduct royalty payments but then attempted to recover the lost tax revenue from the subsidiary company, raising the issue of nexus. The case of *Geoffrey Inc. v. South Carolina Tax Commission* was an attempt by South Carolina to recover royalty payments made by Toys 'R' Us to Geoffrey, located in Delaware. The royalty payments were deducted from

the corporation's taxable income, but the State attempted to recover the lost taxes. In 1993, the Supreme Court of South Carolina ruled that the presence of intangible property was sufficient to establish nexus and the State recovered taxes that were deducted in 1985. [See Appendix E for further details].

Of the ten selected states, only Pennsylvania and Delaware allow deductions for royalty payments to subsidiaries. The remaining states, including Connecticut, Georgia, Maryland, Massachusetts, New Jersey, New York, North Carolina, and Virginia, do not allow corporations to deduct royalty payments to subsidiaries.[82] New Jersey enacted legislation in 2002 that denies corporations the right to deduct expenses or costs related to intangible property, such as patents, trade names, trademarks, copyrights, and trade secrets, if paid directly or indirectly to a related company.[83]

Net Operating Loss (NOL)

Businesses that experience NOLs in an income tax year can deduct their losses against profits in future tax years through the use of a 'carry forward' or can file an income tax return for past years through the use of a 'carry back.'[84] Start-up businesses often experience losses for several years before becoming profitable, making an NOL provision important for new businesses to succeed.

States have different policies with regard to NOLs. New York allows businesses to use current losses to offset past profits and receive refunds of prior-year taxes paid. New York applies a 20-year carry forward and two year carry back policy and caps the dollar amount of losses that can be carried back to $10,000. Additionally, a combined group of New York S corporations cannot include in its deduction any net operating loss sustained prior to 1990.

NOLs in North Carolina can be carried forward and deducted for up to 15 years.[85] Massachusetts permits 100 percent of NOL to be deducted from net income and carried forward for five years.[86] Connecticut allows corporations to deduct NOL and carry the losses forward for 20 years.[87] Georgia allows a carry back of two years, with special rules for farmers and casualty losses, and a carry forward of 20 years.[88] Maryland allows a carry back of two years and a carry forward of 20 years. Delaware allows a carry back of two years and a carry forward for up to 20 years.[89] Pennsylvania recently increased its NOL limit to $3 million or 12.5 percent of taxable income prior to the NOL deduction, whichever is greater. The time limit is 20 years.[90]

Unlike other states in the region, Virginia has no NOL available for carry back or carry forward. However, since the starting point is federal taxable income, there is statutory authority for net operating loss deductions to the extent that such losses are included in federal taxable income.[91] New Jersey allows carry forward for up to seven years,[92] but does not have a carry back rule. Tax experts say that,

> New Jersey is in the minority of states that only allow a company to carry over net operating loss for seven years. Approximately half of the states conform with the federal income tax provision that permits a twenty year carry forward. New Jersey is also out of step with other states in that current law does not permit new operating loss deductions in change of ownership.

Combined Reporting

Combined reporting requires corporations to combine the financial statements of the parent company and its subsidiaries for state income tax purposes.[93] In 1983, the Federal Supreme Court stated that a combined reporting requirement was constitutional. The tax revenue impact of combined reporting depends on the profitability of group companies that are located in different states and whether each of these states has combined reporting requirements. For example, if a subsidiary located in another state reports a loss for the year, this will decrease the tax liability of the parent company that is located in a combined reporting state. However, if both companies report profits, then the tax liability of the parent company in the combined reporting state will increase.[94]

Opinions are mixed as to whether combined reporting should be adopted by states. On the one hand, some tax experts suggest the implementation of combined reporting eliminates the need for a throwout rule. They assert that combined reporting would simplify the tax structure and reduce the need to file multiple reports. On the other hand, some experts assert that combined reporting is more accurate for measuring the income of single legal entities instead of a total conglomerate. Basically, it is just a different, more complex way in which to calculate a corporation's activity. Those opposed to combined reporting point out that the audit cycles are much longer for combined reporting states than for single entity states. This leads to higher levels of uncertainty for businesses, which is unfavorable. Furthermore, they assert that combined reporting can create distortions. For example, a dollar of revenue generated or spent in New Jersey is not equal to a dollar in South Dakota. And, because of non-equivalence, it does not make sense to tax them the same.

In agreeing to a budget for fiscal year 2008, policymakers in New York enacted combined reporting legislation, retroactive to the beginning of 2007, into their corporate income tax code.

Connecticut, Massachusetts, North Carolina, Virginia, Georgia, Delaware, New Jersey and Maryland do not have a mandatory combined reporting requirement. As of 2007, North Carolina Governor Mike Easley, like the Governors of Massachusetts, Iowa, Michigan, and Pennsylvania, publicly supported the adoption of combined reporting.[95] The Governor of Massachusetts, Deval Patrick, proposed legislation in February 2007 entitled *An Act Improving the Fairness of the Tax Laws*, which included a clause to establish combined reporting in the State.[96] The Governor of Maryland also recently recommended the measure, but it was defeated in the State's legislature.[97]

Tax Incentives

Business tax credits are deductions from corporate income tax liabilities and can vary widely among the states.[98]A state's economic activity is positively affected by its tax incentives and is negatively affected by the tax incentives of competitor states.[99] Many states use tax incentives as an economic development tool to encourage new investment, job growth, and retain existing business. Enterprise zones are established to encourage development in economically distressed areas. Businesses located in these zones are given a variety of tax incentives. [For a more in-depth discussion of the enterprise zones, see Appendix F]

Below is a description of the types of tax incentives offered by Connecticut, Delaware, Georgia, Maryland, Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, and Virginia.

Connecticut

Connecticut offers 30 corporate business tax credits, the amount of tax which cannot exceed 70 percent of the tax amount due or reduce the amount of the tax to less than $250. There are a variety of business credits, thereby making tax incentives available to many different types of businesses. Tax credits are available for donations of computers or land to local communities, development in enterprise zones, creation of new jobs, and the hiring of displaced workers and recipients of the Temporary Family Assistance program. There are a number of incentives that encourage growth in specific industries, such as manufacturing, construction, digital animation production, film production, financial institutions, and research and development institutions. In 2005, the use of credits allowed 40,024 businesses to reduce their total corporate business tax by $93.7 million.[100]

Delaware

Delaware offers several different business tax incentives, including: Economic Development Credits, Green Industries Credits, Research and Development Credits, Land and Historic Resource Conservation Credit, Travelink Traffic Mitigation Credits, Neighborhood Assistance Credits, and Historic Property Preservation Credits.

Georgia

Georgia has several significant incentives for businesses, including a manufacturer's investment tax credit, research tax credit, employer's job tax credit, headquarters tax credit, and an employer's credit for basic skills education. Additionally, the State provides investment tax credits that usually range from one to eight percent of 'qualified capital investment.'[101]

Massachusetts

Eleven business tax credit and deductions are available in Massachusetts. Credits encourage the rehabilitation of brownfield properties, investment in industries such as film and research, and investment in solar and wind power.[102]

Maryland

Maryland offers numerous tax credits for businesses, including: Biotechnology Investment Incentive Tax Credits, Businesses That Create New Jobs Tax Credits, Clean Energy Incentive Tax Credits, Community Investment Tax Credits, Commuter Tax Credits, Employer Provided Long-Term Care Insurance Tax Credits, Employment Opportunity Tax Credits, Enterprise Zone Tax Credits, Green Building Tax Credits, Job Creation Tax Credits, Long-Term Employment of Qualified Ex-Felons Tax Credits, Maryland Disability Employment Tax Credits, Maryland-Mined Coal Tax Credits, One Maryland Economic Development Tax Credits, Research and Development Tax Credits, and Water Quality Improvement Tax Credits.

New Jersey

New Jersey has 17 different tax incentives that reduce CBT liabilities of entities. The leading CBT incentives are Urban Enterprise Zone Credit, Manufacturing Equipment and Employment Investment Tax Credit and Research and Development Tax Credit. The majority of CBT related bills currently in the State Legislature or that have recently become law are also related to CBT incentives such as tax credits for employment of ex-offenders, rehabilitation of historic properties, and lowering of the minimum full-time job requirement for business relocation and retention tax credits. [103]

New York

Over the past five years, three specific corporation tax credits have become predominate among corporations located in New York. These corporate tax credits include New York's Empire Zone/Qualified Empire Zone Enterprise and Investment Tax Credits. In 2002, New York's Empire Zone/Qualified Empire Zone Enterprise (EZ/QEZE) credits comprised 48.8 percent of all credits used and refunded. In 2003, they became the majority, with 50.7 percent of the total. In 2004, their share increased dramatically to 62.3 percent. Additionally in 2004, EZ/QEZE and Investment Tax Credits (ITCs) together comprised 96.5 percent of all credits and rebates issued within the State.[104] According to Empire State Development, an economic development agency, there are over 9,800 certified businesses employing more than 380,000 people in 82 Empire Zones statewide.[105]

The following summary is from New York State's Office of Tax Policy Analysis' publication *Analysis of Article 9-A General Business Corporation Franchise Tax Credits for 2004*. That year:

- Corporate taxpayers earned a total of $490 million in credits;
- Corporations claimed a total of $2,646.5 million in credits, used a total of $186.2 million in credits against their Article 9-A liability, and were refunded a total of $118.8 million in credits;
- The amount of credit used and refunded reached nearly $300 million, an increase of $43.4 million over the previous year;
- In 2000, the year before the QEZE credits became effective, the ITC accounted for 83.1 percent of all credits used and refunded; and,
- The other 15 tax credits available in 2004 accounted for the remaining 3.5 percent of all credits used and refunded.

Although the program has been successful in catching the attention of corporation's within New York, a 2007 *New York Times* article reported that State officials have issued warning letters to approximately 3,000 companies announcing they could possibly lose the tax breaks they received under the program.[106] This is the first significant auditing and enforcement effort performed by the state to ensure businesses are fulfilling their responsibilities within the program, which include either creating jobs or investing in their local area.

North Carolina

Recently, the William S. Lee (Article 3A) Tax Credits have been repealed for business activities that occur on or after January 1, 2007. These credits have been replaced by Article 3J Tax Credits, also known as 'Tax Credits for Growing Businesses.' This provides tax credits to qualifying businesses

for job creation, investment in business property and in some cases investment in real property. These credits are based on a system that divides the State into three development tiers by county ranging from most economically distressed to least. The business property credit is calculated as a percentage of the amount of investment over a specified threshold which varies by tier.[107] Other notable business tax credits are: research and development tax credits, NC Ports tax credits, and renewable energy tax credits.

In 2001, North Carolina legislators amended the State's tax-subsidy law to require company-reporting of tax credits and applies to credits earned for training, research and development, and machinery and equipment. The North Carolina law also requires that a company disclose how many new jobs, attributable to the development zone credits, went to residents of the development zone. The purpose of this requirement is to help lawmakers determine the effect of these tax breaks on individual companies' taxpaying behavior.[108]

Pennsylvania

Pennsylvania offers the following CNIT credits: Keystone Opportunity Zone Credit, Educational Improvement Tax Credit, Coal Waste Removal and Ultraclean Fuels Tax Credit, Neighborhood Assistance Credit, Employment Incentive Payment Credit, Jobs Creation Tax Credit, Pennsylvania Research and Development Tax Credit, Film Production Tax Credit, Resource Enhancement and Protection Tax Credit, and Organ and Bone Marrow Donor Tax Credit.[109]

Virginia

Virginia offers businesses several important tax incentives, including credits for the creation of new employment, costs incurred for providing on-site daycare for employees, job retraining, and recycling costs. Also, the State has an enterprise zone tax credit and major facility business credit. The major facility business credit offers businesses in Virginia a potential tax credit if it creates at least 100 "new full-time jobs with the establishment or expansion of a major business facility…The credit is equal to $1,000 per qualified full-time employee."[110]

Conclusions for New Jersey

The comparative analysis of New Jersey and the selected states' corporate income taxes demonstrates that New Jersey lags behind other states with regards to a number of corporate income tax policies. New Jersey has the third highest tax rate among the selected states, lower than only Pennsylvania and Massachusetts. The State also has the highest minimum tax, with a top bracket of $2,000. Most of the selected states define nexus as physical presence in determining a business' taxable activities, while New Jersey defines nexus as physical and economic presence. New Jersey is one of two states in the nation with a throwout rule. Additionally, the State has a net operating loss carry forward of seven years while most selected states have a 20 year carry forward.

All of the selected states have similar corporate income tax bases and treat pass-through entities in similar manners. Most of the states use an apportionment formula that double-weights the sales factor and do not allow corporation to deduct royalty payments to subsidiaries. All of the states have comprehensive tax incentive structures.

New Jersey can improve its business climate by altering several corporate income tax policies to become more competitive with the selected states. Indeed, most selected states are undertaking initiatives and legislation to improve their business climates. [For a more in-depth discussion of the overview of business taxes and recent developments in New Jersey and the selected states, see Appendix G].

Section 5: Recommendations

Public officials, citizens, and the business community of New Jersey have a vested interest in cultivating a climate that is conducive to promoting economic productivity and improving the overall standard of living of the State. Future prospects for business investment and economic development are threatened by the State's current unfavorable business climate.

There are many policy reforms and initiatives that could be pursued to achieve this goal. As seen in states such as Texas and Massachusetts, funding research and development efforts to cultivate a climate of innovation and expertise within the state is one option. An alternate option is implementing improvements to a state's infrastructure and public services to create desirable communities for businesses and employees. Additionally, corporate taxation policy reform is a popular and highly visible way for a state to improve its business climate.

If New Jersey is to reform its corporate income tax to promote an environment in which businesses desire to locate their employees and capital, the authors of this report propose implementing the following seven recommendations. When implementing any taxation reforms, New Jersey is advised keep in mind that above all else, businesses desire a tax structure that is stable, transparent, and efficient.

The seven recommendations are as follows:

1. Reform apportionment formula by increasing the weight on sales

Similar to many of its regional competitors, the State uses a double-weighted apportionment formula. Increasing the weight on sales even further is pro-competitive. Experts contend that "[s]ingle sales factor apportionment formulas are good for in-state companies." Accordingly, by effectively reducing the taxes of corporations that have a significant physical and employment base in the State, New Jersey would be providing major incentives to both retain in-state business and attract new development.

2. Do not pursue combined reporting

Even though there is a trend in the country towards mandatory combined reporting, it is recommended that New Jersey should continue its practice of requiring companies to report separately. Combined reporting does not necessarily increase state tax revenues. For example, if an affiliate of a company in another state is reporting a loss, it will decrease tax revenues in New Jersey. Experts emphasize that "combined reporting increases the complexity of reporting and substantially increases the time required for tax auditing."

3. Make tax incentives predictable and stable

While New Jersey has an array of incentive programs aimed at encouraging businesses to move and grow in New Jersey, these incentives must remain attractive and consistent for a set period of time. One expert referred to the withdrawal of an incentive program as the reason for a major corporation choosing to locate a new facility elsewhere. Experts note that all else being equal, incentives can significantly affect business decisions. For example, the presence of the pharmaceutical industry in New Jersey has been strong because of the State's educated workforce, pharmaceutical infrastructure, and incentive programs, among other reasons. However, there is growing competition from North Carolina, which has all the pharmaceutical infrastructure and workforce requirements while also offering a more attractive incentive program.

4. Eliminate the throwout rule by either adopting the throwback rule or not pursuing these policies

One tax expert noted that New Jersey's throwout rule is a limitation when compared to other states in the region without such a policy. While West Virginia also has a throwout rule, New Jersey enforces the rule on business sales that neither originated nor are destined for the state. New Jersey should either remove the throwout rule entirely or switch to the throwback rule.

5. Clearly define the business activities related to nexus

New Jersey has become very aggressive in determining nexus and the taxes owed by companies with an economic presence in the State. As recently as March 2008, New Jersey tax collectors were stopping trucks at the border or on highways and holding them until the businesses paid taxes to the State.[111]

According to tax experts, "New Jersey's aggressiveness regarding nexus has given the state a bad reputation and could deter businesses from locating in the State as it disseminates the view that New Jersey is not business friendly. Other aggressive states operate within a legal framework and do not use their police force to gather back taxes." New Jersey needs to clearly define the economic and physical presence of businesses and the activities that are subject to State taxes.

6. Repeal the requirement for out-of-state corporations to pay minimum tax when soliciting orders in New Jersey

Federal Public Law 86-272 explicitly states that mere solicitation of orders for sales of tangible property does not create nexus for state corporate income taxation purposes. Making out-of-state corporations that solicit orders in New Jersey liable for filing a return and paying the minimum tax under the Corporate Business Tax creates a negative image for New Jersey.

7. Extend Net Operating Loss

Currently, New Jersey allows a carry forward of up to seven years, but does not have a carry back rule. The State should extend the time period allowed for carry forward and provide businesses with the ability to carry back. Business leaders point out, "New Jersey is out of sync with other states." Reforming its NOL policy would be significant progress towards improving the overall business climate in the State.

Appendix A: Property Tax

Property taxes comprise all taxes levied on the property wealth of individuals and businesses. These include taxes on real and personal property, net worth, and the transfer of assets. Personal property taxes are levied on assets of individuals and business. Specific taxes imposed on the transfer of assets include inheritance taxes, estate taxes, capital stock taxes and gift taxes. They can be imposed on assets ranging from cars to machinery and equipment to office furniture and fixtures. These are separate from real property taxes which are levied on land and buildings. According to the Council on State Taxation, non-federal businesses paid a total of $204.8 billion in property taxes in fiscal year 2006, or 37 percent of all taxes paid by businesses.[112]

Capital Stock/Franchise Taxes

Capital stock taxes, also known as franchise taxes, are levied on the wealth of a corporation. Wealth is usually defined as the corporation's net worth and thus this tax adds a duplicate layer of taxation beyond typical income tax payments. Some states, such as Connecticut, New York, Ohio, and Rhode Island allow corporations to compare their capital stock tax requirement to their corporate income tax requirement and only pay the higher of the two. As of July 2007, twenty-two states levy this tax with West Virginia imposing the highest rate of 0.7 percent (See Appendix A).[113] West Virginia also requires corporations to pay both the corporate income tax and the capital stock tax. This is a duplicative tax and, in effect, causes certain business income and assets to be taxed twice. In 2006, Texas replaced a portion of local school property tax revenue by expanding the number of businesses included within the tax base of the franchise tax.[114]

Intangible Property Taxes

Intangible property taxes include taxes on stocks, bonds and trademarks. These taxes have a high impact on businesses that hold large amounts of their own or other companies' stock and have valuable trademarks. As of July 2007, only Alabama, Mississippi, Ohio and Pennsylvania levied this tax. Florida has recently repealed the tax although certain taxpayers may still have an intangible tax liability.[115]

Inventory Tax

The inventory tax is levied on the value of a company's inventory. This tax has the greatest impact on large retail stores and other businesses that store large amounts of merchandise. A total of 15 states levy an inventory tax.

Asset Transfer Taxes

This category of property taxes includes real estate transfer taxes, estate taxes, inheritance taxes, generation-skipping taxes, and gift taxes. These taxes have a particularly high impact in small, family-owned businesses because inheritance taxes are levied on the heir of an estate. According to the Tax Foundation, a non-profit tax research organization, theoretically a person could inherit a

family-owned company and be forced to down-size, sell part or all of it in order to be able to pay this tax.[116] A total of nine states levy this tax including New Jersey.

Exemptions and Abatements

Many localities and states offer various property tax abatements and exemptions in an attempt to lure businesses to locate in their tax base. Typically these exemptions are aimed at new or expanding businesses or a specific industry or sector. For example, the Mid-Mississippi Development District, covering a six county area and partially funded by the Mississippi Development Authority, offers three types of property tax exemptions.[117] First, local authorities may grant exemptions to new and expanding industries for up to ten years on property taxes for land, building, equipment, furniture, fixtures, and raw materials. Secondly, local authorities may grant a Freeport warehouse exemption for property taxes on finished goods inventory leaving the State of Mississippi. This exemption may be perpetual or for a defined number of years. Lastly, local authorities may also grant an exemption for up to ten years on property taxes for products including finished goods, held by a manufacturer or distributor. It should be noted that these exemptions do not cover school taxes.

Table 5. Property Tax Collections

State	Property Tax Collections Per Capita*	Capital Stock Tax Rate*	Capital Stock Max Payment*	Payment Options for CST and CIT*
Alabama	$419	0.175%	$15,000	pay both
Alaska	$1,384	none	na	na
Arizona	$863	none	na	na
Arkansas	$402	0.30%	$1,075,000	pay both
California	$1,088	none	na	na
Colorado	$1,127	none	na	na
Connecticut	$2,157	0.31%	$1,000,000	pay highest
Delaware	$586	0.025%	$165,000	pay both
Florida	$1,155	none	na	na
Georgia	$948	0.023%	$5,000	pay both
Hawaii	$588	none	na	na
Idaho	$664	none	na	na
Illinois	$1,551	0.10%	$2,000,000	pay both
Indiana	$1,051	none	na	na
Iowa	$1,175	none	na	na
Kansas	$1,337	0.125%	$20,000	pay both
Kentucky	$586	none	na	na
Louisiana	$608	0.30%	unlimited	pay both
Maine	$1,782	none	na	na
Maryland	$1,225	none	na	na
Massachusetts	$1,772	0.26%	unlimited	pay both
Michigan	$1,370	none	na	na
Minnesota	$975	none	na	na
Mississippi	$724	0.25%	unlimited	pay both
Missouri	$834	0.033%	unlimited	pay both
Montana	$1,114	none	na	na
Nebraska	$1,226	0.02%	unlimited	pay both
Nevada	$1,022	none	na	na
New Hampshire	$1,903	none	na	na
New Jersey	$2,241	none	na	na
New Mexico	$489	none	na	na
New York	$1,835	0.178%	unlimited	pay highest
North Carolina	$787	0.15%	$75,000	pay both
North Dakota	$1,009	none	na	na
Ohio	$1,084	0.40%	unlimited	pay highest
Oklahoma	$518	0.125%	$20,000	pay both
Oregon	$1,035	none	na	na
Pennsylvania	$1,124	0.389%	unlimited	pay both
Rhode Island	$1,845	0.025%	unlimited	pay highest
South Carolina	$994	0.10%	unlimited	pay both
South Dakota	$975	none	na	na
Tennessee	$677	0.25%	unlimited	pay both
Texas	$1,388	none	na	na
Utah	$733	none	na	na
Vermont	$2,050	none	na	na
Virginia	$1,132	none	na	na
Washington	$1,145	none	na	na
West Virginia	$590	0.70%	unlimited	pay both
Wisconsin	$1,485	none	na	na
Wyoming	$1,597	0.02%	unlimited	pay both

Source: Tax Foundation, Census Bureau *As of July 1, 2007

Appendix B: Sales Tax

Five states have no general sales tax; these include Delaware, Montana, New Hampshire, Oregon, and Alaska.[118] Colorado has the lowest statewide sales tax rate at 2.9 percent while Tennessee, Mississippi, New Jersey and Rhode Island all have the highest state sales tax rates at seven percent.

Thirty-two states have local option sales taxes at the county and/or municipal level in addition to, or in lieu of, a state sales tax. Alaska has no state sales tax but has the highest average local option sales tax rate at 4.32 percent. New York has the second highest local rate with an average of 4.14 percent.[119] A state's sales tax rate is the combination of state and local option sales tax rates. Tennessee has the highest combined sales tax rate at 9.45 percent and Colorado has the lowest combined rate at 3.83 percent. Additionally, Colorado, Idaho, and New York allow counties and municipalities to define their sales tax base.[120]

Services and Internet Sales

The sales tax base is comprised primarily of tangible goods, but the service industry has grown dramatically and in 2003 made up approximately 60 percent of personal consumption.[121] Few states include a broad array of services in their sales tax base, which can result in a significant amount of lost revenue for states. A 2004 survey of state practices by the Federation of Tax Administrators found that 168 service-related transactions were subject to a general retail sales tax or gross receipts tax. Hawaii, New Mexico, and South Dakota tax services comprehensively while Oregon does not tax any services.[122] Many businesses purchase services such as advertising, telecommunications, and legal services, making tax pyramiding a concern.

Consumers that purchase goods via the internet are often not subject to a sales tax and businesses that sell goods over the internet are often not required to collect and remit state sales taxes. For businesses to be legally required to collect and remit sales taxes on internet sales, the business must have substantial presence in the taxing jurisdiction. Substantial presence, or nexus, often requires the business to have some type of property or commercial holding within the taxing jurisdiction.[123] Without physical presence, the state is not allowed to require the remote seller to collect and remit sales taxes. Instead, the consumer is expected to voluntarily comply with the state sales tax and pay the tax directly to the state. It is roughly estimated that in 2000, internet sales were responsible for less than two percent of total sales and use tax revenues.[124]

Table 6. Sales Tax Rate in the Fifty States

State	State Tax Rates	Average County and City Rates
	Percent	*Percent*
Alabama	4	2.91
Alaska	None	4.32
Arizona	5.6	2.11
Arkansas	6	1.37
California	6.25	1.7
Colorado	2.9	0.93
Connecticut	6	None
Delaware	None	None
Florida	6	0.62
Georgia	4	2.76
Hawaii	4	None
Idaho	6	None
Illinois	6.25	1.39
Indiana	6	None
Iowa	5	1.13
Kansas	5.3	1.54
Kentucky	6	None
Louisiana	4	4.03
Maine	5	None
Maryland	5	None
Massachusetts	5	None
Michigan	6	None
Minnesota	6.5	0.27
Mississippi	7	None
Missouri	4.225	2.94
Montana	None	None
Nebraska	5.5	1.39
Nevada	6.5	1.06
New Hampshire	None	None
New Jersey	7	None
New Mexico	5	0.97
New York	4	4.14
North Carolina	4.25	2.56
North Dakota	5	1.32
Ohio	5.5	1.22
Oklahoma	4.5	2.39
Oregon	None	None
Pennsylvania	6	0.22
Rhode Island	7	None
South Carolina	6	0.59
South Dakota	4	1.95
Tennessee	7	2.45
Texas	6.25	0.44
Utah	4.75	1.79
Vermont	6	None
Virginia	4	1
Washington	6.5	2.08
West Virginia	6	None
Wisconsin	5	0.41
Wyoming	4	0.44

Source: Tax Foundation *As of July 1, 2007

Appendix C: Landmark Court Cases

Commerce Clause

Article I, Section 8, Clause 3 of the United States Constitution, commonly referred to as the Commerce Clause, declares that Congress has the exclusive authority to manage trade activities between the states and with foreign nations and Indian tribes. In 1995, the Federal Supreme Court defined the authority of Congress to regulate only 1) the channels of commerce; 2) the instrumentalities of commerce and; 3) action that substantially affects interstate commerce.

Due Process Clause

The Due Process Clause is the principle that the government is required to respect a person's legal rights to their full extent when the government deprives a person of life, liberty, or property. These rights are extended to all legal persons of whom a composite of individuals, such as a corporations, are considered a part of. This allows corporations to be treated as a person for certain limited purposes such as lawsuits or property ownership.

Quill Corp. v. North Dakota (1992)

In the 1992 Quill Corporation vs. the State of North Dakota case, the Federal Supreme Court made a landmark decision concerning sales tax and interstate commerce. North Dakota filed an action claiming that Quill Corporation – an out-of-state mail-order business with neither outlets nor sales representatives in the State – owed use tax payments for catalogue purchases that North Dakota residents had made. Quill responded that it did not have nexus in North Dakota because it had no physical operations or employees and hence did not have to collect North Dakota use tax on sales made to North Dakota customers. The trial court ruled in Quill's favor, concluding that a seller whose only connection with customers in the State is by common carrier or the mail lacked the requisite minimum contact with the State to be required to pay the tax. Additional reasoning by the court included the fact that the State had not shown that the tax revenues would benefit Quill.

The North Dakota Supreme Court reversed the trial court's decision concluding that minimal physical presence of a business in the State was no longer required for taxation purposes. Thus, the court ruled that Quill was subject to the tax because they received benefits through access to the consumer base of the State. The Federal Supreme Court sided with Quill, ruling that the North Dakota State Supreme Court's "enforcement of the use tax against Quill placed an unconstitutional burden on interstate commerce."[125] Therefore, the Supreme Court decided that the existence of customers alone (i.e. economic presence) does not create sufficient nexus for a state to impose a sale tax collection burden.

J. C. Penney National Bank v. Ruth E. Johnson (1999)

The State of Tennessee required J.C. Penney National Bank (JCPNB) to pay overdue franchise and excise taxes along with interest and penalties. JCPNB, based in Delaware, issued credit cards and managed its accounts through the mail and did not have physical presence in Tennessee. JCPNB appealed the franchise and excise tax assessment on the grounds that the tax and assessment violated the Commerce Clause and Due Process Clause. The trial court upheld the imposition of franchise and excise taxes concluding that the assessment did not violate the requirements of the Due Process Clause, and sufficient nexus existed to satisfy the requirements of the Commerce Clause. The Tennessee Court of Appeals reversed the decision on the grounds that the bank had no physical presence in the State. Therefore, the court decided there was insufficient nexus for the State to levy these taxes.[126]

Geoffrey Inc. v. South Carolina Tax Commission (1993)

The principal issue in Geoffrey Inc. v. South Carolina Tax Commission was whether or not the State had a legal right to tax Geoffrey. A subsidiary of Toys 'R' Us with offices located in Delaware, Geoffrey became the owner of the Toys 'R' Us trademark in 1984. Geoffrey entered into a license agreement permitting Toys 'R' Us to use the trademark. As a stipulation of the agreement, Geoffrey would annually receive a one-percent royalty of Toys 'R' Us' net sales "rendered under the licensed mark."[127] In 1985, Toys 'R' Us established locations in South Carolina and subsequently, began royalty payments to Geoffrey. The company then attempted to deduct these payments from its taxable income in South Carolina. The South Carolina Tax Commission allowed the deduction, but then ordered that Geoffrey pay income tax on the royalties collected and business license fees. Geoffrey sued the Tax Commission and sought reimbursement for the taxes paid. In 1993, the Supreme Court of South Carolina heard the case and ruled in favor of the commission based on the following principles: "(1) royalty income of foreign corporation, obtained from trademark licenses issued to affiliate could be taxed without violating due process clause, and (2) tax could be imposed without violating interstate commerce clause."[128] The ruling was important in defining the types of business operations that are taxable. In addition, it set a precedent by extending the classification of nexus from previous cases. The ruling provided that, "the presence of intangible property alone is sufficient to establish nexus."[129]

MBNA America Bank v. Tax Commissioner of the State of West Virginia (2006)

In tax years 1998 and 1999, MBNA America Bank paid a business franchise tax and corporate income tax to the State of West Virginia. MBNA had no real tangible property or employees within West Virginia and the principle business, promoted via mail and telephone solicitation, was issuing and servicing VISA and MasterCard credit cards.[130] MBNA filed refund claims with the State Tax Commissioner but was denied a tax refund. The appeal went through three different courts before being filed with the Supreme Court of Appeals of West Virginia. The court concluded that the imposition of the business franchise tax and corporate net income tax on MBNA America Bank for tax years 1998 and 1999 did not violate the Commerce Clause and that MBNA could not receive a tax refund. The court reasoned that the physical presence requirement for showing substantial nexus applies only to sales and use taxes and not to business franchise and corporate income taxes.

The court found that an economic presence test is a better indicator of substantial nexus for Commerce Clause purposes.

Lanco, Inc. v. Director, NJ Division of Taxation (2006)

Lanco Inc., a Delaware based company, licensed intangible property (trademarks, trade names and service marks) to a New Jersey based clothing retailer. Lanco sued the New Jersey Division of Taxation for its decision to subject it to the corporate business tax (CBT) as it did not have physical presence in New Jersey. The trial court decided that since Lanco was not physically present in the State, subjecting it to CBT would violate the Commerce Clause. Upon the New Jersey Division of Taxation's appeal, the Appellate Division reversed the judgment of the trial court claiming that physical presence was not applicable to income tax. However, the CBT could be constitutionally applied to income from licensing fees attributable to New Jersey. The Supreme Court of New Jersey affirmed the Appellate Division's determination.[131]

Appendix D: Gross Receipt Tax

A gross receipt tax is a tax on the total receipts of a business regardless of profit. The tax takes effect at each point in, "the chain of production and distribution from the resource extraction to the eventual customer."[132] In contrast to a sales tax, it is applied to the seller of a product. Proponents of gross receipt taxes argue that it has a simple structure compared to other corporate taxes, offers a broad tax base, is predictable for both businesses and governments, provides a stable revenue source, and is generally applied at a lower rate than other taxes. Critics condemn the tax for the following reasons: it is not transparent, severely reduces competition in the market, poses a harsher burden on small business, poses higher startup costs for new businesses, and causes a potential 'pyramiding' effect as they, "create an extra layer of taxation at each stage of production."[133] Furthermore, the tax has been criticized for creating a set of pervasive disincentives to market expansion and new business development.

In the United States, gross receipt taxes became prominent during the 1920s and 1930s as a means for state governments to generate revenue.[134] Several states, such as Delaware, Georgia, Mississippi, Washington, and West Virginia "enacted [the tax] to help with the collapse of state finances during the Great Depression and to reduce property tax burdens."[135] Recently, this form of taxation has gained national attention despite several states repealing the tax decades ago. States are experimenting with gross receipt taxation as a means to supplement the corporate income tax. Currently, gross receipts tax range from 0.00471 percent to eight percent in the United States (see Appendix C).

The experience of gross receipt taxation in New Mexico provides an informative example of its potential effects. Dr. Henry Messenheimer and Paul J. Gessing of the Rio Grande Foundation, a research institution that advocates economic reform and limited government, offered their perspective on the issue in their piece, *New Mexico's Harmful Gross Receipts Tax: A Warning to Other States*. The authors cite the inherent economic flaws of the tax and specifically refer to tax pyramiding and greater burden on small businesses. Unlike other states that employ gross receipt taxes at rates of one percent or below, New Mexico's tax can potentially reach eight percent, making it the highest in the nation. Theoretically, the tax should be broad-based and equitable. However, political considerations have affected the course of tax policy in the State. For instance, New Mexico allows deductions for certain businesses, such as film companies, space industry, and aircraft manufacturers. Furthermore, Messenheimer and Gessing conclude that the high rates and repercussions of tax pyramiding deter economic growth in the State and severely reduce its competitiveness in relation to other states in the region.[136]

Table 7. Gross Receipts

State	Label	Rates	Description
Arizona	Transaction Privilege tax (TPT)	The following classes of businesses are affected by the tax. A range of tax rates follows each classification and combines the State's TPT with county excise rates: Mining (3.281-3.828%); Utilities, communication, transporting, private (rail) car, pipeline, publication, job printing, restaurants and bars, amusement, personal property rental, contracting-prime, retail, use tax-utilities, contracting-owner builder (5.85-6.725%); Commercial lease (0-0.5%); Severance-Metalliferous mining (2.5%); Recreational vehicle surcharge (0-$0.50); Transient lodging (5.78-7.27%); Use tax-utilities (5.6-6.698%); Use tax from inventory, use tax-direct payments, telecommunications devices (1.10%); Jet fuel tax ($0.035302-0.0366 per gallon) Jet fuel use tax ($0.0305 per gallon) Rental car surcharge (0-$3.50) 911 Telecommunications ($0.20 monthly rate)[137] Complete rates by county can be found at: www.revenue.state.az.us/TpT/tptrates/2008/Jan1.pdf	The TPT is "a tax on the privilege to business in Arizona."[138] Certain AZ counties can levy an excise tax on top of the general TPT on businesses within their jurisdiction.[139]
Delaware	Gross Receipt tax	Business gross receipts tax rates range from 0.096% to 1.92%.[140]	DE imposes a gross receipt tax, but not a local or state sales tax.[141]
Kentucky	Gross Receipt tax	The following classes of businesses are affected by the tax. A range of tax rates follows each classification. Utility Gross Receipts License Tax (on those that provide utility services and/or cable within a school district) (Cannot exceed 3.00%);[142] Telecommunications tax (2.4% on multi-channel video and audio programming services, 1.3% on telephone communication services)[143]	
Michigan	Modified gross receipt tax	0.8%[144]	Michigan tax law provides that generally, the modified gross receipts tax base equals a taxpayer's gross receipts minus purchases from other firms.[145]
New Mexico	Gross receipt tax	The state has a 5% gross receipt tax.[146] Combined with local rates, the tax can range from 5.125 to 8%.[147]	New Mexico's gross receipt tax rates are among the highest in the nation. According to the New Mexico Division of Taxation and Revenue, the gross receipt tax is "imposed on persons engaged in business in New Mexico, but in almost every case the person engaged in business passes the tax along to the consumer."[148]
Ohio	Commercial Activity tax (CAT)	The first $1 million in taxable gross receipts are taxed at $150. From April 1, 2007 to March 31, 2008: 0.1560% April 1, 2008 to March 31, 2009: 0.2080%[149]	The CAT applies to most types and forms of businesses. A corporation will be taxed regardless if they are located outside of Ohio—just as long as they have business operation within the State.[150]

Table 7. Gross Receipts continued.

South Dakota	Contractors' Tax	Contractors' Excise Tax: 2%	"The contractors' excise tax is a 2% tax imposed upon the gross receipts of contractors who are engaged in construction services or realty improvements in South Dakota. The contractors' excise tax and the contractors' sales and use taxes are part of the contractor's total bill and are collectible from all entities, both public and private. State law allows contractors to list their tax expense as a separate line item on all contracts and bills."[151]
Texas	Franchise Tax; Miscellaneous Gross Receipts Tax	Franchise Tax: The State levies a 1% gross receipts tax on businesses. Retailers pay 0.5%.[152] Miscellaneous gross receipts tax: levied on utility companies. The rate is calculated as follows: - For business done in cities of more than 1,000 but less than 2,500 population, the rate is 0.581 percent; - in cities of 2,500 or more but less than 10,000, the rate is 1.07 percent; and - in cities of 10,000 or more, the rate is 1.997 percent[153]	
Washington	Business and Occupations Tax	The following types of businesses are subject to the tax: Retailing (0.00471%); Wholesaling (0.00484%); Manufacturing (0.00484%); Service and Other Activities (0.015%)[154]	Most businesses that are based in or have operations in Washington are subject to the tax. This includes LLCs, corporations, sole proprietors, partnerships, and nonprofits.[155]

Appendix E: Enterprise Zones

Enterprise zones aim to encourage development in economically distressed areas by offering tax incentives to businesses and potential investors. The concept was originally devised by British professor Peter Hall in 1977 and soon drew the attention of American policymakers. At the federal level, enterprise zone legislation appeared in 1980 with support from notable Congressmen and President Ronald Reagan. However, the national government did not implement such legislation until 1993. Instead, states were the first to experiment with enterprise zones. In 1981, Connecticut became the first state to designate zones and within four years, over 40 states had implemented the policy.[156]

Supporters of enterprise zones often cite that the program provides significant benefits, including increased employment, decreased poverty rates, economic revitalization, and greater market activity. However, opponents often claim that the billions of dollars states spend in these areas yield mediocre results.[157]

There have been empirical studies that have examined the utility of the program. While some find that there are marginal results, several key reports have noted the great benefits to economically distressed communities. The Rubin Study of New Jersey's Urban Enterprise Zones (UEZs), conducted in 1991, found that its effects were very beneficial. At that time, the UEZ program offered sales and use tax exemption on certain purchases, a $1,500 corporate tax credit to employers who hired workers that were formerly unemployed or receiving welfare, and an unemployment tax credit to workers earning less than $18,000 annually. Specifically, the report found that "for every tax dollar not collected by the state because of zone incentives, $1.90 in state and local taxes was generated by enterprise zone activity, making the program…cost effective."[158] Today, the UEZ program has resulted in a total private investment estimated at $13.8 billion by businesses that locate in those areas.[159]

A more recent study, conducted by the University of Southern California in 2005, analyzed California's experience with enterprise zones. The components of the California Enterprise Zone (CAEZ) program are:

- State tax credits for each qualified employee hired
- Tax credits for sales and use taxes paid on qualified machinery purchases
- Accelerated expense deductions for certain depreciable property
- Carry forward up to 100 percent of net operating loss for 15 years
- Interest deductions for lenders on loans made to firms within an Enterprise Zone
- Enterprise Zone companies can earn preference points on state contracts.[160]

The report concluded that compared with the rest of the State, enterprise zones experienced a 7.35 percent reduction in poverty, 7.1 percent household income increase, and a 3.5 percent increase in salaries.[161] However, the correlation could be due to other factors, such as gentrification.

Table 8. Enterprise Zones

State	# of Zones	Zone Incentives
California[162]	42	California can designate an enterprise zone for up to 15 years. The primary benefits of the California Enterprise Zone (CAEZ) are: "- State tax credits for each qualified employee hired - Tax credits for sales and use taxes paid on qualified machinery purchases - Accelerated expense deductions for certain depreciable property - Carry forward up to 100 percent of net operating loss for 15 years - Interest deductions for lenders on loans made to firms within an Enterprise Zone - Enterprise Zone companies can earn preference points on state contracts." Map of CAEZs: www.hcd.ca.gov/fa/cdbg/ez/Enterprise_Zone_map.pdf
Georgia[163]		The benefits of the Georgia program: " Property tax exemption [and] abatement or reduction in occupation taxes, regulatory fees, building inspection fees, and other fees that would otherwise be imposed on qualifying business"
Maryland[164]	28	Maryland's program has the following benefits: **"Real property tax credits**: Ten-year credit against local real property taxes on a portion of real property improvements. Credit is 80 percent the first five years, and decreases 10 percent annually thereafter to 30 percent in the tenth and last year. **Income tax credits**: One- or three-year credit for creating new jobs. The general credit is a one-time $1,000 credit per new employee. For economically disadvantaged employees, the credit increases to a total of $6,000 per employee distributed over three years." Map of Maryland zones: http://www.choosemaryland.org/Resources/pdffiles/taxincentives/EZ_map_121506_11x17.pdf
Massachusetts	3 federally designated zones	Businesses in these zones have access to several technical and financial assistance programs.[165]
Pennsylvania	12[166]	Pennsylvania's Keystone Opportunity Zones program offers reduced or no tax burden to businesses in those defined areas. As described by Pennsylvania's Department of Community & Economic Development: "Depending on the situation, the tax burden may be reduced to zero through exemptions, deductions, abatements, and credits for the following: "**State Taxes:** Corporate Net Income Taxes, Capital Stock & Foreign Franchise Tax, Personal Income Tax, Sales & Use Tax, Bank Shares and Trust Company Shares Tax, Alternative Bank and Trust Company Shares Tax, Mutual Thrift Institutions Tax, Insurance Premiums Tax, **Local Taxes:** Earned Income/Net Profits Tax, Business Gross Receipts, Business Occupancy, Business Privilege & Mercantile Taxes, Local Real Property Tax, Sales & Use Tax."[167] Map of Keystone Opportunity Zones: http://www.newpa.com/default.aspx?id=347
Connecticut[168]	17	Connecticut was the first state in the Country to institute enterprise zones. Benefits of the Connecticut Enterprise zone (CTEZ) include: "-A five year, 80% abatement of local property taxes on qualifying real and personal property…[and] - A ten year, 25% credit on that portion of the state's corporation business tax that is directly attributable to a business expansion or renovation project as determined by the Connecticut Department of Revenue Services. - As of January 1, 1997, newly formed corporations located in a zone qualify for a 100% corporate tax credit for their first three taxable years, and a 50% tax credit for the next seven taxable years. This is subject to if the corporation has at least 375 employees at least 40% of which are either zone residents or are residents of the municipality -The maximum amount the Connecticut Development Authority can lend to an Enterprise Zone business…is…$300,000." Map of CTEZ: www.ct.gov/ecd/cwp/view.asp?a=1099&q=249772

Table 8. Enterprise Zones continued.

Florida[169]	56	Florida offers a series of tax incentives including a job, property, and community contribution tax credit, business equipment and building material sales tax refund, and sales tax exemption for electrical energy. The following describes each of the incentives through their urban and rural enterprise zone programs: *Jobs Tax Credit (Sales Tax),* Rural Enterprise Zones: Allows a business located within a Rural Enterprise Zone to take a sales and use tax credit for 30 or 45 percent of wages paid to new employees who live within a Rural County. *Jobs Tax Credit (Sales Tax),* Urban Enterprise Zones: Allows a business located within an Urban Enterprise Zone to take a sales and use tax credit for 20 or 30 percent of wages paid to new employees who reside within an enterprise zone. To be eligible, a business must create at least one new job. The Sales Tax Credit cannot be used in conjunction with the Corporate Tax Jobs Credit). *Jobs Tax Credit (Corporate Income Tax),* Rural Enterprise Zones: Allows a business located within a Rural Enterprise Zone to take a corporate income tax credit for 30 or 45%of wages paid to new employees who reside within a Rural County. *Jobs Tax Credit (Corporate Income Tax),* Urban Enterprise Zones: Allows a business located within an Urban Enterprise Zone to take a corporate income tax credit for 15 or 20 percent of wages paid to new employees who reside within an enterprise zone. *Business Equipment Sales Tax Refund,* Rural and Urban Enterprise Zones: A refund is available for sales taxes paid on the purchase of certain business property, which is used exclusively in an Enterprise Zone for at least 3 years. *Building Materials Sales Tax Refund,* Rural and Urban Enterprise Zones: A refund is available for sales taxes paid on the purchase of building materials used to rehabilitate real property located in an Enterprise Zone. *Property Tax Credit (Corporate Income Tax),* Rural and Urban Enterprise Zones: New or expanded businesses located within an enterprise zone are allowed a credit against Florida corporate income tax equal to 96% of ad valorem taxes paid on the new or improved property. *Sales Tax Exemption for Electrical Energy,* Rural and Urban Enterprise Zones: A 50% sales tax exemption is available to qualified businesses located within an Enterprise Zone on the purchase of electrical energy, if the municipality has reduced the municipal utility tax by at least 50%. *Community Contribution Tax Credit Program,* Rural and Urban Enterprise Zones: Allows businesses a 50% credit on Florida corporate income tax, insurance premium tax, or sales tax refund for donations made to local community development projects. Businesses are not required to be located in an enterprise zone to be eligible for this credit. Map of enterprise zones in Florida: http://www.floridaenterprisezone.com/PageView.asp?PageType=M&edit_id=13
Virginia	57[170]	The Virginia Enterprise Zone (VEZ) program offers businesses job creation and real property grants. The grants are described below: "**Job Creation Grants** are based on: Permanent full time job creation over a four job threshold, wage rates of at least 175 percent of the Federal minimum wage, and the availability of health benefits; Personal service, retail, food and beverage positions are not eligible to receive job creation grants; and The amount of the grant will be based on the wages paid for those grant eligible positions. **Real Property Investment Grants** are based on: - Qualified real property investments made by any individual or entity to a commercial, industrial, or mixed use building or facility in a designated Virginia Enterprise Zone; - The amount of the grant is 20 percent of the total cost of qualified real property investment and is capped per building or facility; - The grant is capped at $125,000 per building or facility for investments less than $5 million, and $250,000 for investments of $5 million or more.[171] Map of VEZs: http://www.dhcd.virginia.gov/CommunityDevelopmentRevitalization/PDFs/enterprise_zones_map.pdf

Table 8. Enterprise Zones continued

New Jersey[172]	32	The New Jersey Urban Enterprise Zone (UEZ) program allows businesses to place a 3.5% sales tax on their goods.[173] Furthermore, - Sales tax revenues generated by UEZ businesses are dedicated for use within the zones for economic development projects - In addition, UEZ businesses may enjoy tax exemptions on certain purchases and manufacturers may qualify for sales tax exemption on their energy and utility consumption when they meet specified employment and other criteria. - For each new permanent full-time employee hired, businesses may receive a one-time $1,500 tax credit. - Employers may also benefit from subsidized unemployment insurance costs for certain employees who earn less than $4,500 per quarter. - The UEZ Program allows a tax credit against the Corporate Business Tax up to eight percent of qualified investments within the zone. Also, businesses may be eligible for priority financial assistance. Map of UEZs: http://www.state.nj.us/commerce/pdf/zonesmap.pdf
New York	85[174]	New York's Empire Zone program offers a range of benefits, including sales tax exemptions, credit for property taxes, tax reduction, zone capital, wage tax, investment tax and employment incentive credits, utility rate savings. They are described below: **Sales Tax Exemptions**: Qualified Empire Zone Enterprises (QEZEs) receive a 120 month exemption from State and, in some cases, local sales tax on purchases of goods and services (including utility and telephone services) used predominantly in an Empire Zones **Credit for Real Property Taxes**: Qualified Empire Zone Enterprises may claim a refundable credit against business or income tax equal to a percentage of real property taxes paid in the zone (effective for taxable years beginning on or after January 1, 2001). **Tax Reduction Credit**: Qualified Empire Zone Enterprises may claim a credit against business or income tax equal to a percentage of taxes attributable to the zone enterprise (effective taxable years beginning on or after January 1, 2001). **EZ Wage Tax Credit**: Companies hiring full-time employees in newly created jobs may claim this credit for up to five consecutive years. For employees in special targeted groups, this credit equals $3,000 per year, with a credit of $1,500 per year effective 1/1/2001, for all other new hires. **EZ Investment Tax and Employment Incentive Credits**: Businesses that create new jobs and make new investments in production, property and equipment may qualify for tax credits of up to 19% of the company's eligible investment. **New Business Refund**: Businesses new to New York State are entitled to a 50% cash refund of unused EZ-WTC and ITC amounts. Other businesses may carry forward unused credits indefinitely **Utility Rate Savings**: Special reduced electric and gas rates may be available through investor-owned utilities in New York State. Businesses that locate or expand their operations in an EZ may receive significantly reduced rates. **Zone Capital Credit**: A 25% tax credit against personal or corporate income taxes is available for contributing or purchasing shares in a zone capital corporation; or for a direct equity investment in a certified zone business; or for contributions to approved community development projects within an EZ. **Sales Tax Refund or Credit**: Purchases of building materials to be used in construction, expansion, or rehabilitation of commercial or industrial real property located in an EZ are eligible for a refund or credit of NYS and, in some cases, local sales taxes. **Real Property Tax Abatement**: EZs may offer tax abatements from an increased assessment, with the abatement value based on improvements to real property for up to 10 years. This holds true for up to seven years at 100%, decreasing over the last three years of the exemption. **Technical Assistance**: Professionals qualified to assist businesses locating or expanding in an EZ staff each local zone office.[175]

Appendix F: Review of Selected States' Corporate Income Tax Policies

Table 9. Review of Selected States' Corporate Income Tax Policies

	New Jersey	Delaware	Connecticut	Georgia
Rate	6.5% (net income≤$50,000) 7.5% ($50,000≤net income≤$100,000) 9% (net income>$100,000)[176]	8.7% flat tax on net income	Pay the higher of the two: 1) Net Income Base Method (7.5%) 2) Capital Base Method ($0.0031 per dollar) Max tax of $1,000,000.	6%
Alternative Minimum Tax	Between $500 and $2,000 based on the amount of gross receipts or gross profits.[177]	None	$250, regardless of credits	
Base	All domestic and foreign corporations unless specifically exempt, Joint-stock companies or associations, Business trusts, Limited partnership associations, Financial business corporations, and Banking corporations.[178]	C-corporations Any other business entity choosing to be taxed as a corporation.	Corporations; limited liability company with two or more members if classified as such for federal income tax purposes.	Corporations, S-Corporations
Pass-Through Entities	Corporate business taxation of S corporations is phased out for tax years ending after June 30, 2007. Before, S corporations were subject to either the alternative minimum tax (if net income ≤$100,000) or reduced rates (1.33% before June 30, 2006 and 0.67% for tax year 2007) However, an S corporation's entire net income that is subject to federal CIT will be taxed at 9%. They will also be required to pay the minimum tax.[179]	S-corporations file 1100S form and shareholders pay at highest individual tax rates of 5.95%. Can be filed as composite return or individual.	S corporations and partnerships; income tax payment is due for each nonresident non-corporate member or when the member's share of the entity's income derived from or connected with Connecticut is $1,000 or more.	Tax is due at the individual level of the owners
Definition of Presence	A corporation is subject to the CBT under any of the following circumstances: - holding either authorization to do business in New Jersey or authorization from another state agency or department to engage in corporate activity in New Jersey. - deriving receipts from or engaging in contacts with New Jersey. - employing or owning capital in New Jersey. - employing or owning property in New Jersey. - maintaining an office in New Jersey. Even though New Jersey deems the mere solicitation of orders in New Jersey to be doing business, this kind of a foreign corporation will not be subject to CBT in accordance with the federal Public Law 86-272. However, New Jersey requires this kind of corporations to pay the minimum tax.[180]	Physical presence is the determining factor for tax purposes. Therefore, either an employee or some property is present in the state in order to have presence.	Ownership or disposition of real or tangible personal property within Connecticut; compensation for services performed in Connecticut or income from a business, trade, profession, or occupation carried on in Connecticut; unemployment compensation received from the Connecticut Department of Labor; a partnership or S Corporation doing business in Connecticut; a trust or estate with income derived from or connected with Connecticut sources; a nonqualified deferred compensation plan for services performed wholly within Connecticut.	Corporations that own property or do business in Georgia are subject to corporate income tax.
Apportionment Formula	Sales factor is double weighted	Property, wages, and sales are equally weighted	Sales factor is double weighted	90% Sales, 5% Property, and 5% Payroll[1811]

Table 9. Review of Selected States' Corporate Income Tax Policies continued

	New Jersey	Delaware	Connecticut	Georgia
Throwback/ Throwout Rule	Throwout Rule	No	No	No
Deductions for royalty payments to subsidiaries	No	Yes	No	No
Net Operating Loss	Carry forward: 7 years, limited to an amount that would reduce the entire net income by up to 50%	Carry forward: allowed up to 20 years. Carry back: allowed up to 2 years with a limit of $30,000 per year.	Carry forward: 20 years.	Carry back: 2 years (with special rules for farmers and casualty losses) Carry forward: 20 years
Combined Reporting	Not mandatory (though the Division of Revenue may request it from a corporation)	No	No	No
Tax Incentives	• HMO Assistance Fund Tax Credit • New Jobs Investment Tax Credit • Urban Enterprise Zone Tax Credits • Redevelopment Authority Project Tax Credit • Recycling Equipment Tax Credit • Manufacturing Equipment and Employment Investment Tax Credit • Research and Development Tax Credit • Smart Moves for Business Programs Tax Credit • Small New Jersey based High Technology Business Investment Tax Credit • Neighborhood Revitalization Tax Credit • Effluent Equipment Tax Credit • Economic Recovery Tax Credit • Remediation Tax Credit • Alternative Minimum Assessment Tax Credit. • Business Retention and Relocation Tax Credit. • Sheltered Workshop Tax Credit. • Film Production Tax Credit.	- Economic Development Credit - Green Industries Credit - Research and Development Credit - Land and Historic Resource Conservation Credit - Travelink Traffic Mitigation Credit - Neighborhood Assistance Credit - Historic Property Preservation Credit	Amount of tax credits cannot exceed 70% of the amount of tax due or reduce the amount of tax to less than $250. • Apprenticeship Training • Computer Donation • Digital Animation Production • Displaced Workers • Displaced Workers Hired By Electric Suppliers • Donation of Land • Electronic Data Processing Equipment • Enterprise Zone or Entertainment District • Enterprise Zone Credit for Qualifying Corporations • Film Production • Film Production Infrastructure • Financial Institutions • Fixed Capital Investments • Hiring Incentive • Historic Building and Home Rehabilitation • Historic Structures Rehabilitation • Housing Program Contribution • Human Capital Investments • Insurance Reinvestment Fund • Machinery and Equipment • Manufacturing Facility in a Targeted Investment Community • Neighborhood Assistance Act Program • New Jobs Creation • Research and Development Expenditures • Research and Development Grants to Institutions of Higher Education • Research and Experimental Expenditures • Service Facility • Small Business Guaranty Fee • Traffic Reduction Programs • Urban and Industrial Site Reinvestment	- Employer's Credit for Basic Skills Education - Employer's Credit for Approved Employee Retraining - Employer's Jobs Tax Credit - Employer's Credit for Purchasing Child Care Property, - Employer's Credit for Providing or Sponsoring Child Care for Employees, - Manufacturer's Investment Tax Credit, - Optional Investment Tax Credit, - Qualified Transportation Credit, - Low Income Housing Credit, - Diesel Particulate Emission Reduction Technology Equipment, - Business Enterprise Vehicle Credit, - Research Tax Credit, - Headquarters Tax Credit, - Port Activity Tax Credit, - Bank Tax Credit, - Low Emission Vehicle Credit, - Zero Emission Vehicle Credit, - New Manufacturing Facilities Jobs Credit, - Electric Vehicle Charger Credit, - New Manufacturing Facilities Property Credit, - Historic Rehabilitation Credit, - Film Tax Credit, - Land Conservation Credit, - Teleworking Credit

Table 9. Review of Selected States' Corporate Income Tax Policies continued

	Maryland	Massachusetts	New York[2]
Rate	8.25% flat tax on net income	1) Net Income Measure (9.5%) 2) Property or Net Worth Measure ($2.60 per $1,000 of a corporation's taxable tangible property or taxable net worth) S Corporation income rate on total receipts: 3% on receipts of $6 million to $9 million. 4.5% on receipts of $9 million or more.	Two methods: (pay the higher of the two) 1) Net Income Marginal Tax Rate (7.5%) 2) Pay highest of either Corporate Stock Tax or Franchise (Corporate Income) Tax. Capital Stock Rate (0.178%) with unlimited maximum payment.
Minimum Tax	No	$456	• 1.78 mills per dollar of capital (up to $350,000); or a 2.5% minimum tax; or a minimum tax of $1,500 to $100 depending on payroll size. If any of these is greater than the tax computed on net income. • Small corporations with income under $290,000 are subject to lower rates of tax on net income. • An additional tax of 0.9 mills per dollar of subsidiary capital is imposed on corporations. • For banks, the alternative bases of tax are 3% of alternative net income; or up to 1/50th mill of taxable assets; or a minimum tax of $250.
Base	C-corporations Any other business entity choosing to be taxed as a corporation.	Corporations Limited liability company classified as a corporation for federal income tax purposes S corporations on any income that is federally taxable as an S corporation.	C corporations S corporations Out of state corporations are not subject to tax in New York if engage solely in interstate commerce.
Pass-through entities	Partnerships, LLCs, and S-corporations' tax rate for non-resident individual members is 6.75% and 8.25% for non-resident entity members.	Sole proprietorships owe income tax on business profits Partnerships are taxed on the partner's share of the partnership income.	S corporation are subject to the personal income tax.
Definition of presence	Adheres to definition found in federal Public Law 86-272.	Doing business includes each and every act, power, right, privilege or immunity exercised in the Commonwealth, by virtue of the powers and privileges acquired by the nature of such organizations and the buying, selling or procuring of services or property. Excludes from state net income-based taxation interstate activities of solicitation of orders for sales of tangible personal property filled by shipment or delivery from a point outside Massachusetts after orders are sent outside the state for approval or rejection.	• Imposition of tax requires engages in business in New York, employs capital, owns or leases property or maintains an office in the state. • 'Engaging in business' is used in a comprehensive sense and includes all activities which occupy the time or labor of persons for profit. • Corporation is subject to the NY franchise tax if it engages in the above activities regardless of whether it is authorized to do business in New York.
Apportionment Formula	Sales factor is double weighted	Sales factor is double weighted	Sales factor is double weighted (as of 2008)

Table 9. Review of Selected States' Corporate Income Tax Policies continued

	Maryland	Massachusetts	New York[3]
Definition of business income	All items are considered business income.	Full apportionment. Nonbusiness income: investment income on nondomiciliary corporations is excluded from apportionable income base.	• Entire federal net income with adjustments. • Measured by net income and by the value of subsidiary capital allocated to New York. • Stock ownership of more than 50% is subsidiary, less than 50% is considered investment.
Throwback/ Throwout Rule	No	No	No
Deductions for royalty payments to subsidiaries	No	No	No
Net Operating Loss	Carry forward: allowed up to 20 years. Carry back: allowed up to 2 years.	Carry forward: 100% of net income for 5 years.	Allow businesses to use current losses to offset past profits and receive refunds of prior-year taxes paid at exactly the time that current-year tax collections are falling. Limits the carry forward for 20 years and caps the dollar amount of losses that can be carried back to $10,000.
Combined Reporting	Under consideration	No	Yes
Tax Incentives	- Biotechnology Investment Incentive Tax Credit - Businesses That Create New Jobs Tax Credit - Clean Energy Incentive Tax Credit - Community Investment Tax Credit - Commuter Tax Credit - Employer Provided Long-Term Care Insurance Tax Credit - Employment Opportunity Tax Credit - Enterprise Zone Tax Credit - Green Building Tax Credit - Job Creation Tax Credit - Long-Term Employment of Qualified Ex-Felons Tax Credit - Maryland Disability Employment Tax Credit - Maryland-Mined Coal Tax Credit - One Maryland Economic Development Tax Credit - Research and Development Tax Credit - Water Quality Improvement Tax Credit	- Brownfield Credit for Rehabilitation of Contaminated Property - Economic Opportunity Area Credit - Film Incentive Credit - Harbor Maintenance Credit - Investment Tax Credit - Massachusetts Low Income Housing Credit - Medical Device Tax Credit - Research Credit - Vanpool Credit - Abandoned Building Renovation Deduction - Federal Bonus Depreciation Deduction - Dividend Deduction - Net Operating Loss Deduction - Solar and Wind Power Deduction	- In 2004, Empire Zone/Qualified Empire Zone Enterprise and Investment Tax Credits (ITCs) comprise 96.5% of all credits and rebates issued within the State. - In 2004, corporate taxpayers earned a total of $490.0 million in credits, claimed a total of $2,646.5 million in credits, used a total of $186.2 million in credits against their Article 9-A liability, and refunded a total of $118.8 million in credits - The amount of credit used and refunded in 2004 reached nearly $300 million. This was an increase of $43.4 million over 2003 - In 2002, the EZ/QEZE credits comprised 48.8 percent of all credits used and refunded. In 2003, they became the majority, with 50.7 percent of the total. In 2004, their share increased dramatically to 62.3 percent. - The investment tax credit (ITC), including the ITC for the financial services industry comprised 34.2 percent of all credits used and refunded in 2004. - In 2000, the year before the QEZE credits became effective, the ITC accounted for 83.1 percent of all credits used and refunded. - The other 15 credits tax credits available in 2004 accounted for the remaining 3.5 percent of all credits used and refunded.

Table 9. Review of Selected States' Corporate Income Tax Policies continued

	North Carolina	Pennsylvania	Virginia
Rate	1) Net Income Marginal Tax Rate (6.9%[4]) 2) Must pay both Corporate Income Tax and Capital Stock Tax. Capital Stock Tax Rate (0.15%) with maximum payment of $75,000.	9.99%	6% flat tax
Minimum Tax	No	No	No
Base	LLC classified as a C Corporation for federal income tax purposes is subject to the franchise tax, but all other LLCs are exempt. A non-corporate LLC's assets are attributed to a controlling corporation if the corporation or affiliated group of corporations owned 50% or more the LCC's assets.	All domestic and out of state corporations Limited liability companies and business trusts that are classified as corporations for federal income tax purposes Joint-stock associations	Corporations S corporations
Pass-through entities	S Corporations are subject to the individual income tax. LLCs are subject to income taxation as a partnership if it is classified as a partnership for federal income tax purposes or as a corporation if it is classified as a corporation for federal income tax purposes.	The partners/owners of S corporations are subject to the personal income tax. An S corporation's net income that is subject to federal CIT (federal built-in-gains) is subject the Pennsylvania CNIT.	Pass-through entities doing business in the State and having taxable income derived from Virginia sources are required to pay a withholding tax equal to 5% of their nonresident owners' shares of income from Virginia sources
Definition of presence	Adheres to definition found in federal Public Law 86-272.	A corporation is subject to the CNIT if; - does business and carry on activities, - has capital employed or used in Pennsylvania. - has property employed or used in Pennsylvania. - owns property in Pennsylvania. If a corporation's only interaction within Pennsylvania is the solicitation to sell tangible personal property, it is not subject to CNIT in accordance with the federal Public Law 86-272. However, the leasing, renting, licensing or other disposition of tangible property, or transactions involving intangibles, such as franchises, patents, copyrights, trade marks, service marks and the like, or any other type of property are not protected under the federal Public Law 86-272.	In general, every corporation that is incorporated under Virginia law, or that has registered with the State Corporation Commission for the privilege of conducting business in Virginia, or that receives income from Virginia sources must file a Virginia corporation income tax return. Adheres to definition found in federal Public Law 86-272.
Apportionment Formula	Sales factor is double weighted	Sales 70%, Payroll 15%, Property 15% (Governor Rendell recommended switching to single sales factor formula)	Sales factor is double weighted
Definition of business income	1) Business income: all income that is apportionable under the United State Constitution 2) In general, apportionable business income is all income from transactions and activities that are dependent upon or contribute to the operations of a taxpayer.	Income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if either the acquisition, the management or the disposition of the property constitutes an integral part of the taxpayer's regular trade or business operations. The term includes all income which is apportionable under the Constitution of the U.S.	Virginia does not distinguish between business and nonbusiness income.
Throwback/ Throwout Rule	No	No	No
Deductions for royalty payments to subsidiaries	No	Yes	No

Table 9. Review of Selected States' Corporate Income Tax Policies continued

	North Carolina	Pennsylvania	Virginia
Net Operating Loss	Carry forward: deduct for 15 years.	Carry forward: 20 years, capped at greater of $3 million per year or 12.5% of the Taxable Income prior to the NOL deduction	*There is no Virginia net operating loss*, as such, available for carryback or carryover. However, since the starting point is federal taxable income, there is statutory authority for net operating loss deductions to the extent that such losses are included in federal taxable income.
Combined Reporting	No	No	No
Tax Incentives	- Article 3J Tax Credits – Also known as "Tax Credits for Growing Businesses", provides tax credits to qualifying businesses for job creation, investment in business property and in some cases investment in real property. - **William S. Lee (Article 3A) Tax Credits** – Repealed for business activities that occur on or after January 1, 2007. - **Research and Development Tax Credits** - **N.C. Ports Tax Credits** - **Renewable Energy Tax Credits** - Income tax credits are also available for the following: - **Investing in renewable energy property** - **Construction of low-income housing** - **Construction of renewable fuel facilities** - **North Carolina State Ports Authority wharfage, handling and throughput charges** - **Contributions of cash or property to improvement projects undertaken by development zone agencies** - **Rehabilitating historic structures and historic mills** - Donations of real property used form public access or conservation, conservation tillage equipment, gleaned crops - S&L supervisory fees - Construction of cogenerating power plants - Recycling of oyster shells - Certain telephone subscriber line charges - Investing in large or major recycling facilities - Construction of dwelling units for handicapped persons - Construction of poultry composting facilities - Certain holding company expenses related to dividends - Qualified film or television production expenses - Small business health insurance costs - Expenses of research performed in the state of payments for research to universities in the states.	- Keystone Opportunity Zone Credit 3) Educational Improvement Tax Credit • Coal Waste Removal and Ultraclean Fuels Tax Credit • Neighborhood Assistance Credit • Employment Incentive Payment Credit • Jobs Creation Tax Credit • Pennsylvania Research and Development Tax Credit • Film Production Tax Credit • Resource Enhancement and Protection Tax Credit • Organ and Bone Marrow Donor Tax Credit.	- Credit for taxes paid to another state - Agriculture Best Management Practices Credit - Cigarette Export Credit - Coalfield Employment Enhancement Credit - Conservation Tillage Equipment Credit - Day-Care Facility Investment Credit - Employers of Disabled Individuals Credit - Enterprise Zone Act Credit - Fertilizer and Pesticide Application Equipment Credit - Foreign Source Retirement Income Credit - Historic Rehabilitation Credit - Land Preservation Credit Provision Prior to 2007 - Land Preservation Credit Provision for 2007 and after - Low Income Housing Credit - Low Income Individuals Credit - Major Business Facility Credit - Neighborhood Assistance Act Credit - Political Contributions Credit - Qualified Equity and Subordinated Debt Investments Credit - Recyclable Materials Processing Equipment and Alternative Recycling Credit - Rent Reduction Program Credit - Riparian Waterway Buffer Credit - Trust Beneficiary Accumulation Distribution Credit - Vehicle Emissions Testing Equipment, Clean Fuel Vehicle and Certain Refueling Property Credit - Waste Motor Oil Burning Equipment Credit - Worker Retraining Credit

Sources: See Section 4 of Report.

Appendix G: Overview of Business Taxes in the Selected States

Businesses are critical components of a state's economy because they employ residents and contribute to state revenues. New Jersey and the key states have proposed a variety of initiatives and legislation to improve their business climate and overall economy.

Delaware

Delaware was ranked 9th in business tax climate for FY2008 by the Tax Foundation. Delaware's ranking is much more attractive than its neighboring states; Pennsylvania is ranked 27th, New Jersey 49th, and Maryland ranked 24th.[182] Delaware is ranked favorably in business tax climate for a variety of reasons, including its lack of a sales or use tax, low property tax rates (averaging just $1,530 per household),[183] and its exemption of corporate income tax for business income limited to the management of intangible investments and the collection and distribution of income earned on these investments.[184]

Virginia

Virginia has experienced substantial economic growth in the past decade. A 2007 report by the Council on Virginia's Future concluded that the State's significant growth is matched with a high skilled workforce and consistent increases in per-capita-income, entrepreneurship, and employment.[185]

A highly competitive tax climate compliments the State's economic performance. The Tax Foundation ranks Virginia as fourth in the nation in its Corporate Tax Index. In the past years, the State has consistently performed well in the rankings.[186] Moreover, the State's corporate tax collections have risen recently. Virginia attributes this growth to "[a] combination of strong productivity growth and low unit labor costs [that] have allowed firms to build cash holdings."[187]

Additionally, Virginia is actively pursuing policies to augment its tax climate. In 2007, the State passed Senate Bill 1283, which provides a deduction for shareholders of an S-corporation that is "subject to the Virginia bank franchise tax."[188]

Georgia

In recent years, Georgia has experienced positive economic growth and a strong business climate. In fact, Georgia received high rankings by several important organizations that evaluate state business climate, taxation, and economic performance, including the Tax Foundation, Site Selection, and the Small Business Entrepreneurship Council. Furthermore, a survey of "corporate site seekers" assessed Georgia as the third best state to locate a business based on a skilled workforce, job growth in the region, a competitive tax climate, and land prices.[189] The State experienced a 1.5 percent employment increase in 2007, realizing 59,600 new jobs.[190] Georgia is also home to a diverse range of companies with

headquarters or major facilities located in the State, including Home Depot, Delta Airlines, Porsche, Coca-Cola, CNN, Phillips Electronics, the US Center for Disease Control, and Newell Rubbermaid.[191] These statistics demonstrate the strength of Georgia's economy, its competitiveness, and attractiveness to new business and investment.

Georgia's competitive tax climate contributes to its economic and business strength. The Tax Foundation ranks it as sixth in the nation in their most recent Corporate Tax Index. The organization's evaluation of a state's corporate tax is "designed to gauge how a state's corporate income tax top rate, bracket structure, and gross receipts rate affect its competitiveness compared to other states, as the extent of taxation can affect a business' level of economic activity within a state."[192] From 2003 to 2008, the State's rank in the Tax Foundation's index has consistently been in the top tier of the country.

Additionally, the State is looking to promote investment and development. For example, in 2005, Georgia passed House Bill 191, which transitioned the State's apportionment formula to a single-sales factor. Much of the support for this apportionment plan stems from the idea that single-sales apportionment would spur economic development by providing incentives to corporations to locate in a particular state.[193] Moreover, major objectives of the shift to single sales are as follows: lower effective income tax rates for in-state manufacturing, distribution or service companies that sell goods within a respective state and to reverse the "policy of subjecting corporations to higher income tax burdens the greater the physical presence in a state."[194] Several key studies have demonstrated that single-sales apportionment has positive effect for a state. In a 2003 report analyzing tax returns, compliance levels, and policy, Kelly D. Edmiston of the Andrew Young School of Policy Studies at Georgia State University, argues that after an initial adjustment to the new apportionment formula, Georgia would experience a positive net revenue impact and new economic development.[195] Another study, published by the Atlanta law firm, Arnall Golden Gregory, LLP, concludes that single-sales would "greatly reduce Georgia income tax on Georgia-based manufacturing"[196] and other companies that have major facilities in Georgia and sell out of state. As a result, the policy of single sales apportionment would promote manufacturing, in-state employment, and new business development.

Maryland

Faced with a $1.7 billion structural deficit and a need to raise an additional $400 million for transportation projects, Maryland's Governor O'Malley in September 2007 proposed a wide-ranging tax reform that included increasing the sales tax from 5 to 6 percent, increasing the corporate income tax from 7 to 8 percent, and making combined reporting mandatory.[197] Over the past few years several states have enacted combined reporting as a way of requiring multi-state corporations to report all of their income through parent and subsidiary companies together, and to determine its' tax liability on that basis.[198]

After a three week special legislative session, the Maryland general assembly enacted $1.4 billion in new taxes. Maryland's businesses will pay $800 million of these taxes. Among the reforms, the Assembly raised the corporate income tax from 7 to 8.25 percent, hiked the sales tax from 5 to 6 percent, and created a business tax reform commission which will study changes to the state's business taxes and make recommendations for change to the tax

structure. However, the Governor's endorsement of combined reporting was defeated in the special session.[199]

The Tax Foundation ranks Maryland 24th in their overall ranking of state business climate. Maryland's business tax structure is still relatively business friendly in comparison to New York and New Jersey, which rank 48th and 49th respectively.[200] This is partly because its corporate income tax and sales tax are still lower than competitor states. In fact, the Tax Foundation ranks Maryland 7th in state business climate for both the CIT and sales tax.[201]

Pennsylvania

Pennsylvania was ranked 27th in business tax climate index of the Tax Foundation in 2008.[202] In 2006, businesses paid $22 billion in state and local business taxes in Pennsylvania. This figure constituted 42.5 percent of all state and local tax collections.[203] Businesses are required to pay both the Corporate Net Income Tax (CNIT) and Capital Stock and Franchise Tax (CSFT) in Pennsylvania. CNIT rate is 9.99 percent and is the second highest in the nation. CSFT is $ 3.89 per $1,000 of capital stock as of tax year 2007. However, CSFT is currently being phased out and will be completely eliminated by the end of 2010. Until then, CSFT rate will decrease $1 each year.[204]

In 2004, Pennsylvania Governor Ed Rendell established a Business Tax Reform Commission charged with reviewing the business tax structure and developing policy recommendations to improve the business tax climate of Pennsylvania. The recommendations of the commission that were supported by Governor Rendell included reduction of the CNIT rate to 7.9 percent, switching to a single sales factor formula for apportionment, mandatory combined reporting, and removal of $2 million cap on Net-Operating Loss (NOL)deductions.[205] However, the Pennsylvania State Legislature did not adopt these recommendations. Instead, they adopted different measures. Pennsylvania recently increased the weight of the sales factor in the apportionment formula from 60% to 70% and increased the cap on NOL deductions from $2 million to the greater of $3 million or 12.5% of the Pennsylvania Taxable Income.[206]

Massachusetts

Massachusetts has two parts to the corporate tax which businesses must pay, the corporate income tax and the corporate franchise tax. The corporate income tax rate is the fourth highest in the nation for 2008 at 9.5 percent and is applied to a corporation's net income. The corporate franchise tax is $2.60 per $1,000 of either a corporation's taxable Massachusetts tangible property or its taxable net worth.[207] As with other Northeastern states, Massachusetts has high property taxes and therefore has a property tax ranking of 45th nationally. In July 2007, the per capita property tax collections were $1,772.[208] Massachusetts has a good sales ranking because the sales tax rate is moderate at five percent, most business inputs items are exempt, and excise taxes are moderate. Overall, the Tax Foundation ranked Massachusetts' business climate 34th nationally for 2008. [209]

Massachusetts does not currently utilize combined reporting, but Governor Deval Patrick proposed legislation in February 2007 to establish the policy tool. The proposed legislation, entitled *An Act Improving the Fairness of the Tax Laws*, includes a clause to establish combined

reporting as a means to close a corporate tax loophole. Initiating combined reporting in the State of Massachusetts is expected to increase tax revenues by $136 million in Fiscal Year 2008 and $226 million in Fiscal Year 2009.[210]

Connecticut

The Tax Foundation ranked Connecticut's overall business climate 38th in the country for FY2008, due in large part to the State's high diesel excise tax and property tax rates. Connecticut has a diesel tax of 37 cents per gallon, second only to Pennsylvania. The high costs of transporting goods in vehicles that use diesel fuel increases the cost of conducting business in the State and deters manufacturing companies that need to transport goods around the country from locating in the State.[211] In July 2007, per capita property tax collections were $2,157, giving the Connecticut the worst property tax ranking in the country.

Corporations are required to pay the corporate income tax or the corporate stock tax, whichever is higher. The corporate income tax is 7.5 percent of a corporation's net income base. The capital stock tax, a component of the property tax, has a rate of 31 percent ($0.0031 per dollar) with a maximum payment of $1,000,000.[212]

North Carolina

The Tax Foundation ranked North Carolina overall business climate 40th in the country for FY2008, one position higher than the state was placed in FY2007 and a four position improvement over FY2004.[213] The Tax Foundation ranked North Carolina favorable in its unemployment insurance tax index (6th) and its corporate tax index (25th) but much lower in its individual income tax index (44th) and sales tax index (39th).
In 2007, North Carolina experienced various tax policy changes. As of December 1, 2006, the State increased the general retail sales and use tax to 4.25 percent and was scheduled to decrease to 4 percent effective July 1, 2007. Instead, the State's General Assembly approved a permanent extension of the 4.25 percent state sales tax rate.[214] The Assembly also voted to give counties the option of enacting an additional sales tax or a land transfer tax. Legislation was also passed to reinforce the State's position on captive real estate investment trusts (REITs) and further clarify the requirements for taking a tax credit for conservation donations. This was done to limit abuse of these incentives. Additionally, new tax credit was created for biodiesel producers, while the incentive for research and development was further enhanced and become effective for taxable years beginning January 1, 2007.

New York

The Tax Foundation ranked New York overall business climate 48th in the country for FY2008, the same ranking the state experienced in FY2007 and an improvement over FY2006-2004 index placements.[215] New York is ranked unfavorably in business tax climate for a variety of reasons, including its high property tax rate (averaging $1,835 per household and ranked 43rd among states) and its unfavorable sales tax index ranking (49th).[216] New York also ranked poorly in the Tax Foundations unemployment insurance tax index (46th) and individual income tax index (41st). Additionally, New York's State and Local tax burden

ranked third highest in the nation in 2007 at a rate of 13 percent, two percent higher than the nation average of 11 percent.[217]

Despite New York's high rate of tax collection, the state is currently facing a major budget deficit, estimated at $4.7 billion for the fiscal year 2008-2009 starting April 1. One of the cited factors for this deficit is a deceleration in revenue from financial services and real estate industries.218

As of FY2007, New York has adopted a double-weight sale apportionment formula. However, a 2000 report from the University of Chicago entitled, *The Economic Impact of Single Factor Sales Apportionment for the State of New York*, concluded that increasing the weight on the sales factor in the state of New York would have a significant positive effect on in-state employment.219 By their estimation, switching to single factor sales will have a long-run impact of creating an additional 32,000 manufacturing jobs and 101,000 non manufacturing jobs in New York.

In 2006, New York State collected $147.69 per capita in corporate taxes, ranking the State 23rd highest nationally.[220] Between 2002 and 2003, New York State experienced a trend in which S corporations accounted for a decreased portion of the corporate tax base while C corporations liable for taxes on their entire net income (as opposed to paying the alternative minimum tax) accounted for an increasing portion of the tax base. In 2003, there were 587,638 C corporations and S corporations located in New York State with a total tax liability of $1,387,190,655, up 20.7 percent from 2002.[221] The majority of corporate income taxpayers were S corporations (335,122 entities) with a total tax liability of $51,367,644. Between 2002 and 2003, the number of S corporations in New York increased 5.8 percent while their tax liability increased 45.9 percent. Of the C corporations located in the State, the majority (158,232 entities) paid the alternative minimum tax. The remaining 51,693 C corporations paid taxes on their entire net income and had a total tax liability of approximately $1.3 billion, significantly higher than the corporations that paid the alternative minimum tax. The tax liability of C corporations that paid taxes on their entire net income increased 26.5 percent from 2002 to 2003. In contrast, C corporations that paid the alternative minimum tax experienced a 2.8 percent decrease in tax liability.

Table 10. New York C Corporation and S Corporation by Base, Number of Taxpayers and Tax Liability - 2002 and 2003

Corporation Base of Primary Tax		Number of Taxpayers			Tax Liability*		
		2002	*2003*	*Percent Change*	*2002*	*2003*	*Percent Change*
C Corporation	Entire Net Income	52,138	51,693	-0.9%	$896,427,495	$1,133,762,074	26.5%
	Fixed Dollar Minimum Tax	159,702	158,232	-0.9%	38,590,543	37,641,152	-2.5%
	Capital	37,208	35,564	-4.4%	131,925,636	125,987,137	-4.5%
	Alternative Minimum Taxable Income	7,007	7,027	0.3%	39,552,978	38,432,648	-2.8%
C Corporation Total		**256,055**	**252,516**	**-1.4%**	**$1,106,496,652**	**$1,335,823,011**	**20.7%**
S Corporation	Entire Net Income & Fixed Dollar Minimum Filers	316,784	335,122	5.8%	94,962,259	51,367,644	-45.9%
Combined Total		**572,839**	**587,638**	**2.6%**	**1,201,458,911**	**1,387,190,655**	**15.5%**

*Tax liability includes the tax on subsidiary capital paid by 1,830 taxpayers valued at $15.1 million in 2002, and 1,657 taxpayers valued at $15.8 million in 2003. Tax liability excludes the MTA surcharge.
Source: New York State Department of Taxation and Finance.

New Jersey

New Jersey is behind all neighbor states in its 2008 Tax Foundation ranking of 49th in the nation. New Jersey has bad reputation especially for its high property taxes. New Jersey had the highest per capita property tax in the nation at $2,099.[222] In 2006, businesses paid $18.6 billion in state and local business taxes in New Jersey. This figure constituted 38.4 percent of all state and local tax collections.[223] Businesses in New Jersey are required to pay Corporate Business Tax (CBT). The CBT rate is 9 percent for businesses that have net income above $100,000. New Jersey has the 7th highest corporate income tax rate in the country.[224]

The last year New Jersey made substantial changes to corporate taxation was 2002. With those changes, New Jersey enacted alternative minimum tax, a throwout rule, and new rules for related party transactions and broadened the definition of corporations that are subject to CBT. The most recent change in 2006 imposed a 4 percent surcharge on the CBT liability until the end of fiscal year 2009 and increased the minimum tax.[225] According to the web site of the New Jersey State Legislature, in the 2008-2009 legislative session there are 46 bills related to business taxation. Most of these bills are related to tax credits, but there are also some bills that propose fundamental changes such as adoption of a singles sales factor apportionment formula and elimination of the minimum tax.[226]

Appendix H: Methodology

The focus of this report is on the corporate income taxation policy of New Jersey as compared to ten key states. Our major objective is to propose reforms and methods New Jersey can implement to improve the State's business climate and economic performance.

To effectively evaluate the issues, we conducted a literature review of pertinent reports relating to overall business climate among the 50 states, the most significant taxes that affect business location decisions, and critical aspects of corporate taxation policies. Additionally, we interviewed several tax experts from corporations in different industries in New Jersey to obtain primary source data information. The New Jersey Policy Research Organization (NJPRO) identified the experts for their experience, accessibility, and intimate knowledge of the State's taxation policies. We subsequently identified variations in the corporate income tax structure and policies of New Jersey and ten key states. The ten states were selected because they are New Jersey's primary competitors in the country. Finally, we analyzed the differences to offer recommendations to improve the business climate in New Jersey.

We conducted our research, interviews, and analysis from January to May 2008.

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