

Report shows N.C. more than competitive on business tax expenses

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Volker Mornhinweg, the head of Mercedes-Benz Vans, and Gov. Nikki Haley of South Carolina unveil a drawing of the Sprinter van assembly plant the company plans to build in North Charleston. The plant represents a \$500 million investment and is expected to create 1,300 jobs. A recent report says the way South Carolina calculates corporate taxes is a big attraction for businesses.

Setting priorities for funding economic recruitment in North Carolina comes down to which side of a philosophical fence legislators fall on — lower corporate tax rates or higher performance-based incentive packages.

Lack of agreement on the issue not only has been a source of frustration for House and Senate legislative leaders and Gov. Pat McCrory but also a key roadblock to reaching a state budget compromise and replenishing state incentive funds.

A recent report by the Tax Foundation, a nonpartisan, business-friendly research group, puts North Carolina in a favorable light in seven key industry categories when it comes to state tax costs of doing business.

The report, “Location Matters,” compares “state tax burdens faced by real-world businesses in different industries.” The group said the report highlights how tax codes treat new and previously established firms differently within each state. For the report’s purposes, the higher the ranking, the lower the tax expense cost for businesses.

North Carolina’s best rankings are having the fifth lowest business tax costs for corporate headquarters and for independent retail stores. The worst ranking is 19th for manufacturers producing labor-intensive products.

Yet, having the most overall favorable corporate tax rate climate among six Southeast states didn’t help North Carolina win several recent major projects, including the relocating corporate headquarters of Mercedes-Benz USA (going from New Jersey to north Atlanta) and a \$500 million Volvo Car Group manufacturing plant near Charleston, S.C.

The Volvo announcement came only months after Mercedes-Benz Vans announced plans to build a new van assembly plant in North Charleston, S.C. That plant represents a \$500 million investment and is expected to create 1,300 jobs.

Both South Carolina and Georgia had lower corporate tax climate rankings: Georgia at 16th for corporate headquarters and South Carolina at 42nd for capital-intensive manufacturing projects.

N.C. Senate leaders, most vocally state Sen. Bob Rucho, R-Mecklenburg, argue that reducing the state corporate tax rate — which was cut to 5 percent in January — won’t just make North Carolina more competitive for corporate expansion and relocation projects. They say a lower tax rate will also reduce the importance of incentive packages that can run into the hundreds of millions of dollars for the largest projects for capital investment and job creation.

That’s the primary reason why the Senate proposed putting \$20 million into North Carolina’s Job Development Investment Grant, or JDIG, program for fiscal 2015-16 and 2016-17 rather than the \$45 million that House leaders and McCrory have proposed.

McCrory, N.C. Department of Commerce officials, analysts and economists have said the lack of new committed JDIG funds played roles in North Carolina not landing either project.

Georgia offered between \$40 million and \$50 million in incentives to Mercedes-Benz USA for about 1,000 corporate jobs. The North Carolina offer was not made public.

South Carolina offered Volvo \$204 million in economic incentives for at least 2,000 jobs, plus officials had the success of the BMW plant in Spartanburg to demonstrate how the state supports a major automobile plant. North Carolina has not publicly disclosed its incentive offer, although it had a \$50 million carrot from the Golden Leaf Foundation to include.

“Per incentives, Gov. McCrory is correct: North Carolina is at significant disadvantage vs. South Carolina and Georgia,” said John H. Boyd, a principal at The Boyd Co., a corporate site-selection firm in Princeton, N.J.

“North Carolina has assumed the bridesmaid role in so many of the trophy projects — both in and out of the auto industry,” Boyd said.

A ‘sweet spot?’

State Sen. Joyce Krawiec, R-Forsyth, said the Tax Foundation’s report “shows that we are already seeing the benefits of the tax reform that North Carolina has implemented over the last few years.”

“With regards to incentives, it is not wise to determine winners and losers on the taxpayer dime,” Krawiec said.

“Instead, by creating an economic environment where businesses are not burdened by heavy corporate income taxes, we make it easier for existing businesses to expand their workforce, as well as attract new businesses to employ the many talented workers we have in North Carolina,” she said.

House Bill 117, also known as the N.C. Competes Act, would not only provides up to \$45 million annually to JDIG, it also allots up to \$20 million as an infrastructure enticement to help close the deal on major manufacturing projects.

By comparison, the Senate version of the bill provides \$20 million annually, and from \$30 million to \$35 million if there is a “high-yield project.”

The House and Senate formed a concurrence committee on Aug. 27 to reach a compromise on the legislation. A major roadblock remains the Senate’s plan for sales tax redistribution that would send more revenue into rural counties at the expense of the largest urban counties and major tourism counties.

“We need to move ahead ASAP with deciding how we are funding JDIG,” said state Rep. Debra Conrad, R-Forsyth.

Incentives are going to play a role for some time to come, although many legislators do not like the state incentives entirely or in a limited fashion,” Conrad said.

Within state budget negotiations, the Senate would remove a “trigger” economic-criteria requirement for further reducing the state corporate tax rate. That would allow it to go to 4 percent in 2016 and 3 percent in 2017.

The corporate tax rate is also 5 percent in South Carolina, and 6 percent in Georgia and Virginia, according to the Tax Foundation.

“I have heard that 3 percent is sort of the sweet spot that will really put North Carolina in the best position to lure businesses here and also reduce the need for tax credits,” Conrad said.

Of states that have a single corporate tax rate, the lowest is 4.63 percent in Colorado.

Ohio, Texas and Washington do not have corporate income taxes, but they do have gross receipts taxes with rates that the Tax Foundation says are “not strictly comparable to corporate income tax rates.”

“The Senate and N.C. Chamber in support of removal,” Conrad said, referring to the state chamber of commerce. “The House seems reluctant.

“The Senate is anxious to energize economic development to get to that magic number. The House seems to think we should stick with what we agreed on in the tax reform with the triggers.”

New vs. mature firms

Tax Foundation officials found that businesses in North Carolina face different effective tax rates, depending on their industry and how long they have been located in the state.

“All mature firms in North Carolina experience below-average tax rates” when compared nationally, according to the report. It said companies planning to add operations in North Carolina are now receiving “less-generous incentives” on the whole than in the past, with research and development groups not receiving “substantial subsidies” in North Carolina that are available in other states.

“Discussions of business taxes sometimes focus on top-line rates, while ignoring how unequally those taxes may fall on different kinds of businesses,” said Jared Walczak, a policy analyst for the foundation.

“Tax reform discussions often focus on lowering the tax burden on business in general,” he said. “However, it’s also crucial to address the tax code’s unequal treatment of new and mature businesses in different industries.”

For example, the report measured the corporate tax rate in the seven categories for existing businesses and business recruits.

In all but one category — labor-intensive manufacturing — North Carolina’s ranking fell for new businesses, whether one spot (fifth to sixth) for corporate headquarters or by 18 spots (17th to 35th) for capital-intensive manufacturing.

The study found that corporate income taxes are just one part of a business’s tax burden. Sales, property and unemployment insurance taxes “can impose significant burdens on businesses,” the report said.

Senate leaders tout establishing the single-sales factor method for determining corporate income tax. According to The News & Observer of Raleigh, that method calculates companies’ tax liability based entirely on their sales instead of also factoring in their payroll and property value, resulting in an overall tax cut.

Tax Foundation officials cited South Carolina’s use of the single-sales factor as a major attraction to businesses. However, they added, South Carolina has some of the nation’s highest property taxes on equipment, which affects its ranking for distribution centers and capital-intensive manufacturers.

North Carolina edged Louisiana and Texas in being ranked first in 2014 for economic competitiveness by Site Selection magazine.

Although Site Selection officials touted North Carolina’s performance, they also questioned its future competitiveness with JDIG replenishing in limbo.

Timing is critical

“Timing is everything in site selection — and right now the timing could not be better for North Carolina to reduce its tax rates,” Boyd said.

“We liken site selection in 2015 to the second war between the states — that’s how competitive it is today.

“The public backlash in Connecticut has put the corporate income tax issue front and center in corporate boardrooms,” he said.

Jeffrey Immelt, the top executive of General Electric, has gone on a media tour “blasting the second increase in Connecticut’s corporate income tax and publicly stating he is considering moving the headquarters to a more tax-friendly state,” Boyd said.

“Keep in mind that the early front-runner for the new GE headquarters is Atlanta,” Boyd said. “Developers there are already designing architectural renderings of their new buildings sporting a GE logo.”

Still, Boyd said operating costs continue to be a defining site-selection variable “and that is good news for North Carolina as it re-calibrates its tax rates and explores upping its incentive program.”

North Carolina should consider the entire business environment, “not just taxes and not just regulation,” said Andrew Brod, a senior research fellow for the Center for Business and Economic Research at UNC Greensboro.

“Differential tax effects mean that we’re essentially promoting certain industries more than others, which may or may not be what we want to be doing,” Brod said.

“There are a number of high-cost states with much stronger economies than North Carolina’s, and it’s precisely because economic vitality is not only about low taxes and low wages,” he said. “Worker skills also matter, as do proximity to certain resources and capital and technology.”

Brod said that if a state has little else going for it economically, “then competing via low taxes and low wages may be its only good option.”

“But that should hardly be North Carolina’s first choice for how to compete for jobs and business.”