



Case Study 2: Cutting Corporate Taxes

Reduction and elimination of corporate income taxes (CIT) and the economic result: Examples from North Carolina and Ohio

The **corporate income tax (CIT)** is levied by federal and state governments on business profits, which are revenues (what a business makes in sales) minus costs (the cost of doing business).

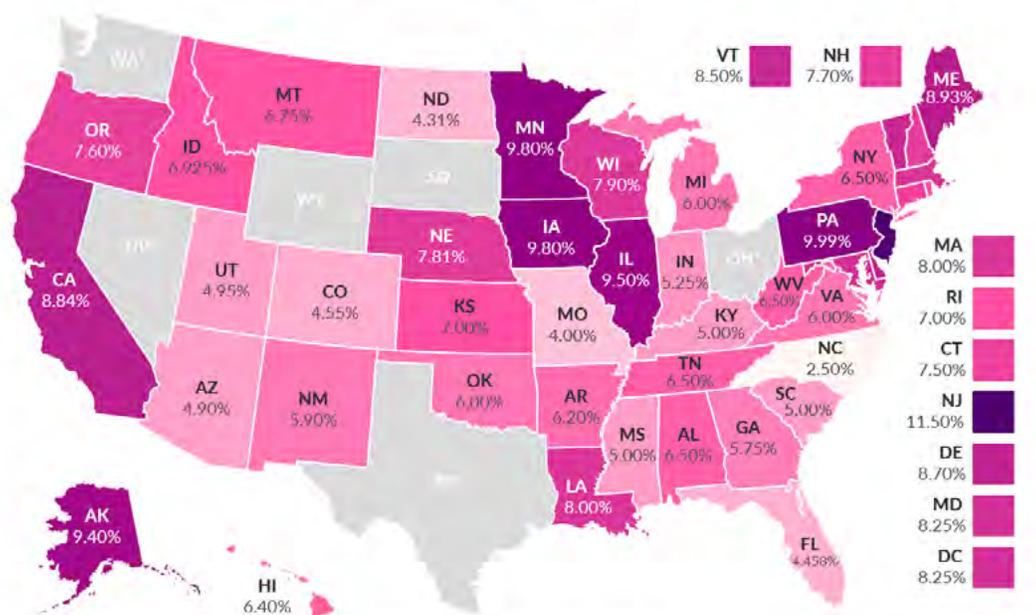
State-level corporate income tax rates vary across the country. Six states (Nevada, Ohio, South

Dakota, Texas, Washington, and Wyoming) levy no corporate income tax, while the remaining states and the District of Columbia do tax corporate profits.

Note: Many companies are not subject to the CIT because they are taxed as pass-through businesses, with income reportable under the individual income tax.

How High are Corporate Income Tax Rates in Your State?

Top Marginal Corporate Income Tax Rates as of January 1, 2021



Note: (*) Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Delaware, Tennessee, and Oregon have gross receipts taxes in addition to corporate income taxes, as do several states like Pennsylvania, Virginia, and West Virginia, which permit gross receipts taxes at the local (but not state) level. Illinois' rate includes two separate corporate income taxes, one at a 7% rate and one at a 2.5% rate. Indiana's rate will change to 4.9% on July 1, 2021. In New Jersey, the rates indicated apply to a corporation's entire net income rather than just income over the threshold. A temporary and retroactive surcharge is in effect from 2020 to 2023, bringing the rate to 11.5% for businesses with income over \$1 million. In addition to regular income taxes, many states impose other taxes on corporations such as gross receipts taxes and capital stock taxes. Some states also impose an alternative minimum tax and special rates on financial institutions.

Sources: Tax Foundation; state tax statutes, forms, and instructions; Bloomberg Tax.

Top State Marginal Corporate
Income Tax Rates as of January 1, 2021

Lower Higher

Lowering the CIT: North Carolina

North Carolina's tax environment is one of the nation's most competitive. As of 2021, the state [boasted](#) the nation's third-lowest effective tax rates for newly established firms and fifth-lowest rates for mature firms.

Just eight years ago, North Carolina had the highest statutory corporate income tax rate in the Southeast. Today, North Carolina's [corporate income tax](#) rate is the nation's lowest at 2.5 percent. The corporate tax rate was cut from 6.9 percent to 6 percent in year one, with further reductions to 3 percent, subject to meeting revenue targets, implemented through 2017. Subsequently, the legislature chose to lower the rate even further, to 2.5 percent.

With the reduction of the CIT over seven years came a broadening of the state [sales tax base](#), while the [individual income tax](#) and franchise tax were both reduced.

Overall, state tax collections per capita are lower than 32 other states, at \$2,795, but state revenues per capita are also some of the lowest, at \$5,675.

North Carolina CIT reduction

Simplicity	
Transparency	
Neutrality	
Stability	

North Carolina is in a competitive region, and, as of 2021, [now ranks](#) 10th for overall state business tax competitiveness and 4th for corporate tax competitiveness.

Following these reforms, North Carolina has enjoyed stronger GDP, higher in-migration rates, and a better business climate.

The state has a [bill](#) awaiting further consideration that would gradually reduce the corporate income tax to zero percent by 2027 while making reforms to the state's franchise (capital stock) tax, the least competitive remaining component of the state's tax code. The legislation would make North Carolina the third state to forgo both a CIT and a gross receipts tax.

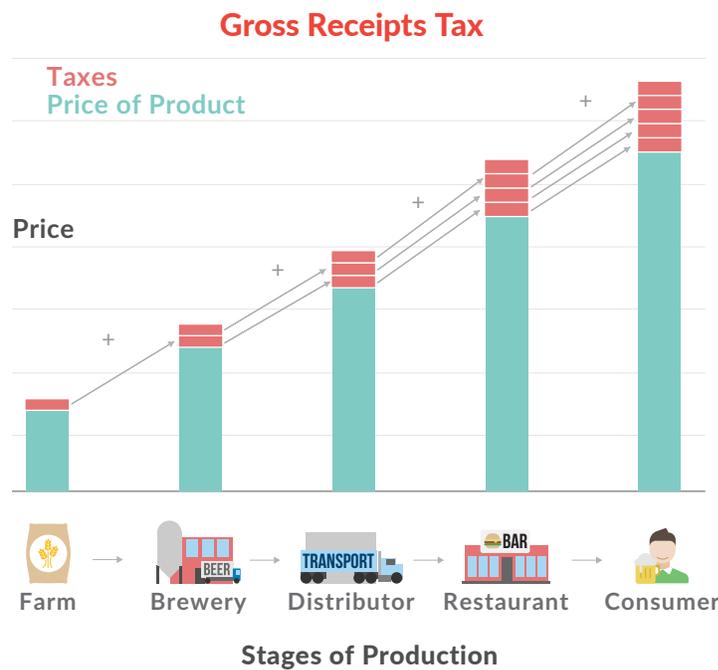
Eliminating the CIT: Ohio

Ohio's 2005 tax reform package included provisions to make Ohio's business climate more economically competitive and incentivize business investment in the state.

An important part of this package was the elimination of Ohio's corporate income tax, which was phased out by 2009. The tax was phased out in annual reductions of 20 percent, until no liability remained. The legislation also eliminated a capital stock tax (on business net worth) and the property tax on business machinery and equipment, in addition to making changes to individual income and sales taxes.

Ohio is the only state to repeal a corporate income tax to date, but it did so by replacing it with a [gross receipts tax](#) (GRT), called the Commercial Activity Tax (CAT). GRTs provide a relative advantage to large and profitable businesses but can be harmful to others. GRTs result in [tax pyramiding](#), where the same tax is imposed multiple times on the final product, and tax businesses regardless of profitability or profit margins.

While CITs only tax net income and provide loss carryforward provisions to smooth payments over the business cycle, the CAT does not differentiate between profitable and unprofitable businesses.



Whereas North Carolina saw a significant increase in in-migration following its reforms, Ohio's tax changes have failed to stem the tide of outmigration, with the state [losing residents and continuing](#) to have one of the [worst business climates](#) in the nation despite the legislation representing a net tax reduction and containing the elimination of several highly uncompetitive taxes, particularly the capital stock tax.

Ohio CIT Elimination

Simplicity	✓
Transparency	✗
Neutrality	✗
Stability	✓

Further Reading

Below are some resources regarding the reduction and elimination of the CIT from Tax Foundation and other sources. Please conduct additional research on the case prior to discussion.

[State Corporate Income Tax Rates and Brackets for 2021](#)

[2021 State Business Tax Climate Index](#)

[North Carolina's Tax Competitiveness](#)

[North Carolina Tax Reform Options: A Guide to Fair, Simple, Pro-Growth Reform](#)

[Ohio's Commercial Activity Tax: A Reappraisal Ohio Tax and Revenue Structure](#)

Reflect on the following questions:

- What is the problem(s) being addressed in each state?
- How do these policies meet (or not meet) the [Principles of Sound Tax Policy](#)?
- What general options are available to develop more sound policy?
- Who are the stakeholders and what are their interests?
- How has this been addressed in other states?