

# Effective Tax Rates for the States: 2004-2008

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(Forthcoming, *State Tax Notes*)

This article reports the effective overall business tax rates by state from 2004-2008, periods for which the most recent data is available.<sup>2</sup> Effective rates are more indicative of the true tax burden than nominal rates, because they implicitly take into account deductions, credits, and the effects of various tax rules. Moreover, overall rates take into account the *total* tax burden faced by a business: income, property (both state and local), payroll, gross receipts, and other miscellaneous taxes.

Overall effective rates are computed as:

$$\text{BETR}_{s,t} = \sum_{ix=1}^n tx_{i,s,t} / \text{BGSP}_{s,t} \quad (1)$$

where:

$\text{BETR}_{s,t}$  = business overall effective tax rate for state  $s$  in year  $t$

$tx_{i,s,t}$  = business taxes of type  $i$  paid into state  $s$  in year  $t$ , an

$\text{BGSP}_{s,t}$  = business gross state product for state  $s$  in year  $t$ .

Business gross state product is obtained from the U.S. Department of Commerce (Bureau of Economic Analysis, or BEA). Business taxes are collected from a variety of sources, including Census (*State Government Finances*, various years, *State Government Tax Collections*, various years, *Census of Local Governments*, various years, and related reports) and the Tax Foundation.

## Business Effective Tax Rates by State

Overall effective business tax rates are shown in Table 1. Average (across all states) rates are shown graphically in Figure 1. Three observations are in order. First, there is a high variance between states. Second, there is an increase in rates over time. Finally, there are some general geographic patterns; northeastern states tend to have the highest effective rates, and southeastern (except Florida<sup>3</sup>) and rural states, the lowest. Note that severance tax collections in New Mexico and North Dakota (which arguably are borne by out of state business conglomerates) inflate the effective tax rates for those two states.

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2 At this writing, while 2009 tax collections are known, 2009 business income has not yet been reported by BEA. For effective business tax rates prior to 2004, using the same methodology, the reader is referred to Swenson, C. 2005. "Effective Business Tax Rates for the States: 1991-2002". *State Tax Notes* (Dec. 19).

3 Florida has relatively high stock and document transfer taxes

**Table 1**  
**Overall Effective Business Tax Rates by State<sup>4</sup>**

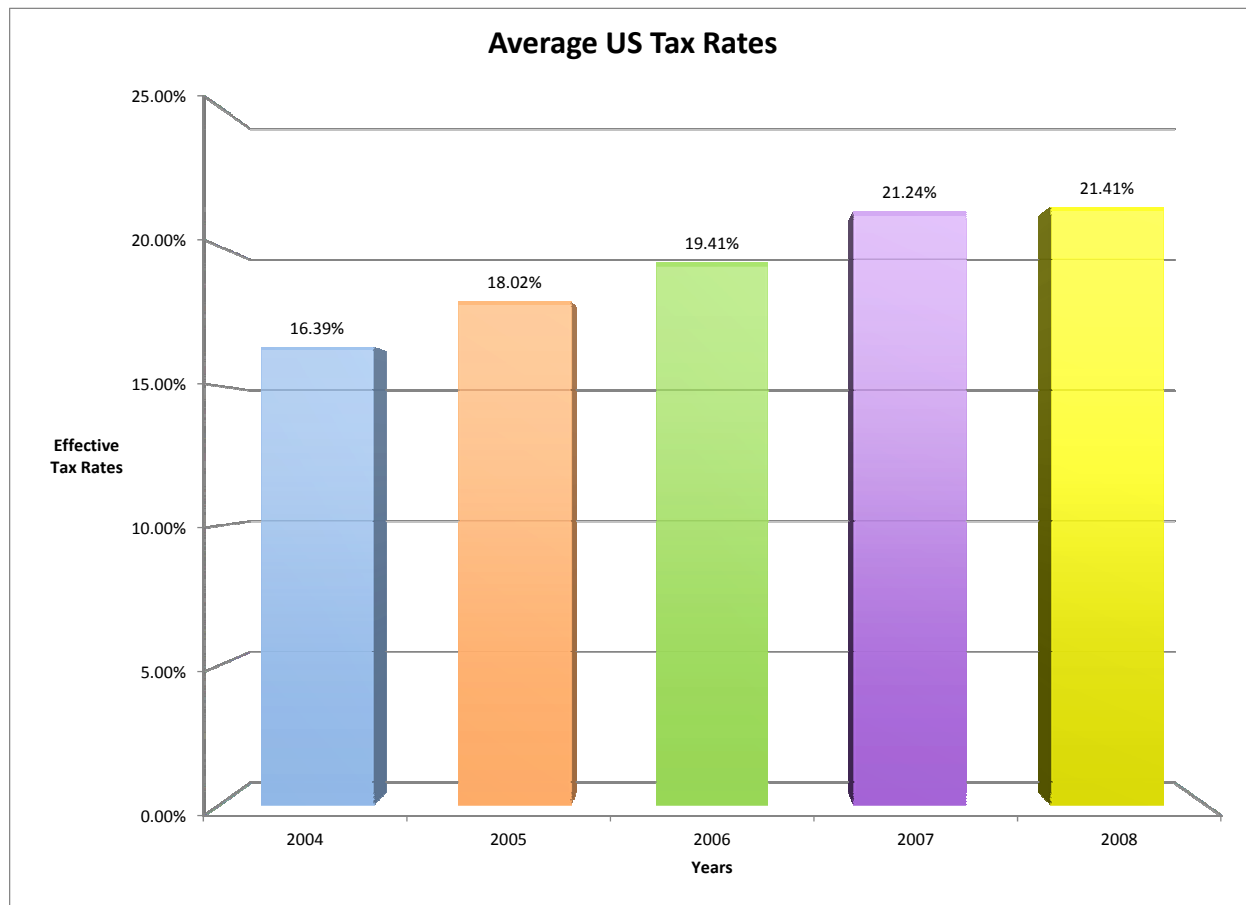
<b>STATE</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>United States</b>	16.39%	18.02%	19.41%	21.24%	21.41%
<b>Alabama</b>	10.90%	12.27%	14.16%	14.86%	16.27%
<b>Arizona</b>	14.98%	15.52%	19.01%	21.35%	22.34%
<b>Arkansas</b>	11.35%	15.39%	17.07%	17.70%	17.88%
<b>California</b>	14.03%	15.09%	16.23%	19.44%	21.18%
<b>Colorado</b>	8.19%	8.44%	9.13%	24.95%	10.76%
<b>Connecticut</b>	15.90%	17.16%	16.38%	19.60%	20.02%
<b>Florida</b>	28.19%	30.71%	33.89%	35.35%	36.27%
<b>Georgia</b>	11.99%	12.55%	13.55%	14.60%	14.93%
<b>Hawaii</b>	10.08%	12.64%	14.54%	15.06%	16.97%
<b>Idaho</b>	10.03%	11.61%	12.47%	11.30%	12.05%
<b>Illinois</b>	17.99%	20.66%	20.45%	23.24%	22.63%
<b>Indiana</b>	16.01%	21.88%	21.04%	18.68%	19.15%
<b>Iowa</b>	10.61%	12.69%	14.41%	14.76%	13.32%
<b>Kansas</b>	14.82%	14.48%	16.84%	19.23%	17.87%
<b>Kentucky</b>	19.00%	19.88%	25.09%	27.30%	22.39%
<b>Louisiana</b>	13.09%	16.49%	16.99%	20.52%	19.18%
<b>Maine</b>	23.33%	24.03%	25.05%	24.96%	28.02%
<b>Maryland</b>	19.86%	20.49%	20.70%	22.66%	23.32%
<b>Massachusetts</b>	18.71%	18.72%	19.51%	20.83%	22.57%
<b>Michigan</b>	28.28%	29.18%	28.80%	32.37%	30.97%
<b>Minnesota</b>	19.69%	20.74%	21.49%	25.00%	23.90%
<b>Mississippi</b>	13.65%	14.71%	17.50%	19.12%	20.40%
<b>Missouri</b>	10.29%	11.30%	11.70%	13.45%	13.92%
<b>Nebraska</b>	12.08%	12.67%	16.09%	14.59%	13.47%
<b>Nevada</b>	20.06%	20.89%	21.14%	20.60%	23.40%
<b>New Jersey</b>	25.90%	28.05%	28.46%	31.07%	34.49%
<b>New Mexico</b>	21.12%	25.08%	31.65%	34.46%	37.00%
<b>New York</b>	17.76%	18.73%	19.46%	22.71%	23.68%
<b>North Carolina</b>	14.98%	16.56%	16.56%	19.70%	21.15%
<b>North Dakota</b>	17.98%	19.70%	27.81%	25.09%	29.41%
<b>Ohio</b>	19.47%	21.77%	20.04%	23.04%	23.51%
<b>Oklahoma</b>	11.33%	12.09%	14.46%	16.22%	14.47%
<b>Oregon</b>	15.09%	15.73%	16.37%	18.10%	20.85%
<b>Pennsylvania</b>	19.02%	20.07%	20.61%	22.43%	22.52%
<b>Rhode Island</b>	23.09%	24.64%	26.03%	27.46%	27.61%
<b>South Carolina</b>	18.38%	18.37%	18.87%	21.45%	22.51%
<b>South Dakota</b>	7.59%	8.39%	11.29%	10.13%	8.72%
<b>Tennessee</b>	11.23%	11.88%	12.39%	14.58%	14.39%
<b>Texas</b>	12.13%	12.61%	13.41%	14.46%	14.54%
<b>Utah</b>	11.81%	12.86%	14.79%	16.63%	18.10%
<b>Virginia</b>	16.48%	18.46%	20.68%	22.19%	21.66%
<b>Washington</b>	18.98%	20.71%	20.12%	21.17%	20.60%

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<sup>4</sup>Excluded from the analysis are some states with enormous severance taxes which yield a distorted effective tax rate.

<b>West Virginia</b>	21.05%	31.16%	32.59%	34.12%	32.84%
<b>Wisconsin</b>	24.58%	25.68%	25.13%	28.20%	30.76%

FIGURE 1



### Sensitivity of the Results to Certain Taxes

#### *Local Property Tax Collections*

Local property tax collections account for about one-third, on average, of business effective tax rates. Although such collections are known in total with accuracy (by state and year), the per cent of such taxes paid by businesses has been estimated<sup>5</sup>. While local taxes are paid by property owners, it is reasonable to assume that at least a portion of such taxes are passed onto business lessees in the form of higher rental costs and, as such, are part of the effective rates faced by businesses.

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<sup>5</sup> The most recent Census of Local Government statistic on this indicates that approximately 31 per cent of local taxes are paid on commercial/industrial property.

### *Income Taxes on Pass-Through Entities and Sole Proprietorships*

In general, there are no corporate income taxes paid by business owners of sole proprietorships and pass-through entities. Since the denominator in effective rates—business income—includes income from such entities as well, there is the potential that the true tax burdens faced by such owners is actually understated here.<sup>6</sup> Given the nature of available data, there appears no reliable way to include the effects of individual income taxes on business owners.

### *Sales/Use Taxes*

Sales/use taxes in general account for approximately 48 per cent of state tax collections. However, there is no apparent ways to reliably determine the proportion of such taxes paid by businesses, by state. However, even assuming a modest ten per cent of such taxes are paid by businesses, the above effective tax rates would increase (on average, for states having sales/use taxes) by approximately 19 per cent. Accordingly, the average U.S effective business tax rate for 2008 would be  $(1.19) \times 21.4\%$ , or approximately 25.5 per cent.

### **Conclusion**

State business effective tax rates are significant, and continue to increase. Studies which examine only corporate income taxes only capture part of the picture, since corporate income taxes capture only 30 per cent of total business taxes, on average, across states. Overall tax rates provide a richer view of burdens facing businesses.

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<sup>6</sup> Other taxes paid by such owners are included, however. Such taxes include fees charged to pass-through entities, and where applicable, taxes on them. For example, the annual franchise fees and gross receipts taxes paid by LLCs in California, and the 3.5 income tax on S corporations in California, are included in the calculations.