

The State of State (and Local) Tax Policy

SPECIFIC STATE AND LOCAL TAXES

How do state and local corporate income taxes work?

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A. Forty-four states and the District of Columbia levy corporate income taxes. Ohio, Nevada, Texas, and Washington tax corporate gross receipts. South Dakota and Wyoming had no corporate income tax or gross receipts tax in 2020.

HOW MUCH REVENUE DO STATE AND LOCAL GOVERNMENTS RAISE FROM CORPORATE INCOME TAXES?

State and local governments raise a small share of revenue from corporate income taxes (table 1). States collected \$45 billion from corporate income taxes in 2017, or 3 percent of their own-source general revenue. (Own-source revenue excludes intergovernmental transfers.) Local governments collected \$8 billion from corporate income taxes in 2017, or 1 percent of own-source revenue. The Census Bureau includes the District of Columbia's \$554 million of revenue in the local total. The local total is low partly because only seven states allowed localities to levy a corporate income tax. Among them, New York (and mostly New York City) was responsible for 81 percent of all corporate income tax revenue collected by local governments in 2017.

TABLE 1

State and Local Corporate Income Tax Revenue 2017



	Revenue (billions)	Percentage of own source general revenue
State and local	\$53	2%
State	\$45	3%
Local	\$8	1%

Source: Urban-Brookings Tax Policy Center, "State and Local Finance Initiative, Data Query System."

Note: Own-source general revenue does not include intergovernmental transfers.

At the state level, New Hampshire collected 13 percent of state own-source general revenue from corporate income taxes in 2017, the highest share of any state. New Hampshire does not have a broad-based individual income tax or general sales tax. Corporate income taxes were also more than 5 percent of state own-source revenue in California, Illinois, Massachusetts, New Jersey, and Tennessee. Among the 44 states with a corporate income tax, the lowest percentage was in, New Mexico, North Dakota, Oklahoma, and South Dakota, which each collected only 1 percent of revenue from the tax in 2017.

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WHAT INCOME IS TAXED?

Most states use the federal definition of corporate income as a starting point. However, states deviate from federal rules in some instances. For example, when the federal government enacted “bonus depreciation” in 2008, which allowed businesses to deduct a larger portion of capital investment in the year the investment is first made, many states did not enact conforming rules.

While states benefit from federal tax administration and enforcement by following the federal definition of corporate income, they must take additional steps to determine what portion of multistate corporation income is taxable in their states.

States must first establish whether a company has “nexus” in the state, that is, enough physical or economic presence to owe tax. Next, they must determine the taxable income generated by activities in the state. For example, multistate companies often have subsidiaries in no-tax or low-tax states that hold intangible assets such as patents and trademarks. The rent or royalty payments to those wholly owned subsidiaries may or may not be considered income of the parent company operating in another state. Finally, states must determine how much of a corporation’s taxable income is properly attributed to that state.

Until 20 years ago, most states used a three-factor formula based on the Uniform Division of Income for Tax Purposes Act to determine the portion of corporate income taxable in the state. That formula gave equal weight to the shares of a corporation’s payroll, property, and sales in the state. Now, however, most states use formulas that either weight more heavily or rely exclusively on sales within the state to apportion income. In 2020, only five states used the traditional three-factor formula, while 26 states and the District of Columbia relied exclusively on sales in their formula. By using the portion of a corporation’s sales rather than employment or property to determine tax liability, states hope to encourage companies to relocate or to expand their operations within these states.

HOW MUCH DO CORPORATE INCOME TAX RATES DIFFER ACROSS STATES?

In 2020, top corporate income tax rates ranged from 2.5 percent in North Carolina to 12 percent in Iowa (figure 1). Six states (Alaska, Illinois, Iowa, Minnesota, New Jersey, and Pennsylvania) had top corporate income tax rates at or above 9.0 percent. Fourteen states had top rates below 6.0 percent.

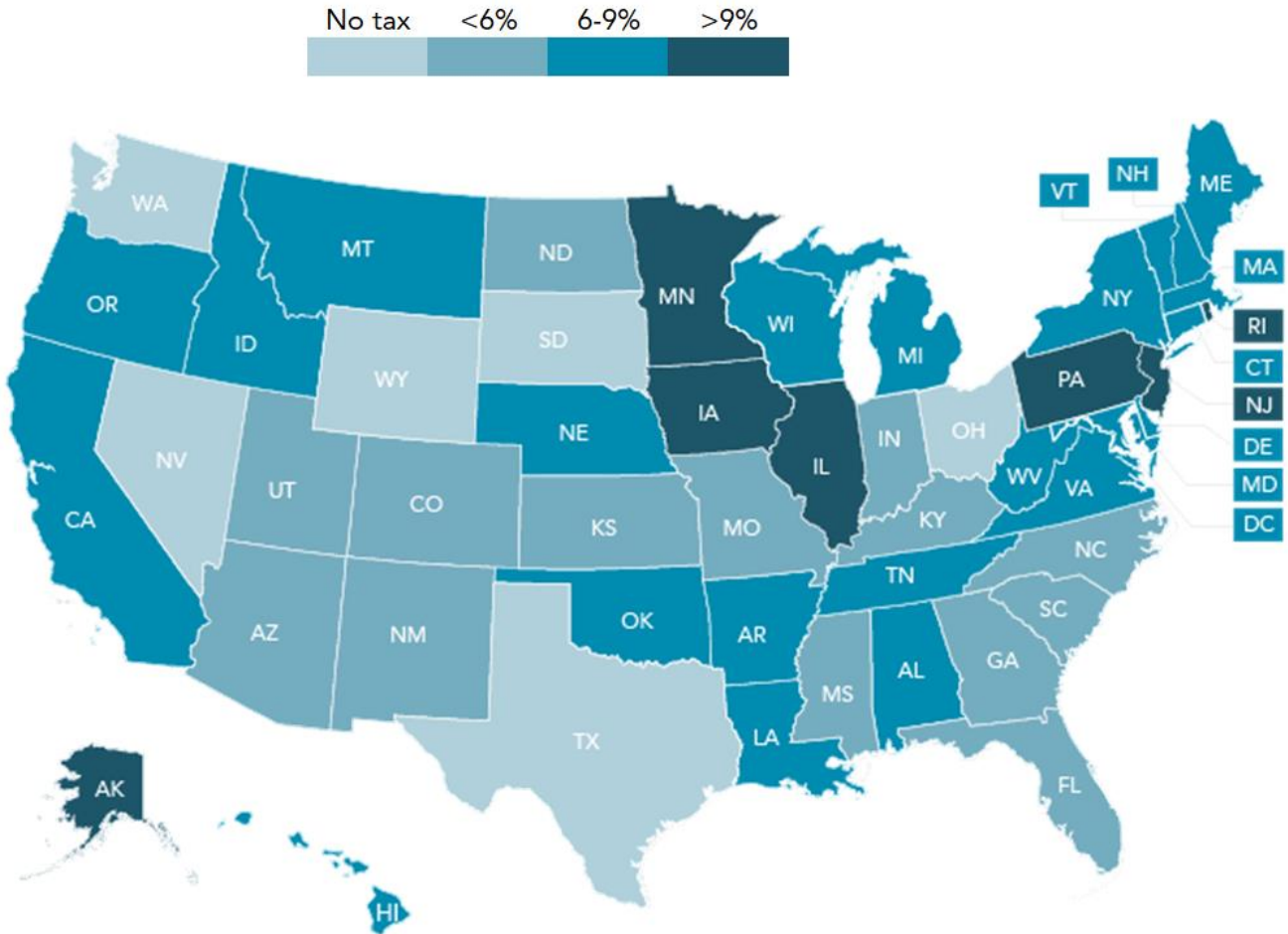
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FIGURE 1

Top State Corporate Income Tax Rates 2020



Source: Federation of Tax Administrators (FTA), Tax Rates (as of January 1, 2020).

Note: Ohio and Texas have gross receipts taxes; various states apply different rates for financial institutions, including Ohio and South Dakota, which do not otherwise tax corporate income.

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Data Sources

Urban-Brookings Tax Policy Center. [State and Local Finance Data: Exploring the Census of Governments](#). Washington, DC: Urban-Brookings Tax Policy Center.

———. *Statistics*. “[State Corporate Income Tax Rates: 2002 to 2018](#).” Washington, DC: Urban-Brookings Tax Policy Center.

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Further Reading

Urban Institute. [State Tax and Economic Review](#). State and Local Finance Initiative. Washington, DC: Urban Institute.

Francis, Norton. 2013. "[Business Franchise Taxes in the District of Columbia](#)." Washington DC: Urban-Brookings Tax Policy Center.

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