PAYING TAXES TO THE BOSS:

HOW A GROWING NUMBER OF STATES SUBSIDIZE COMPANIES WITH THE WITHHOLDING TAXES OF WORKERS

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Executive Summary

As Americans file their state income tax returns this month, some may dislike paying taxes but most take heart from the fact that their dollars support public schools and colleges, roads and transit, health care and public safety. However, for some people, the personal income taxes they see deducted from their paychecks aren't supporting public services. Indeed, this is true for workers at more than 2,700 companies in 16 states.

Nearly $700 million is getting diverted each year. And it is very unlikely that the affected workers are aware, given that no state requires that the diversion be disclosed on pay stubs.

Where is the money going? To the employers of those workers. A growing number of states are diverting revenue traditionally devoted to funding essential government services to pay for lavish subsidy awards to corporations for job creation or sometimes simply job retention. The practice of redirecting large portions of the state personal income tax (PIT) withholding deducted from paychecks means many workers are, in effect, paying taxes to their boss.

Along with the worker deception, many of the programs are entwined with two of the most controversial practices in economic development: the economic war among the states and job blackmail. Many PIT diversions are paying corporations to simply relocate existing jobs from one state to another; others are used by states when they capitulate to companies that threaten to move to another state.

These are the findings of the first systematic examination of state economic development programs derived from withholding taxes and PIT revenue. Good Jobs First has identified 22 PIT-based programs in 16 states that together involve the annual diversion of about $684 million in revenue. They are:

- Colorado: Job Growth Incentive Tax Credit
- Connecticut: Job Creation Tax Credit
- Georgia: Job Tax Credits
- Georgia: Research and Development Tax Credit
- Illinois: Economic Development for a Growing Economy (EDGE) Tax Credit
- Indiana: Economic Development for a Growing Economy (EDGE) Tax Credit
- Kansas: Promoting Employment Across Kansas (PEAK) Program
- Kentucky: Kentucky Business Investment (KBI) Program
- Kentucky: Kentucky Industrial Revitalization Act (KIRA)
- Maine: Employment TIF (ETIF)
- Maine: Shipbuilding Facility Credit

- Mississippi: Impact Withholding Rebate Program/Existing Industry Withholding Rebate Program
- Mississippi: Mississippi Advantage Jobs Incentive Program
- Missouri: Quality Jobs Program
- Missouri: The Missouri Automotive Manufacturing Jobs Act
- New Jersey: Business Employment Incentive Program (BEIP)
- New Mexico: High Wage Jobs Tax Credit
- North Carolina: Job Development Investment Grants (JDIG)
- Ohio: Job Creation Tax Credit
- Ohio: Job Retention Tax Credit
- South Carolina: Job Development Credits
- Utah: Economic Development TIF (EDTIF)

Some of the programs have been around since the 1990s, but in recent years more states have resorted to PIT-based subsidies. Indeed, six of the 22 programs (and portions of others) were enacted since the beginning of 2009.

The programs work in various ways. Some allow employers to immediately retain (and never remit to the state) a large portion of the withholding taxes generated by designated new or retained workers. Some provide cash rebates or grants calculated the same way. Others provide credits against corporate income taxes or other business levies, with the value of those credits based on the withholding taxes of new or retained workers. (Some of these credits are cash-refundable if the credit exceeds the company's tax liability.)

The share of withholding taxes diverted into subsidies can be as high as 100 percent, as is the case with programs such as the EDGE tax credits in Illinois and Indiana, and the duration can be as long as 25 years, as is the case with Mississippi's Withholding Rebates. A total of 12 programs divert 75 percent or more of withholding, and 18 provide ten or more years of subsidies.

These large percentages and the absence of ceilings on individual deals in many programs can translate into high dollar costs. The most expensive of the programs is New Jersey's BEIP, which in FY2011 approved new grants worth up to $73.2 million over their multi-year terms and disbursed $178 million during the year for previously approved contracts.

The states with the largest number of current recipient companies are: Ohio (567), Kentucky (509), Illinois (315), New Jersey (306) and Indiana (283).

Many of the PIT-based programs have played a central role in perpetuating the economic war among the states—the competition to win major investment projects that has led to the excessive use of subsidies. None of the programs prohibit their use in interstate job piracy and some openly practice it.

Last year, for example, Kansas provided $47 million in PEAK subsidies to AMC Entertainment to get the movie theatre chain to move its headquarters from downtown Kansas City, Missouri about 10 miles across the state line to suburban Leawood. And a Job Development Investment Grant worth up to $16 million was part of the subsidy package that North Carolina gave Chiquita Brands to move its headquarters to Charlotte from Cincinnati.

Other PIT-based subsidies have paid job blackmail. Last year, Motorola Mobility (now part of Google) got state officials in Illinois to provide $100 million in EDGE tax credits over ten years to keep its headquarters in the Chicago suburb of Libertyville. Moreover, these were newly enhanced EDGE benefits, meaning that the company can immediately keep employee withholding taxes rather than crediting them against its state corporate income tax liability. Later in the year, Sears got a 10-year, $150 million conventional EDGE deal.

Policy Options

For three reasons detailed in our Preface, our policy recommendation is that states seriously consider abolishing PIT-based subsidy programs. Until that happens, we recommend Truth in Taxation: that companies receiving PIT-based subsidies be required to disclose the details of how much money is going where on the pay stubs of affected workers.