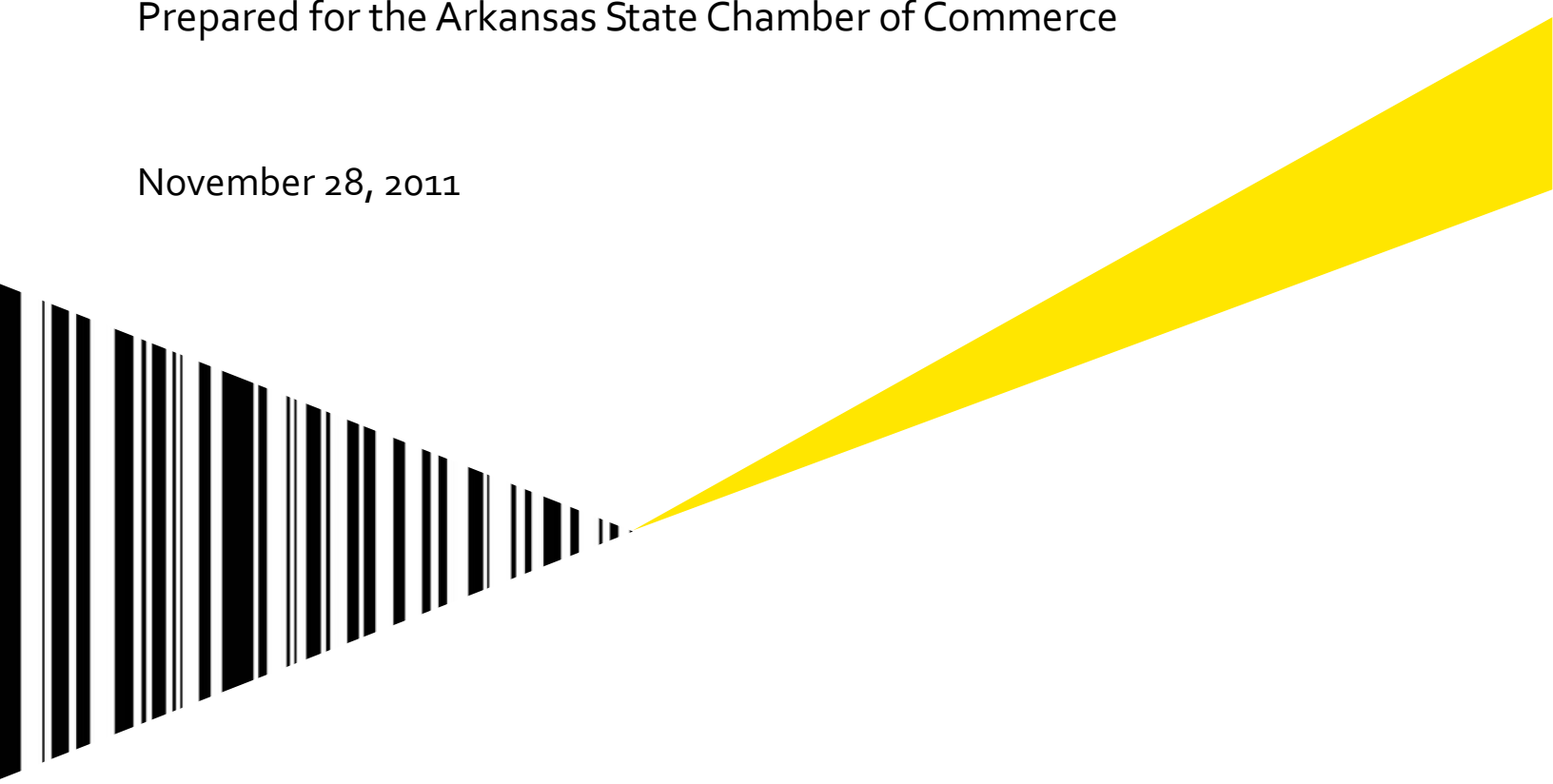


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Arkansas Business Tax Competitiveness

Prepared for the Arkansas State Chamber of Commerce

November 28, 2011



Arkansas Business Tax Competitiveness

EXECUTIVE SUMMARY

Overview

This analysis, prepared by Ernst & Young LLP for the Arkansas State Chamber of Commerce, compares the state and local tax burdens on selected new business investments in Arkansas and seven competitive states. The tax burden estimates presented in this study can be used to evaluate how competitive Arkansas's state and local business tax system is for new investment and job creation in the state for seven selected industries. The estimates measure the additional state and local taxes that a new or expanding business would pay on the capital investment, and economic activity added to the Arkansas economy. This comparative information is important in understanding the competitiveness of Arkansas's current tax system and in evaluating proposed tax changes to improve the state's competitiveness.

The eight states included in this analysis are: Arkansas, Kansas, Louisiana, Mississippi, Missouri, Oklahoma, Tennessee, and Texas. The representative investments or types of economic activities include: a headquarters facility, a research and development facility, a business support services firm and investments for durable goods, food products, renewable energy equipment and motor vehicle parts manufacturing investments.

Estimates of state and local business tax burdens by industry are derived from EY's business tax competitiveness model (BTCM). The BTCM calculates current state and local business tax burdens imposed on new in-state capital investments, and projects these burdens by year over a 30-year life span. The methodology used in this analysis follows that used in EY's recent 50-state business tax competitiveness study.¹ The BTCM uses income statement and balance sheet financial information to estimate the major state and local tax bases for each investment and calculates tax liabilities on the new investments based on current-law state and local tax system parameters. The state and local taxes included in the study are: corporate income taxes, franchise taxes, sales and use taxes on business purchases, and local property taxes.

The state and local tax burdens are summarized as effective tax rates (ETRs). The ETR on new investments measures the percentage reduction in the before-tax rate of return due to the state and local taxes imposed on the investment. For example, if the before-tax rate of return on an investment is 10% and the after-tax rate of return is 9%, the ETR is 10%. The study presents two sets of ETRs: 1) ETRs before the consideration of tax credits, and 2) ETRs including statutory tax credits that are generally available to corporate taxpayers. The comparison of before- and after-credit ETRs illustrates how statutory tax credits affect a state's business tax competitiveness.

¹ See Ernst & Young LLP, *Competitiveness of State and Local Business Taxes on New Investment: Ranking States by Tax Burden on New Investment* (April 2011). This study was done in conjunction with the Council on State Taxation (COST).

Study Results

Table ES-1 provides an overview of the preliminary BTCM results. It presents the average ETRs (before credits) by state for the manufacturing and services investments included in the study. The states are ranked in Table 1 in terms of their ETRs with 1 representing the highest ETR. Table ES-1 shows that Arkansas's general business tax system, before credits, imposes above average taxes on the investments included in the study. The table shows that:

- Compared to the average in the seven other states, Arkansas's ETR for the services investments is 7.5 percent higher; Arkansas ranks 4th highest for the services investments.
- Arkansas ranks 3rd highest for the manufacturing investments, 6.5 percent higher than the other-states average.
- For all industries combined, Arkansas is 6.5 percent above the average for the other seven states, ranking 2nd highest in the overall effective tax rate.
- The ETRs on the manufacturing and service investment groups are very similar. However, the ETRs for the separate investment examples do show significant variation within both manufacturing and services. (See Table ES-2.)

Figures ES-1 to ES-3 show how Arkansas compares to the seven other states in terms of average ETRs (before credits) for manufacturing (Figure ES-1), services (Figure ES-2), and all industries included in the study (Figure ES-3). The horizontal dotted lines in each figure show the average seven-state ETRS for each category of investment. The bars also show the level and composition of the state and local tax ETRs for property, sales, and corporate income and franchise taxes. A comparison of the ETRs by tax type (illustrated by the components of each bar) shows each tax type's contribution to the overall ETR.

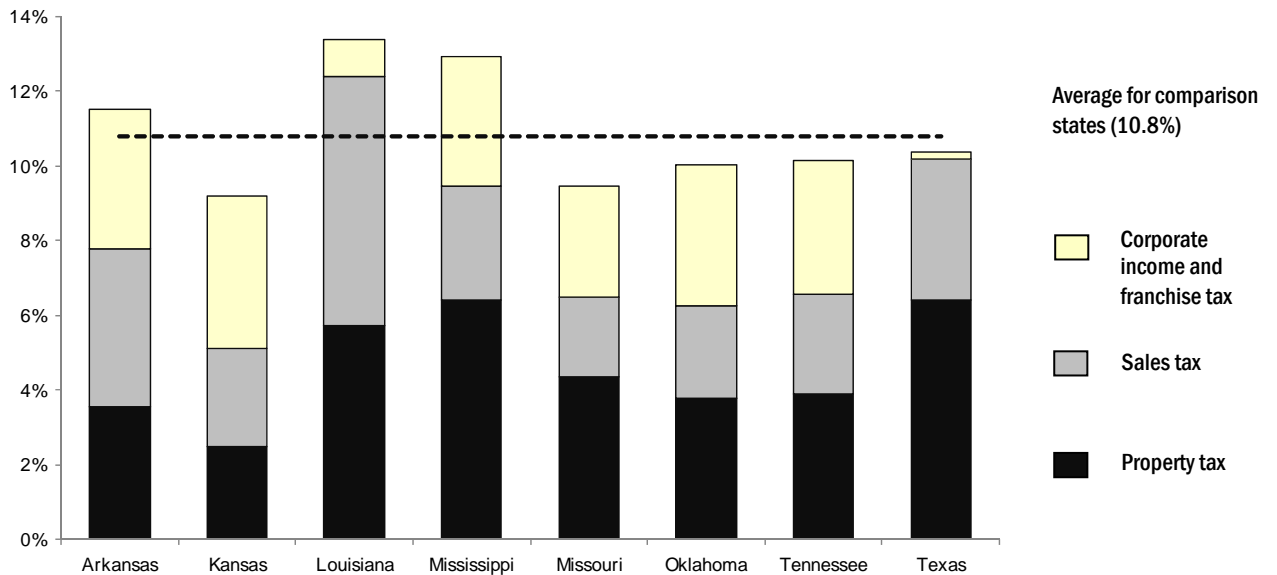
As shown in Figure ES-1, Arkansas imposes relatively high sales and corporate income tax burdens on the manufacturing investments that are only partly offset by below-average property taxes. The study results further show that:

- The sales tax ETR on manufacturing investments in Arkansas is almost 24% higher than the seven-state average.
- The sales tax in Arkansas accounts for 37% of the total state and local ETR on the four manufacturing investments, 20% higher than the sales tax share in other states. Arkansas's sales tax share is second only to the unusually high sales tax share in Louisiana (50%).
- The effective corporate income tax rate on manufacturing investments is 37% higher than the other states' average.
- The relatively high ETRs from sales taxes and corporate income taxes is only partly offset by a property tax ETR for manufacturers that is 23% below the average for the other states.

Table ES-1
Average Effective State and Local Business Tax Rates by Investment Type,
Before Credits

State	Services		Manufacturing		All Industries	
	ETR	Rank	ETR	Rank	ETR	Rank
Arkansas	11.5%	4	11.5%	3	11.5%	2
Kansas	12.6%	1	9.2%	8	10.7%	5
Louisiana	11.8%	3	13.4%	1	12.7%	1
Mississippi	8.8%	7	12.9%	2	11.2%	3
Missouri	11.0%	6	9.5%	7	10.1%	7
Oklahoma	11.2%	5	10.0%	6	10.5%	6
Tennessee	12.0%	2	10.2%	5	10.9%	4
Texas	7.5%	8	10.4%	4	9.1%	8
<i>Other States' Average ETR</i>	<i>10.7%</i>		<i>10.8%</i>		<i>10.8%</i>	

Figure ES-1
Average Effective Tax Rates for Manufacturing Industries



Source: E&Y Business Tax Competitiveness Model

Figure ES-2 shows that the sales tax is the largest contributor to the overall ETRs for service firms. In fact, the sales tax share of total business taxes for the services investments averages 57% for all the included states. Arkansas's share is only slightly lower. Figure ES-3 combines the services and manufacturing investments.

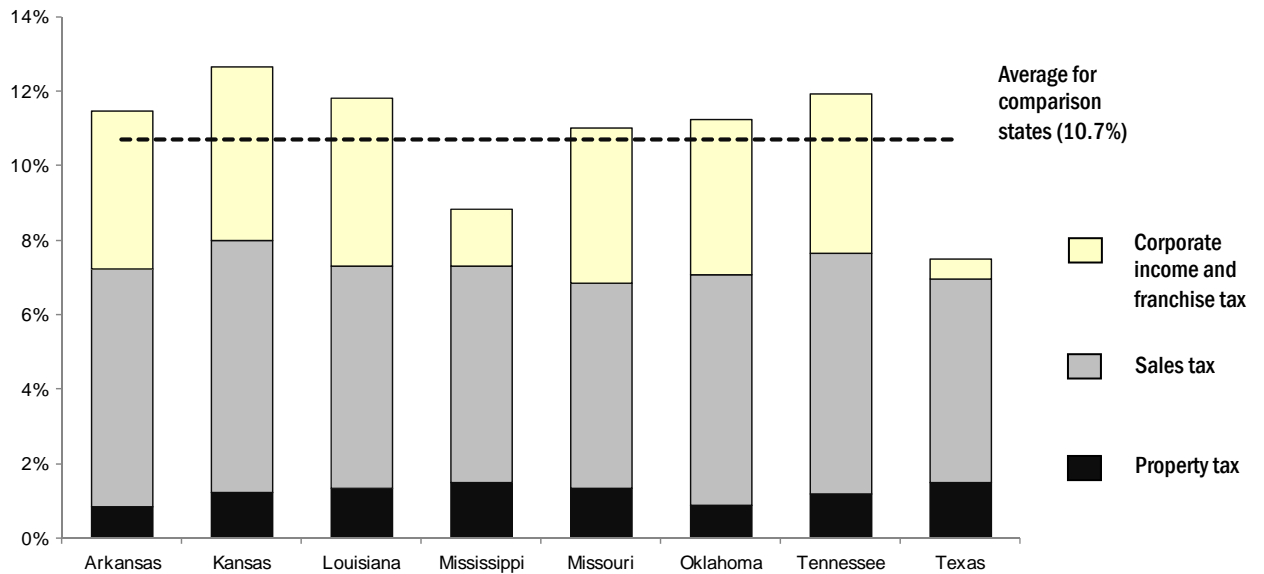
The relatively high sales tax ETRs in Arkansas are not the result of high statutory tax rates. The combined state and average local sales tax rate in Arkansas (7.8%) is only slightly higher than the average for the other states (7.7%). Arkansas's relatively high sales tax burden comes from the tax being imposed on a broader base of business purchases of goods and services. These include purchases of machinery and equipment by manufacturers and purchases of other tangible products and services by all businesses.

The Arkansas statutory corporate income tax rate (6.5%) is equal to the average rate for the other states (excluding the Texas margin tax). The relatively high Arkansas ETRs for manufacturers is partly due to the use of an apportionment formula with a 50% weight on the in-state sales factor to determine Arkansas's share of U.S. income. Three other states (Louisiana, Mississippi and Texas) use an apportionment formula for manufacturers with a 100% weight on the sales factor that reduces ETRs for the types of investments included in the study.

Figure ES-3 shows that the combined ETR in Arkansas (11.5%) ranks 2nd highest in the comparison states.

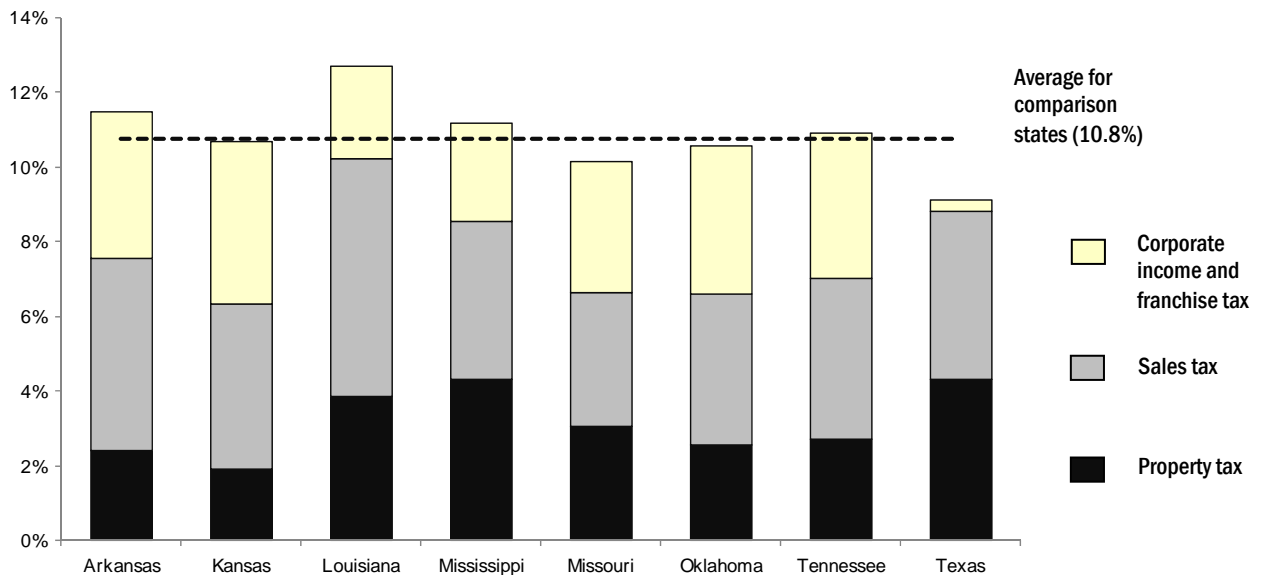
Table ES-2 shows the separate ETRs by state for each of the seven industries. While the average Arkansas manufacturing and service industry ETRs are equal, the ETRs in Arkansas differ across industries from a high of 18.0% for business support services to a low of 4.7% for corporate headquarters. Relative to other states, Arkansas's industry-specific ETRs vary from less than 1% above the other states' average for research and development to 27% above average for the headquarters investment.

Figure ES-2
Average Effective Tax Rates for Service Firms



Source: E&Y Business Tax Competitiveness Model

Figure ES-3
Overall Average Effective Tax Rates for All Included Industries



Source: E&Y Business Tax Competitiveness Model

Table ES-2
State and Local Effective Business Tax Rates and Rankings among Comparison States,
by Industry and State, Before Credits

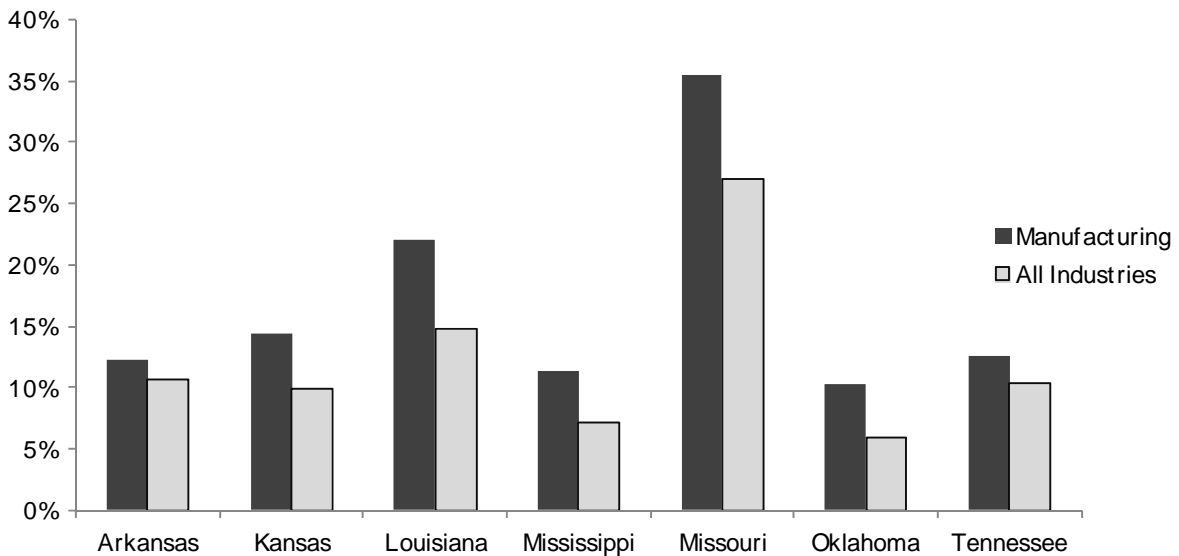
State	Headquarters		Research & Development		Durable Goods Manufacturing		Business Support Services		Food Product Manufacturing		Renewable Energy Equipment Manufacturing		Motor Vehicle Parts Manufacturing	
	ETR	Rank	ETR	Rank	ETR	ETR	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank
Arkansas	4.7%	2	11.6%	4	10.5%	2	18.0%	3	9.6%	3	13.8%	3	12.1%	4
Kansas	4.6%	3	13.1%	2	9.6%	5	20.2%	1	8.1%	5	10.2%	8	8.9%	8
Louisiana	6.2%	1	13.9%	1	9.1%	7	15.3%	6	10.7%	1	17.6%	1	16.2%	1
Mississippi	1.5%	7	10.1%	7	11.7%	1	15.0%	7	10.6%	2	15.8%	2	13.5%	3
Missouri	4.2%	6	11.6%	5	9.2%	6	17.3%	5	8.0%	7	10.4%	7	10.2%	6
Oklahoma	4.4%	5	11.4%	6	10.2%	4	18.0%	4	8.1%	6	11.8%	5	10.1%	7
Tennessee	4.6%	4	12.5%	3	10.5%	3	18.8%	2	8.5%	4	11.1%	6	10.7%	5
Texas	0.4%	8	8.4%	8	8.7%	8	13.7%	8	6.5%	8	12.6%	4	13.6%	2
<i>Other States' Avg.</i>	3.7%		11.6%		9.9%		16.9%		8.6%		12.8%		11.9%	

Impacts of Credits

The EY competitiveness study also includes estimates of the major statutory tax credits that are available to general taxpayers. Examples of credits included in the analysis are investment tax credits that reduce the net cost of in-state capital investment, tax incentives to hire new employees and research and development spending credits.

As shown in Figure ES-4 all of the comparison states (with the exception of Texas) provide substantial credits to partially offset before-credit taxes. For the seven industries, Arkansas's tax credits offset an average of 11% of the before-credit tax liability, equal to the average reduction for the competitive states, excluding Texas. The largest credit offsets are in Louisiana (15%) and Missouri (27%).

Figure ES-4
Potential Reduction in Total State and Local Effective Tax Rate from Statutory Credits,
(Percentage Reduction in Pre-Credit Overall Effective Tax Rate)



Arkansas Business Tax Competitiveness

Introduction

This analysis, prepared by Ernst & Young LLP for the Arkansas State Chamber of Commerce, compares the state and local tax burdens on selected new business investments in Arkansas and seven competitive states. The states included in this analysis are: Arkansas, Kansas, Louisiana, Mississippi, Missouri Oklahoma, Tennessee, and Texas.

The tax burden estimates can be used to determine how competitive Arkansas's business tax system is for new investment and job creation in the state for specific industries. Estimates of state and local business tax burdens by industry are derived from EY's Arkansas business tax competitiveness model (BTCM). The BTCM calculates current state and local business tax burdens imposed on new in-state capital investments, and projects these burden by year over a 30-year life span.

The BTCM provides a firm-level perspective on how Arkansas's business tax burdens compare to the tax burdens a firm would face in other states. Unlike aggregate measures of total taxes paid by business, this approach looks at the marginal impact of making a new, profitable investment in a state. It is a forward-looking, marginal tax burden analysis as opposed to an aggregate measure of average business taxes paid on existing investments. This is the type of analysis that businesses conduct when deciding to locate or expand in a state. The competitiveness model identifies the additional taxes that a firm faces in adding investment and jobs in a state. Differences in state business tax systems can have a significant impact on these marginal investment decisions.

The Arkansas BTCM generated the measures of a state's tax competitiveness reported in this study. EY designed the tax simulation model to estimate combined state and local business tax burdens paid by different types of firms expanding in various states. The BTCM provides comprehensive estimates of additional state and local taxes paid by the business as a direct result of the expansion. Effective tax rates (ETRs), presented in the next two sections are tax rates on new investments before tax credits that are generally available to most taxpayers. These ETRs measure the competitiveness of Arkansas's business tax system before the consideration of statutory and negotiated tax credits used to offset business tax burdens.

It is important for policy makers to understand how competitive Arkansas's state and local tax structure is when taxpayers compare general tax provisions, both rates and bases, across states. While tax credits are important in almost all states, the value to taxpayers may be limited by number of years, caps based on operating results, and uncertainty over qualification for credits. As a result of the uncertainty of credits, firm's considering new investments in Arkansas may place more weight on the expected tax burdens before credits in making investment decisions.

The final section of the paper reports ETRs for the industries included in the study after any reductions due to major statutory tax credits designed to encourage new capital investment, increased employment and higher research and development expenditures. The comparison of before and after-credit ETRs indicates how statutory tax credits affect a state's business tax

competitiveness. Negotiated tax credits and geographically limited credits, such as enterprise zone credits, are not considered in the analysis.

Modeling Business Tax Burdens

Taxes are computed for selected types of firms expanding in Arkansas and seven comparison state locations. State and local taxes included in the analysis are: state and local corporate income and franchise taxes, state and local sales taxes on business inputs (including Arkansas's gross receipts tax), and local property taxes. The tax parameters are based on current tax laws applicable to tax year 2011. (See Appendix A for the current-law, general tax parameters used in the analysis.) Current-law changes in tax provisions through 2015, including tax rates and apportionment formulas, are modeled in the year the changes are scheduled to take effect.

Firm financial profiles (balance sheets and income statements) are used to capture relevant financial characteristics of the investments for representative firms in selected industries.² The seven industries or activities included are: corporate headquarters, research and development facilities, durable goods manufacturing, business support services, food products manufacturing, renewable energy equipment manufacturing and motor vehicle parts manufacturing. (See Appendix B for a detailed description of the included industries.)

State and local tax laws are programmed into the BTCM. Each industry or activity's income and balance sheet data are extrapolated over a 30-year period. The model computes state and local taxes for each year using the tax law parameters and the tax base estimates generated from the financial data. The resulting stream of annual tax burdens is then subtracted from the before-tax income stream of each new investment to derive the after-tax income stream. The tax impacts are summarized as effective tax rates (ETRs) measured as the percentage reduction in the rate of return on the before-tax income stream due to state and local taxes on the new investment. For example, if the before-tax rate of return is 10% and the after-tax rate of return is 9%, the ETR is 10%.

Overall Competitiveness Results

Table 1 provides an overview of the BTCM results. It presents the average ETRs (before credits) and rank by state for the manufacturing and services investments included in the study, as well as all industries combined. The states are ranked in Table 1 in terms of their ETRs with 1 representing the highest ETR. The last line in the table presents the average ETRs for the groups of investments in all the states other than Arkansas.

Table 1 shows that Arkansas's general business tax system, before credits, imposes above average taxes on the investments included in the study:

- Compared to the average in the seven other states, Arkansas's ETR for the services investments is 7.5 percent higher; Arkansas ranks 4th highest for the services investments.

² The financial profiles of the representative industries are derived from U.S. Internal Revenue Service, Statistics of Income Division corporate income tax return data by major industry groups. Additional information on asset distributions for the representative firms is based on U.S. Bureau of Economic Analysis data on the net stock of capital by industry.

- Arkansas ranks 3rd highest for the manufacturing investments, 6.5 percent higher than the other-states average.
- For all industries combined, Arkansas is 6.5 percent above the average for the other seven states, ranking 2nd highest in the overall effective tax rate.
- The ETRs on the manufacturing and service investment groups are very similar. However, the ETRs for the separate investment examples do show significant variation within both manufacturing and services. (See Table 2.)

Figures 1 to 3 show how Arkansas compares to the seven other states in terms of average ETRs (before credits) for manufacturing (Figure 1), services (Figure 2), and all industries included in the study (Figure 3). The horizontal dotted lines in each figure show the average seven-state ETRs for each category of investment. The bars also show the level and composition of the state and local tax ETRs for property, sales, and corporate income and franchise taxes. A comparison of the ETRs by tax type (illustrated by the components of each bar) shows each tax type's contribution to the overall ETR.

As shown in Figure 1, Arkansas imposes relatively high sales and corporate income tax burdens on the manufacturing investments that are only partly offset by below-average property taxes. The study results further show that:

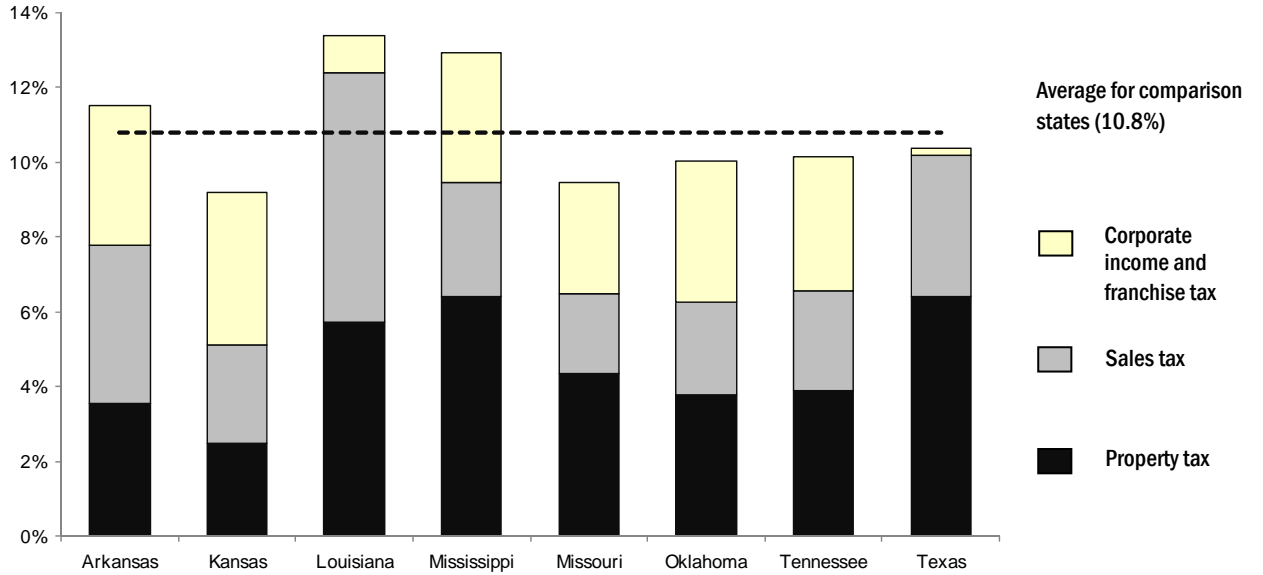
- The sales tax ETR on manufacturing investments in Arkansas is almost 24% higher than the seven-state average.
- The sales tax in Arkansas accounts for 37% of the total state and local ETR on the four manufacturing investments, 20% higher than the sales tax share in other states.³ Arkansas's sales tax share is second only to the unusually high sales tax share in Louisiana (50%).
- The effective corporate income tax rate on manufacturing investments is 37% higher than the other states' average.
- The relatively high ETRs from sales taxes and corporate income taxes is only partly offset by a property tax ETR for manufacturers that is 23% below the average for the other states.

³ The percentage shares of each tax type are derived from the ETRs reported by tax type and industry in Table 4.

Table 1
Average Effective State and Local Business Tax Rates by Investment Type, Before Credits

State	Services		Manufacturing		All Industries	
	ETR	Rank	ETR	Rank	ETR	Rank
Arkansas	11.5%	4	11.5%	3	11.5%	2
Kansas	12.6%	1	9.2%	8	10.7%	5
Louisiana	11.8%	3	13.4%	1	12.7%	1
Mississippi	8.8%	7	12.9%	2	11.2%	3
Missouri	11.0%	6	9.5%	7	10.1%	7
Oklahoma	11.2%	5	10.0%	6	10.5%	6
Tennessee	12.0%	2	10.2%	5	10.9%	4
Texas	7.5%	8	10.4%	4	9.1%	8
<i>Other States' Average ETR</i>	<i>10.7%</i>		<i>10.8%</i>		<i>10.8%</i>	

Figure 1
Average Effective Tax Rates for Manufacturing Industries



Source: E&Y Business Tax Competitiveness Model

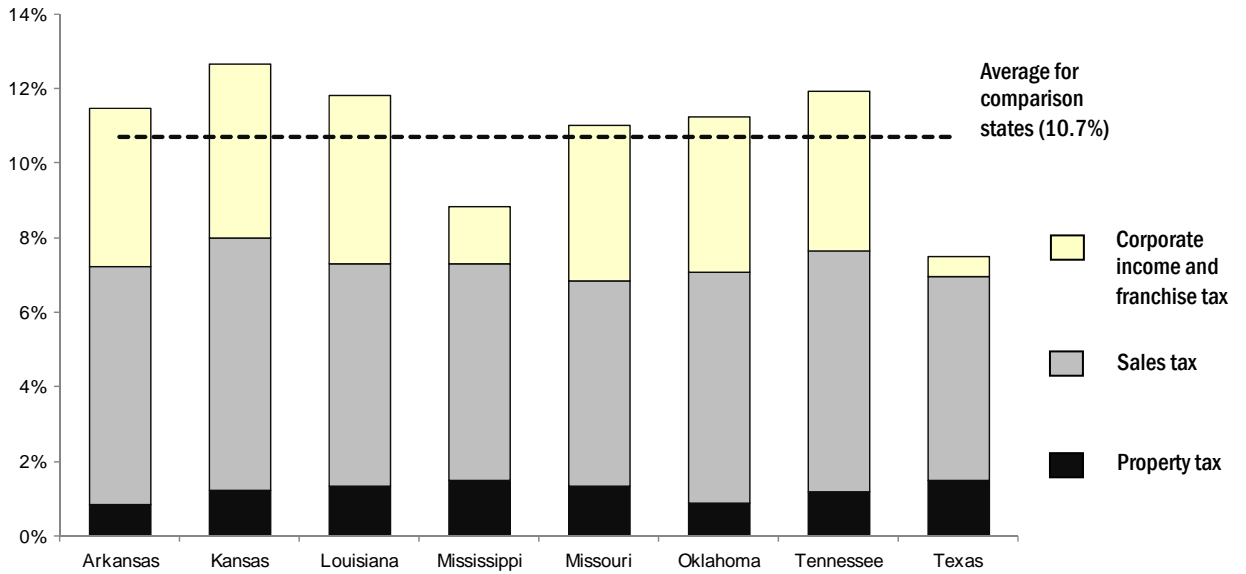
Figure 2 shows that the sales tax is the largest contributor to the overall ETRs for the services investments. In fact, the sales tax share of total business taxes for the services investments averages 57% for all the included states. Arkansas's share is only slightly lower.

The relatively high sales tax ETRs in Arkansas are not the result of high statutory tax rates. The combined state and average local sales tax rate in Arkansas (7.8%) is only slightly higher than the average for the other states (7.7%). Arkansas's relatively high sales tax burden comes from the tax being imposed on a broader base of business purchases of goods and services. These include purchases of machinery and equipment by manufacturers and purchases of other tangible products and services by all businesses.

The Arkansas statutory corporate income tax rate (6.5%) is equal to the average rate for the other states (excluding the Texas margin tax). The relatively high Arkansas ETRs for manufacturers is partly due to the use of an apportionment formula with a 50% weight on the in-state sales factor to determine Arkansas's share of U.S. income. Three other states (Louisiana, Mississippi and Texas) use an apportionment formula for manufacturers with a 100% weight on the sales factor that reduces ETRs for the types of investments included in the study.

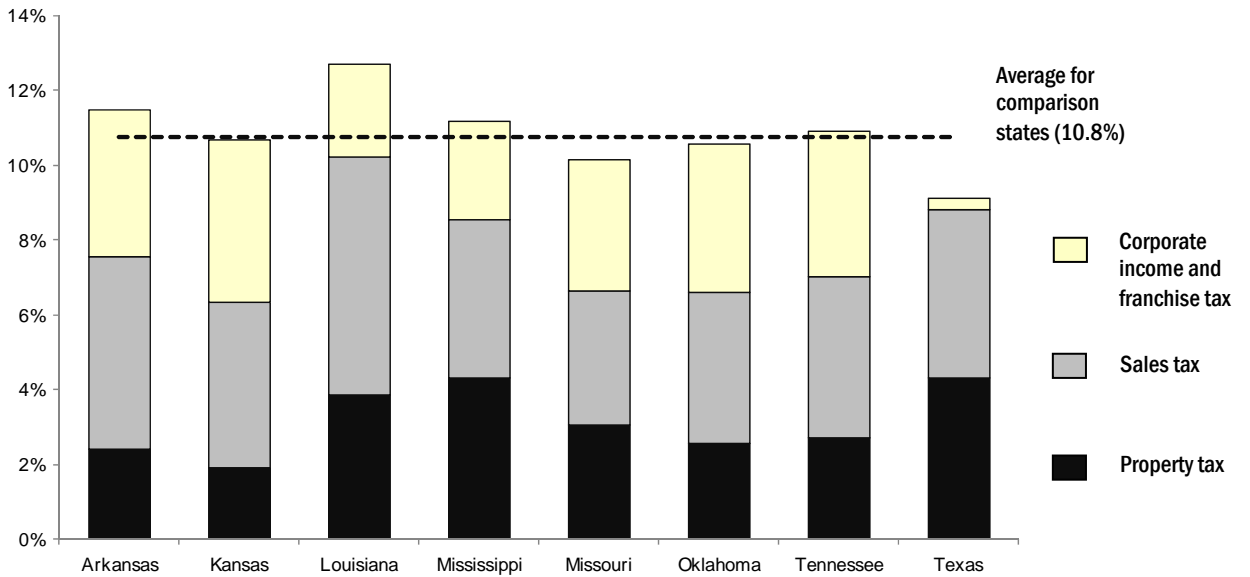
Figure 3 combines the services and manufacturing investments and shows that the combined ETR in Arkansas (11.5%) ranks 2nd highest in the comparison states.

Figure 2
Average Effective Tax Rates for Service Firms



Source: E&Y Business Tax Competitiveness Model

Figure 3
Overall Average Effective Tax Rates for All Included Industries



Source: E&Y Business Tax Competitiveness Model

Detailed Results by Industry and Tax Type

Tables 2, 3 and 4 provide more detail on Arkansas's business tax competitiveness. Table 2 presents the ETRs (before credits) by industry and by state for all state and local business taxes combined. It shows for example that Arkansas's total effective tax rate on the headquarters investment is 4.7% compared to the seven-state average of 3.7%; for durable goods manufacturing, Arkansas's ETR is 10.5% compared to the other states' average of 9.9%. Arkansas's highest-ranked ETRs are for the headquarters and durable goods manufacturing investments (ranked second). Its lowest rankings (rank of 4) are for the research and development and motor vehicle parts manufacturing investment.

Table 3 shows tax burdens for each state indexed to Arkansas's ETR for each industry; the Arkansas rate is set equal to 100 percent. For example, Kansas's state and local tax burden on the headquarters firm is 2.5 percent lower than Arkansas's ETR (an index number of 97.5%). For food product manufacturing, the average ETR for the other seven states is almost 10% lower than Arkansas's rate on this new investment.

Table 4 presents information on the ETRs and rankings by state and by industry for each category of state and local tax included in the study. State business taxes are presented in the first section of the table followed by local business taxes.

The results of the analysis show that:

- By ranking, Arkansas's ETR ranges from 2nd highest (corporate headquarters and durable goods manufacturing) to 4th highest (research and development and motor vehicle parts manufacturing). Louisiana has the highest effective tax rate on three of the four new investments in manufacturing, in part because of relatively high state and local sales taxes.
- Sales taxes on business purchases of capital and operating goods and services generally impose higher business tax burdens than the corporate income tax and may approach the level of the property tax burden. For example, the combined state and local sales tax ETR for the renewable energy equipment manufacturing example averages 4.1% for the seven other competitive states. For these states the corporate income and franchise tax ETR averages 2.7% and the local property tax ETR averages 6.0%.
- Arkansas imposes some of the highest corporate income taxes of the comparison states for the four manufacturing industries in this study. Manufacturers primarily exporting final products generally face higher corporate income tax burdens in states that assign lower weights to the in-state sales factor and higher weights to the in-state payroll and property factors used to apportion U.S.-wide income to a state. Arkansas assigns a double weight (50%) to in-state sales and 25% weights to in-state payroll and property. Because the BTCM assumes that the new investment has 100% of its payroll and property in the state, but exports 95% to other states, Arkansas's apportionment formula assigns a little more than 50% of the income generated by the new investment to the state. In contrast, in states with a 100% weight on the sales factor, only 5% of the income from the investment is taxed within the state.

For this reason, manufacturers face higher business income tax burdens in Arkansas, Kansas, Louisiana, Missouri, Oklahoma, and Tennessee and lower burdens in Mississippi and Texas.

Effective corporate income tax rates for the five states with double-weighted or equally-weighted sales factors in the apportionment formulas average 2.8 percent compared to an average rate of only 1.5 percent in states with a 100% weight on the sales factor.

- Arkansas's rank ranges from second to fourth overall for each of the three service industries, due to generally high burdens for sales and property taxes and the imposition of a corporate franchise tax.

Table 2
State and Local Effective Business Tax Rates and Rankings among Comparison States,
by Industry and State, Before Credits

State	Headquarters		Research & Development		Durable Goods Manufacturing		Business Support Services		Food Product Manufacturing		Renewable Energy Equipment Manufacturing		Motor Vehicle Parts Manufacturing	
	ETR	Rank	ETR	Rank	ETR	ETR	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank
Arkansas	4.7%	2	11.6%	4	10.5%	2	18.0%	3	9.6%	3	13.8%	3	12.1%	4
Kansas	4.6%	3	13.1%	2	9.6%	5	20.2%	1	8.1%	5	10.2%	8	8.9%	8
Louisiana	6.2%	1	13.9%	1	9.1%	7	15.3%	6	10.7%	1	17.6%	1	16.2%	1
Mississippi	1.5%	7	10.1%	7	11.7%	1	15.0%	7	10.6%	2	15.8%	2	13.5%	3
Missouri	4.2%	6	11.6%	5	9.2%	6	17.3%	5	8.0%	7	10.4%	7	10.2%	6
Oklahoma	4.4%	5	11.4%	6	10.2%	4	18.0%	4	8.1%	6	11.8%	5	10.1%	7
Tennessee	4.6%	4	12.5%	3	10.5%	3	18.8%	2	8.5%	4	11.1%	6	10.7%	5
Texas	0.4%	8	8.4%	8	8.7%	8	13.7%	8	6.5%	8	12.6%	4	13.6%	2
<i>Other States' Avg.</i>	3.7%		11.6%		9.9%		16.9%		8.6%		12.8%		11.9%	

Table 3
Summary of State and Local Effective Tax Rates by Industry, Indexed to Arkansas' Effective Tax Rate
(Arkansas = 100%)

State	Headquarters	Research & Development	Durable Goods Manufacturing	Business Support Services	Food Product Manufacturing	Renewable Energy Equipment Manufacturing	Motor Vehicle Parts Manufacturing
Arkansas	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Kansas	97.5%	113.3%	91.4%	111.9%	84.3%	74.0%	73.5%
Louisiana	132.3%	119.6%	86.5%	84.9%	111.2%	126.8%	134.2%
Mississippi	31.9%	86.7%	111.0%	83.0%	111.2%	114.4%	111.8%
Missouri	88.0%	99.9%	87.3%	96.1%	83.5%	75.2%	84.6%
Oklahoma	92.8%	98.0%	96.6%	99.6%	84.2%	84.9%	83.8%
Tennessee	97.0%	108.1%	99.1%	104.1%	88.8%	80.0%	88.3%
Texas	8.6%	72.3%	82.8%	75.7%	68.3%	90.8%	112.5%
<i>Other States' Avg.</i>	78.3%	99.7%	93.5%	93.6%	90.2%	92.3%	98.4%

Table 4
State and Local Effective Business Tax Rates, by Industry, Tax Type and State, Before Credits

State	Headquarters		Research & Development		Durable Goods Manufacturing		Business Support Services		Food Product Manufacturing		Renewable Energy Equipment Manufacturing		Motor Vehicle Parts Manufacturing	
	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank
Total State and Local Taxes														
Arkansas	4.7%	2	11.6%	4	10.5%	2	18.0%	3	9.6%	3	13.8%	3	12.1%	4
Kansas	4.6%	3	13.1%	2	9.6%	5	20.2%	1	8.1%	5	10.2%	8	8.9%	8
Louisiana	6.2%	1	13.9%	1	9.1%	7	15.3%	6	10.7%	1	17.6%	1	16.2%	1
Mississippi	1.5%	7	10.1%	7	11.7%	1	15.0%	7	10.6%	2	15.8%	2	13.5%	3
Missouri	4.2%	6	11.6%	5	9.2%	6	17.3%	5	8.0%	7	10.4%	7	10.2%	6
Oklahoma	4.4%	5	11.4%	6	10.2%	4	18.0%	4	8.1%	6	11.8%	5	10.1%	7
Tennessee	4.6%	4	12.5%	3	10.5%	3	18.8%	2	8.5%	4	11.1%	6	10.7%	5
Texas	0.4%	8	8.4%	8	8.7%	8	13.7%	8	6.5%	8	12.6%	4	13.6%	2
<i>Other States' Avg.</i>	3.7%		11.6%		9.9%		16.9%		8.6%		12.8%		11.9%	
State Corporate/Business Tax														
Arkansas	3.0%	5	3.4%	6	2.9%	4	3.7%	5	2.9%	4	2.9%	4	2.9%	4
Kansas	4.2%	2	4.7%	2	4.1%	1	5.1%	1	4.1%	1	4.1%	1	4.1%	1
Louisiana	4.8%	1	5.2%	1	0.3%	7	1.5%	6	0.3%	7	0.3%	7	0.3%	7
Mississippi	0.2%	7	1.3%	7	2.9%	3	1.4%	7	2.9%	3	2.9%	3	2.9%	3
Missouri	3.7%	3	4.2%	3	2.9%	6	4.5%	2	2.9%	6	2.9%	6	2.9%	6
Oklahoma	3.6%	4	3.9%	4	3.5%	2	4.2%	3	3.5%	2	3.5%	2	3.5%	2
Tennessee	3.0%	5	3.7%	5	2.9%	4	4.0%	4	2.9%	4	2.9%	4	2.9%	4
Texas	0.0%	8	0.5%	8	0.2%	8	1.0%	8	0.1%	8	0.2%	8	0.1%	8
<i>Other States' Avg.</i>	2.8%		3.3%		2.4%		3.1%		2.4%		2.4%		2.4%	
State Sales Tax														
Arkansas	0.2%	5	4.3%	4	2.9%	1	10.1%	4	2.2%	2	4.1%	2	3.6%	3
Kansas	0.2%	2	4.6%	3	2.6%	4	10.9%	2	1.2%	4	2.5%	5	1.9%	6
Louisiana	0.1%	8	2.6%	8	1.7%	8	6.1%	8	2.5%	1	4.4%	1	4.6%	2
Mississippi	0.2%	1	5.1%	1	2.9%	2	12.1%	1	2.1%	3	3.9%	3	3.4%	4
Missouri	0.1%	7	3.1%	6	1.8%	7	7.5%	6	0.9%	7	1.7%	8	1.3%	8
Oklahoma	0.1%	6	3.1%	7	1.9%	6	7.4%	7	0.8%	8	1.7%	7	1.4%	7
Tennessee	0.2%	4	4.7%	2	2.9%	2	10.6%	3	1.1%	5	2.4%	6	2.1%	5
Texas	0.2%	3	3.9%	5	2.6%	5	9.1%	5	1.1%	6	3.2%	4	5.4%	1
<i>Other States' Avg.</i>	0.1%		3.9%		2.3%		9.1%		1.4%		2.8%		2.9%	

Table 4 (continued)
State and Local Effective Business Tax Rates, by Industry, Tax Type and State, Before Credits

State	Headquarters		Research & Development		Durable Goods Manufacturing		Business Support Services		Food Product Manufacturing		Renewable Energy Equipment Manufacturing		Motor Vehicle Parts Manufacturing	
	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank
Franchise Tax														
Arkansas	1.4%	1	0.9%	1	0.8%	1	0.3%	1	0.9%	1	0.9%	1	0.6%	1
Kansas	0.0%	7	0.0%	7	0.0%	7	0.0%	7	0.0%	7	0.0%	7	0.0%	7
Louisiana	1.1%	3	0.7%	3	0.7%	3	0.2%	3	0.7%	3	0.7%	3	0.5%	3
Mississippi	0.9%	4	0.6%	4	0.5%	4	0.2%	4	0.6%	4	0.6%	4	0.4%	4
Missouri	0.1%	6	0.1%	6	0.1%	6	0.0%	6	0.1%	6	0.1%	6	0.0%	6
Oklahoma	0.5%	5	0.3%	5	0.3%	5	0.1%	5	0.3%	5	0.3%	5	0.2%	5
Tennessee	1.2%	2	0.7%	2	0.7%	2	0.2%	2	0.8%	2	0.8%	2	0.5%	2
Texas	0.0%	7	0.0%	7	0.0%	7	0.0%	7	0.0%	7	0.0%	7	0.0%	7
<i>Other States' Avg.</i>	0.5%		0.3%		0.3%		0.1%		0.3%		0.3%		0.2%	
Local Property Tax														
Arkansas	0.1%	7	1.7%	8	3.0%	7	0.7%	8	2.8%	7	4.7%	6	3.8%	7
Kansas	0.2%	2	2.5%	5	2.1%	8	1.0%	6	2.4%	8	3.0%	8	2.3%	8
Louisiana	0.1%	6	2.7%	3	4.8%	3	1.2%	4	4.5%	3	7.6%	3	6.1%	3
Mississippi	0.2%	5	3.0%	2	5.3%	2	1.3%	3	5.0%	2	8.5%	1	6.8%	2
Missouri	0.2%	1	2.6%	4	3.5%	4	1.3%	2	3.7%	4	4.9%	5	5.3%	4
Oklahoma	0.1%	8	1.8%	7	3.1%	6	0.8%	7	2.9%	6	5.0%	4	4.0%	6
Tennessee	0.2%	3	2.2%	6	3.2%	5	1.1%	5	3.4%	5	4.3%	7	4.6%	5
Texas	0.2%	4	3.0%	1	5.3%	1	1.3%	1	5.1%	1	8.5%	2	6.8%	1
<i>Other States' Avg.</i>	0.2%		2.6%		3.9%		1.1%		3.9%		6.0%		5.1%	
Local Sales Tax														
Arkansas	0.0%	5	1.3%	5	0.9%	4	3.2%	5	0.7%	2	1.3%	2	1.1%	3
Kansas	0.0%	4	1.3%	4	0.8%	5	3.3%	4	0.4%	5	0.7%	6	0.6%	6
Louisiana	0.1%	2	2.7%	1	1.7%	1	6.3%	1	2.6%	1	4.5%	1	4.7%	1
Mississippi	0.0%	8	0.0%	8	0.0%	8	0.0%	8	0.0%	8	0.0%	8	0.0%	8
Missouri	0.1%	3	1.7%	3	0.9%	3	4.0%	3	0.5%	4	0.9%	4	0.7%	5
Oklahoma	0.1%	1	2.3%	2	1.4%	2	5.5%	2	0.6%	3	1.3%	3	1.0%	4
Tennessee	0.0%	6	1.2%	6	0.7%	6	2.7%	6	0.3%	6	0.6%	7	0.5%	7
Texas	0.0%	7	0.9%	7	0.6%	7	2.2%	7	0.3%	7	0.8%	5	1.3%	2
<i>Other States' Avg.</i>	0.1%		1.4%		0.9%		3.4%		0.6%		1.3%		1.3%	

Impact of Tax Credits

The business tax competitiveness results presented above do not include the impact of business tax credits. This section examines the additional impact of the major statutory credits on the ETRs by state and by industry. The credits included in the calculations below are those available statutorily, as opposed to negotiated credits that are determined on a case-by-case basis. Examples of credits included in the analysis are those that reduce the cost of new in-state capital investment, tax incentives to hire new employees and research and development spending credits.⁴ (Appendix C lists the credits that are included for each state.)

Table 5 presents estimates of the percentage point reduction in the combined state and local ETRs by industry from statutory credits related to business investment, job expansion, and research activities. As evident in Table 5, there is wide variation in the impact of tax credits on the total state and local ETR by state and by industry. Generally, the tax credits are more significant for manufacturing (15.2% average reduction) than for services investments (4.8% average reduction). Figure 5 compares the percentage reduction in before-credit taxes by state for manufacturing and services investments.

With the exception of the headquarters investment, Arkansas has similar credit offset percentages across the industries. Credit reductions to Arkansas ETRs range from 9.9% for renewable energy equipment manufacturing investments to 14.4% for research and development activities. For all industries, Arkansas's tax credits offset an average of 10.7% of the before-credit tax liability. This reduction is equal to the average reduction for the seven other states. The largest credit offsets are in Louisiana (15%) and Missouri (27%). Following the adoption of the margin tax in 2006, Texas eliminated general tax credits for margin taxpayers.

⁴ The impact of credits on the before-credit ETRs often depends upon limits on the size of combined business credits. For example, a state may limit the amount of credits that can be claimed to no more than 50% or 100% or claiming one credit may prohibit a taxpayer from claiming another credit. The BTCM calculations include the impact of these limits and restrictions.

Table 5
Percentage Reduction in Total State and Local Business
Effective Tax Rates Due to Statutory Credits

State	Headquarters	Research & Development	Durable Goods Manufacturing	Business Support Services	Food Product Manufacturing	Renewable Energy Equipment Manufacturing	Motor Vehicle Parts Manufacturing
Arkansas	-0.9%	-14.4%	-13.2%	-10.3%	-14.2%	-9.9%	-12.0%
Kansas	-0.2%	-9.0%	-15.4%	-2.2%	-2.3%	-21.6%	-18.4%
Louisiana	0.0%	-8.2%	-24.9%	-6.9%	-16.3%	-23.3%	-23.5%
Mississippi	0.0%	-5.0%	-12.3%	0.0%	-13.4%	-8.9%	-10.9%
Missouri	-0.1%	-33.2%	-45.7%	-13.5%	-18.7%	-35.5%	-42.2%
Oklahoma	0.0%	0.0%	-9.2%	0.0%	-10.6%	-7.9%	-13.7%
Tennessee	-0.4%	-11.4%	-12.0%	-10.8%	-14.0%	-11.0%	-13.3%
Texas	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
<i>Other States' Avg.</i>	<i>-0.1%</i>	<i>-9.5%</i>	<i>-17.1%</i>	<i>-4.8%</i>	<i>-10.8%</i>	<i>-15.5%</i>	<i>-17.4%</i>

Figure 5
Potential Reduction in Total State and Local Effective Tax Rate from Statutory Credits,
(Percentage Reduction in Pre-Credit Overall Effective Tax Rate)

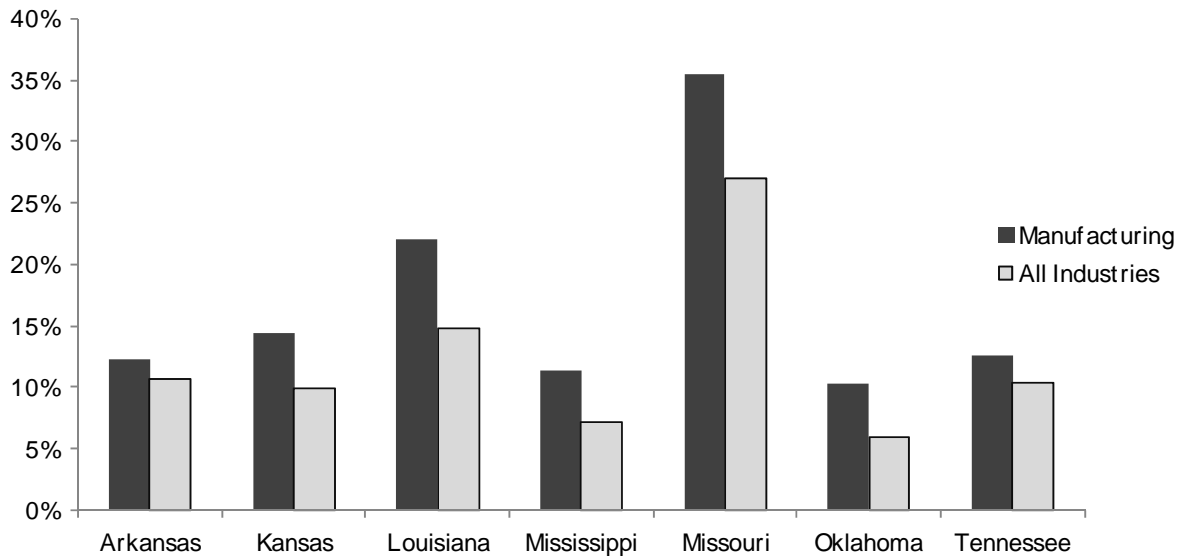


Table 6 presents the net ETRs for industries and states after the subtraction of statutory credits from the before-credit tax liabilities. A comparison of the ETR rankings before credits (Table 2) and after credits (Table 6) shows that credits in Arkansas do improve Arkansas’s business tax competitiveness, but the changes are generally large. Arkansas’s rankings are unchanged for the headquarters, food product manufacturing, and motor vehicle parts manufacturing investments. Arkansas’s tax competitiveness improves (drops) by one rank for research and development (from 4th to 5th highest), business support services (from 3rd to 4th highest), and renewable energy equipment manufacturing (from 3rd to 4th highest). For the durable goods manufacturing investment, Arkansas’s ranking improves by two places (from 2nd to 4th highest).

Table 6
State and Local Effective Tax Rates Net of Statutory Credits, by Industry and State

State	Headquarters		Research & Development		Durable Goods Manufacturing		Business Support Services		Food Product Manufacturing		Renewable Energy Equipment Manufacturing		Motor Vehicle Parts Manufacturing	
	ETR	Rank	ETR	Rank	ETR	ETR	ETR	Rank	ETR	Rank	ETR	Rank	ETR	Rank
Arkansas	4.7%	2	9.9%	5	9.2%	4	16.2%	4	8.2%	3	12.5%	4	10.6%	4
Kansas	4.6%	3	12.0%	2	8.1%	6	19.7%	1	7.9%	4	8.0%	7	7.2%	7
Louisiana	6.2%	1	12.7%	1	6.9%	7	14.3%	7	8.9%	2	13.5%	2	12.4%	2
Mississippi	1.5%	7	9.5%	6	10.3%	1	15.0%	6	9.2%	1	14.4%	1	12.0%	3
Missouri	4.1%	6	7.7%	8	5.0%	8	15.0%	5	6.5%	8	6.7%	8	5.9%	8
Oklahoma	4.4%	5	11.4%	3	9.2%	2	18.0%	2	7.2%	6	10.8%	5	8.7%	6
Tennessee	4.6%	4	11.1%	4	9.2%	3	16.8%	3	7.3%	5	9.9%	6	9.2%	5
Texas	0.4%	8	8.4%	7	8.7%	5	13.7%	8	6.5%	7	12.6%	3	13.6%	1
<i>Other States' Avg.</i>	3.7%		10.4%		8.2%		16.1%		7.7%		10.8%		9.9%	

Conclusion

The analysis of the effective state and local tax rates on selected new investments in Arkansas and seven comparison states provides important information needed to evaluate Arkansas's business tax competitiveness. Key study results find that:

- Arkansas business taxes, before credits, rank among the highest for five of seven industries included in the analysis. Compared to the all-industry average ETR for the other states included in the analysis, Arkansas's average ETR is 6.5% higher.
- The burden of the Arkansas state and local sales taxes, before credits, is higher than the burden of sales taxes imposed by every other state except Louisiana. State and local sales taxes represent 37% of the total state and local business tax burden in Arkansas, 20% higher than the sales tax share in the other states.
- Arkansas's ETRs for the corporate income tax are relatively high, partly due to the effect of the apportionment formula that applies a 50% weight to the in-state sales factor.
- Arkansas's ETRs for local property taxes are below the average for the other states.
- Business tax credits in Arkansas are competitive with tax credits in the comparison states.

The business tax burden estimates presented in this study can be used to evaluate how competitive Arkansas's state and local business tax system is for in-state investments and job creation. The results are summarized as effective tax rates on the selected investments, a measure that is widely used by businesses making location choices. This comparative information is important in understanding the competitiveness of Arkansas's current tax system and in evaluating proposed tax changes to improve the state's competitiveness.

Appendix A Tax Parameters by State and Tax Type

**Table A-1
State Business Entity Tax Characteristics**

State	Top marginal rate	Apportionment weighting	Special apportionment for selected industries	Business income tax base
Arkansas	6.50%	Double weighted sales	No	Corporate income
Kansas	7.00%	Equally weighted	Yes	Corporate income
Louisiana	8.00%	Equally weighted	Yes	Corporate income
Mississippi	5.00%	Single sales factor	Yes	Corporate income
Missouri	6.25%	Equally weighted	No	Corporate income
Oklahoma	6.00%	Equally weighted	No	Corporate income
Tennessee	6.50%	Double weighted sales	No	Corporate income
Texas	1.00%	Single sales factor	No	Modified gross receipts

**Table A-2
State and Local Sales Tax Rates**

State	State rate	Local rate	Total state and local tax rate
Arkansas	6.0%	1.8%	7.8%
Kansas	6.3%	1.8%	8.1%
Louisiana	4.0%	4.1%	8.1%
Mississippi	7.0%	0.0%	7.0%
Missouri	4.2%	2.3%	6.5%
Oklahoma	4.5%	3.3%	7.8%
Tennessee	7.0%	1.7%	8.7%
Texas	6.3%	1.5%	7.7%

Notes: Local tax rate is a statewide average based on local sales tax collection data; differential rates may apply to some types of business purchases.

**Table A-3
Effective Property Tax Rates**

State	Commercial structures	Industrial structures	Commercial equipment	Other industrial machinery and equipment
Arkansas	1.38%	1.38%	1.41%	1.41%
Kansas	2.90%	2.90%	3.00%	0.00%
Louisiana	2.14%	2.14%	2.29%	2.29%
Mississippi	2.41%	2.41%	2.56%	2.56%
Missouri	2.91%	2.91%	2.66%	2.66%
Oklahoma	1.26%	1.26%	1.57%	1.57%
Tennessee	2.89%	2.89%	2.16%	2.16%
Texas	2.32%	2.52%	2.41%	2.52%

Notes: Effective tax rates are from Minnesota Taxpayers Association, 50-State Property Tax Comparison Study, April 2011; rates are for the largest cities in each state.

Table A-4
State Franchise Tax Characteristics

State	Rate	Apportionment weighting	Franchise tax base
Arkansas	0.300%	Equally weighted	Capital stock
Kansas	-	-	-
Louisiana	0.300%	50% weighted sales	Capital stock
Mississippi	0.250%	50% weighted sales	Capital stock
Missouri	0.007%	100% weighted property	Capital stock
Oklahoma	0.125%	50% weighted sales	Capital stock
Tennessee	0.250%	Equally weighted	Capital stock
Texas	-	-	-

Appendix B Industry Descriptions

The following describes the industries (and North American Industry Classification System codes) included in the Arkansas business tax competitiveness analysis.

NAICS	Industry	NAICS Definition
551112	Offices of Other Holding Companies	This U.S. industry comprises legal entities known as holding companies (except bank holding) primarily engaged in holding the securities of (or other equity interests in) companies and enterprises for the purpose of owning a controlling interest or influencing the management decisions of these firms. The holding companies in this industry do not administer, oversee, and manage other establishments of the company or enterprise whose securities they hold.
5417	Scientific Research and Development Services	This industry group comprises establishments engaged in conducting original investigation undertaken on a systematic basis to gain new knowledge (research) and/or the application of research findings or other scientific knowledge for the creation of new or significantly improved products or processes (experimental development). The industries within this industry group are defined on the basis of the domain of research; that is, on the scientific expertise of the establishment.
33	Durable Goods Manufacturing	This U.S. industry comprises establishments primarily engaged in primary metal manufacturing, fabricated metal product manufacturing, machinery manufacturing, computer and electronic product manufacturing, electrical equipment, appliance, and component manufacturing, transportation equipment manufacturing, furniture and related product manufacturing, and other miscellaneous manufacturing.
561499	All Other Business Support Services	This U.S. industry comprises establishments primarily engaged in providing business support services (except secretarial and other document preparation services; telephone answering and telemarketing services; private mail services or document copying services conducted as separate activities or in conjunction with other office support services; monetary debt collection services; credit reporting services; repossession services; and court reporting and stenotype recording services).
311	Food Manufacturing	Industries in the Food Manufacturing subsector transform livestock and agricultural products into products for intermediate or final consumption. The industry groups are distinguished by the raw materials (generally of animal or vegetable origin) processed into food products. The food products manufactured in these establishments are typically sold to wholesalers or retailers for distribution to consumers, but establishments primarily engaged in retailing bakery and candy products made on the premises not for immediate consumption are included.
333611	Turbine and Turbine Generator Set Units Manufacturing	This U.S. industry comprises establishments primarily engaged in manufacturing turbines (except aircraft); and complete turbine generator set units, such as steam, hydraulic, gas, and wind.

NAICS	Industry	NAICS Definition
3363	Motor Vehicle Parts Manufacturing	This industry comprises establishments primarily engaged in manufacturing and/or rebuilding motor vehicle gasoline engines, and engine parts, whether or not for vehicular use. It also comprises establishments engaged in manufacturing: vehicular lighting and/or manufacturing and/or rebuilding motor vehicle electrical and electronic equipment, rebuilding motor vehicle steering mechanisms and suspension components (except springs), motor vehicle brake systems and related components, motor vehicle transmissions and power train parts, motor vehicle seating, seats, seat frames, seat belts, and interior trimmings, motor vehicle stampings, such as fenders, tops, body parts, trim, and molding, or motor vehicle parts and accessories.

Appendix C State and Local Tax Credits

The following are the tax credits included in the business tax competitiveness analysis for each state. The credits are the statutory credits available to general taxpayers.

ARKANSAS

Job Creation Credit (Advantage Arkansas)

- Non-refundable
- Payroll requirement for tier III of \$75,000
- Credit rate for tier III county of 3%

Retention Sales and Use Tax Credit (InvestArk)

- Non-refundable
- Credit rate of 6.5%

In-House Research Credits

- Non-refundable
- Credit rate of 20% of the increment in research expenditures

KANSAS

Research and Development Credit

- Non-refundable
- Credit rate of 6.5% of incremental R&D expenditures

Machinery and Equipment Credit

- Refundable
- Credit rate is 25% of the property taxes paid on commercial and industrial machinery and equipment

High Performance Incentive Program (Investment Credit)

- Non-refundable
- Credit rate is 10% of qualified business investment exceeding \$50,000
- Minimum investment and wage requirements

High Performance Incentive Program (Training and Education Tax Credit)

- Credit is equal to portion of investment in training that exceeds 2% of the businesses total payroll costs.

LOUISIANA

Jobs Creation Credit

- Non refundable
- Credit per employee is \$100

Ad Valorem Tax Credit (Inventory Tax)

- Refundable

Research and Development Tax Credit

- Refundable
- Credit rate is 8% of incremental R&D spending

Modernization Tax Credit (ITC)

- Refundable
- Credit rate is 5% of capital expenditures
- There is a \$10 million annual statewide cap on the program in credits awarded to projects

MISSISSIPPI

Jobs Tax Credit

- Non-refundable
- Credit rate is 5% of total eligible payroll

National and Regional Headquarters Credit

- Non-refundable
- Credit per employee vary from \$500 to \$2000 depending on wage level

Manufacturing Investment Tax Credits

- Non-refundable
- Credit rate is 5%, max credit is \$1,000,000

Ad Valorem Inventory Tax Credit

- Refundable
- Credit is based on the amount of ad valorem tax actually paid on the inventory

MISSOURI

Missouri Quality Jobs

- Refundable

Headquarters New or Expanding Business Facility Credit

- Credit rate per employee is \$100 and rate per \$100,000 investment is \$100
- Minimum jobs and investment requirements

TENNESSEE

Jobs Tax Credit

- Non-refundable
- Minimum jobs and capital investment requirements
- Credit per job created is \$4,500

Industrial Machinery Tax Credit

- Non-refundable
- Credit rate is 1% of investment in industrial machinery

Headquarters Tax Credit

- Minimum jobs and investment requirements
- Credit rate is 6.5% of state sales tax

OKLAHOMA

Investment/New Jobs Credit

- Non-refundable
- Credit is calculated as larger of : 1) 1% of the qualifying investment, or 2) multiplying \$500 per new employee

TEXAS

General tax credits were eliminated with the adoption of the Margins Tax in 2006.