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ARKANSAS ADVOCATES FOR CHILDREN & FAMILIES

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The Vanishing Arkansas Corporate Income Tax:

Should we close the loopholes?

Executive Summary

The share of Arkansas income tax revenue generated by the corporate income tax has fallen from 31 percent in 1972 to only 10 percent in 2002. The personal income tax now generates 90 percent of all Arkansas income tax revenue.

Corporate tax loopholes and shelters cost Arkansas $44 million a year in lost state tax revenue.

As a result of various tax write-offs and corporate loopholes, over half of all companies filing state corporate income tax returns in Arkansas have no state tax liability and pay no state income tax (53 percent in tax year 1998 and 58 percent in 2002).

Arkansas has yet to close two major corporate tax loopholes. One loophole allows companies to deduct from their income the payments they make to a "related" company in another state. Companies take advantage of this loophole by establishing tax shelters in other states, such as "Delaware Holding Companies," that serve no real purpose other than to reduce or eliminate the income taxes they would otherwise owe in Arkansas.

Another loophole allows businesses to count certain types of profitable transactions as "nonbusiness" income rather than as "business income," thereby reducing their taxable incomes in Arkansas. Closing these loopholes could generate valuable state tax revenue for education and other services.

Arkansas could generate $26 to $52 million in new state tax revenue annually if it simply adopted "combined reporting," the best strategy for closing corporate loopholes.

Closing state corporate income tax loopholes and shelters would not only generate critical revenue for education and health care, but would improve tax fairness for the state's small- and medium-sized businesses and low- and middle-income families.

Introduction

During the recent special legislative session on education reform, the Arkansas General Assembly passed one of the largest tax increases in the state's history. It raised over $380 million in new tax revenue, mostly through a 7/8ths cent increase in the state sales tax, expanding the sales tax base to some personal services, and a small increase in the corporate franchise tax. While the tax increase raised critical revenue to fund reforms in the state's public education system, it did so by placing a disproportionate share of the new tax burden on the state's low- and middle-income families.

During the 2003-2004 special session, there was a growing recognition among legislators that new ways must be found to raise future tax revenue and improve tax fairness for the state's families. One of the options frequently discussed by legislators was the closing of corporate income tax loopholes. Although bills to close loopholes failed to pass during the session, it's an issue likely to receive attention in future legislative sessions.

Because of its complexity, the Arkansas corporate income tax is not well understood by the general public, the media, or even some legislators. The purpose of this issue brief is to provide an overview of the Arkansas corporate income tax, how loopholes are eroding its role in the state tax structure, options for reforming it, and its impacts on tax fairness and state economic competitiveness.

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Individuals are now responsible for 9 out of every 10 dollars Arkansas collects in income taxes – with corporations paying the other dollar.

The Declining Role of the Corporate Income Tax

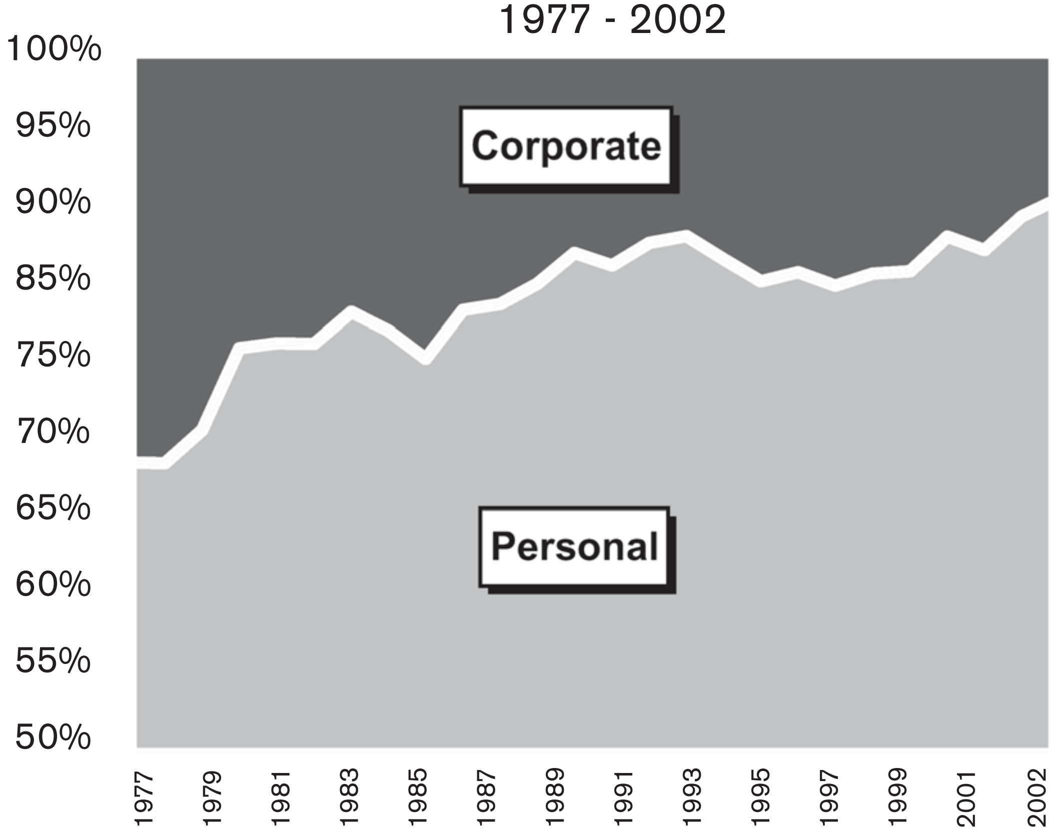
The Arkansas state corporate income tax is expected to generate $248.3 million in general revenue for state fiscal year 2004 ($189 million after issuing corporate refunds).[1] But the corporate income tax is a small part of the state's tax structure, and it's getting smaller. According to data from the U.S. Census Bureau, in 1992 the corporate income tax generated 4.6 percent of all Arkansas state tax revenue.[2] Ten years later in 2002, it generated just 3.4 percent of all state tax revenue.

A similar decline has occurred in other states. State corporate income taxes nationally accounted for 4.8 percent of all state tax revenue during 2002, down from 6.6 percent in 1992. In 2002 Arkansas ranked 36th among the states in the share of state tax revenue generated by corporate income taxes.

Individuals, not corporations, are picking up a greater share of the state income tax bill. During the last 30 years, there has been significant decline in the share of Arkansas income taxes paid by corporations. In 1972 corporations generated nearly a third (31 percent) of all income tax revenue in Arkansas, while individuals paid the rest (69 percent).[3] In 2002 corporate income taxes represented just 10 percent of all income tax revenue, and individuals picked up the tab for 90 percent of Arkansas income taxes.[4] Individuals are now responsible for 9 out of every 10 dollars Arkansas collects in income taxes – with corporations paying the other dollar.

Arkansas mirrors other states in the declining role of corporate income taxes relative to personal income taxes. Nationally, the share of state and local income taxes paid by corporations declined from 22.6 percent in 1972 to 13.5 percent in 2001.[5] However, the decline in the share of income taxes paid by corporations (relative to personal income taxes) was much steeper in Arkansas, decreasing from 31 percent to 11.5 percent during the same period.

Shares of Arkansas Income Taxes:
1977 - 2002



Source: U.S. Census Bureau data compiled by the Institue on Taxation and Economic Policy and AACF.

Many corporations pay no Arkansas income tax

What's behind the decline of Arkansas' state corporate income tax? Part of the reason may be that many companies, after claiming various deductions and write-offs, report no net taxable income and pay no state corporate income taxes. For tax year 1998, one of the boom years during the late 1990s, 16,369 companies out of the 30,657 filing corporate income tax returns in Arkansas (53 percent) reported no net taxable income and had no state income tax liability.

This figure was higher for tax year 2002 (the latest year of available data), a year in which many companies lost money because of the economic recession. Of the 28,212 companies that filed corporate income tax returns in Arkansas, 16,253 — 58 percent of all corporate income tax filers — reported no net taxable income and had no tax liability for the year.

What is noteworthy about these numbers is that even during good economic times — such as tax year 1998 — over half of all companies filing Arkansas corporate income tax returns report no net taxable income after taking advantage of various deductions, write-offs, and loopholes. These companies have no state corporate income liability. Even if allowances are made for the fact that some companies filing corporate tax returns lose money during the year, and others are inactive or go out of business during the year, this suggests companies are very adept at taking advantage of existing tax laws to avoid paying, or at least reducing, Arkansas corporate income taxes.

Number and Percent of Companies Reporting No Taxable Income

on Arkansas State Corporate Income Tax Returns, Tax Years 1998 and 2002

Number of Returns (percent of all corporate income tax returns)

Net Taxable Income	1998		2002	
$0 or less (no taxable income)	16,369	(53.4%)	16,253	(57.6%)
$1 to 100,000	11,731	(38.3%)	9,719	(34.4%)
$100,001 to 500,000	1,743	(5.7%)	1,554	(5.5%)
$500,000 to $1 million	328	(1.1%)	304	(1.1%)
More than $1 million	486	(1.6%)	382	(1.4%)
Total	30,657		28,212	

Source: AACF calculations based on data from Arkansas Department of Finance Administration (DF&A), Net Taxable Income by NTI Range report, years 1998 and 2002.

How does the Arkansas corporate income tax work?

Many small businesses in Arkansas don't file a "corporate" income tax return. Sole proprietorships (companies owned by a single individual) report profits and losses directly on their individual income tax returns. Companies owned by "partnerships" typically file a "partnership" state income tax return, but the profits are "passed through" and taxed through the individual income tax returns of the partners. Finally, many small (often family-owned) businesses with less than 75 shareholders file "subchapter-S" corporate returns. The profits of subchapter-S companies, like sole proprietorships and partnerships, are passed through to shareholders and taxed on their individual income tax returns.

Larger businesses, i.e., those with more than 75 shareholders, file corporate income tax returns. Companies that file corporate income tax returns must pay a state income tax on the net incomes they earn. Under Arkansas law there are six corporate income tax brackets ranging from 1 percent to 6.5 percent. The top marginal rate of 6.5 percent kicks in at net corporate incomes over $100,000.

Among the many "write-offs" that corporations can claim are the rents paid on business properties, moving expenses, salaries or wages of employees, the cost of producing goods that are sold, worthless debts, equipment depreciation, net operating losses from prior years, etc. In most cases these "write-offs" represent legitimate expenses that reduce a corporation's net profit. These "write-offs" lower the amount of a corporation's income that is subject to taxes (e.g., its net taxable income) and reduce the amount of taxes it must pay.

Corporate Tax Loopholes

One likely reason for the diminishing role of the corporate income tax is the growing exploitation by corporations of loopholes in the state tax structure. Unlike legitimate tax "write-offs" of the costs of doing business, loopholes open the door to strategies that corporations adopt for the sole purpose of avoiding or reducing the state income taxes they pay, or that simply allow corporate profits to fall through the cracks. Two examples of these loopholes are (1) Arkansas' vulnerability to the "Delaware Holding Company" tax shelter and (2) the state's weak definition of business income.

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"Delaware Holding Companies"

One corporate tax avoidance strategy that has received a great deal of attention in recent years is the "Delaware hholding company" tax shelter.[6] This tax shelter takes advantage of a loophole in Arkansas tax law – the fact that it recognizes as a legitimate tax deduction those payments made to a related company in another state.

Under the "Delaware Holding Company" tax shelter, Arkansas companies transfer ownership of the corporation's trademarks and patents to a subsidiary corporation in a state that either does not tax certain types of income, such as royalties, interest, or intangible income (such as Delaware) or doesn't levy a corporate income tax at all (such as Nevada). Those subsidiaries referred to as "passive investment companies" or PICs are called Delaware Holding Companies. PICs are often shell corporations, subsidiaries existing only on paper, conducting little real business, and having few, if any, real employees. They are most often established in Delaware or Nevada.

Michael Mazerov, a corporate tax expert with the Center on Budget and Policy Priorities, recently described the Delaware Holding Company loophole to a joint meeting of Arkansas House and Senate Tax Committees.[7] Here's how it works.

Step 1: Parent Corporation sets up a "passive investment company" (PIC) in a state without a corporate income tax (NV) or a state that doesn't tax corporations whose only income is from intangible assets (Delaware or Michigan).

Step 2: Parent transfers its patents, trademarks, "know-how," etc., to a PIC.

Step 3: PIC licenses back to its parent company the right to use patents, trademarks in exchange for royalties. The result is that the payment of royalties is recognized as a "legitimate" cost of doing business for Arkansas tax purposes, reducing or eliminating the taxable profit of the company doing business in Arkansas, while the PIC is not subject to a tax on its profit.

Step 4: The PIC then lends its profit to the parent in exchange for the payment of interest, further reducing the parent company's profit (and taxable income) in Arkansas.

At present, it's impossible to know how many companies operating in Arkansas are utilizing the "Delaware Holding Company" tax shelter to shift their Arkansas income to another state. Such tax records are confidential. However, according to a 2002 press report, there were at least 132,000 corporations in Nevada with no employees.[8] Many of these are probably PICs. By the end of 1998, at least 6,000 Delaware PICs had been created, with 600-800 new ones being created each year.[9] A 2002 *Wall Street Journal* article identified at least one Arkansas company having a PIC – Tyson Foods.[10] Given what is known about the national numbers, there are undoubtedly more Arkansas companies involved with PICs.

Closing the Loophole through Combined Reporting

During the 2003 regular session, the Arkansas General Assembly passed Act 1286 in an effort to curb the PIC problem. Act 1286 sets forth the conditions under which companies are allowed to claim the deduction for intangible income on their corporate income tax returns. Unfortunately, industry opposition helped weaken the bill's language and its potential effectiveness in preventing PICs. In particular, one word in the bill – an "or" instead of "and" — makes it relatively easy to qualify for the deduction. Unless it's changed, Act 1286 is unlikely to slow the proliferation of Arkansas companies with ties to Delaware holding companies.

Arkansas could take stronger action to close the PIC loophole. According to the Center on Budget and Policy Priorities, Arkansas is one of 22 states with a corporate income tax that could realize more corporate income tax revenue if it adopted either "combined reporting" or laws modeled on states such as Alabama or Mississippi.[11] The best option, "combined reporting," treats the in-state company and out-of-state PIC as one corporation for tax purposes. This nullifies any tax advantage from shifting income on paper to an out-of-state corporation.

During the 2003 special session on education, Representative Phil Jackson (Republican-Berryville), co-chair of the House Revenue and Tax Committee, introduced a combined reporting bill (House Bill-1105). Although the bill died in committee because of opposition from the State Chamber of Commerce, it stirred the beginnings of what is likely to be an ongoing public debate in the legislature. More combined reporting bills are likely to be introduced in future legislative sessions.

To date, 16 states have adopted combined reporting, mostly in the Midwest and West.[12] Most of these states have had combined reporting for several decades, and it has worked effectively. Seven other states have recently considered combined reporting legislation. The U.S. Supreme Court has twice upheld the constitutionality and fundamental fairness of combined reporting systems.

The "Non-Business Income" Loophole

A second type of corporate tax loophole concerns the definition of "business income." In response to U.S. Supreme Court decisions, most state corporate income tax laws distinguish between "business income" and "nonbusiness income." The distinction is important because part of a corporation's "business income" may be taxed in each of the states in which a corporation is doing business. In contrast, a company's "nonbusiness income" may only be taxed in the state in which the corporation is managing the asset that is generating the income, e.g., such as the corporate headquarters. This loophole allows businesses operating in Arkansas (but not domiciled here) to exclude certain types of profitable transactions and income from "business income" and thus exclude them from state corporate income taxes.

Of particular interest is the treatment of the sale or disposition of a corporation's tangible, i.e., a plant building, and intangible property, such as company stock shares. In Arkansas, such income is counted as business income only if constituted as an "integral part of the taxpayer's regular trade or business operations." In some cases, this narrow definition of business income means that certain transactions have been considered irregular or non-integral and thus not counted as part of the corporation's "business income."

One major example is the sale of a plant or factory site (include the real property, building, and factory equipment) that has been taken out of operation. Under Arkansas law the sale of the plant's real property, any buildings, and equipment likely would be considered "nonbusiness income," rather than "business income," and would not be subject to Arkansas corporate income taxes.

Arkansas could close this loophole by broadening its definition of "business income" to include all transactions and income allowed by U.S. Supreme Court standards. Arkansas is one of 26 states that have yet to take this step.[14]

During the 2003 special session on education, Representative Phil Jackson, introduced legislation (HB 1104) that would have expanded the definition of business income and closed this loophole. This bill, like the combined reporting bill Jackson introduced, died in committee. The legislature will likely re-visit this issue in future sessions.

Closing Loopholes — the Impact on Revenue?

It is difficult to estimate how much these and other loopholes cost the Arkansas treasury each year. According to a 2003 study by the Multi-State Tax Commission, domestic tax shelters reduce revenue from the Arkansas state corporate income tax by $28 to $60 million annually (with $44 million being the mid-point estimate).[15]

The Arkansas Department of Finance and Administration (DF&A) has not estimated the potential revenue that could be gained from the adoption of combined reporting, the single best step the state could take to close the "Delaware Holding Company" loophole and related strategies used to shift profits earned in Arkansas to beyond the reach of the state's tax laws. A recent review by the Center on Budget of other states' estimates of the impact of adopting combined reporting suggests it could increase state corporate income tax revenue by 10-20 percent.[16] The current DF&A forecast for corporate income tax collections for SFY05 is $261 million (gross general revenue collections before refunds). Based on the estimates of other states, closing corporate loopholes through combined reporting could generate about $26 to $52 million in general revenue.

Closing Loopholes — A Matter of Fairness

Closing corporate loopholes is also important as a matter of fairness. It's fairness not only for low- and middle-income families who currently bear the burden of a regressive tax system, but also for small companies who don't benefit from corporate tax loopholes.

The Arkansas state and local tax system is regressive. That is, low and middle-income families pay a higher share of their income in state and local taxes than do upper-income families. The poorest 20 percent of Arkansas families pay about 11.3 percent of their income in taxes, while the middle 20 percent pay 10.7 percent, and the top 1 percent only 5.8 percent in taxes.[17] These estimates do not include the impact of recent tax changes adopted by the Arkansas General Assembly, such as the recent 7/8ths cent sales tax increase (the most regressive of all taxes). That increase has made the tax system even more regressive. According to one estimate, the sales tax increase has increased the state and local tax burden for the poorest 20 percent of families to more than 12 percent of their income, with the tax burden of the top one percent still at about six percent.[18]

As corporations have increased their ability and willingness to take advantage of various loopholes and cut their tax burden, this has driven up the amount of tax revenue that must be raised through other regressive sources – such as the sales tax – that disproportionately hurt low- and middle-income families. Higher corporate taxes make the state tax system fairer because they reduce the burden on low- and middle-income families that is caused by over-reliance on the sales tax.

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Corporate loopholes benefit relatively few companies (many are large corporations) at the expense of the many, small mom and pop businesses or those that only do businesses within the state. Many smaller companies do not have the expertise or the resources to hire the accountants and lawyers to take advantage of complex corporate tax loopholes. This hurts small businesses and gives larger businesses an unfair advantage in the marketplace. Closing corporate loopholes would help level the economic playing field for the state's small businesses.

Closing Loopholes and Economic Development

One of the arguments made by opponents of closing corporate tax loopholes (or raising corporate income taxes) is that it would impose too high a cost on business and hurt the state's economic competitiveness. The research, however, suggests this simply isn't true. In 2000, state and local taxes comprised just 1.2 percent of a company's total cost of doing business and reduced their total receipts by only 1.1 percent (other factors, such as company payrolls, transportation costs, supplies, etc. represent much higher costs for companies).[19]

The actual impact of state and local taxes, however, is much less than even these small numbers. Companies can deduct or "write off" the state and local taxes they pay on their federal income tax returns. After being deducted on their federal returns, state and local taxes paid by businesses comprised just 0.8 percent of a company's cost of doing business and reduced their total receipts by just 0.7 percent.[20]

State corporate income taxes are only a small part of the total state and local taxes paid by businesses. Corporate income taxes generally comprise just 10 percent of the total state and local taxes that companies pay.[21] Even before federal write-offs of the state taxes paid, state corporate income taxes represent only 0.12 percent of the company's total cost of doing business and reduce their total receipts by about 0.11 percent.[23] To put these numbers into perspective, state corporate income taxes have an impact equal to slightly more than 1/10 of one percent of a company's bottom line.

These findings suggest that even if corporate income taxes were increased by say, 20 percent over their current levels (either by raising rates or closing loopholes), the impact on state corporate income taxes and total state and local taxes, especially after write-offs on federal returns, would be negligible.

Industry-sponsored studies have tried to paint a different picture of business tax burdens. A 2004 study conducted by Ernst and Young for the Council on State Taxation (COST) found that businesses bear a greater share of state tax revenue if other taxes besides corporate income taxes are added to the mix. However, the study has been widely criticized for its many methodological flaws, such as attributing certain taxes to businesses that are actually paid for by individuals, including some utility taxes that are directly charged to customer bills and property taxes on owner-occupied houses owned by farmers.

Despite its shortcomings, the COST study is interesting because of its Arkansas findings. The study found that Arkansas ranks low on most measures of business taxation (a ranking of 1 means a high burden, while 50 means a low tax burden). Arkansas neighbors generally had higher rankings and higher business tax burdens. Below are the rankings from the COST study.

Arkansas' highest ranking in the COST study of business tax burdens was 27th — on business taxes per dollar ($) of capital income — with Arkansas ranking in the middle of its surrounding states. Claims that Arkansas corporations face a high tax burden relative to surrounding states are not supported by government data or industry-sponsored studies.

State Rankings on Measures of Business Taxes, FY 2003

Measure	AR	LA	MO	MS	OK	TN	TX
Business Share of All Taxes	37	5	39	21	23	11	6
Business Taxes Per Employee	45	5	46	25	28	38	13
Business Taxes per $ of Private Sector Econ Activity	31	12	43	11	16	34	21
Business Tax Per $ of Capital Inc.	27	35	41	11	8	23	15
Change in Business Taxes, 2000-03	42	3	26	18	22	35	16
Business Share of Tax Revenue Growth 2002-03	45	21	37	12	36	41	28

Source: "Total State and Local Business Taxes, A 50-State Study of the Taxes Paid by Business in FY2003, by Ernst and Young, for the Council on State Taxation, Jan. 2004.

But what has happened in states that have closed corporate income tax loopholes? Sixteen states have adopted combined reporting (CR) procedures to close loopholes such as the "Delaware Holding Company" problem. These states were among the leaders in economic growth during the late 1990s.[23] Consider that states with combined reporting were:

- 4 of the top 5 states in manufacturing job growth
- 8 of the top 10 states in manufacturing job growth
- 12 of the top 20 states in manufacturing job growth

These numbers suggest that states are unlikely to be at a competitive economic disadvantage simply because of efforts to close corporate tax loopholes.

Who Would Bear the Burden?

Although closing corporate tax loopholes would have very little impact on the bottom line of Arkansas companies or the state's economic competitiveness, it would be a tax increase for a minority of companies. This raises the obvious question: who would bear the burden of closing loopholes?

The corporate income tax is one of the most progressive taxes that states can levy. It has become even more so in recent years since the Arkansas General Assembly reduced the progressivity of other parts of the state tax structure, such as exempting of 30 percent of capital gains (such as gains from the sales of stocks) from the personal income tax and its recent decision to follow the lead of the U.S. Congress in phasing out the estate tax.

Corporate income tax increases, such as those resulting from the closing of loopholes, are generally passed along to corporate stockholders in the form of lower dividends or slower increases in corporate stock values. The makeup of a company's corporate stockholders greatly influences who would bear the burden of a corporate tax increase. In Arkansas, corporate stock ownership is heavily concentrated among the state's upper-income taxpayers.[24] The top 20 percent of Arkansas taxpayers (those making more than $55,000 annually) own three-fourths (79 percent) of the corporate stock held by Arkansas residents. The top one percent alone (those making more than $242,000) own more than 35 percent.

To the extent that any corporate income tax increase would be passed along to Arkansas residents, the burden would fall mostly on the state's wealthiest taxpayers, not Arkansas' low- and middle-income families or the state's small businesses.

Out-of-state residents own more than 80 percent of the stock in Arkansas corporations.[25] Arkansas residents own one-fifth (19.6 percent) of corporate stock. Since most of the stock in Arkansas companies is owned by outside stockholders, the cost of closing corporate loopholes would be borne heavily by out-of-state stockholders. The rest of the burden would fall mostly on wealthier taxpayers living in state.

Although much of the burden of a corporate income tax increase would be borne by out-of-state shareholders, companies may also try to shift part of the burden to consumers in the form of higher prices. Since the closing of tax loopholes would mostly affect large corporations (many of whom presumably have large shares of out-of-state sales), out-of-state consumers would be most impacted by any effort to shift part of the burden to consumers.

What Are the Prospects for Closing Loopholes?

Theoretically, it's much easier to pass legislation closing corporate tax loopholes than raising taxes. Amendment 19 to the Arkansas Constitution requires a 3/4ths vote of both chambers of the Arkansas General Assembly to increase personal or corporate income tax rates. The closing of corporate tax loopholes only requires a simple majority vote of both chambers. Why? The closing of a loophole only increases the amount of a corporation's income that is subject to the tax, not the rate at which the income is taxed.

Share of Arkansas Corporate Stock Ownership, By Income Group

Income Group A: Top 1 percent
35% of stock ownership

B: Next 4 percent
23% of stock ownership

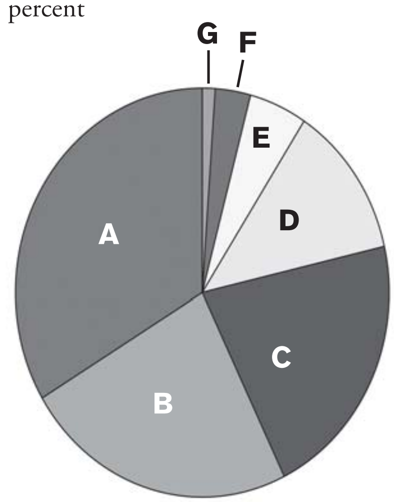
C: Next 15 percent
21% of stock ownership

D: Fourth 20 percent
12% of stock ownership

E: Middle 20 percent
5% of stock ownership

F: Second 20 percent
3% of stock ownership

G: Lowest 20 percent
1% of stock ownership



Source: Institute on Taxation and Economic Policy

...state corporate income taxes have an impact equal to slightly more than 1/10 of one percent of a company's bottom line.

During the first special session of 2003, the Arkansas General Assembly adopted a three percent personal and corporate income tax surcharge to close a projected budget shortfall and prevent budget cuts in the state Medicaid program. However, the income tax surcharge is temporary and will eventually disappear if the economy generates stronger than anticipated state tax revenues. Given the legislature's historical reluctance to increase income tax rates, closing corporate income loopholes might be easier to pass politically than permanently increasing corporate income tax rates.

Whither the Corporate Income Tax?

The corporate income tax is critical to the future fairness of the Arkansas tax system and its ability to generate adequate revenue for education, health care, and other vital services for families. If steps are not taken to reform the corporate income tax, its base will continue to erode over time, thereby reducing its relevance to the Arkansas tax system. The closing of corporate income tax loopholes, such as that associated with "Delaware Holding Companies" and the definition of nonbusiness income, are critical to saving the corporate income tax.

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Endnotes

1. Official General Revenue Forecast for the 2003-2005 Biennium. Prepared by Economic Analysis and Tax Research, The Arkansas Department of Finance and Administration.
2. Data from the U.S. Bureau of the Census, available on the web at: http://www.census.gov/govs/www/state.html.
3. Matthew Gardner, Rich Huddleston, James Metzger, and Richard Sims, *Tax Options for Arkansas*, a study conducted for the Winthrop Rockefeller Foundation, July 2003.
4. AACF calculations based on data from the U.S. Bureau of the Census at: http://www.census.gov/govs/www/state.html. This shift does not appear to be simply the result of more businesses filing as pass-through entities rather than as corporations. (The incomes of pass-through entities such as partnerships, limited liability companies, and subchapter-S corporations are passed through to the personal income tax returns of the stockholders.) At the federal level, the share of federal income tax revenue generated by corporations declined from 17.5% in 1987 to 14.5% in 2002. In Arkansas, the share of state income revenue generated by corporations declined much more steeply over the same interval, from 17.8% to 10.2%. Since the growth in the number of pass-through entities reduces federal corporate tax collections in the same way that it affects Arkansas, the fact that the corporate share declined more steeply in Arkansas suggests that the decline in the role of the corporate income tax in Arkansas is due, at least in part, to corporations exploiting state-specific corporate loopholes, not converting to pass-through entities.
5. AACF calculations based on data from the U.S. Bureau of the Census at: http://www.census.gov/govs/estimate/01sl00us.html. The data includes income taxes levied at both the state and local level. The latest year of data for all 50 states is the 2001 fiscal year.
6. For a comprehensive discussion of these issues, see Michael Mazerov, *Closing Three Common Corporate Income Tax Loopholes Could Raise Additional Revenue for Many States*, Center on Budget and Policy Priorities, May 23,2003.
7. Michael Mazerov, "Combined Reporting – HB 1005: The Key to a Robust and Fair State Corporate Income Tax In Arkansas," Presentation to the Arkansas General Assembly, Joint Meeting of the House and Senate Committees on Revenue and Taxation, January 14, 2003.
8. "Corporate Fee Bills Aim to Raise $65 Million," Las Vegas Review-Journal, May 16, 2001.
9. Statement of William Remington, Director of the Delaware Division of Revenue, at the "Delaware: The First Choice for Financial and Tax Planning Conference," December 15, 1998, Wilmington, Delaware, as cited in Mazerov, *Closing Three Common Corporate Income Tax Loopholes Could Raise Additional Revenue for Many States*.
10. Glenn R. Simpson, "A Tax Maneuver in Delaware Puts Squeeze on Other States," *Wall Street Journal*, August 9, 2002.
11- 12. Mazerov, *Closing Three Common Corporate Income Tax Loopholes Could Raise Additional Revenue for Many States*.
13. Mazerov, Presentation to the Arkansas General Assembly.
14. Mazerov, *Closing Three Common Corporate Income Tax Loopholes Could Raise Additional Revenue for Many States*.
15. This amount only includes revenues lost because of domestic tax shelter targeted at states. Arkansas loses an additional $34 million because of international tax shelters created at the federal level. See *Corporate Tax Sheltering and the Impact on State Corporate Income Tax Revenue Collections*. The Multistate Tax Commission, July 15, 2003.
16. Michael Mazerov, unpublished review of fiscal impact studies conducted by other states.
17. Matthew Gardner, Rich Huddleston, James Metzger, and Richard Sims, Tax Options for Arkansas, a study conducted for the Winthrop Rockefeller Foundation, July 2003.
18. AACF calculations based on data from the Institute on Taxation and Economic Policy, February 2004.
19-20. Robert G. Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development,* Economic Policy Institute, 2004.
21. Mazerov, Presentation to the Arkansas General Assembly.
22. AACF calculations using data from Lynch, *Rethinking Growth Strategies* and data from Mazerov, Presentation to the Arkansas General Assembly. If state and local taxes comprise 1.2 percent of a company's total cost of doing business, and state corporate income taxes represent 10 percent of this 1.2 percent, then corporate taxes equal 0.12 percent of the company's total cost of doing business (1.2 *.10 = 0.12 percent).
23. Mazerov, Presentation to the Arkansas General Assembly.
24-25. Unpublished data from the Institute on Taxation and Economic Policy.