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The Center for Public Policy and the Social Sciences

Policy Research Shop

Is New Hampshire Friendly to Business?

An Analysis of New Hampshire's Business Tax Environment

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Taxes
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EXECUTIVE SUMMARY

This report's goals are to evaluate how New Hampshire's tax and incentive structure affects business investment in the state, compare it to other states', and discuss policies that could enhance business investment in different areas of New Hampshire's economy. To evaluate New Hampshire's business environment, we looked at the existing taxes and incentives affecting business in the state. We compared New Hampshire to neighboring states: Vermont, Maine, and Massachusetts, and to other states with similar tax rates and incentives to New Hampshire's. Once we thoroughly understood New Hampshire's tax and incentive policies, and how they compared nationally, we incorporated economists' and academics' evaluations of different tax levels. Our research suggests that a state should know its specific policy goals before making any tax code changes. There is no perfect tax bundle, rather bundles can be designed specifically to meet particular policy goals such as an increase in small business start ups or increased employment in a struggling county.

1. INTRODUCTION

Many variables shape the climate for businesses in a state. Companies do not just look at the business profits tax or the price of land, but at a composite of many factors that will determine the "cost of occupancy".¹ A key premise of our study was that the tax environment and incentive programs, as well as other non-governmental factor costs, do have an effect on business investment decisions. Most scholars accept premise. Even if they believe aspects of the tax structure do not directly affect the economy, they agree that the broader tax environment does affect companies' decisions on where to locate their business activities. Intel Corp. provides one prominent example of a major corporation relocating to a state that is more business friendly. Intel was drawn to relocate from California, which had become "expensive" according to the Intel spokesman, to Arizona, where the government had restructured its apportionment formula.² While not an effect of any specific state tax rate, Intel's move demonstrates that companies pay attention to cost differences across state lines and locate accordingly.

This report will begin with a discussion of the relative importance, or weights, of different taxes when determining effects on businesses. Debates in state houses and think tanks across the country revolve around which taxes are most harmful for the economy. Some organizations, including the OECD and the Tax Foundation, have done studies on this topic on a wide scale and have determined their own rankings for tax weights. Other studies, which will be discussed later in the report, focus on the effects of specific taxes on specific sectors of the economy.

Next, we will break New Hampshire's tax structure into categories, (including individual taxes) that have direct effects on businesses and business activity levels in the state. This will include an analysis of the Business Profits Tax. The Business Profits Tax is a major



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component of New Hampshire's tax system, and probably the most frequently criticized tax in the state. However, we will discuss how this tax is not the only tax policy affecting businesses and how the lack of a general sales tax or personal income tax in New Hampshire is greatly beneficial.

Once we have discussed the variety and effects of taxes in New Hampshire, we will move on to analyze the positive and negative effects that can result from cutting or increasing these taxes. State revenue is a much more targeted aid to the economy than tax cuts. Tax cuts can help the economy grow overall, but will have different effects in different areas. It is impossible to say that decreasing taxes by X will increase jobs in every sector by Y. However, it is much more plausible to say that allocating X tax revenue to employment programs will create Y new jobs. State revenue is used for important state programs, and cutting the budgets of these programs, such as public education, can have more negative effects on the economy than a heavy tax might. On the other hand, high taxes can be debilitating to the sectors most directly affected by the given tax. Thus we also analyzed econometric studies on more specific aspects of the economy and the different factors that determine growth.

Finally we will discuss tax incentives as a targeted method to increase business activity in a specific area or to encourage specific business habits. We compared New Hampshire's incentive and credit policies to others around the country and outlined programs from other states that could be molded to fit New Hampshire and the state's policy goals.

2. TAX WEIGHTS

A study done by the Organization for Economic Co-operation and Development (OECD) concluded that, of all possible tax types, corporate income taxes were the most harmful to economic development.³ However, when the Tax Foundation compared business environments by state, the organization compared five taxes, of which they ranked the corporate income tax third, weighted at 19.35 percent, below individual income tax and sales tax.⁴ Because of the lack of a general sales tax or personal income tax in New Hampshire, the Tax Foundation rated New Hampshire as the seventh best state for businesses. So the question becomes, how important is the corporate income tax? Is the tax the leading factor of economic development, as the OECD suggests? Or is the tax a lesser factor, like the Tax Foundation believes?

The Tax Foundation determined their weights by looking at the variance across states of each tax's rates. This method was justified by the argument that "businesses that are comparing states for new or expanded locations must give greater emphasis to tax climates when the differences are large," and that "component indexes in which the 50 state scores are clustered together, closely distributed around the mean, are those areas of tax law where businesses are more likely to de-emphasize tax factors in their location decisions".⁵ The Tax Foundation essentially argues that businesses and consumers pay



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proportionally much more attention when a given tax rate is high in one state and nonexistent in the neighboring state than if the decision is between states with only slight differences in sales tax. For example, many residents of Washington State, which has a sales tax minimum of seven percent, cross the border to Oregon, which has no sales tax, to get their shopping done. A business deciding between locations in the two states may pay more attention to this than to other, smaller variances in tax rates. States' recognition of this fact was indicated by an increase in tax holidays this year, with 19 states in total sponsoring sales tax free shopping days.⁶

On the other hand, the OECD argues that high corporate income tax rates severely discourage investment by firms in a given area, especially foreign direct investment, as the cost of user capital is dramatically increased in states with high corporate taxes. They argue that corporate income taxes are the main criteria that businesses look at when deciding where to invest their money.⁷ Therefore, they argue, a state should keep its corporate income tax as low as possible to cultivate an open market and facilitate economic development. While they disagree on the weight given to individual taxes, both institutions did agree that simplicity in tax law is optimal; the OECD report said, "Complex corporate tax codes can cause high tax compliance costs for firms and high administrative burdens for governments, which absorb resources that could be used for productive activities, causing productivity and efficiency losses".⁸ The Tax Foundation lowered rankings for states with regulations or standards that were not consistent with those of the federal government.⁹ Because there is little academic consensus for which type of evaluations to use or how heavily to weigh a given taxes, we have looked at all taxes or programs that we believe have relevant direct or indirect effects on businesses in New Hampshire.

3. TAX STRUCTURE

3.1 Taxes on Businesses

3.1.1 Business Profits Tax

In 2009 the Business Profits tax brought in revenue of over \$305,000,000.¹⁰ The business profits tax rate, applied to all business activity within the state, has at times been as high as 9.56 percent, but is currently fixed at a rate of 8.5 percent. This is the 11th highest corporate income tax in the country, according to the Tax Foundation. Academic consensus suggests that while high corporate income taxes have a negative effect on a state's economy, the magnitude of that effect is difficult to decipher. The effect varies widely by sector, and depends on the use of the revenue from the tax.¹¹ Some sectors can benefit greatly from employment programs or incentives that are funded by tax revenues, but sectors that are not affected by many state programs will benefit more from tax cuts. Additionally some sectors are more affected by corporate income taxes than others because of the size or structure of the businesses. For example, small start



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ups (discussed in detail later in the brief), are not immediately concerned with the Business Profits tax. New Hampshire's tax is quite high compared to other states' in the region.

New Hampshire's approach is probably most similar to that of Massachusetts, which currently has a flat 8.75 percent rate. Massachusetts however is lowering its corporate income tax from 8.75 percent to 8.25 percent in tax year 2011. Massachusetts's income tax will drop further to 8.0 percent in 2012.¹² Already, the Massachusetts Department of Revenue has reported that "the corporate and business tax collections have posted strong growth in the first five months of FY11, with a baseline growth of 32.4 percent through November compared with a decline of 0.9 percent baseline in FY10".¹³ Although more of this growth is likely from economic revitalization after the crisis than from a decrease in tax rates. Both Maine and Vermont have progressive corporate income taxes that have lower rates for most categories. Maine's corporate income tax has four income brackets with rates ranging from 3.5 percent for the lowest bracket (profits from \$0-\$25,000) to 8.93 percent for the highest one (profits over \$250,000).¹⁴ Any company that earns less than \$250,000 has a corporate income tax rate below that of New Hampshire's. Likewise, Vermont has three income brackets with different rates: companies earning up to \$10,000 in profits pay a six percent corporate income tax, companies that profit \$10,000-\$25,000 pay seven percent, and companies that garner over \$25,000 in profit pay 8.5 percent.¹⁵

3.1.2 Business Enterprise Tax

The business enterprise tax rate is relatively low, only 0.75 percent, and is levied on a wide tax base of all interest, dividends, and wages paid or accrued. Even with a relatively low rate, this tax brought in revenue of \$174,855,792 in 2009, and \$222,225,230 in 2008.¹⁶ These numbers suggest that the tax base for the business enterprise tax, which is described as the "enterprise value" of a business, is significantly larger than the tax base for the business profits tax.¹⁷ This difference indicates that a small increase in the tax rate of the business enterprise tax would bring in a greater increase in revenue than a small increase in the business profits tax and would be a much larger burden on businesses. On the other hand, a decrease in the tax rate would severely decrease the revenue that the state received and significantly reduce the tax burden on businesses. A business enterprise tax is not a common tax; New Hampshire is the only state in the surrounding area with this kind of tax. Unfortunately this tax is one of the largest reasons for New Hampshire's low ranking in the Tax Foundation's evaluation of national corporate income tax structures. In a speech to New Hampshire state lawmakers in 2009, Tax Foundation president Scott Hodge stated that the Business Enterprise Tax made New Hampshire's already expensive tax system even more onerous and confusing for businesses in the state.¹⁸



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3.1.3 Net Operating Loss and Depletion Schedule Policy

An unusual aspect of the state's tax policy is New Hampshire's limit on carry-forwards for Net Operating Loss (NOL) deductions. To clarify, a Net Operating Loss occurs when "a company's allowable tax deductions are greater than its taxable income."¹⁹ In these situations, a company is sometimes allowed to receive the sum of this "negative taxable income" as a payment drawn off of previous taxes paid (carry-back), or it can subtract the sum from future tax liabilities (carry-forward).²⁰ These mechanisms are used to ensure that the income tax is being assessed on a business's "average profitability."²¹

Currently, New Hampshire only allows NOL carry-forwards, not carry-backs.²² This policy is not well-regarded because some believe that it reduces the NOL deduction's ability to "level the playing field among cyclical and non-cyclical industries".²³ To execute a carry-forward, a company must first attempt to offset its Net Operating Loss in a given year with profits accrued in the three years prior to the loss.²⁴ If the loss is not completely eradicated, then the company is allowed to (as of 2005) carry a maximum of \$1,000,000 forward for up to ten years.²⁵ The carry-forward limit is a NOL regulation that is rarely seen in other states (Pennsylvania is actually the only other state to have such a restriction).

New Hampshire's depletion schedule policy also complicates things for businesses. The state's deduction of depletion schedule does not fully comply with the federal depletion schedule, and as the Tax Foundation argues, the more a state's standards and methods differ from the national structure, the larger the burden on businesses in the state becomes.²⁶ While a depletion schedule only determines the rates at which companies owning and producing natural resources can claim deductions for depletion of their supply, having a different schedule than that of the federal government can make the tax process more complicated. Additional complications mean more expenses for businesses with economic interests in natural resources.²⁷

3.2 Taxes on Factors

3.2.1 Property Tax

In New Hampshire, there are both state and local property taxes. The revenues of local property taxes go directly to local school districts while the state property taxes are distributed throughout the state's public education systems. As the property tax is public education's main supply of income, the property taxes in New Hampshire are relatively high. In fact, of the \$2,696,787,351 of revenue for public education in New Hampshire in the 2008-2009 fiscal year, state and local property taxes accounted for approximately 68 percent.²⁸ While New Hampshire does provide credits and exemptions for the property tax, none apply to or reduce the tax burden of businesses.²⁹



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However, New Hampshire's ranking in the Tax Foundation's Property Tax Index of 2006-2011 is surprisingly good given the circumstances. Even though New Hampshire's property tax rate (6.20 percent) is the third highest in the country, following Wyoming (7.94 percent) and Vermont (6.69 percent), New Hampshire still ranks only 35th worst out of 50 on the Tax Foundation's Index.³⁰ This is because the report takes into account other factors that determine the burden of a property tax on businesses. For example, many states have added additional types of property taxes such as intangible property taxes, inventory taxes, estate taxes, inheritance taxes, generation-skipping taxes, and gift taxes, none of which are levied by the New Hampshire state government. New Hampshire did have an inheritance and estate tax, but it was repealed in 2003. New Hampshire's actual per capita property tax collection is lower than multiple states that have lower tax rates because of these other taxes and the lower valuation of property in the state.

3.2.2. Electricity Consumption Tax

Both the electricity consumption tax and the actual price of electricity in an area affect businesses. Corporations looking for new business locations look closely at electricity costs as it is one variable that can be evenly compared across states and has a high impact on their product costs.³¹ Unfortunately for New Hampshire businesses, electricity is relatively expensive here. It costs 50 percent more than the national average. In comparison to our neighbors, New Hampshire is only 10 percent above average, with the third highest electricity costs among New England states.³² New Hampshire's electricity consumption tax increases the price of electricity by adding \$.00055 per kilowatt hour.³³ If we use the average price of electricity in 2010, this equates to a tax rate of 0.356 percent. Additionally, New Hampshire's tax on electricity is unique compared to surrounding states. Massachusetts, Vermont, and Maine do not collect this type of tax. Still, some states impose a sales tax on electricity. Vermont, for example, levies its sales tax on "electricity used commercially".³⁴ North Carolina collects a three percent sales tax on electricity, although this is below the state's general sales tax rate of 5.75 percent in the state.³⁵

3.2.3 Communications Tax

New Hampshire has a seven percent tax on communications within, ending, or originating in the state of New Hampshire.³⁶ This means that out-of-state companies doing business with companies in New Hampshire are also affected by this tax. Thus, when a company estimates how it will be affected by this tax, it must look at what it will have to pay directly to the state as well as the costs that its business partners will face. New Hampshire's Communications Tax is again unique in that surrounding states do not have an individual tax solely devoted to communications itself. However, (like what is seen above with regards to the electricity tax) some states may include communications as a service that permits a sales tax. For example, Massachusetts extends its 6.25 percent



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sales tax to “certain telecommunications services” such as “telephone and other transmissions of information.”³⁷

3.2.4 Real Estate Transfer Tax

Real estate pricing is another factor businesses take into account when looking for a new location. The real estate transfer tax increases real estate prices by 0.75 percent or \$750 for every \$100,000.³⁸ A tax rate of 0.75 percent is also applied to the seller, theoretically causing them to raise their prices to compensate, and creating a total tax rate of 1.5 percent on real estate transfers. This rate resulted in revenues of \$117,153,685 in 2008.³⁹ However, smart companies analyzing costs to find a new location often look at the total cost of procuring real estate in a state, not just the listing prices, and real estate prices in New Hampshire are increased more by taxes than in the average state.

Thirty-five states in the United States have real estate transfer taxes, but only eight states have tax rates of over one percent, and New Hampshire’s is the fourth highest.⁴⁰ New Hampshire’s tax rate is higher than those of Vermont, Maine, and Massachusetts. Vermont uses a 1.25 percent rate, Maine collects \$2.20 for every \$500 of property sold (coming out to a rate of 0.44 percent), and Massachusetts has a 0.456 percent rate.⁴¹ According to the NCSL, other states with high real estate transfer taxes include Delaware (with a 2 percent rate) and Washington (with between a 1.53 percent and a 2.03 percent rate when local transfer taxes are added in).⁴²

3.3 Taxes on Consumers

3.3.1 Meals and Rentals Tax

Recently, both the scope and the rate of the meals and rentals tax have increased. Currently the tax rate is nine percent on any restaurant meal or hotel room of over \$0.36, and is paid directly by the consumer.⁴³ While this is not a tax on businesses, any business selling an elastic good is affected by the increased price to the consumer because of the decrease in the demand for their product. The rentals tax is commonly justified as a tax on tourists, and a way to generate revenue from tourism in the state. This can consequently shift at least some of the tax burden off of New Hampshire residents.

Although the Meals and Rentals Tax may be a “tourist tax,” it is unlikely to decrease tourist traffic to the state, since similar taxes are seen in surrounding states. Vermont has a nine percent “Meals and Rooms Tax” that rises to 10 percent for “sales of alcoholic beverages served in restaurants.”⁴⁴ Maine raised its “Meals and Lodging Tax” from seven percent to 8.5 percent in 2009 to fund its decision to lower state income taxes.⁴⁵ Lastly, Massachusetts applies its regular sales tax (6.25 percent) to meals and imposes a 5.7 percent tax on “rooms rented for \$15 or more per day.”⁴⁶ These taxes do however increase the cost of traveling to the New England area, possibly deterring some



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vacationers. A lower tax rate in New Hampshire, and therefore lower travel costs, could possibly steal business away from other states in the area, although the magnitude of any increase would need further research.

3.4 Taxes on Employees

3.4.1 Individual Income tax (lack of)

As is commonly known, New Hampshire does not collect an individual income tax. This directly affects the tax burden on employers. Without an individual income tax, employees will actually earn the same amount of money from a lower salary. Therefore, businesses can draw workers with the same level of skill and education at a lower cost. Additionally, businesses such as sole proprietorships, partnerships, and S-corporations will very often file their income as individual income, instead of business income. Companies filing individual incomes will not only be directly attracted to states without income taxes such as New Hampshire, but are also often the type of companies that are easiest and most willing to relocate.

The absence of an income tax in New Hampshire compares favorably with other surrounding states as well. Vermont's current individual income tax ranges from 3.6 percent for those making under \$32,550 to 9.5 percent for individuals earning over \$357,700.⁴⁷ Maine has income tax rates that start at two percent but are 8.5 percent for citizens earning \$39,550 or more.⁴⁸ However, Vermont and Maine have both decided to reduce their income tax levels. In Maine, the plan is to decrease the income tax from 8.5 percent to 6.5 percent.⁴⁹ These states are outliers in terms of the national trend. Many states have raised income tax rates to deal with falling state revenue from the economic crisis. While some were temporary increases, the changes in New York, Oregon and Delaware's tax code have no set expiration dates. New York increased their tax on the bracket earning above \$200,000 from 6.85 percent to 7.85 percent. More aggressively, Delaware increased its income tax from 1 percent to 6.95 percent on those earning more than \$60,000.⁵⁰ However, this trend is not indicative of current economic theory, which fits better with Vermont and Maine's actions. States are raising taxes not because they believe it will help their economies, but because their current budget gaps demand it.

3.4.2 Interest and Dividends Tax

The interest and dividends tax allows New Hampshire to tax income, without actually having to create an individual income tax. The tax rate is five percent, as it has been for the last 33 years.⁵¹ The tax base reached by the interest and dividends tax has been a contentious issue. In 2009, the interest and dividends tax was extended to include limited liability companies (LLCs), adding them to a list that already included S-corporations, C-corporations, individuals, fiduciaries and trusts. Economists such as Micah Cohen argue that this double taxes some business income on the state level, as LLCs and C-



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corporations are taxed both on the business level and on the individual level for the same revenue.⁵² C-corporations are already double taxed by the federal government. However, this double taxation does not apply to a large number of businesses; LLC's can choose to file as S-corporations, if they meet certain criteria, avoiding business revenue taxes and paying only the interest and dividends tax.⁵³ Because of New Hampshire's interest and dividends tax, the state is ranked only 10th in the Individual Income Index by the Tax Foundation, even with its lack of a general individual income tax.⁵⁴

4. ACADEMIC RESEARCH AND TAX BUNDLES

Academic research relating to taxes and tax policies provides little widespread consensus. Research can be used to support either side of the partisan debate surrounding the issue. However, on a deeper level there is some consensus among economists. First, taxes harm the economy. Taking money from businesses hurts their chances of succeeding and reduces the amount of money flowing through the economy. Second, there is no low level of taxes that will encourage so much growth in the economy as to bring in tax revenue equal to that of a higher tax rate. Third, tax revenue targeted to help a specific industry or demographic is more beneficial to that specific group than a widespread tax reduction. And finally, different taxes affect different sectors of the economy differently, making the 'ideal tax bundle' entirely dependent upon a state's business demographics and policy goals. Does the state want to encourage small business start ups? Or would they prefer to entice existing businesses to locate their new headquarters or plant in their state?

To a policy maker, these conclusions mean that the three most important ratios to look at when determining tax policy are: 1) the balance between ideal tax rates and needed tax revenue, 2) the proportion of tax revenue allocated to economic growth programs, and 3) the ratio of individual tax rates inside the tax bundle.

4.1 State Revenue

A change in a tax policy results in a change in state revenue. The revenue from an increase in tax rates and the resulting cuts from a decrease in tax rates both have direct effects on the economy. The direct impact on a state's GDP from any given tax increase or decrease is difficult to measure because it will affect different sectors of the economy in different ways. There are few, if any, opportunities to collect data where everything but a change in tax code is held constant. However, academics discuss the magnitude of tax's effects through econometric analysis, and when they do so, they always account for the use or loss of state revenue. While the increase in business activity that results from tax cuts is beneficial to the state's economy, the increase is not large enough to balance out the cut in terms of the state's tax revenue. However, in some areas, revenue applied directly to a problem is more beneficial than the benefits of a growing economy. Therefore, the allocation of tax revenue is as vital a part of the conversation as the tax itself; "The state and local tax increases significantly retard economic growth when the



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revenue is used to fund transfer payments. However, when the revenue is used instead to finance improved public services (such as education, highways, and public health and safety) the favorable impact on location and production decisions provided by the enhanced services may more than counterbalance the disincentive effects of the associated taxes”.⁵⁵ As a state with relatively low tax revenue and comparatively little involvement in residential life, any losses of revenue in New Hampshire can have a large impact on the social programs and infrastructure provided by the state.

4.2 Employment Impact

The employment impact of tax decreases varies with the type of tax and the allocation of the revenue. Reducing personal income taxes, for example, leads to a larger increase in employment levels than a corporate income tax cut that costs the same amount. If instead of reducing taxes, the state used the difference in tax revenue to fund employment opportunities, more jobs would be provided than would occur as a result of a tax decrease. However, while employment levels alone would be better off from government programs than a tax cut, other areas of the economy would be negatively affected. Thus the state must look at the whole picture and decide on its priorities. The chart below depicts the varying effects of different economic policies calculated by the Canadian government. For example, the chart suggests that spending one billion dollars on infrastructure would have economic benefits of approximately 1.6 billion dollars and create 17,652 jobs. This can then be compared with the same one billion dollars going towards corporate income tax cuts, which would result in only 300 million dollars of economic benefit and 3,310 new jobs. Of course there are large differences between Canada’s economic models and New Hampshire, so the numbers would not be identical for this state, but the relative impacts of each fiscal measure would be similar in ratio.

GDP and Employment Impact of Federal Fiscal Measures: Final Impact from \$1 billion Stimulus		
Fiscal Measure	GDP Impact (\$bil)¹	Employment Impact²
Support to unemployed & low-income	\$1.7	18,755
Infrastructure investment	\$1.6	17,652
Housing investment	\$1.5	16,548
Other spending measures	\$1.4	15,445
Personal income tax reductions	\$1.0	11,032
EI premium reductions	\$0.6	6,619
Corporate income tax reductions	\$0.3	3,310

1. Dept. of Finance Canada, *Canada's Economic Action Plan Report #6*, Table A.1, p. 142, for 3Q 2010.
2. Assumes average employment-GDP ratio of 11,032 jobs per billion dollars of GDP. 2009 average nominal GDP \$1,527 billion, and average employment of 16,849,000 (Source: Statistics Canada CANSIM database). $16,849,000 \div 1,527 = 11,032$ jobs per billion.



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4.3 Tax Bundles

Different types of businesses have different business models, different fixed costs, and different revenue streams. Therefore each sector of the economy is affected in its own way by different tax bundles.

4.3.1 New Headquarters, Plant, or Branch Locations

When looking at sectors of the economy, and the different taxes that affect them specifically, it is important to first analyze the demographics of New Hampshire's businesses. A very small portion of New Hampshire's businesses are large corporations, giving the state ample room to improve and grow. While only one of 35 companies with over 1,000 employees terminated their operations in New Hampshire in the 2008 – 2009 fiscal year, 145 percent of the change in employment in that year came from companies in this bracket.⁵⁶ Thus even though there are only a few companies affected by this discussion, they can have a large effect on New Hampshire's employment levels. Therefore, changes in the tax code favorable to large corporations would be worth their cost if they actually were to bring in new companies.

Academics do not generally debate whether or not tax rates have an effect on business plant location decisions. There is a strong consensus that taxes have a negative effect, but the debate is over the magnitude of that effect. For example according to one source, "when deciding in which state to live or locate their business, one of the factors that top earners must weigh is the marginal tax rate they will face in each state. While high statutory tax rates on high incomes may bring a revenue increase in the short term, they can harm long-term economic growth as providers of jobs and capital choose to locate in lower-tax states".⁵⁷ On the other hand, another study concluded that taxes and state incentive programs do not have as much influence on business location decisions as expected. Larger issues of consideration include "existing concentrations of employment," such as energy costs and available technology in the area.⁵⁸

There are many factors more relevant to a business's new location than tax rates, but there is economic evidence that the rates do have some effect. According to economist Timothy Bartik's study, corporate and property tax both have negative correlations to the number of new plants in a region, but "the estimated coefficients for the property tax variable are never quite significantly different from zero".⁵⁹ In terms of the plant location decisions of established businesses, when comparing a corporate income tax and a property tax that result in the same revenue, the income tax would have one and a half to five times the "negative effect on business activity".⁶⁰ Bartik's calculations suggest that a ten percent increase in a state's corporate tax results in a two to three percent decrease in number of plants, while a ten percent increase in a state's property tax will result in a one to two percent decrease in number of plants.⁶¹



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Bartik’s conclusions suggest that “modest cuts in state business taxes are unlikely to cause a massive influx of new business”. Thus, if tax cuts result in “cuts in public services, increase in wages, or increases in land prices” or other factors that are important to businesses, the costs of a tax cut may outweigh the benefits to businesses.⁶² For example, the education level of the population is also highly correlated to the number of new businesses. If money is being moved from education to tax cuts, the results could counteract or even result in a worse business climate.

However, many of the most important qualities that businesses look at are difficult for the state government to control. For example, Bartik’s study showed that a state with ten percent more manufacturing activity correlates to eight to nine more new plants. This data suggests that areas that industrialization level is more important than low taxes or an educated labor force. Other important factors included population density and existing infrastructure.⁶³

4.3.2 Small Businesses and Startups

On the other hand, small business start ups are most negatively affected by high property tax rates. This is most likely because, unlike corporate income taxes, “property taxes are paid regardless of profits,” meaning that high property taxes would be a heavy burden to a struggling startup.⁶⁴ Additionally, high sales taxes on equipment make it less likely that a small business will succeed. High corporate income taxes and low property and sales taxes are therefore the ideal tax bundle for a state trying to encourage small business start ups and to support struggling businesses. However tax incentives, such as corporate tax relief to small, low profit businesses, may actually harm new businesses by “helping to maintain a pool of small corporations that compete with startups”.⁶⁵ New Hampshire has a comparatively large number of small businesses, with only 2.2 percent of the state’s companies hiring over one hundred employees.⁶⁶ This layout is more likely a result of New Hampshire’s natural demographics than current tax setup, but maintaining a beneficial sales tax rate or reducing property taxes could help these companies flourish and benefit the economy state wide. Each small business, while maybe only hiring a few employees, will have its own individual role and play its own part in New Hampshire’s economy. Having a vital network of small businesses and startups can be vital in New Hampshire both as a source of employment and a network of resources for larger businesses.

5. INCENTIVES PROGRAMS

Low business, income, and property taxes are not the only factors involved with business investments. New Hampshire has chosen to provide incentives to businesses in the form of tax credits, loans, and cash grants. Through these programs, the state encourages investment in specific geographic areas, types of businesses, and technological fields. New Hampshire’s incentive programs are primarily focused upon a goal of expanding



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employment. While these programs remain simple and effective, expanding incentive programs to other types of policy goals such as energy efficiency may help the state achieve its goals in those policy areas.

5.1 Incentive Programs in New Hampshire

The most prominent incentive program in the state is the Research and Development Tax Credit. Adopted in 2007, the R and D tax credit was created partly in response to similar programs in neighboring states that sought to attract technology, manufacturing, and advanced research. Through the tax credit program, businesses are given a tax credit based upon wages they pay to employees involved in research in New Hampshire. While critics like the Tax Foundation argue that supporting tax credits for qualified businesses requires higher taxes overall, negatively impacting the revenues of other, non-qualifying businesses in the state, the Research and Development Tax Credit specifically encourages the expansion of new, innovative, technologically sophisticated businesses in the state, an important goal to maintaining high-paying jobs in the state.⁶⁷

The Coos County Job Creation Tax Credit is another state incentive program, although with different aims. Coos County, in the northern-most part of the state, remains one of the most economically disadvantaged areas in the state.⁶⁸ Through this program, the state government awards a tax credit to qualifying business based upon the number of new full time employees hired by the target businesses in Coos County. A similar program that also seeks to enhance investment by targeted businesses in specific geographic regions of the state is the Economic Revitalization Zones program. Through this program the state awards tax credits against the corporate income tax for businesses operating in qualified regions. Municipalities and other local governments separately apply to the state to become designated economic revitalization zones and therefore make businesses operating in their area eligible for the credit. Together, these two programs allow the government to encourage the social benefits of increased business activity and job growth to specific areas in need of economic support without grants of public funds.

In addition to the Research and Development Tax credit and the geographic tax credit, two additional incentive programs are offered by the state to make New Hampshire more attractive to businesses and support employment in the state. Through the Job Training Fund, the state seeks to encourage encourages businesses to retrain their workers for new, higher qualified positions, using the NH Community College System. The program provides a 50 percent match towards those funds provided by the business. Finally, several private non-profit institutions have been established to provide grants and other resources for small, innovative businesses operating in New Hampshire. One prominent example is the Granite State Development Corporation.⁶⁹

New Hampshire's alternative incentive programs have been fairly successful in attracting new businesses to the state. In particular, the Research and Development Tax credit has



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encouraged development of a growing technology industry in the state.⁷⁰ While successful, the state has been extremely limited in its promotion of alternative incentives. Low tax rates are almost always appealing to businesses; however, the social benefits of increased business investment can be shaped and focused by effective use of incentive programs. While New Hampshire's incentive programs are primarily focused on supporting new or higher paid employment for the state's workforce, other policy goals such as alternative energy, energy efficiency, and waste reduction can be supported by targeted incentive programs. Just as the successful Research and Development Credit was established after New Hampshire began to fall behind its competition in attracting research investment, a close look at incentive programs in other states and innovative new ideas for supporting policy goals through incentive programs are necessary to ensure that New Hampshire remains one of the nation's most attractive locations for business activity.

5.2 Incentive Programs in Nearby States

While a search for innovative incentives programs in use outside the state is essential, hundreds of incentives programs are in place all over the country. Therefore, we have chosen a few interesting programs from nearby states. More focused research can be done according to specific policy areas. If policymakers are interested in incentive programs that pursue a specific policy goal, targeted research in that area would be appropriate.

The state of Delaware offers four incentives of particular interest. The state's "Targeted Industry Tax Incentives," offer \$400 in tax credits to companies in "targeted industries" that spend \$100,000 to develop themselves, as well as \$400 to companies that invest at least \$40,000 on a new employee.⁷¹ Delaware's targeted industries include "manufacturers,...engineering firms,...[and] computer software wholesalers," among other businesses.⁷² The state also provides "Green Industries Tax Credits," encouraging companies that lower their total waste by at least 50 percent and chemical waste by at least 20 percent through \$400 in tax credits for every 10 percent that their waste is reduced.⁷³ A third incentive strategy used by the State of Delaware is its "Retention and Expansion Tax Credits." This program offers up to a \$500,000 discount off of a company's corporate income and gross receipts taxes if the company is "expanding [its] asset base without expanding...employment".⁷⁴ Lastly, there is the "New Economy Jobs Program," where companies that add 50 or more jobs with salaries over \$100,000 will receive tax credits of up to 40 percent of the state individual income tax collected that year from those new jobs.⁷⁵

Vermont's "Employment Growth Initiative" is also an interesting business incentive program. The Employment Growth Incentive is unique in that it sets specific goals in "job creation and capital investment [levels]" for the businesses that subscribe to it.⁷⁶ If businesses achieve these objectives, they receive a cash "reward" for their efforts.⁷⁷ One important part of this program to note is its required cost-benefit analysis. Businesses are



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required to complete this cost-benefit analysis before being rewarded a grant in order to insure that the availability of the grant is a factor in their continuing business in the state. While the goals set forth by this program are not particularly innovative, the cost-benefit analysis is unique. Many states have failed to set specific conditions for businesses that apply for their incentives or systems of monitoring the effectiveness of their incentive programs. Without effective oversight, incentive programs can become simple government handouts. To maintain the effectiveness of incentive programs for promoting policy goals, the state should require similar cost-benefit analyses and oversight in new incentive programs.

In Maine, the state government offers “tax-exempt financing” in the form of bonds for companies looking to build complexes or obtain “machinery and equipment.”⁷⁸ Additionally, Maine has the “Pine Tree Development Zone Program,” which seeks to encourage businesses to move into areas of the state that are struggling economically, or to continue to grow if they are already in these locations.⁷⁹ In return, the program offers to return 80 percent of state individual income taxes for each of these companies’ new employees, to eliminate the company’s corporate income tax for up to five years, and to levy no sales tax on the company’s purchases of “construction materials” or “real property” for their building needs in these destitute parts of the state.⁸⁰

6. POLICY RECOMMENDATIONS

Although the nonpartisan Tax Foundation rates New Hampshire quite highly (seventh best) in its “2011 State Business Tax Climate Index,” there is still room for improvement in the state’s business taxes and incentives system.⁸¹ We have provided a few small areas for further investigation where easy changes could be made to improve the complexity of New Hampshire’s system. Our recommendations include particular tax code changes that standardize New Hampshire’s policies with national policies, areas for further research, and incentive options for the state.

6.1 Tax Recommendations

The first possible step is to remove the limit on the amount of NOL deduction carry-forward. Most importantly, this would improve tax equity. Allowing companies to claim net operating deductions for past (carry-back) or future years (carry-forward) helps ensure that a company's average income is being taxed.⁸² This is vital for cyclical industries and gets rid of the inequality between the treatment of cyclical and noncyclical industries. New Hampshire is one of only two states in the country that limits the amount of carry-forward allowed.⁸³ Additionally, removing the carry-forward limit would also increase the state's ranking in the Tax Foundation's Corporate Income Tax Index. While this may seem merely evaluative, national perception of New Hampshire's business environment is almost as important as its actual tax structure. Many businesses use such



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studies as the 2011 State Business Tax Climate Index to help determine possible locations.

Another possible step for New Hampshire is to eliminate the inconsistencies between the national depletion schedule and New Hampshire's depletion schedule. New Hampshire is one of only eleven states that do not fully comply with the national schedule. Removing the inconsistencies would both reduce tax complexity in the state and improve New Hampshire's Corporate Income Tax rating. However, in our research we have not found enough data to be able to thoroughly predict the outcome of this change and therefore do not recommend this action without significant further evaluation.

A final possible topic of further research is the debate over whether a state should use a flat corporate income tax (with one rate) or a progressive corporate income tax (with numerous rates based on a company's income). New Hampshire's Business Profits Tax is at a flat 8.5 percent rate, but the state could still be construed as using a progressive tax since the Business Enterprise Tax only comes into effect for businesses that have over \$150,000 in receipts.⁸⁴ Again, opinions on this matter differ. The Tax Foundation supports a flat tax, since in their opinion progressive taxes cause businesses to change their natural practices.⁸⁵ For example, with a progressive tax some businesses may balk at growing their presence in the state if it will put them into a new, more costly tax bracket.⁸⁶ On the other hand, some believe that progressive taxes work best because they allow the government to obtain more revenue from those who can afford to pay more in taxes (called the "ability-to-pay principle") and because they force those who have more at stake in a government's decisions to bear a greater cost in order to fund those decisions (called the "benefit principle").⁸⁷

6.2 Incentive Program Recommendations

The state should also consider emulating some of the business tax incentives seen in other states to further increase New Hampshire's appeal to businesses. This topic is widely debated by scholars. On one hand, the Tax Foundation is completely against incentives. They believe that incentives such as tax credits can "complicate the tax system, narrow the tax base, [and] drive up tax rates for companies that do not qualify," and they advocate that states instead work on improving the components of their respective business climates.⁸⁸ The OECD disagrees, saying that tax incentives on research and development can "raise R and D expenditure and innovative activity," albeit "with long time lags."⁸⁹ They believe that another benefit of tax incentives is that they give businesses more freedom in how they decide to spend the additional funds that the incentives themselves bestow.⁹⁰ A study conducted on the potential effects of tax incentives for research and development in New Hampshire concurs somewhat with the OECD's belief. Ross Gittell and Edinaldo Tebaldi found that increasing the research and development tax credit in New Hampshire would indeed increase business spending on R and D while also creating a moderate number of jobs at a relatively low cost for the



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government (about \$14,000 per job) (89-90).⁹¹ But, the two note that these tax credits also have a high “fiscal cost” for the state government due to a large amount of “forgone tax revenue.”⁹² Again, the benefits and problems of business tax incentives will be a topic of further research.

7. CONCLUSION

In our evaluation, we found that New Hampshire remains a largely business friendly state. However, there are areas in which the state could improve. New Hampshire’s business tax structure is overly complicated by the Business Enterprise tax. It and the Business Profits tax are the main costs to businesses in New Hampshire. New Hampshire’s relative advantage is that its other taxes are so low, or nonexistent. Taxes on consumers and employees consist of only the Meals and Rentals tax and the Interest and Dividends tax, which have much smaller tax bases than the standard sales tax or individual income tax. As the costs of these taxes are often passed on to businesses, companies in New Hampshire benefit greatly from this part of the tax structure. While New Hampshire’s property tax is very high, it imposes a smaller burden on local companies in comparison to other states in the region. However, reducing the property tax even further could have a large positive impact on small, new businesses. Additionally, New Hampshire’s tax structure could become more business friendly through small changes such as an adjustment of the depletion schedule or the lifting of limitations on Net Operating Loss carry-forwards.

The state’s incentive programs are effective in promoting investment, especially in areas such as Coos County and those areas included as Economic Revitalization Zones. Even if incentive programs can be argued to be economically inefficient, programs such as New Hampshire’s Research and Development Tax Credit program provide important social benefits, in addition to increasing research and development in New Hampshire. However, the state’s incentive programs also have room for improvement, as they are limited in scope in comparison to those of other states. An expansion of those incentives could encourage additional investment in selected areas. When combined with New Hampshire’s comparatively low cost tax structure, the state’s incentive programs make New Hampshire a desirable location for new businesses.

Before accepting any recommendations or making any tax code changes, the questions New Hampshire’s politicians and government workers must ask are “What types of business does New Hampshire want?” and “What types of business does New Hampshire want its tax policy to encourage?” When New Hampshire has answers to these questions, the state can use targeted incentives, purposefully allocated revenue, and specific tax bundles to reach these policy goals.



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