The Vermont Legislative Research Shop

The Role of Taxes in Business Location Decisions

This report focuses on the findings of research by economists and policy experts into the role that taxes, including capital gains tax rates, have on business decisions to locate and relocate. For research on state and national policies on capital gains taxes, a history of capital gains tax policy and arguments for and against capital gains taxes see the analysis prepared by Sara Teachout of The Vermont Legislative Joint Fiscal Office (http://www.leg.state.vt.us/JFO/Reports/Taxation%20of%20Capital%20Gains.pdf).

In general, the extant literature on business decisions suggests that state and local taxes (and, conversely, tax incentive packages, including capital gains exemptions) are but one of a number of factors that businesses consider when deciding where to locate or relocate. Furthermore, while state and local tax burdens are considered when businesses move, they are usually rated by the business decision makers as being of secondary importance in such decisions. According to one published study, "cost factors" in location decisions are not limited to quantitative analysis but also include the measurement of intangible and qualitative factors, such as

> risks associated with the costs or demand estimates, business climate of locations, education of the labor force, attitudes of the workforce toward productivity, change, unionization, cultural attributes of the location, local and state government attitudes, commuting distances for workers and managers, and impact of other businesses in the area (Schemenner and Cook 1987).

According to Professors Saiz and Clarke's review of the literature on the subject, many scholars find that, at best, "(tax) incentives work about 10 percent of the time and are simply a waste of money the other 90 percent." This conclusion seems to be consistent with research findings going back to the 1960s. A study by Benjamin Bridges in 1965 found that a surprisingly small number of employers included taxes as primary reasons for choosing to invest. Another study by Bennet Harrison and Sandra Kantor (1978) found that in every case they studied, businesses took actions according to their own plans, and then applied for tax credits after learning of their existence.

There is a lack of consensus among the experts with regard to capital gains taxes, leaving state policymakers with little strategic information or guidance in making policy decisions. An article on the subject by two economics professors concluded:

> The debate concerning the responsiveness of capital gains realizations and revenues to tax rates is far from settled; moreover, there appears to be an increased realization that all

Fisher states this data shows that “to argue a causal relationship at this level of screening between the level of taxation and a decision to locate in any of the communities under consideration would appear most difficult, given the low priority and minimum cost impact associated with taxation. In addition to a determination of ‘geographically variable operating costs,’ pertinent operating conditions and quality of life factors are also considered during this step, so that at its conclusion only a handful or even fewer locations remain” (Fisher 1997, p. 79).

The final phase in selecting a location compares the greatest advantages and disadvantages of all locations under consideration, utilizing all information and decisions gained from the process detailed above. This comparison includes an evaluation and comparison of all taxes and tax abatements. Other factors, however, are included as well and just as crucial. For example, the services the company will receive for its tax dollars are carefully measured. In this study, education was the single most important service, exceeding the value of all other services combined. Second in importance was highway adequacy, then public safety and then infrastructure. Operating conditions and quality-of-life factors are also gathered in this final selection process (Fisher 1997).

Fisher concludes that the only way taxes alone could sway a location decision is when relocation occurs within an autonomous geographic area, where labor, transportation, and utility costs are consistent.

> In summary, site selection data do not suggest any correlation between low taxes and positive economic growth, or between high

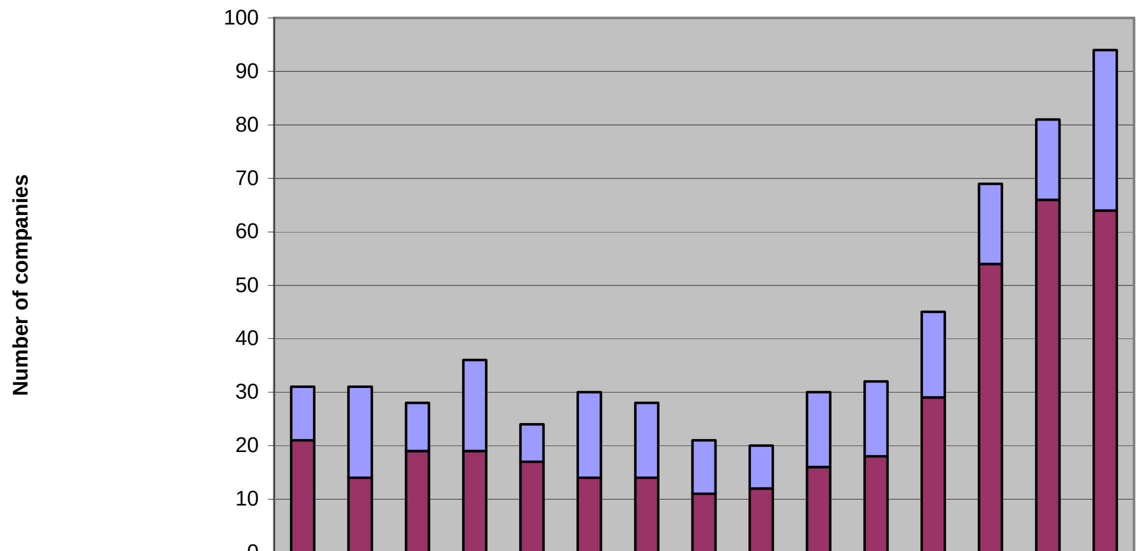
A survey done by the same author in 1987 found, similarly, that "higher technology firms emphasized the importance of ambiance and availability of labor and property in location decisions" (Galbraith and De Noble, 1988).

Business Relocation and Employment Change in Vermont

The National Establishment Time Series (NETS) Database, a longitudinal file measuring employment change and growth among intrastate businesses (a long-term project of Walls & Associates in conjunction with Dun & Bradstreet) shows that:

1. The number of businesses moving out of Vermont from 1990-2004 was nearly the same as the number moving in;
2. Nearly as many companies move into Vermont from low tax states as move to low tax states; and
3. Employment change is driven primarily by business contraction and expansion, and by business start-ups and closures.

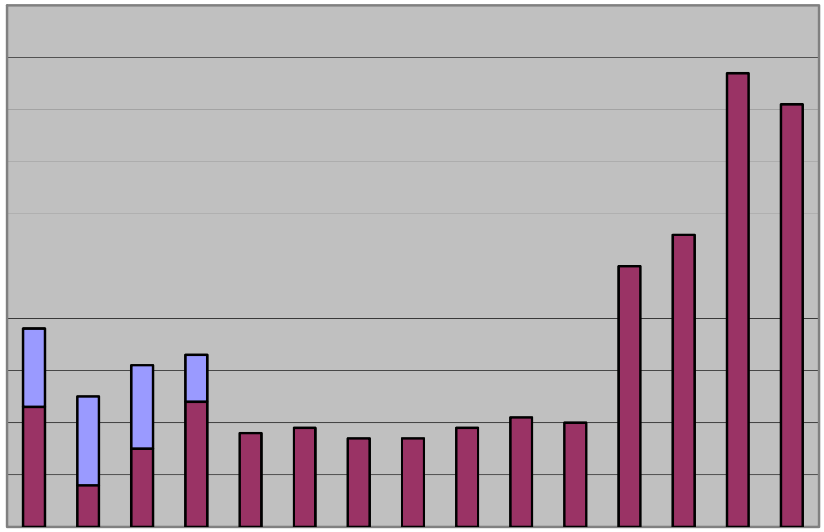
Figures 1 through 5 illustrate these findings.



	90	91	92	93	94	95	96	97	98	99	2000	2001	2002	2003	2004
5 or more employees	10	17	9	17	7	16	14	10	8	14	14	16	15	15	30
<5 employees	21	14	19	19	17	14	14	11	12	16	18	29	54	66	64

Year

Figure 1: Number of companies leaving VT by year and size of firm, 1990-2004
Source: National Establishment Times Series (NETS) Database. April, 2006. Addendum to Phase 9 of the Job Gap Study.



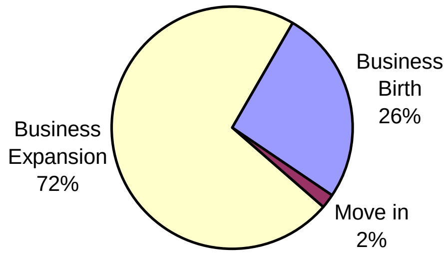


Figure 4: Sources of VT job creation, 2000-2004
Sources: VT Department of Labor; National Establishment Times Series (NETS) Database. April, 2006. Addendum to Phase 9 of the Job Gap Study.

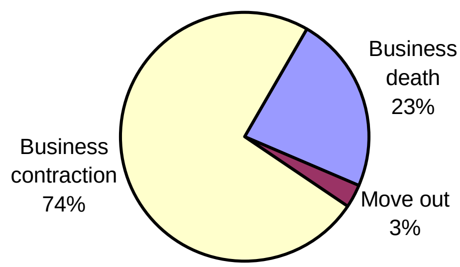


Figure 5: Sources of VT job loss, 2000-2004
Sources: VT Department of Labor; National Establishment Times Series (NETS) Database. April, 2006.

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