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It Would be Good to be First

Governor Jack Markell and Director of Economic Development Alan Levin are canvassing the state meeting with individuals, business owners, academics and other community leaders to find ways to make Delaware more attractive to businesses.

When families are struggling mightily, why the focus on business? Because business creates jobs. More than ninety percent of Delaware's businesses are small businesses. Further, nearly 50 percent of Delaware's workforce is employed by small businesses.

As the state seeks to do what it can, separate from any misconceived federal policy du jour being debated in Washington, a focus on improving Delaware's economic competitiveness is the right priority. Making Delaware a great state for business makes Delaware a great state for families and workers.

We don't need the state's leaders traversing the state to find the solution. Even in these difficult times, there is a preponderance of evidence pointing policymakers in the right direction.

This evidence shows that Delaware should eliminate, or at the very least reduce, its Gross Receipts Tax.

Opponents of such a policy and legislators wondering how they will balance the budget will call this idea crazy when there is an estimated $337 million budget shortfall for fiscal year 2011 and a $50 million shortfall in the budget passed last June.

Put aside the fact that there is nothing stopping the General Assembly from calling a special session and dealing with this problem now.

Also put aside that the goal of the General Assembly is not to pass a balanced budget. Yes, that is something they are required to do. The broad goal of the General Assembly is to implement policies that will benefit the state of Delaware.

The simple fact is corporate taxes, whether they are a Corporate Income Tax or a Gross Receipts Tax, are an issue of economic competitiveness – both regionally and globally.

While Delaware ranks 8th in the Tax Foundation's 2010 Business Tax Climate Index, if the state is to improve its standing and performance, the state needs to have a competitive advantage to attract new businesses and grow already existing businesses.

Improving this climate will not only help create new businesses within the state's borders, but it can also help make Delaware attractive to the pool of firms looking to relocate. As noted by the Tax Foundation, "Although the market is now global, the Department of Labor reports that most mass job relocations are from one U.S. state to another, rather than to overseas locations."

By separating itself from other states – whether it is neighbors in the Mid-Atlantic region or a state on the west coast – Delaware can differentiate itself and put up a bright and shiny billboard alerting states that it is in their interest to set up shop here.

It should be intuitive that taxes matter to businesses. It should be obvious that businesses create jobs. Policies that are pro-business lead to job creation and retention and impact decisions on where a company invests for the future. Further, policymakers must come to understand that taxes on business are passed through to consumers (higher prices) and workers (lower wages or fewer jobs).

The simple beauty of this concept is it casts a broad net for the state. Delaware shouldn't be chasing one industry or another, whether said industry is green, black, blue or purple. There is a better way than tax incentives or subsidies targeted to one industry or another. That yellow brick road is to improve the business climate across the board.

There are looming threats to Delaware's global standing as the corporate capital of the world. Nevada and South Dakota have implemented policies to make their states more attractive to business, and there is federal legislation that would nationalize incorporation policy and chop of Delaware's competitive advantage at the knees.

Yes, Delaware still has the Chancery Court with decades of case law. Yes, Delaware has a far superior geographic location as compared to Nevada and South Dakota. But, is that enough? The most important issue is for Delaware to have a stable and low cost environment that allows the market to work.

Is Delaware efficient enough in its government-led economic endeavors? Is the state's lackluster education system too much of a deterrent?

There is little doubt that improving the state's public education system is one of the most important undertakings that can be accomplished to truly boost the state's competitiveness. Unfortunately, education reform won't happen overnight – or over the course of a couple years.

Thus, taxes become the priority. With this focus, lawmakers can change policy to have a more immediate impact. This is not to say that the other improvements shouldn't be pursued, but that changes can be made to have a more immediate impact.

Currently, only Kentucky, Minnesota, New Hampshire, Delaware and Ohio have both a Gross Receipts Tax and a Corporate Income Tax. If a repeal of the Gross Receipts Tax won't be considered, at the very least, legislators should allow deductions from the Gross Receipts Tax for employee compensation costs and costs of goods sold.

Writing in *The New York Times* in June 2008, Harvard University economist Greg Mankiw stated, “The ultimate payers of the corporate tax are those individuals who have some stake in the company on which the tax is levied. If you own corporate equities, if you work for a corporation or if you buy goods and services from a corporation, you pay part of the corporate income tax. The corporate tax leads to lower returns on capital, lower wages or higher prices — and, most likely, a combination of all three.”[1]

Indiana University professor John Mikesell offers more evidence when he writes, “A gross receipts tax does not treat equally situated businesses the same. Firms with the same net income will face radically different effective tax rates on that income, depending on their profit margins. Low-margin firms will be at great disadvantage relative to higher-margin firms, regardless of their overall profitability. Many new and expanding firms have low margins (or even are initially unprofitable) and the gross receipts tax reduces the chance that these firms will survive. This also is not consistent with a climate for growth and development.”

He continues, “A gross receipts tax is a stealth tax with its true burden hidden from taxpayers. Hiding the cost of government is inconsistent with efficient and responsive provision of government services and contrary to the fundamentals of democratic government.”

As any businessman knows, profits are never guaranteed. Yet, the gross receipts tax is a tax on receipts regardless of a business’ profitability. If an entrepreneur has $5 million in receipts and $5 million in costs, he still pays the tax.

How is that for common sense?

The Caesar Rodney Institute is a 501(c)(3) non-partisan research and educational organization and is committed to being a catalyst for improved performance, accountability, and efficiency in Delaware government.

[1] Mankiw, Greg. “The Problem with the Corporate Tax.” *The New York Times*, June 1, 2008. Accessed at http://www.nytimes.com/2008/06/01/business/01view.html.