

State Government As Tax-Dollar Shredder?

**A critique of Ernst & Young's
*Economic and Fiscal Impact Analysis of
Maryland Tax Policy Options* as released
by the Maryland Chamber of Commerce**

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The Maryland Chamber of Commerce recently released a report it commissioned from Ernst & Young entitled *Economic and Fiscal Impact Analysis of Maryland Tax Policy Options*, which makes the case that raising taxes of any kind in Maryland – especially raising corporate taxes and closing corporate tax loopholes – will cost Maryland jobs with no positive economic effects to compensate for the job losses.¹ This report analyzes the findings of Ernst & Young's analysis.

Ernst & Young: A Credible Source of Tax Policy Advice?

Before analyzing the substance of a policy analysis, one looks first at its author to determine his or her credibility.

The accounting firm Ernst & Young (hereafter E&Y) wrote the report. It did so because of a fee it received from a number of Maryland business and trade associations led by the Maryland Chamber of Commerce, all of which have a direct financial interest in keeping corporate taxes low and keeping corporate tax loopholes open.

E&Y writes most of its policy reports for paying, corporate clients. But the bulk of E&Y's income comes from its work as one of the world's biggest accounting firms. In this capacity, too, the vast majority of E&Y's clients are for-profit corporations. E&Y advises these corporations on how to lower their taxes. In so doing, E&Y violates the law on a disturbingly frequent basis:

- In the 1990s, E&Y was fined hundreds of millions of dollars and punished by the federal Office of Thrift Supervision for its role in the Keating S&L scandal.²
- In 2003, E&Y was fined \$15 million by the IRS for inventing loopholes for clients that the IRS ruled illegal.³
- In 2004, E&Y was punished by the SEC and by the California Board of Accountancy for violating auditor independence rules.⁴
- This spring, E&Y was fined again by the SEC for compromising its auditor independence.⁵
- This spring, E&Y was indicted by the U.S. Prosecutor in New York for again inventing illegal tax loopholes for wealthy clients.⁶

Given E&Y's disgraceful record of serial lawbreaking -- particularly its non-stop invention of illegal tax loopholes -- why would we in Maryland take seriously any tax policy advice it offers?

Judging Ernst & Young's Analysis on the Merits

So what substantive merits does the Ernst & Young report have?

Few, if any. That's because the report assumes that none of the revenues raised by the tax changes it examines will be recycled into the state economy in the form of new schools, more teachers in the classroom, more state investment in roads and transit, Chesapeake Bay cleanup, expansion of health care access, etc. Ernst & Young lets this cat out of the bag in footnote 4 on page 6 of the report. E&Y's weird methodology assumes that when government takes tax revenue out of the private economy, it stuffs that money into a mattress, or runs it through a shredder. Perhaps the Maryland Chamber of Commerce thinks the Governor will take the money and have a big bonfire with it on the State House lawn?

In fact, of course, government invests the revenue it collects in economically productive ways, such as improving schools and infrastructure.⁷

Ironically, the very groups that paid for the E&Y study seem to understand this obvious fact. Why else are business groups like the Greater Baltimore Committee and the Greater Washington Board of Trade clamoring for the state of Maryland to raise the gas tax and use the money to improve transportation infrastructure? On the one hand, these business groups are using E&Y's study to claim that all tax increases kill jobs with no offsetting positive economic effects; but at the same time they are saying the exact opposite regarding the need to raise the gas tax to pay for more government investment in transportation.⁸

But even if we agreed with E&Y's assumption that government takes tax revenue and puts it into a paper shredder, the E&Y study "appears to significantly exaggerate the job losses from state tax increases [also] because it fails to account for the fact that state personal income taxes and all business taxes are deductible for federal income tax purposes," says Michael Mazerov of the Center on Budget and Policy Priorities. Mazerov continues: "This deductibility offsets the net reduction in purchasing power from state tax increases because there is a smaller federal tax liability that flows out of the state. Since the federal corporate income tax is 35 percent, effectively one-third of state business tax increases are paid for by the federal treasury rather than by corporations."⁹

Conclusion

One can agree with E&Y's findings only if we accept the word of a serial tax cheater that every tax dollar government collects is put into a paper shredder. A more objective analysis would ask how government would spend the new revenue and specifically whether proposed public expenditures would promote economic growth. Gov. Martin O'Malley says he wants to use new revenue to expand access to higher education, invest more in health care, and invest more in transportation, among other things.¹⁰ That adds up to a recipe for economic

growth and prosperity.

The bottom line: Maryland's current status as a low-tax state for business¹¹ means we can afford to raise the corporate tax rate as well as comprehensively close corporate tax loopholes, the latter reform accomplished by implementing the proven reform of combined reporting.¹²

¹ Report available at: <http://www.mdchamber.org/news/07taxstudy.asp>

² <http://www.fundinguniverse.com/company-histories/Ernst-amp;-Young-Company-History.html>

³ <http://www.citizenworks.org/news/index.php?id=204>

⁴ http://w4.stern.nyu.edu/news/news.cfm?doc_id=3198

⁵ <http://www.accountingweb.com/cgi-bin/item.cgi?id=103345&d=883&h=884&f=882&dateformat=%25o%20%25B%20%25Y>

⁶ http://www.usatoday.com/money/perfi/taxes/2007-05-30-ernst-young-tax-fraud_N.htm

⁷ For an example of a more realistic state-level analysis that takes into account public sector activity on job creation, see Timothy Bartik and George Erickcek, "Economic Impact of Various Budgetary Policy Options for the State of Michigan to Resolve its Budget Deficit for FY 2004", W.E. Upjohn Institute for Employment Research, 2004, at: www.upjohninst.org/Michigan_budget_study.pdf

⁸ See for example, http://www.baltimoresun.com/news/local/politics/bal-taxes0924,0,3297624.story?page=1&coll=bal_tab01_layout. See also http://www.mdchamber.com/blog/2007/02/maryland_chamber_committed_to_icc.php

⁹ Email from Michael Mazerov to author, September 2007.

¹⁰ <http://www.gov.state.md.us/pressreleases/DeficitPowerpoint.pdf>

¹¹ www.AllianceForTaxFairness.org see esp. "Maryland Fiscal Crisis Briefing Book", chapters 3 and 4. Even senior economists at Ernst & Young seem to agree that business taxes in Maryland are comparatively low. See Robert Cline, Thomas Neubig, Andrew Phillips, and William Fox, "Total State and Local Business Taxes: Nationally 1980-2004 And by State 2000-2004", State Tax Notes, May 9, 2005.

¹² <http://www.cbpp.org/4-5-07sfp.pdf>