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STATE TAX INCENTIVES HAVE HIDDEN COSTS

States offer tax incentives with the goal of encouraging new investment and economic development in their state, but just because most states offer numerous incentives doesn't mean doing so is the best approach, according to a report by the nonpartisan Washington-based Tax Foundation.

The foundation's Katherine Loughead lists the major categories of incentives: Job creation tax credits; Investment tax credits; Research and development tax credits; Payroll withholding tax rebates; Property tax abatements.

The foundation's research has shown that incentive-heavy tax structures undermine tax equity, with tax breaks for new firms driving up the tax burdens established firms pay.

> In most states, tax incentives abound, usually offered as a way of promoting new investment or attracting certain industries by shielding them from the full impact of otherwise high tax rates. Altogether, state and local governments give out an estimated $95 billion a year in business incentives. By way of comparison, state and local governments collected less than $66 billion in corporate income taxes in FY 2019.

Loughead states that "While proponents of incentives view them as a tool to promote desirable economic activities—like job creation and new capital investment—their effectiveness at achieving desired outcomes is dubious and difficult to measure. Numerous studies have shown that tax incentives often fail to live up to expectations for inducing job creation and growth… these incentives only reduce taxes for qualifying firms engaging in qualifying activities, meaning non-favored activities and businesses remain on the hook to bear the full impact of the state's tax code."

The foundation makes the following points:

- In any discussion regarding incentives, it is important to keep in mind that tax policy is all about trade-offs; when special tax breaks are given to some taxpayers, other taxpayers are left to pick up the tab.

- If business owners see that they will face favorable tax treatment in a state during the company's first few years in operation but will face much higher burdens later on, this nonneutral tax treatment may discourage that business from investing in the state at all.

- States that make the mistake of relying too heavily on incentives will find that this makes it more difficult to maintain competitive tax burdens on established operations.

The study concludes, “States that maintain a competitive underlying tax code will then find they can attract business investment and experience strong long-term economic growth without picking winners and losers and without cluttering their tax code with complex carveouts, a goal all states should work to achieve.”

“States that lower taxes for all will find businesses streaming in,” said Jim Tobin, economist and president of the Taxpayer Education Foundation. “There is no need for these targeted gimmicks.”

Source:
https://taxfoundation.org/state-tax-incentives-costs/