

## Tax Proposal Review Part Two: Ending the Corporate Income Tax

The provision to end the corporate income tax is in both of Gov. Heineman's tax package bills; LB405 would end the corporate income tax, individual income tax, and close numerous sales tax exemptions, and LB406, would eliminate the corporate income tax while reducing individual income taxes on Social Security and other retirement income, and close fewer sales tax exemptions.[\[1\]](#)

Nebraska's corporate income tax is divided into two brackets: the lower rate of 5.58 percent applies to the businesses with a net income under \$100,000, while businesses with net income over \$100,000 pay a 7.81 percent rate.[\[2\]](#) The 7.81 percent rate is the 19<sup>th</sup> highest nationally and puts Nebraska at a competitive disadvantage when compared to other states in the region.[\[3\]](#) Among Nebraska's neighbors, South Dakota and Wyoming do not have a corporate income tax at all, and Colorado (4.63 percent), Kansas (7 percent), and Missouri (5 percent) all have lower rates. Only Iowa surpasses Nebraska with a top rate of 12 percent for net income over \$250,000.[\[4\]](#)

The negative impacts of high corporate income taxes become very clear when examined in the context of other taxes that affect businesses, such as individual income, sales, unemployment insurance, and property taxes. The non-partisan Tax Foundation, which analyzes tax policy at the local, state, and federal levels, estimates that when these taxes are taken together, Nebraska ranks 31<sup>st</sup> in Business Tax Climate. To put that in perspective, Wyoming and South Dakota ranked first and second, respectively, for their Business Tax Climate, and with the exception of Iowa-which ranked 42<sup>nd</sup>-all our other neighbors have better rankings: Colorado at 18<sup>th</sup>, Kansas at 26<sup>th</sup>, and Missouri at 16<sup>th</sup>.[\[5\]](#)

In addition to the competitive disadvantage of a high corporate income tax, there is also the negative impact on ordinary people, particularly shareholders, consumers, and especially workers. Because businesses are made up of these three groups, the costs of the tax are inevitably passed down to them, either through lower returns for shareholders, higher prices for consumers, or lower wages for workers. Recent evidence suggests the people hurt most by the corporate income tax are average workers. One international study of 72 countries over 22 years found that for every one percent increase in the corporate income tax rate, wage rates decrease by approximately 0.8 percent.[\[6\]](#) A similar study of the fifty states found that every \$1 paid in state and local corporate income taxes causes a \$2.50 drop in wages five years later, and that the reverse is also true: for every dollar not paid in state and local corporate income tax, wages rise

by \$2.50.<sup>[7]</sup> The impact on wages is even more pronounced when analyzed by the level of education, as higher rates have a progressively negative wage impact as the level of education increases. A paper from the Federal Reserve Bank of Kansas City estimates that every one percent increase in the corporate income tax rate causes a 0.26 percent wage decrease for those without a high school diploma, a 0.31 percent decrease for workers with a high school diploma (or some college), and a 0.44 percent decrease for those with a bachelor's degree or higher.<sup>[8]</sup> High corporate income taxes hurt all workers at all incomes-particularly low-income workers where wages are often the only source of revenue-and are especially punitive for higher skilled workers,<sup>[9]</sup> which may contribute to them leaving Nebraska.

One additional question that should be considered is whether the corporate income tax is even a good source of state revenue. Between Fiscal Year (FY) 1980 and FY 2002, corporate income tax as a percentage of state revenue dropped almost in half from slightly over 7 percent to approximately 3.8 percent, a trait that was reflected in other states.<sup>[10]</sup> While FY 2011 saw the tax make up 6.4 percent of state revenue,<sup>[11]</sup> the overriding trend for the past 30 years has been for the revenues from this tax to decrease in comparison to other taxes and to grow well under the rate of inflation.<sup>[12]</sup> This trend suggests that in addition to doing real harm to economic competitiveness and all Nebraska workers, state government is seeing little benefit from the tax.

The corporate income tax has a substantial effect on Nebraska's economy, putting the state at a competitive disadvantage for attracting businesses, lowering wages for workers-particularly higher educated workers-and seeing minimal and overall decreasing returns in tax receipts. Eliminating Nebraska's corporate income tax would immediately begin to reverse the economic harm it causes and make Nebraska more attractive for businesses and workers.

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<sup>[1]</sup> Nebraska Legislature, "Legislative Bill 405," January 22, 2013. Accessed February 6, 2013, <http://nebraskalegislature.gov/FloorDocs/Current/PDF/Intro/LB405.pdf>; Nebraska Legislature, "Legislative Bill 406," January 22, 2013. Accessed February 6, 2013, <http://nebraskalegislature.gov/FloorDocs/Current/PDF/Intro/LB406.pdf>.

<sup>[2]</sup> Nebraska Legislature, *Corporate Income Tax*, Accessed February 6, 2013: [http://nebraskalegislature.gov/app\\_rev/source/corpincometax.htm](http://nebraskalegislature.gov/app_rev/source/corpincometax.htm). This particular website uses the outdated information that the top corporate tax rate cutoff is \$50,000. This is incorrect, and the cutoff was raised to \$100,000 in 2009 as noted by Nebraska Tax Commissioner Doug Ewald in an interview with the author.

<sup>[3]</sup> Tax Foundation, "Nebraska: Corporate Income Tax." Accessed February 6, 2013, <http://taxfoundation.org/state-tax-climate/nebraska>.

[4] Tax Foundation, "State Corporate Income Tax Rates, 2000-2012," February 16, 2012. Accessed February 6, 2013, <http://taxfoundation.org/article/state-corporate-income-tax-rates-2000-2012>.

[5] Scott Drenkard and Joseph Henschman, "2013 State Business Tax Climate," Tax Foundation Background Paper, October 2012, Number 64. Accessed February 6, 2013, [http://taxfoundation.org/sites/taxfoundation.org/files/docs/2013\\_Index.pdf](http://taxfoundation.org/sites/taxfoundation.org/files/docs/2013_Index.pdf).

[6] Kevin A. Hassett and Aparn Mathur, "Taxes and Wages," American Enterprise Institute Working Paper #128, June 2006. Accessed February 6, 2013, [http://www.aei.org/files/2006/07/06/20060706\\_TaxesandWages.pdf](http://www.aei.org/files/2006/07/06/20060706_TaxesandWages.pdf).

[7] Robert Carroll, "\$1 Increase in State-Local Corporate Tax Rate Causes \$2.50 Drop in Wages Five Years Later," Tax Foundation Special Report No. 169, August 3, 2009. Accessed February 6, 2013, <http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr169.pdf>.

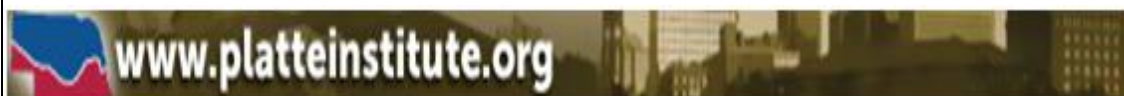
[8] R. Alison Felix, "Do State Corporate Income Taxes Reduce Wages?" Federal Reserve Bank of Kansas City, 2007. Accessed February 6, 2013, <http://www.kc.frb.org/publicat/econrev/pdf/09q2felix.pdf>.

[9] Ibid.

[10] Nebraska Legislature, "Taxes in Nebraska: Corporate Income Tax Receipts." Accessed February 6, 2013, [http://uniweb.legislature.ne.gov/app\\_rev/source/corpincometax\\_analysis.htm](http://uniweb.legislature.ne.gov/app_rev/source/corpincometax_analysis.htm).

[11] Nebraska Department of Revenue, "Monthly Report of General Fund Receipts by Fiscal Year." Accessed February 6, 2013, [http://www.revenue.ne.gov/research/gen\\_fund.html](http://www.revenue.ne.gov/research/gen_fund.html).

[12] Nebraska Legislature, "Taxes in Nebraska: Corporate Income Tax Receipts." Accessed February 6, 2013, [http://uniweb.legislature.ne.gov/app\\_rev/source/corpincometax\\_analysis.htm](http://uniweb.legislature.ne.gov/app_rev/source/corpincometax_analysis.htm).



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