

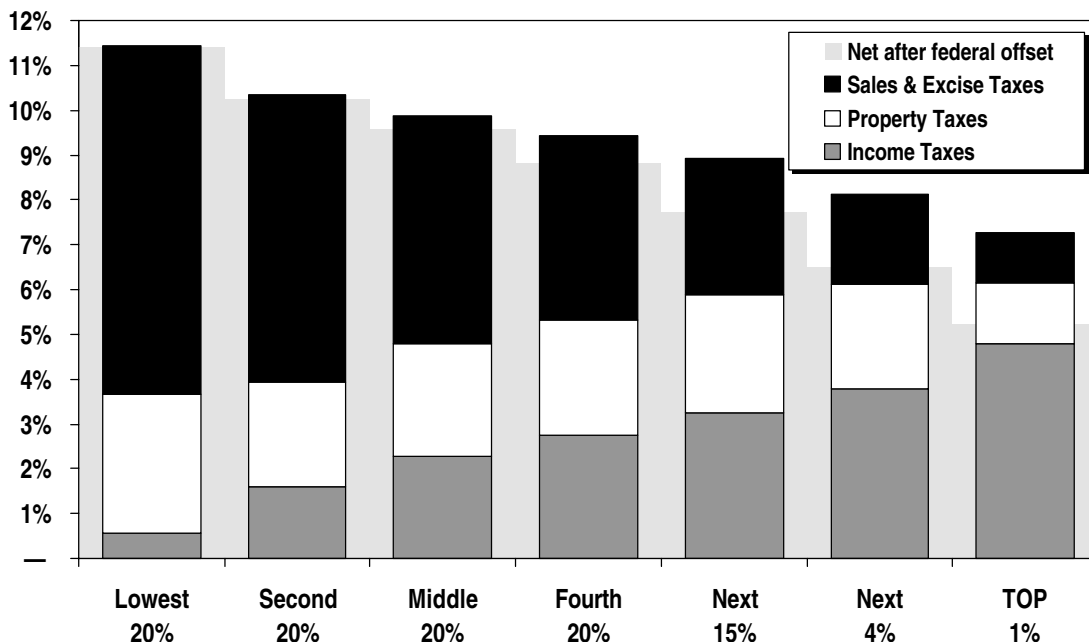
State & Local Taxes Hit Poor & Middle Class Far Harder than the Wealthy

By an overwhelming margin, most states tax their middle- and low-income families far more heavily than the wealthy, according to a new study by the Institute on Taxation & Economic Policy.

- Nationwide, middle-income families pay almost 10 percent of their earnings in state and local taxes and poor families pay more than 11 percent. But the richest people effectively pay only 5.2 percent of their income in state and local taxes.
- Since 1989, state and local taxes have risen on low- and middle-income taxpayers, but have fallen on the very wealthiest.

“At a time when cuts in federal aid and declining state tax revenues are forcing state lawmakers to seek increased revenues, it’s important to evaluate who currently pays state and local taxes,” said Robert S. McIntyre, ITEP’s tax policy director and lead author of the study, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*. “Unfortunately, most states require their poor and middle-income taxpayers to pay the most taxes as a share of income—and the ways in which states have managed their budgets during the last decade have made this problem worse.”

State & Local Taxes in 2002, All States
 State & local taxes imposed on own residents as shares of income



Sad National Norm: Soak the Poor and Middle Class to Spare the Rich

Nationwide, the study found that middle- and low-income non-elderly families pay much higher shares of their income in state and local taxes than do the very well-off:

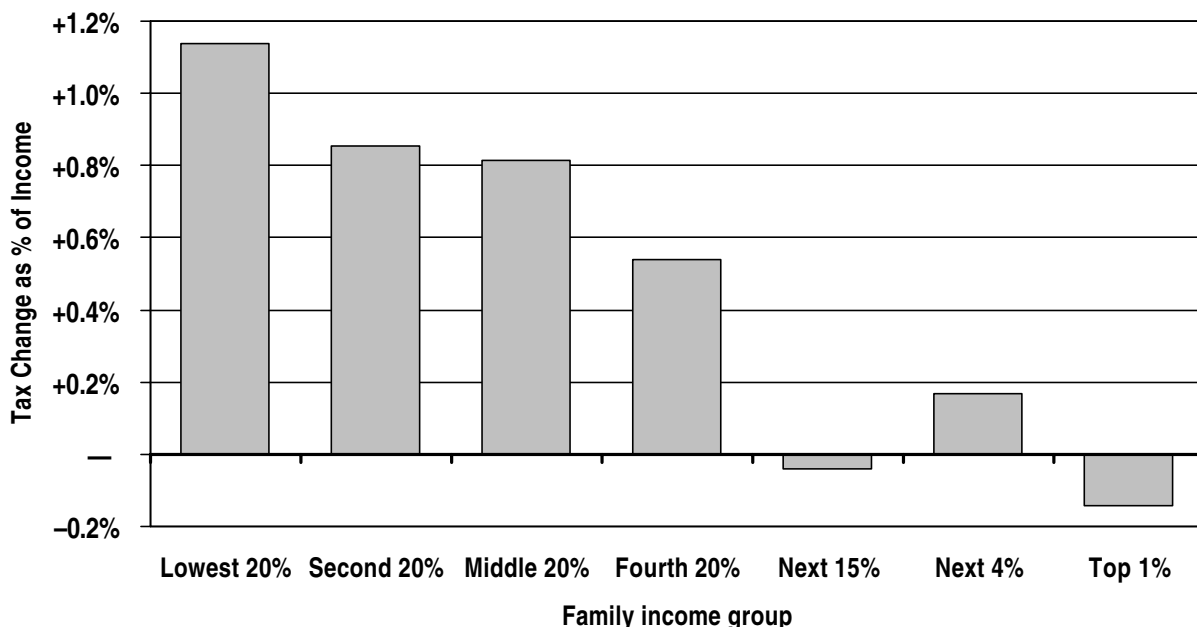
- The average state and local tax rate on the best-off one percent of families is 7.3 percent before accounting for the tax savings from federal itemized deductions. After the federal offset, the effective tax rate on the best off one percent is a mere 5.2 percent.
- The average tax rate on families in the middle 20 percent of the income spectrum is 9.9 percent before the federal offset and 9.6 percent after—almost twice the effective rate that the richest people pay.
- The average tax rate on the poorest 20 percent of families is the highest of all. At 11.4 percent, it is more than double the effective rate on the very wealthy.

A Regressive Long-Term Trend

A second key finding of the study is that overall, changes in state and local taxes over the past decade have made state tax systems even more regressive. While lawmakers in many states have taken steps to provide low-income tax relief through earned-income tax credits and similar mechanisms, these progressive changes have often been insufficient to offset the growing use of regressive consumption taxes—and many states have not enacted substantial low-income tax relief at all. At the same time, many states have actually lowered taxes on their best-off residents.

State and local taxes in the United States as a whole rose slightly as a share of income from 1989 to 2002, as states were required to assume additional program responsibilities abdicated by the federal government due to its budget problems. That's not surprising. But because of the way those tax increases were structured, state and local taxes rose most on poor and middle-income families, and least—or not at all—on upper-income families.

Average Changes in State & Local Taxes as Shares of Income
All States, 1989 – 2002 (after federal offset)



The “Terrible Ten” Most Regressive Tax States

Ten states—Washington, Florida, Tennessee, South Dakota, Texas, Illinois, Michigan, Pennsylvania, Nevada, and Alabama—are particularly regressive. These “Terrible Ten” states ask poor families—those in the bottom 20% of the income scale—to pay up to five-and-a-half times as great a share of their earnings in taxes as do the wealthy. Middle-income families in the “Terrible Ten” states pay up to three-and-a-half times as high a share of their income as the wealthiest families. (These figures are before the benefits the wealthy enjoy from federal itemized deductions.)

The Ten Most Regressive State Tax Systems					
Taxes as shares of income by income for non-elderly residents					
Income Group	Taxes as a % of Income on				
	Poorest 20%	Middle 60%	Top 1%	Poor/Top 1%	Middle/Top 1%
Washington	17.6%	11.2%	3.3%	537%	343%
Florida	14.4%	9.8%	3.0%	476%	325%
Tennessee	11.7%	8.9%	3.4%	347%	264%
South Dakota	10.0%	8.4%	2.3%	440%	369%
Texas	11.4%	8.4%	3.5%	331%	244%
Illinois	13.1%	10.5%	5.8%	224%	180%
Michigan	13.3%	11.2%	6.7%	199%	168%
Pennsylvania	11.4%	9.0%	4.8%	238%	187%
Nevada	8.3%	6.5%	2.0%	420%	331%
Alabama	10.6%	9.6%	4.9%	216%	195%

What Makes a State’s Tax System Regressive?

The study highlights the common features of states with particularly regressive tax systems. In the ten most regressive tax states, several items particularly stand out:

- Six of the ten states lack a broad-based personal income tax.
- The other four states levy broad-based income taxes, but have structured the tax in a way that makes it much less progressive than in other states. Three of them have flat-rate income taxes, and one allows a deduction for federal income taxes paid.
- Seven of the ten states—Washington, Florida, Tennessee, South Dakota, Texas, Alabama and Nevada—rely very heavily on sales and excise taxes. In these seven states, about half to three-quarters of the total state and local taxes imposed on the families in our study come from these consumption taxes (compared to the national median of 35% for all states).

Characteristics of the Most Regressive Tax Systems			
	Personal Income Tax		Heavy Use of Sales & Excise Taxes*
	Little or None	Other Details	
Washington	✓		✓
Florida	✓		✓
Tennessee	✓		✓
South Dakota	✓		✓
Texas	✓		✓
Illinois		Flat Rate	
Michigan		Flat Rate	
Pennsylvania		Flat Rate	
Nevada	✓		✓
Alabama		Fed. Ded.*	✓

* Greater than 25% reliance for overall revenue.

The Least Regressive States

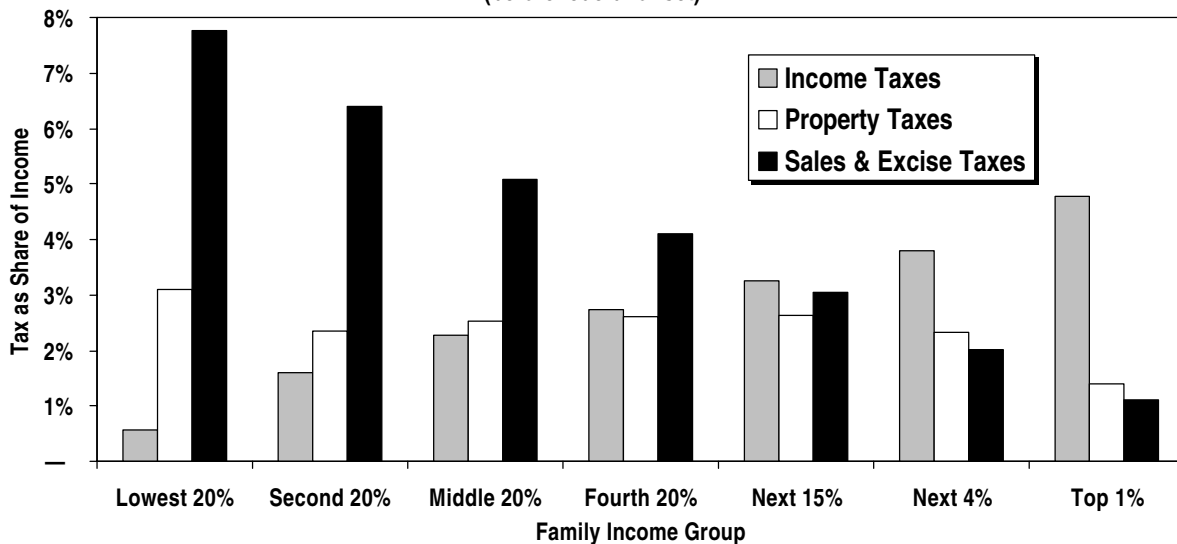
The study also examined the tax characteristics of the four least regressive states (those few that by some measures have progressive tax systems). These states have progressive personal income taxes and/or low reliance on sales and excise taxes. For example, Vermont succeeds in making its overall tax system relatively fair with a combination of a highly progressive income tax and a relatively low reliance on sales and excise taxes.

Characteristics of the Least Regressive Tax Systems			
	Personal Income Tax		Low Use of Sales & Excise Taxes
	Very Progressive	Other Details	
Delaware		High reliance	✓
Montana			✓
Vermont	✓	Ref. Credits*	✓
California	✓		

**Refundable credits are allowed even if they exceed a low-income family's income tax liability.*

Comparing Types of Taxes: Averages for All States

(before federal offset)



The Kind of Tax Matters

The study found that the kind of taxes that a state imposes on its citizens makes a huge difference.

- State and local income taxes are typically progressive. On average, poor families pay only a fourth the effective income tax rate that the richest families pay, and middle-income families pay about three-fifths the effective rate on the well-to-do.
- Property taxes, including both taxes on individuals and business taxes, are usually somewhat regressive.
- Sales and excise taxes are very regressive. On average, poor families pay more than six times as high a share of their income in these consumption taxes as do the best-off families, and middle-income families pay at four times the rate of the wealthy.

Federal Itemized Deduction Offset

State and local personal income and property taxes, unlike sales and excise taxes, are allowed as itemized deductions in computing federal income taxes. This has a significant impact. On average, a

MORE . . .

fifth of all state personal income and individually-paid property taxes are “exported” to the federal government (and to taxpayers nationwide) as a result of these deductions. For the best-off state and local taxpayers, close to 40 percent of their state and local income and property tax bills are effectively paid by the federal government. The state-by-state tables in the study shows the benefits of federal itemized deduction offsets by income group. States that rely heavily on sales and excise taxes get much less benefit from these federal offsets than do states that rely more on income taxes.

Highest Taxes on the Poor

Some states that try to style themselves as “low-tax” are actually among the highest-tax states when it comes to taxing poor families.

- Florida, a state without an income tax, taxes its poor families at a rate of 14.4 percent—second highest in the country.
- Washington State, which also does not have an income tax and might look like an average-tax state from the aggregate numbers, is actually the highest-tax state in the entire country for poor people. When all state and local sales, excise and property taxes are tallied up, poor families in the State of Washington pay 17.6 percent of their total income in taxes. In neighboring Idaho and Oregon, which have much less regressive tax systems, the poor pay 9.7 percent and 9.4 percent, respectively, of their incomes in state and local taxes—far less than in Washington.

“Are no-income-tax states like Washington and Florida ‘low-tax’ states for poor families?” said McIntyre, “No. In fact, these states’ heavy reliance on sales and excise taxes make their tax burdens on the poor very high.”

Conclusion

“In many states, 2003 will mark the beginning of a new cycle of revenue raising,” McIntyre said. “States may choose to pay for new services in the same way that they have in the past—regressively. Or they may decide instead to ask wealthier families to pay tax rates more commensurate with their incomes. In either case, the path that states choose in the upcoming year will have a major impact on the well-being of their citizens—and on the fairness of state and local taxes.”

Two pages of tables summarizing U.S. average state & local taxes by income group follow

The Institute on Taxation and Economic Policy is a nonpartisan Washington-based research group. The full *Who Pays?* report is available in PDF format at www.itepnet.org. Printed copies can be ordered by calling ITEP at 202-737-4315.

Who Pays? examines the tax systems of all 50 states and the District of Columbia, using the Institute on Taxation & Economic Policy Microsimulation Tax Model. The ITEP Model is similar in methodology and data sources to the elaborate computer models used by the U.S. Treasury and the congressional Joint Committee on Taxation, except that the ITEP Model adds state-by-state estimating capabilities.

The findings published in the study detail state and local taxes paid by non-elderly couples and individuals. The study includes all major state and local taxes: personal and corporate income taxes, property taxes, and sales and excise taxes.

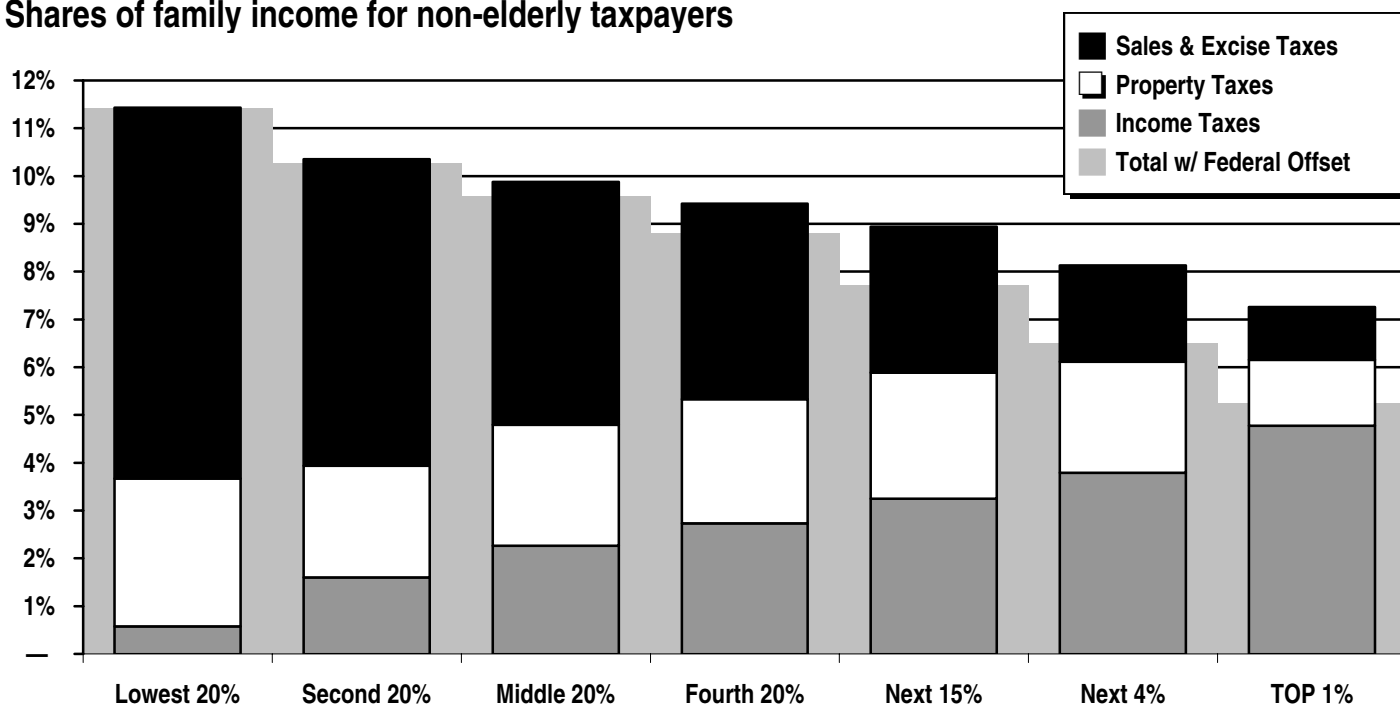
The Ten States with the Highest Taxes on the Poor

Washington	17.6%
Florida	14.4%
Michigan	13.3%
Illinois	13.1%
Rhode Island	13.0%
New York	12.7%
Hawaii	12.6%
Arizona	12.5%
New Jersey	12.5%
New Mexico	12.1%

Averages for All States

State & Local Taxes in 2002

Shares of family income for non-elderly taxpayers

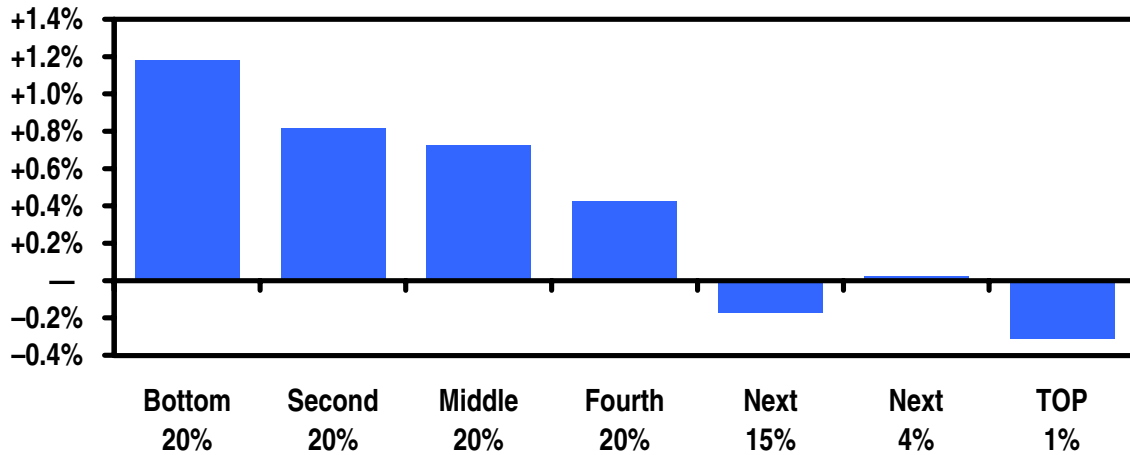


Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	TOP 1%
Income Range	Less than \$15,000	\$15,000 – \$25,000	\$25,000 – \$40,000	\$40,000 – \$69,000	\$69,000 – \$147,000	\$147,000 – \$304,000	\$304,000 or more
Average Income in Group	\$9,300	\$19,700	\$31,900	\$52,500	\$95,300	\$202,000	\$1,081,000
Sales & Excise Taxes	7.8%	6.4%	5.1%	4.1%	3.1%	2.0%	1.1%
General Sales—Individuals	3.6%	3.3%	2.7%	2.3%	1.8%	1.2%	0.6%
Other Sales & Excise—Ind.	1.9%	1.3%	0.9%	0.7%	0.5%	0.3%	0.1%
Sales & Excise on Business	2.3%	1.9%	1.4%	1.1%	0.8%	0.6%	0.4%
Property Taxes	3.1%	2.3%	2.5%	2.6%	2.6%	2.3%	1.4%
Property Taxes on Families	3.0%	2.2%	2.4%	2.4%	2.4%	2.0%	0.8%
Other Property Taxes	0.1%	0.1%	0.1%	0.2%	0.2%	0.3%	0.6%
Income Taxes	0.6%	1.6%	2.3%	2.7%	3.2%	3.8%	4.8%
Personal Income Tax	0.5%	1.6%	2.2%	2.7%	3.2%	3.7%	4.5%
Corporate Income Tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.3%
TOTAL TAXES	11.4%	10.4%	9.9%	9.4%	8.9%	8.1%	7.3%
Federal Deduction Offset	-0.0%	-0.1%	-0.3%	-0.6%	-1.2%	-1.6%	-2.0%
TOTAL AFTER OFFSET	11.4%	10.3%	9.6%	8.8%	7.7%	6.5%	5.2%

Note: Table shows 2002 tax law at 2000 income levels.

All States: Average Tax Trends

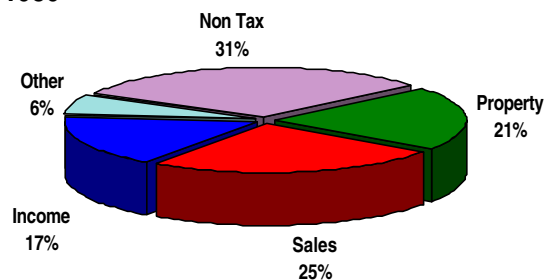
Changes in Taxes as Shares of Income, 1989 – 2002



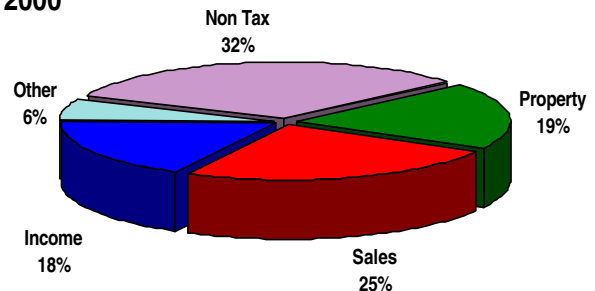
	Bottom 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	TOP 1%
Sales & Excise	+0.8%	+0.5%	+0.4%	+0.3%	+0.2%	+0.1%	+0.0%
Property	+0.5%	+0.3%	+0.4%	+0.2%	-0.4%	-0.3%	-0.2%
Income	-0.1%	+0.0%	+0.1%	+0.2%	+0.2%	+0.4%	+0.5%
Federal Offset	-0.0%	-0.0%	-0.1%	-0.2%	-0.2%	-0.1%	-0.6%
Overall Change	+1.2%	+0.8%	+0.7%	+0.4%	-0.2%	+0.0%	-0.3%

Composition of Revenues

1989



2000



Source: Government Finances, US Department of Census