Several national studies have examined both the level of business taxation in Massachusetts and the “tax climate.” Studies have consistently found that the overall level of business taxation is significantly lower in Massachusetts than in most states, as much as two billion dollars less. One prominent study, however, finds that the business tax climate in Massachusetts is among the bottom third of the states. This Facts at a Glance examines several recent studies and discusses the implications of their findings for Massachusetts.

How Does The Overall Level of Taxation of Businesses in Massachusetts Compare to Other States?

Studies by the consulting firm of Ernst & Young and by Robert Tannenwald, Vice President and Economist at the Federal Reserve Bank of Boston, suggest that, by four separate measures, overall business taxes are lower in Massachusetts than in the large majority of states.

One of the studies was conducted by Ernst & Young for the Council on State Taxation (COST), a Washington, DC based trade association that represents 550 multistate and multinational corporations. The study determined that, in FY 2006, businesses in 41 states paid a greater percentage of state and local taxes than they did in Massachusetts, in which businesses paid 38.7 percent of total taxes, according to Ernst and Young’s methodology. Moreover, COST found that 39 states collected a greater share of private Gross State Product (GSP) in business taxes in Fiscal Year 2006 than did Massachusetts, where state and local business taxes amounted to 4.4 percent of private sector GSP, as calculated by Ernst and Young. Nationally this study found that business taxes were 5.1 percent of GSP. Thus, this study suggests that Massachusetts business taxes in 2006 were $2 billion lower than they would have been if the Commonwealth was at the national average for business taxes as a share of GSP.

A second study, by Boston Federal Reserve Bank Economist Robert Tannenwald, uses data for Fiscal Year 2000. As illustrated below, it finds that Massachusetts’ business taxes compared to business profits were lower than in 48 states, and business taxes relative to personal income were lower than in 46 states.
Between them, these two national studies examine four different measures of business taxation: business taxes as a share of all taxes collected; business taxes as a share of gross state product; business taxes as a share of state business profits; and business taxes as a share of state personal income. By all four measures Massachusetts ranked among the eight states with the lowest business taxes.

Why Does Tax Foundation Rank the Massachusetts Business Tax Climate as Below Average When the Level of Business Taxes is Among the Lowest in the Nation?

Another national study that has looked at business taxes is the Tax Foundation’s State Business Tax Climate Index (SBTCI). In this study Massachusetts ranks fairly low, with 35 states having a better “business tax climate.” It is not surprising that this study finds something very different from the others, because it is measuring something very different. This study does not seek to measure the level of business taxation in each state (as did the studies by Ernst & Young and Tannenwald). Instead it measures the manner in which states tax businesses. The authors of the study explain this clearly:

“The SBTCI does not measure business tax burdens. While it is unquestionably important how much revenue states collect in business taxes, the manner in which they extract tax revenue is also important…. Good state tax systems levy low, flat rates on the broadest bases possible, and they treat all taxpayers the same. Variation in the tax treatment of different industries favors one economic activity or decision over another. The more riddled a tax system is with politically motivated preferences the less likely it is that business decisions will be made in response to market forces.”

While business taxes in Massachusetts are low, the state’s tax system does not meet these criteria for a good tax system. The Massachusetts corporate tax system includes numerous special tax breaks for specific industries, such as mutual funds, manufacturing, and the motion picture industry. Tax policy analysts can agree or disagree with the Tax Foundation’s criteria for judging a tax system. It is important to recognize, however, that this study does not purport to compare the level of business taxation in different states.

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ii Also called Gross National Product by State.
v This study also includes a specific index for the corporate tax, and that places Massachusetts even lower: 47th (the overall climate ranking also includes income taxes, sales taxes, unemployment insurance taxes, and property taxes).
vi For instance, the Tax Foundation corporate tax index examines two sets of policies. One is measured by a rate sub-index consisting of the top tax rate, the level of taxable income at which the top rate kicks in, and the number of brackets. Because when Massachusetts cut business taxes during the 1990s it did so by creating special tax breaks rather than reducing the overall rate, the tax foundation appears not to count those cuts as improving the tax climate. The second sub-index relates to the tax base. The Tax Foundation explains that “States that score well on the corporate tax base sub-index generally will have few business tax credits, generous carry-back and carry-forward provisions, deductions for net operating losses, conformity to the internal revenue code, and provisions for alleviating double taxation.” It is interesting to note that the enactment or expansion of business tax credits appears to produce a lower score in this ranking, while other forms of reducing business taxes would produce a higher score. Dubay and Atkins, p. 12-13.
vii Dubay and Atkins, p.4, highlights added.