

Minnesota Cannot Afford Proposed Corporate Tax Cut

Legislature Should Reject Single Sales Factor

A proposal being considered by the Legislature this session would provide a tax cut for a relatively small percentage of corporate taxpayers. This policy, called Single Sales Factor, would change what portion of a multistate corporation's income is subject to Minnesota's corporate income tax. Currently, Minnesota uses a three-factor apportionment formula that is based 75% on sales and 12.5% each on property and payroll. The proposal in the Legislature would use a formula based completely on sales.

The advocates of this provision argue that it would help create jobs in the state. However, Single Sales Factor is wrong for Minnesota for several reasons, including:

- We can't afford it,
- More businesses would be hurt than would be helped, and
- Single sales factor is not an effective job creation tool.

We Can't Afford It

The state cannot afford a corporate tax cut that would widen existing budget deficits, which are currently measured at \$160 million for the 2004-05 biennium and \$441 million in the next budget cycle.

The version of Single Sales Factor endorsed by the Governor and House masks the true cost by phasing in the change gradually over eight years, resulting in a modest cost of \$1.9 million in corporate tax cuts in FY 2005 and \$23.9 million in FY 2006-07. However, if Single Sales Factor were immediately implemented, as in the Senate Omnibus Tax bill, the cost would be significantly more: \$46.9 million in FY 2005 and similar amounts in each following fiscal year.

More Businesses Would Be Hurt Than Would Be Helped

While Single Sales Factor is advocated as a tool to improve the state's business climate, in fact only 9% of businesses who file corporate tax returns in Minnesota — about 4,500 companies — would benefit. Companies receiving tax cuts include multistate corporations with a high percentage of their manufacturing facilities in Minnesota but lots of sales outside the state. Of those corporations who would benefit from Single Sales Factor, an estimated 130 companies would receive tax cuts averaging \$500,000 if Single Sales Factor were in effect in 2004.

But 13%, or 6,500 corporations, would pay higher taxes under Single Sales Factor. Tax increases would fall on manufacturing companies with a significant amount of sales in Minnesota but small amounts of their total facilities and employees located in the state. An estimated 80 corporations would receive tax increases that average \$200,000 if Single Sales Factor were in effect in 2004.

The majority of corporations (78%) would see no change in their corporate taxes — these are primarily businesses that have all of their payroll, property, and sales in Minnesota, as well as those with no taxable income.

Single Sales Factor Is Not An Effective Job Creation Tool

While proponents of Single Sales Factor argue that it will eliminate an "anti-jobs tax," Single Sales Factor is not directly tied to job creation. There is no requirement that the corporations receiving a tax cut create jobs — or even maintain existing jobs — in Minnesota.

Single Sales Factor has a poor track record in this regard. Massachusetts enacted Single Sales Factor in 1995 largely in response to a threat by the Raytheon Company that they would otherwise close plants in the state. Single Sales Factor was passed, and Raytheon still laid off 3,000 people in Massachusetts. Black and Decker was the leading proponent of Single Sales Factor in Maryland; within two years of Maryland's adoption of the formula, Black and Decker had closed its last manufacturing plant in the state.

When Illinois was considering Single Sales Factor, University of Chicago economist Austan Goolsbee predicted that Illinois would gain 155,000 manufacturing jobs if it adopted Single Sales Factor. In fact, Illinois lost 66,000 manufacturing jobs between the time it adopted Single Sales Factor (July 1998) and the end of the most recent economic boom (March 2001). It has lost an additional 133,000 manufacturing jobs since then, despite cutting corporate taxes by \$100 million annually due to Single Sales Factor. Goolsbee did a similar study in 1999 predicting that 35,000 jobs would be created in Minnesota by adopting Single Sales Factor — a claim that should be looked on skeptically, given how poorly his predictions matched the outcome in Illinois.

No one can deny that Minnesota needs economic development strategies that will create good jobs. But Single Sales Factor does not make the grade. Minnesota cannot afford an expensive corporate tax cut that is not tied to job creation. Policymakers should not enact Single Sales Factor into law.

Sources:

Center on Budget and Policy Priorities, *The "Single Sales Factor" Formula for State Corporate Taxes: A Boon to Economic Development or a Costly Giveaway?*, www.cbpp.org/3-27-01sfp.htm.

Minnesota House of Representatives Fiscal Analysis Department, *Governor Tim Pawlenty's 2004 Supplemental Budget Recommendations*, www.house.mn/fiscal/files/04GovB/tax.pdf