



TAXPAYER REPORT

Business Tax Comparison: A Pilot Study between Colorado and Arizona By: Phyllis Resnick, CPEC Center for Tax Policy

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INTRODUCTION

Recently CPEC Center for Tax Policy was approached by a representative from a legislative task force and asked to provide a multi-state comparison on taxes affecting business. Before undertaking the complete study, the Center board recommended the development of a trial survey and a pilot with a state in the region. The purpose of this pilot was to collect data from a regional comparison state, in this case Arizona, and publish the results, with the intent of using the feedback from this pilot publication as a final opportunity for the members and other users of Center reports to provide input into the final survey instrument. This publication, while presenting a bilateral comparison between Colorado and Arizona, is also intended to be that trial report. With the preliminary Board feedback we have received, we now intend to expand our surveying efforts and regularly update our multi-state business tax comparison database with current comparisons among the states.

COMPARATIVE STUDIES

Many tax research organizations publish multi-state comparisons. The Center, along with other organizations, publish studies such as *How Colorado Compares*, our annual 50 state comparison on the relative burdens of different taxes. Other organizations such as the Tax Foundation publish reports ranking states according to an index of "tax friendliness" from both an overall and a business perspective. In fact, a recent Tax Foundation report ranked Colorado as the 4th friendliest according to their State Business Tax Climate Index¹. Included in indices such as the one derived by the Tax Foundation are some or all of the determinants of the tax burden in a state, particularly the burden of the sales, income and property tax, the legs of the proverbial three-legged stool of taxation. However, as with any macro level rankings such as tax friendliness indices, the devil lies in the details. When all tax burdens are indexed into a measure comparable across states, one casts a particular lens on the relative tax friendliness of states across the nation. The final ranking will be uniquely dependent upon the construction of the index and the manner in which different tax burdens are weighted in a particular index. Almost all indexed studies yield different results.

¹ Hodge, Scott A., J. Scott Moody, and Wendy P. Warcholik. 2002. State Business Tax Climate. Tax Foundation Background Paper Number 41.

It is not that such indexed studies are without merit. Undoubtedly, they provide a picture. And, if replicated annually with the same index construction, they provide a reliable time series of changes in relative position among the states. Studies such as the indexed studies should be continued. There is, however, a gap in such comparative reporting on state business tax systems. While the indexed studies provide an overall, macro view of relative tax friendliness, they do not provide sufficient detail for individual businesses or business sectors to evaluate their specific tax position on a state by state basis. This Center study, when fully complete and regularly updated, will fill that void by providing a detailed comparative look at the specific tax laws of the states instead of an index of business tax climate. This Center report, perhaps taken together with the readily available indexed rankings, will provide businesses in a variety of industries the ability to better evaluate the relative tax friendliness of states' tax codes as they relate to the specific circumstances of their particular business or industry.

The comparison contained in this report represents a pilot at providing the relevant comparative data. It represents the results of a survey drafted in coordination with the Center research committee and piloted with the state of Arizona. It was our intention to survey one state, report the results, and then make final revisions to the survey instrument before expanding the breadth of our surveying. The data and analysis that follow reflect the findings from Phase 1 of this project. These findings both stand alone as a bilateral comparison between Colorado and Arizona and provide a preview of the final multi-state comparison to be collected and updated regularly by the Center. Over time, the Center, through its new initiative to develop a data repository for the state, will collect and report on comparisons such as this one on business taxes in comparable states.

COLORADO vs. ARIZONA

Property Tax

Real Property

The table below summarizes the comparison between Colorado and Arizona in the area of property tax on real property. The overall comparison reveals a difference between the two states of just over 37%, with the effective rate on real property higher in Arizona than in Colorado. It is important to note that this effective rate of real property taxation for Colorado is for non-residential property only. Due to the mechanism of the Gallagher Amendment, which results in a non-residential assessment rate of over three times that of the rate on residential property, the effective rate of taxation on residential real property is estimated to be well under 1%.

<i>Real Property</i>	ARIZONA	COLORADO
Effective Tax Rate	2.91%	2.12 % calculated by using 2003 actual property values and 2002 average mill levies, the latest data available.
Major Real Property Tax Exemptions	None with the exception of those businesses located in enterprise zones	None with the exception of qualifying organizations such as religious institutions, non-profit schools, and other charitable organizations. Real property exemptions are constitutionally set in Colorado so the legislature has no authority to grant others.

Personal Property

Both Colorado and Arizona impose property tax on business personal property. Although some states have repealed this tax as an economic development incentive², the business personal property tax is a component of the tax picture in both of these western states. According to calculations based upon the best information available, the effective rate of taxation of personal property in Arizona of 2.91% is again approximately 37% higher than that of 2.12% in Colorado. However, given that personal property tax information is not always separable from that of real property and therefore does not account for the major exemptions listed below, these calculations should be considered estimates. With such estimates, and considering Arizona's more favorable schedule of exemptions, it is reasonable to conclude that the difference between Arizona's 2.91% and Colorado's 2.12% is smaller than appears. It would not be unreasonable to conclude that the two states tax business personal property at rates closer to each other than the raw percentages suggest. However, the comparison does suggest that the burden in Arizona is higher than that in Colorado.

Personal Property Tax	ARIZONA	COLORADO
<i>Does state impose BPPT?</i>	Yes, at both state and local levels	Yes
<i>Effective Tax Rate</i>	Not possible to separate from real property for analysis purposes, therefore ETR of 2.91% used. In actuality, ETR is likely lower than the 2.91% for real property.	Using 2003 valuations and 2002 average mill levies, the latest information available, effective tax rate calculated at 2.12% .
<i>Major exemptions</i>	1) The first \$54,000 is exempt as per 1996 measure. The exemption is limited to one location per taxpayer. 2) Arizona uses an accelerated depreciation schedule of 35%, 51%, 67%, 83%. 3) Personal Property is not taxed during construction work in progress.	1) Businesses with depreciated value of \$2500 or less are exempt from BPPT; over \$2500 in depreciated value, everything is taxable including the first \$2500. 2) Consumable personal property defined as having an acquisition cost of \$250 or less or having a life of 1 year or less is exempt. 3) Items held for sale are exempt from BPPT. 4) In years with a TABOR surplus of \$170 million or more, the automatic rebate mechanism kicks in refunding the first \$700 + 16% of taxes paid for business personal property. 4) Local governments have the option to negotiate up to 50% rebate or credit on their portion of personal property tax as an economic development incentive.
<i>Reforms of the past 10 years</i>	The first \$54,000 exemption passed in 1996 and accelerated depreciation schedule outlined above instituted in past 10 years.	All of the above major exemptions were enacted in the last 10 years.

² The Center for Tax Policy has been asked previously to study the use of the business personal property tax (BPPT) around the country. Once we expand the current survey to states other than Arizona and compile the data into the Center's newly formed Colorado Data Repository, we will have the necessary comparative data to report on and study the use of the BPPT across states.

Corporate Income Tax

Both Colorado and Arizona impose corporate income tax, and in both cases the tax is a flat tax. Each state provides corporate income tax credits for particular activities as listed below in the following table. The extent to which such credits benefit business in the state will vary with the particular circumstances of a particular business' environment. As such, it is difficult to make side by side rankings from the side by side comparisons. Instead, the particular credits are listed so that individual businesses may conclude appropriately.

Corporate Income Tax		
Corporate tax graduated or flat?	Flat	Flat
Corporate Income Tax Rate	6.97%	4.63%
Corporate Income Tax Credits	Agricultural Pollution Control Equipment, Agricultural Water Conservation, Alternative Fuel Delivery System, Alternative Fuel Vehicles, Construction Materials, Correctional Industries, Defense Contracting, Donation of Motor Vehicles to Work Program, Employer Dependent Day Care, Employment of TANF Recipients, Enterprise Zone, Environmental Technology Facility, Military Reuse Zone, Neighborhood Electric Vehicles, Pollution Control Device, Recycling Equipment, Research and Development, Solar Hot Water Plumbing Stub Outs & Electric Vehicle Recharge, Summer School & Jobs, Taxes Paid for Coal Consumed in Generating Electrical Power, Underground Storage Tanks, Vehicle Refueling Apparatus & Infrastructure	Colorado has both a new and an old investment tax credit. In addition, the following credits are available: Colorado coal credit, Alternative fuel vehicle, Alternative fuel refueling facility, Gross conservation easement, Crop and livestock contribution, Historic property preservation, Child care contribution, Child care center-family home care investment credit, Employer child care facility investment credit, School-to-career investment, Colorado works program, Contaminated land redevelopment, Low income housing, Weather related livestock sale. In Enterprise Zones, the following credits are also available: Investment tax credit, New business facility employee credit, Credit for contribution to enterprise zone administrator, Commercial building rehabilitation credit, Research and experimental credit, Job training credit, Rural technology credit.
Apportionment Formula	3 factor formula that double weights sales (50% sales, 25% property, and 25% payroll)	Colorado uses 2 alternative apportionment formulas and allows the taxpayer to select the method that results in the lesser liability. The 2 formulas are the Three Factor Multi-State Tax Commission formula that equally weights payroll, property, and sales or the alternative 2 factor formula which averages only property and sales.

Sales Tax

Both Colorado and Arizona impose sales taxes at both the state and local levels. While Arizona's state sales tax rate is significantly higher than that of Colorado, the opposite is true at the local level. The combined average local sales tax rate at the local level is just under 4% in Colorado. This is almost double the local rate in Arizona. Additionally, Colorado funds a trio of local districts in the Denver metro area with sales taxes, increasing the local sales tax burden slightly from what is outlined below. In fact,

Colorado is generally considered to be in the top 3 states in the nation when local sales tax burdens are ranked.

Sales Tax	ARIZONA	COLORADO
State Sales Tax Imposed?	Yes	Yes
State Sales Tax Rate	5.60%	2.90%
Local Sales Tax Imposed?	Yes, at both city and county levels	Yes, at both city, county, and special district levels
Average local sales tax rate?	2%	2.81% at the municipal level, 1.97% at the county level
Major categories of business transactions exempt from sales tax?	Machinery and equipment used directly in manufacturing, processing, mining, fabricating and production of electrical power is the major one. Also sales/leases for resale or subsequent sale/lease; labor associated with retail sale; certain pipes and valves; certain aircraft and related property; securities; prescriptions and prosthetics; warranty and service contracts; freight in connection with retail sale; specific fuel; sales by certain nonprofit organizations; sales of commodities consigned for resale; certain sales to US government.	At the <u>state level</u> , the following exemptions are in place: Purchase of manufacturing equipment or machine tools of over \$500; Component parts; Fuels and electricity; Ink and newsprint; Aircraft parts used in general maintenance; Interstate long distance telephone charges; Farm equipment and machinery; Packaging materials. Pollution control equipment may be eligible for a refund of state sales tax in the years of a state budget surplus and in surplus years 50% of sales and use tax is refundable on personal property used for research and development. Sales and use tax on tangible personal property used in Colorado directly and predominately in research and development of biotechnology is refundable. The following are exemptions in place at the <u>municipal level</u> (actual policy varies by municipality): Food for home consumption; Machinery and machine tools; Gas, electricity, etc., for residential use; Occasional sales by charitable organizations; Farm equipment; Pesticides; Food sold through vending machines; Low-emitting vehicles

Sales taxes burden business in a multitude of ways. The first is the direct burden borne by a business from the sales tax burden on its specific purchases. However, there are additional burdens on business from state and local sales tax. When a business' goods are subject to sales tax on the final sale, the economic burden of the tax is generally split between the business and the customer. The extent to which the business can pass through the sales tax onto the consumer is related to the type of good sold by the business. Therefore, the true burden of the state and local sales tax rates will vary differently from business to business. However, all else being equal, the higher the sales tax, the larger the economic burden

ultimately borne by business. In this sense, sales taxes, paid both by the consumer on final goods and by the producer on supplies, can have a double effect on business.

Finally, there is a third burden placed on business by all taxes, but particularly burdensome under certain sales tax systems. Sales tax reporting, compliance, and remittance, particularly in states such as Colorado with locally administered and

collected sales taxes, imposes an administrative burden on business that is generally unmeasurable with side by side comparisons and indexed studies. Anecdotal evidence provided by businesses across the nation places Colorado's local sales tax among the most administratively burdensome in the nation due to the significant levels of local control maintained by Colorado's municipalities. With all three factors taken together, and without regard for the specific sales tax credits listed below, it is arguable that the sales tax burden in Colorado overall exceeds that of Arizona.

CONCLUSION

When complete, the ultimate purpose of the Center's multi-state business tax comparison will be to provide data for comparison and analysis rather than for ranking or indexing. As noted in the introduction, there are a multitude of organizations that publish indexed rankings of the tax burden on businesses. However, what all of those indices lack is transparency. Although they provide an overall ranking, they do not provide the level of detail necessary for a particular business to assess its comparative tax burden across states. When complete and periodically updated, this Center resource will complement the indexed studies by providing the transparency necessary for such business level comparisons.

This preliminary reporting of the findings of Colorado's comparison with Arizona is intended to provide a preview of the comparative data that the Center plans to collect and report for a sample of states. It is our future intention to develop this database of comparative business taxes, update the database periodically, and annually report the comparative data. Ultimately, these business tax comparisons will become an integral portion of the data collected by the newly established Colorado Data Repository, a one stop shopping data resource currently under development by the Center for Tax Policy.

Appendix A: The Survey Instrument
MULTI STATE BUSINESS TAX BURDEN SURVEY

State _____

Real Property

1. On average, what is the effective rate of taxation on business real property?
2. Are there any major property tax exemptions for business?

Personal Property

3. Does your state tax business personal property?
4. If so, on average what is the effective rate of taxation on business personal property?
5. Have there been any major reforms to the business personal property tax in the last 10 years? If so, will you briefly explain what changes were made?

Income Tax

6. Is the corporate income tax a graduated or flat tax in your state?
7. What is the corporate income tax rate?
8. Are there any major exemptions? If so, please provide details.

Sales Tax

9. Does your state have a state sales tax?
10. What is the state sales tax rate?
11. Does your state have local sales tax?
12. What is the average local sales tax rate?
13. At the state level, are there major categories that are exempt from sales tax (ie: clothing)?