New Jersey's Business Tax Competitiveness: Modelling the Prospects for Growth

The Garden State Initiative, May 2018

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EY Quantitative Economics & Statistics Business Tax Competitiveness Model Using Tax Law Current as of January 2018

Executive Summary

Tax policy is a leading source of debate in New Jersey. During the current legislative session, momentous decisions loom regarding property, corporate, and personal income taxes. Much of the debate is driven by concerns that the state needs to raise new revenues to fund services and address its legacy cost burden.

But, in addition to being a revenue source, tax systems play an outsized role in defining a state's business climate. The decision to raise taxes should be undertaken not only with a view towards the budget, but also with regard for how well a state is positioned to compete against other states. While many factors affect a firm's investment decisions, a more favorable tax environment can – at the margin – sway a firm to select a particular location. Thus, understanding a location's tax competitiveness is critical for businesses and policymakers interested in strengthening prospects for economic growth.

This report attempts to inform debate about tax policy in New Jersey by benchmarking the state's current corporate tax structure against a sample of five competitor states (New York, Connecticut, Pennsylvania, Ohio and North Carolina). The benchmarking also focuses on six distinct industries: three manufacturing (pharmaceutical and biotech, food processing, renewable energy device manufacturing) and three commercial (logistics, software development, credit intermediation).

Major findings include:

- Widespread perception that New Jersey is uncompetitive is borne out by its current business-tax structure. New Jersey's top marginal corporate tax rate (CIT; technically known as the "corporation business tax") is the sixth-highest in the nation. And the sales tax rate (poised to go up again) is already the eighth-highest.
- New Jersey's current corporate tax rate is higher than every other state in the six-state sample except Pennsylvania. Any CIT surcharge under consideration in the state Legislature, if imposed, would make New Jersey even less competitive than those states it was already lagging behind, such as Ohio and North Carolina, and reduce any advantage it currently holds over states like Connecticut and Pennsylvania.
- In order to make New Jersey the most competitive state among its peers, deep tax cuts would be necessary. Even if New Jersey cut the state CIT rate by 6 percentage points (to 3%) to match the lowest rate in the nation, the state would still need to cut the sales-tax rate by 2.6 points in order to claim the most competitive tax climate among the peer states examined in this report.
- With respect to the regions and industries studied in this report, New Jersey is best-positioned to compete in commercial industries (logistics, software development, credit intermediation) against Connecticut, New York and Pennsylvania. It is somewhat less competitive in manufacturing (pharmaceutical and biotech, food processing, renewable energy device manufacturing) when benchmarked against both its regional and more distant (North Carolina and Ohio) competitors' business tax structures.

Looking Forward

Regardless of what happens this legislative session, New Jersey's competitive standing relative to other states should not be seen as static. As New Jersey state officials move toward raising taxes, some competitor states are moving in the opposite direction, or considering doing so. In Connecticut, which has budget struggles as serious as New Jersey's, state officials have become wary of raising taxes further for risk that it would harm the economy. Many candidates campaigning in the 2018 Connecticut gubernatorial race are promising to cut taxes if elected.[1] North Carolina has been reducing its corporate tax rates, a change that actually has resulted in an *increase* in revenues.[2]

The topic of tax reform more broadly certainly merits evaluation by New Jersey lawmakers. All states place different weights on personal and corporate income taxes, and the sales and property taxes. With respect to the business-tax question, some states have been exploring a "gross receipts" tax option, which features a broader base and lower rates overall."[3] The possibility of improving New Jersey's tax system to make it fairer or more efficient might result in ways to improve the state's competitiveness on a revenue- neutral basis.

New Jersey is unlikely to be able to compete with the top benchmark states in every industry. It is more competitive with other states in its region than with Ohio and North Carolina, and is more competitive in commercial industries than in manufacturing industries. Efforts focused on attracting businesses from across the border are more likely to succeed in the near-term. Taxes matter in trying to determine policy solutions to gain industry share, but a fuller analysis of New Jersey's economic prospects would also take into consideration the state's existing strengths, assets and geographical advantages.

New Jersey's Tax Climate

Many reports and surveys of states' business climates have rated that of New Jersey as uncompetitive.[4] There is no serious debate that business taxes are high in New Jersey compared with the rest of the nation. New Jersey is one of just six states with a corporate income tax (CIT) rate of 9% or more. Despite reductions in New Jersey's sales tax rate (to 6.625%) beginning in 2017, the rate still ranks as the eighth highest in the country.[5] There is a proposal in Trenton to push it back up to 7%, which would tie for second highest in the country.

Figure 1 shows how New Jersey's major business taxes rate compare with five competitor states.

FIGURE 1: BUSINESS TAX RATES, NEW JERSEY AND COMPETITOR STATES

	State Corporate Tax	Real Property EATRS+	Personal Property EATRs	State Sales Tax	Local Sales EATRs
Connecticut	7.50%	3.71% / 3.67%	2.93%	6.35%	0.00%
New Jersey	9.00%	2.19%	0.00%	6.63%	0.10%
New York	6.50%	3.52%	0.00%	4.00%	3.00%
North Carolina	3.00%	1.28%	1.28%	4.75%	1.30%
Ohio	*	2.56% / 3.18%	0.00%	5.75%	0.80%
Pennsylvania	9.99%	4.63%	0.00%	6.00%	0.50%

Source: Thomson Reuters Checkpoint. All rates are effective January 1, 2018 and represent the top marginal rate per state.
+ EATR (Effective Average Tax Rate). Real property taxes distinguish between 'Industrial / Commercial' w here applicable.
* Ohio does not have a CIT, but applies a 0.26% tax to gross receipts.

Connecticut is the only state whose reputation for non-competitiveness may rival New Jersey's, though it's important to note that it has lower statutory rates for the most part. (Connecticut levies a corporate excess tax of 10% on firms with gross income of $100 million or more.) New York's business tax structure differs significantly between industrial and commercial activities. As a result of 2014 reforms, New York's CIT rate was cut from 7.1% to 6.5% and went down to 0% for qualified manufacturers and 4.9% for qualified emerging technology companies (effective January 2018). Compared with its tri-state area neighbors, Pennsylvania has a more business-friendly reputation. However, its 9.99% CIT rate, which is flat regardless of business size or activity, is the second-highest in the nation.

New York, Ohio and Pennsylvania permit additional corporate income taxes at the local level. New York's local income tax generates about 60% of the total state revenue from corporate income taxes. On the plus side, New Jersey has relatively low business-property taxes and very limited local corporate-tax options (though it's questionable how much weight companies give to local-tax environments at the pre-investment phase).

In order to provide a more precise look at New Jersey's tax competitiveness, this report presents estimates of the current-law business-tax burdens faced by corporations in New Jersey compared with five peer states: Connecticut, New York, North Carolina, Ohio and Pennsylvania. The report models the impact of the business-tax climate on hypothetical firms in pharmaceutical and biotech manufacturing, food processing, renewable energy device manufacturing, logistics, software development, and credit intermediation.

These six industries represent 6.6% of all employment and 9.2% of total payroll; average wages range from about $50,000 to $136,000. These industries employ over 280,000 workers in New Jersey and in some cases have been making important new investments. Examples include the $80 million (400 jobs) investment in 2017 in a new campus by the biotech firm Mallinckrodt PLC, the $250 million that Goya invested across the state in 2015, including a new headquarters in Jersey City, and FedEx' 340,000 sq. ft. distribution center in Hamilton, which opened in 2017.

The model generates hypothetical firms representing the industry average and projects a $100 million investment over 30 years. Tax rates for 2018 and projected future tax rates are applied to the various investment components and the present value of each line item on the income statement and balance sheet is calculated. These values are used to calculate the effective average tax rates per state and industry.[6] This model attempts to replicate the type of tax analysis that most sophisticated businesses would conduct when selecting a new location for a facility such as a headquarters or distribution center and produces the results that are most relevant to understanding the economic development consequences of New Jersey's level of taxation. It takes into account the corporate income tax (CIT), real property taxes, and the sales tax. Some of the five states New Jersey is compared with leverage additional taxes that New Jersey does not, including local corporate income taxes, state franchise taxes, and gross receipt taxes.

After incorporating all of these taxes, as well all relevant exemptions and deductions, the total "effective" (as opposed to statutory) tax burden is estimated for each state and for each industry. [7] The effective tax rate (ETR) is expressed as the percentage change in the rate of return due to taxes. (Specifically, the pre-tax rate of return less the post-tax rate of return, divided by the pre-tax rate of return.)

Manufacturing Industries

FIGURE 2: ECONOMIC PROFILE OF THREE MANUFACTURING INDUSTRIES MODELLED

Industry	Description	Share of Total State Employment	Share of Total Annual Payroll	Average Annual Wage
Biotech and life sciences	Medical Equipment and Supplies Manufacturing; Research and Development in the Physical, Engineering, and Life Sciences; Pharmaceutical and Medicine Manufacturing	2.8%	5.8%	$134,940
Food Processing	Food Manufacturing	0.8%	0.6%	$49,140
Renewable energy device manufacturing	Engine, Turbine and Power Transmission Equipment; Electrical Equipment Manufacturing	0.1%	0.1%	$74,932
Total		**3.7%**	**6.5%**	

Source: BLS Quarterly Census of Employment and Wages, 2017 Second Quarter

Figures 3 and 4 present the baseline overall ETRs that a manufacturing company would be expected to pay on a $100 million investment over a 30-year period in each benchmark state.

FIGURE 3: TOTAL EFFECTIVE TAX RATE, MANUFACTURING INDUSTRIES

Total State and Local Taxes	Pharmaceutical and Biotech Manufacturing		Food Manufacturing		Renewable Energy Device Manufacturing	
	ETR	**Rank**	**ETR**	**Rank**	**ETR**	**Rank**
Connecticut	13.21%	5	11.72%	4	13.56%	5
New Jersey	10.63%	4	11.86%	5	12.70%	4
New York	4.83%	1	5.55%	1	7.06%	1
North Carolina	6.60%	2	6.66%	2	7.11%	2
Ohio	6.81%	3	7.87%	3	9.53%	3
Pennsylvania	15.24%	6	15.81%	6	17.29%	6

In Figure 3, New York is shown to have the most competitive tax environment for manufacturing firms, owing to its 0% CIT rate for qualified manufacturers. North Carolina is also very competitive, which is driven by the state's low CIT rate of 3% and broad sales tax exemptions. For all states, many exemptions offered to manufacturers are not offered to commercial industries, which leads to significantly higher ETRs for the latter (see Figure 6 below).

Another way to examine New Jersey's tax competitiveness is to ask what changes would be required to move New Jersey into the most-competitive or second-most-competitive tax environment for each industry investment.

The analysis in Figure 4 assumes New Jersey would need to cut its CIT from 9% to 3% to match the most competitive rate in the benchmark set. Since that alone was not enough to improve New Jersey's competitiveness lower than third in food manufacturing, a further sales tax cut from 6.625% to 4% was assumed. As Figure 4 shows, though, despite these drastic cuts, New Jersey would still be less competitive than New York with respect to the pharmaceutical manufacturing and food processing industries, because of New York's 0% CIT rate for manufacturers.

FIGURE 4: EFFECT OF DRASTIC RATE CUTS (CIT 9 TO 3 AND SALES 6.625 TO 4) ON STATES' TAX COMPETITIVENESS, MANUFACTURING INDUSTRIES

Total State and Local Taxes	Pharmaceutical and Biotech		Food Manufacturing		Renewable Energy Manufacturing	
	ETR	Rank	ETR	Rank	ETR	Rank
Connecticut	13.21%	5	11.72%	5	13.56%	5
New Jersey	5.42%	2	6.26%	2	6.72%	1
New York	4.83%	1	5.55%	1	7.06%	2
North Carolina	6.60%	3	6.66%	3	7.11%	3
Ohio	6.81%	4	7.87%	4	9.53%	4
Pennsylvania	15.24%	6	15.81%	6	17.29%	6
New Jersey change from current law status	-5.21%	-2	-5.60%	-3	-5.98%	-3

Commercial Industries

For three commercial industries (logistics, software development, credit intermediation), Figures 6 and 7 show the same modelling results as the preceding section showed for the manufacturing sector. Under current tax law, New Jersey is slightly more competitive with this cohort: it ranks third in each industry, as opposed to fourth or fifth for the manufacturing industries (Figure 3).

With respect to the dramatic tax-cut scenario (bringing the CIT down to 3% and the sales tax to 4%), New Jersey would become the most competitive state in all three commercial (non-manufacturing) industries included in the model, although its margin over Ohio would be very slim.

FIGURE 5: ECONOMIC PROFILE OF THREE COMMERCIAL INDUSTRIES MODELLED

Industry	Description	Share of Total State Employment	Share of Total Annual Payroll	Average Annual Wage
Logistics	Truck Transportation; Warehousing and Storage	2.3%	1.6%	$52,104
Software / web based services	Software Publishers	0.4%	0.8%	$136,240
Credit Intermediation	Financial Transactions Processing, Reserve, and Clearinghouse Activities	0.2%	0.3%	$84,604
Total		**2.9%**	**2.7%**	

Source: BLS Quarterly Census of Employment and Wages, 2017 Second Quarter

FIGURE 6: TOTAL EFFECTIVE TAX RATE, COMMERCIAL INDUSTRIES

Total State and Local Taxes	Logistics		Software Development		Credit Intermediation	
	ETR	Rank	ETR	Rank	ETR	Rank
Connecticut	36.57%	6	16.45%	5	11.42%	4
New Jersey	26.88%	3	11.78%	3	9.72%	3
New York	34.08%	5	17.52%	6	15.36%	6
North Carolina	15.75%	2	6.66%	1	5.23%	2
Ohio	15.54%	1	7.02%	2	4.37%	1
Pennsylvania	32.04%	4	15.77%	4	12.71%	5

FIGURE 7: EFFECT OF DRASTIC RATE CUTS (CIT 9 TO 3 AND SALES 6.625 TO 4) ON TAX COMPETITIVENESS FOR COMMERCIAL FIRMS

Total State and Local Taxes	Logistics		Software Development		Credit Intermediation	
	ETR	Rank	ETR	Rank	ETR	Rank
Connecticut	36.57%	6	16.45%	5	11.42%	4
New Jersey	15.47%	1	5.64%	1	4.27%	1
New York	34.08%	5	17.52%	6	15.36%	6
North Carolina	15.75%	3	6.66%	2	5.23%	3
Ohio	15.54%	2	7.02%	3	4.37%	2
Pennsylvania	32.04%	4	15.77%	4	12.71%	5
New Jersey change from current law status	**-11.41%**	**-2**	**-6.14%**	**-2**	**-5.45%**	**-2**

One implication to draw from Figures 4 and 7 (which model radical changes to New Jersey's revenue system) is that it might be difficult to achieve the most competitive tax environment through enacting tax changes on a revenue-neutral basis. In 2016, New Jersey collected $2.3 billion from the CIT and approximately $9.2 billion from the then 7% sales tax, for a total $11.5 billion in revenue.[8] Reducing the CIT rate from 9% to 3% and the sales- and use-tax rate to 4% could mean a possibility of reducing total revenue from these sources to $6.1 billion. As was pointed out earlier, however, North Carolina *increased* revenue when it cut taxes.

Clearly, New Jersey's current tax climate is very far from competitive. A 67% cut to the CIT and a 40% cut to the 2018 sales-tax rate would be necessary for the state to challenge the most competitive states.

Effects of Raising the CIT to 12%

The "baseline" or current law results in the previous two sections show that while New Jersey is currently competitive with nearby states such as Pennsylvania (which has an almost 10% corporate rate) and Connecticut, it is far outpaced by Ohio and North Carolina. But that's the current law. A proposal now under consideration by state lawmakers[9]—though controversial among the business community[10]—would raise the marginal CIT rate from 9% to 12% for business income starting at $1 million with the goal of increasing state revenue.

Figures 8 and 9 model the results of a 12% rate. New Jersey becomes much less attractive for manufacturing firms, especially given that neighboring New York would offer the businesses an average ETR approximately one-third the magnitude of New Jersey (Figure 3). The 12% CIT rate raises the typical New Jersey manufacturing and commercial firm's ETR by about 2.3 percentage points.

FIGURE 8: TOTAL EFFECTIVE TAX RATE, MANUFACTURING INDUSTRIES, 12% CIT

Total State and Local Taxes	Pharmaceutical and Biotech		Food Manufacturing		Renewable Energy Manufacturing	
	ETR	Rank	ETR	Rank	ETR	Rank
Connecticut	13.21%	5	11.72%	4	13.56%	4
New Jersey	12.93%	4	14.11%	5	14.95%	5
New York	4.83%	1	5.55%	1	7.06%	1
North Carolina	6.60%	2	6.66%	2	7.11%	2
Ohio	6.81%	3	7.87%	3	9.53%	3
Pennsylvania	15.24%	6	15.81%	6	17.29%	6
New Jersey change	2.30%	0	2.25%	0	2.25%	1

FIGURE 9: TOTAL EFFECTIVE TAX RATE, COMMERCIAL INDUSTRIES, 12% CIT

Total State and Local Taxes	Logistics		Software Development		Credit Intermediation	
	ETR	Rank	ETR	Rank	ETR	Rank
Connecticut	36.57%	6	16.45%	5	11.42%	3
New Jersey	29.16%	3	14.05%	3	12.00%	4
New York	34.08%	5	17.52%	6	15.36%	6
North Carolina	15.75%	2	6.66%	1	5.23%	2
Ohio	15.54%	1	7.02%	2	4.37%	1
Pennsylvania	32.04%	4	15.77%	4	12.71%	5
New Jersey change	**2.28%**	**-**	**2.27%**	**-**	**2.28%**	**1**

To bring into focus the potential effect of the corporate tax surcharge, it is helpful to divide New Jersey's competitor states into two groups: competitive (North Carolina and Ohio) and non-competitive (New York, Connecticut and Pennsylvania). While instituting a top business tax rate of 12% may not greatly affect New Jersey's absolute ranking, it would more firmly establish it, based on its ETR, as part of the non-competitive camp (compare Figures 3 and 4 with Figures 8 and 9). Under the state's current ETR, one could argue that Figures 3 and 4—the "current law" scenario—show that New Jersey is generally the most competitive among the non-competitive states. While such a reputation is not ideal, it is certainly preferable to being a definitively non-competitive state, which would be its status were the CIT surcharge to go through.

Many factors influence economic competitiveness, from climate and geography to infrastructure and the quality of the workforce. But any serious management team, when weighing decisions about whether to relocate to another jurisdiction or expand operations in their current location, will take into account that jurisdiction's tax climate. To compete, New Jersey employers must focus not only on improving their products and services but also on lowering costs. Higher corporate taxes reduce employers' flexibility to reduce those costs.

Endnotes

[1] Source: http://www.timforconnecticut.com/tax_reform; https://www.bobforgovernor.com/issues/; http://boughton2018.com/issues/; http://davewalkerct.com/daves-commitments-to-connecticut/; https://www.davidstemerman.com/turnaround-story/.

[2] A broad tax reform enacted in 2014 reduced the state statutory rates to some of the lowest in the nation and reduced the sales tax base for select business activities. North Carolina's 2014 CIT rate of 6.0% has gradually been cut to 3.0% in 2018 and will stabilize at 2.5% in 2019. A static comparison shows the state collected $1.2 billion in 2013 from the CIT, the last year before tax reform. In 2017, the state collected $2.0 billion from the CIT: a 14% compounded annual growth rate despite a sliding reduction in the statutory rate. Fiscal Research Division, North Carolina General Assembly. 2018. "General Fund Revenue Update, State of North Carolina."

[3] Examples of states that have instituted a form of gross receipts tax, in some cases only on a temporary basis, are Delaware, Michigan, Nevada, Ohio, Texas and Washington. New Jersey itself used to have a gross receipts tax. Enacted in 2002, its rates ranged from 0.125% to 0.4% and were levied on companies with more than $2 million in gross receipts. It sunsetted in 2006.

[4] "Best States for Growth," US News and World Report, in partnership with McKinsey and Company (New Jersey ranks 45th of all states); "Best States for Business," Forbes, (39th); "2018 State Business Tax Climate Index," Tax Foundation, (50th); "2017 Best & Worst States For Business," CEO Magazine (47th); "Rich States, Poor States, 10th Edition," American Legislative Exchange Council, 2017 (48th); "59th Annual Business Outlook Survey," New Jersey Business and Industry Association, December 2017.

[5] ThomsonReuters. 2018. CheckPoint. 03 01.

[6] It is assumed that the firm will undergo a one year pre-expansion or runup phase to purchase and prepare property and labor requirements, and then operate the facility for 30 years, deducting depreciation based on property compositions. The model is a discounted cash flow model, which contains 30-year capital investment and operating financial profiles for six industries of interest (excluding regulated industries), organized as C-corporations. The financial profiles are used to project the total state and local taxes that would accrue during the start-up and ongoing operation of a new business in each jurisdiction.

[7] The model used in this report makes certain assumptions regarding the level of in-state (intrastate) versus cross-border (interstate) sales made by the representative businesses, which impacts the level of apportioned income attributed to the state where the representative firm is located. Generally, the model assumes the businesses primarily engage in intrastate trade and receive 80% of revenue from sales in the state. Modelling the results for businesses with 80% of revenue from out-of-state sales as opposed to intrastate sales reduces New Jersey's average ETR from 11.73% to 6.70% (on average) in the case of manufacturing firms and 16.1% to 11% (on average) in the case of commercial firms. However, New Jersey still ranks 4th best in the benchmark set because the comparative states all respond similarly to this effect.

[8] "The State of New Jersey Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2016," New Jersey Department of the Treasury, Mar. 15, 2017, p. 33.

[9] "Senate President Sweeney Announces Plan to Recapture State Share of Massive Federal Corporate Windfall," Office of New Jersey State Senate President Steve Sweeney, March 6, 2018; John Reitmeyer, "Sweeney Wants to Find Funds for Education by Bumping up Corporate Tax Rate," NJSpotlight.com, March 7, 2018.

[10] "Senate Leader Proposes Corporate Business Tax Surcharge," New Jersey Business and Industry Association, March 6, 2018.

Our Mission

The Garden State Initiative is a 501(c)3 nonprofit organization dedicated to strengthening New Jersey by providing an alternative voice and commonsense policy solutions in the state -- solutions that promote new investment, the growth of businesses, the creation of economic opportunities, and innovation to the benefit of all New Jerseyans.

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