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A Review of State Tax History

NCSL Fiscal Analysts Seminar

New Orleans, LA

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With thanks to my colleague, Lucy Dadayan.

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Rockefeller Institute of Government

- Public policy research arm of State University of New York

- Focused on helping state and local governments examine and address important problems.

- Independent. Data-driven. Bringing research to bear on public problems.

- Fiscal policy program: Finances of state and local governments. Special emphasis on taxes, pensions and pensions risk, Medicaid, K-12 education, overall finances.

Selected history

Early days – 1800s-plus

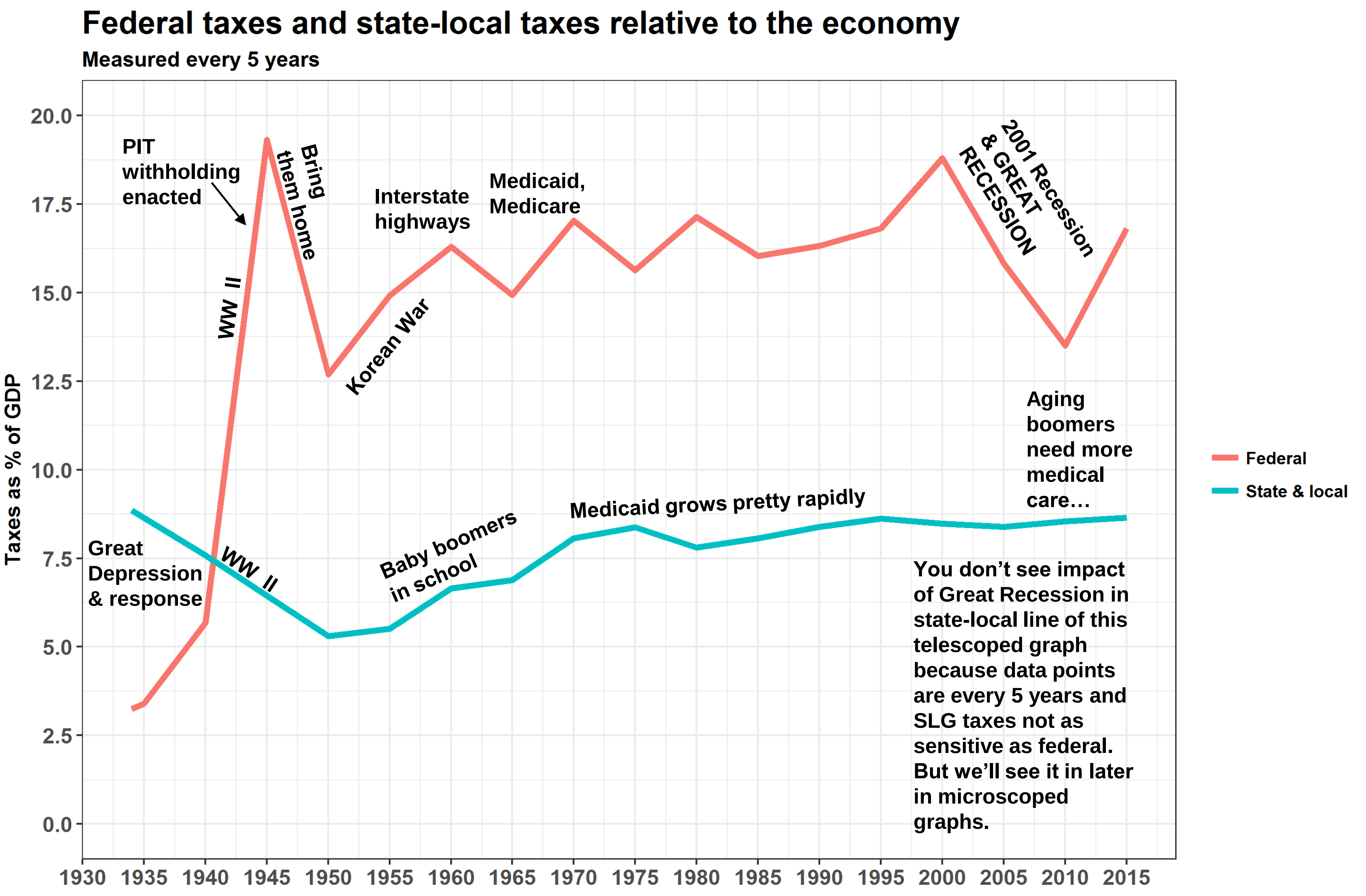
- Pre-1930s federal government was smaller than states & localities. States and localities responsible for most spending.

- Federal revenue mostly from customs duties and excises

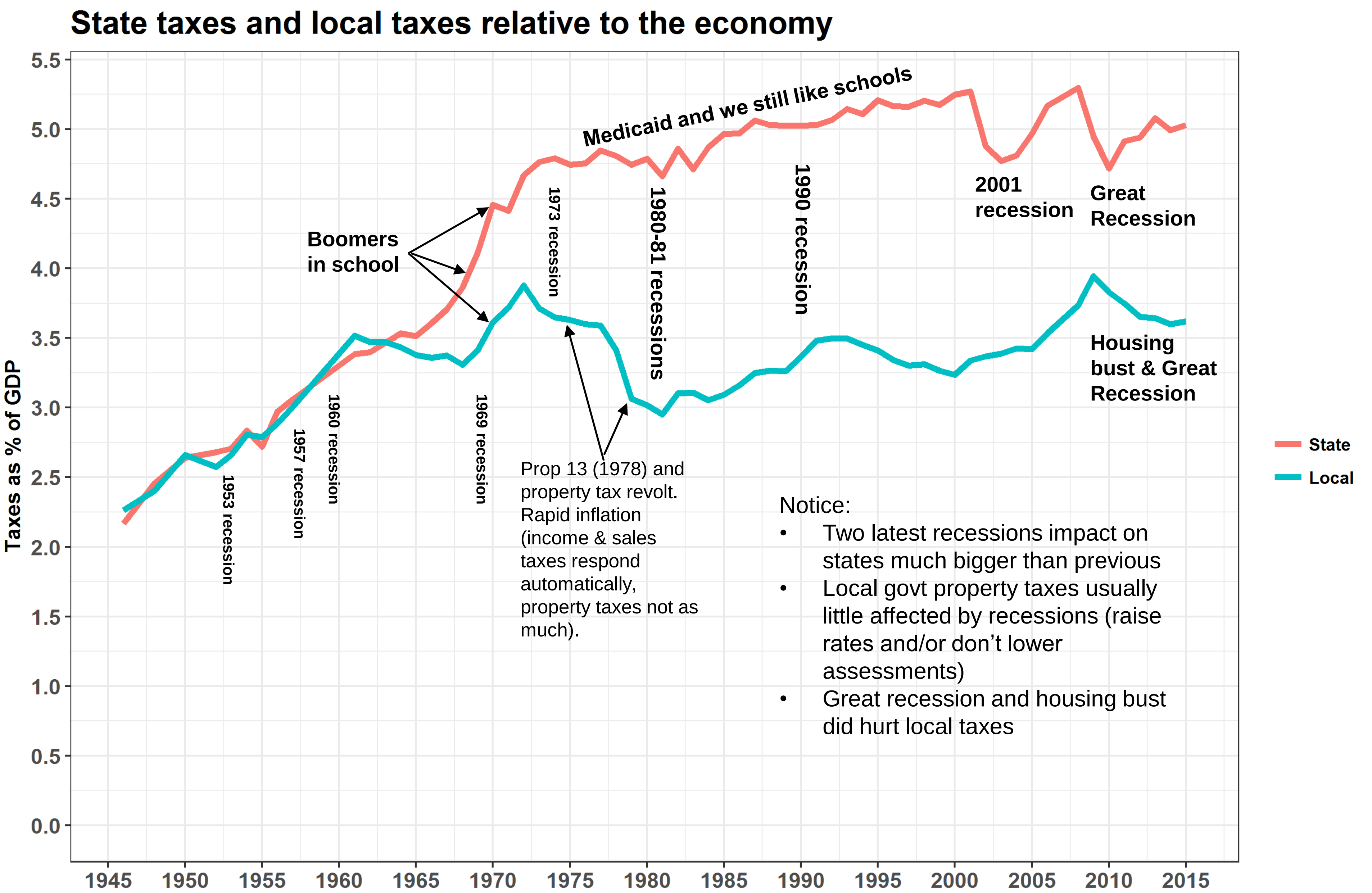
- Federal income tax – 16^{th} amendment ratified 1913. Made state income taxes more practical

- Many states reliant on “non-general” property taxes (tax this specific item, that specific item)

Growth of federal and state & local government tax revenue, and selected events



The 1960s-plus rise of states



Bursts of new state tax enactments

- 1911+ decade: states moving away from property taxes.
- Property tax difficulties – delinquencies, intangibles - lead to more increases in other taxes:
  - 30 income-tax states by 1940.
  - Widespread sales tax adoptions in 1930s
  - Also, post-Prohibition alcohol taxes
- 1960s – much pressure from educating baby boomers
- Later decades, Medicaid adds to pressure

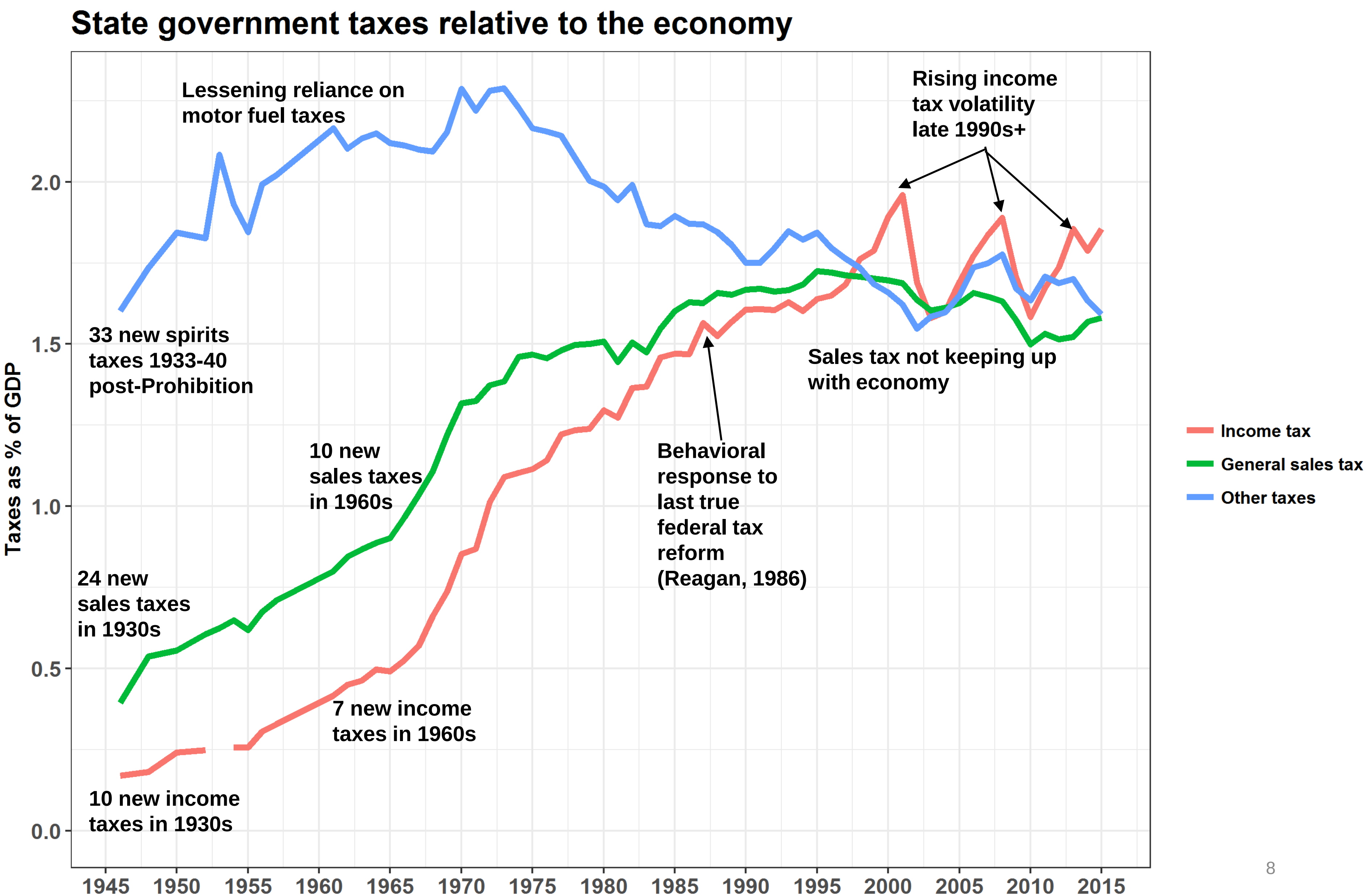
Numbers of states adopting major taxes, by decade

	Individual income tax	General sales tax	Corporate income tax
Before 1911	1	0	1
1911 - 1920	9	0	8
1921 - 1930	5	0	8
1931 - 1940	15	24	15
1941 - 1950	1	5	2
1951 - 1960	0	6	2
1961 - 1970	7	10	6
1971 - 1980	4	0	3
1981+	0	0	0
Total- gross	42	45	45
Repeals*	1	0	1
Total - net	41	45	44

Note: Only broad-based taxes are counted. Only states. *Not 100% sure of corporate income tax repeals.

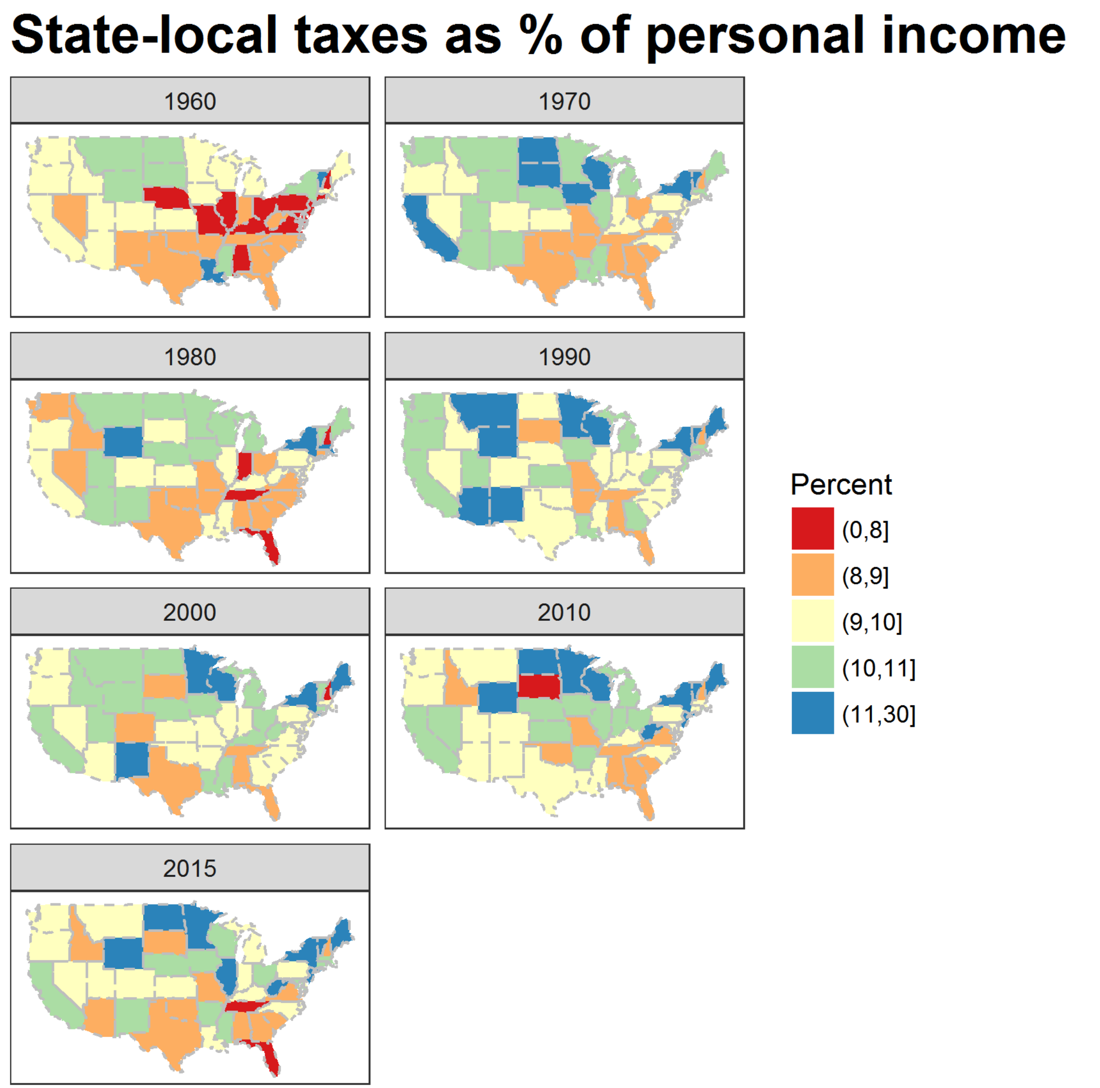
Source: Advisory Commission on Intergovernmental Relations

Shifting composition of state taxes



State & local tax burdens

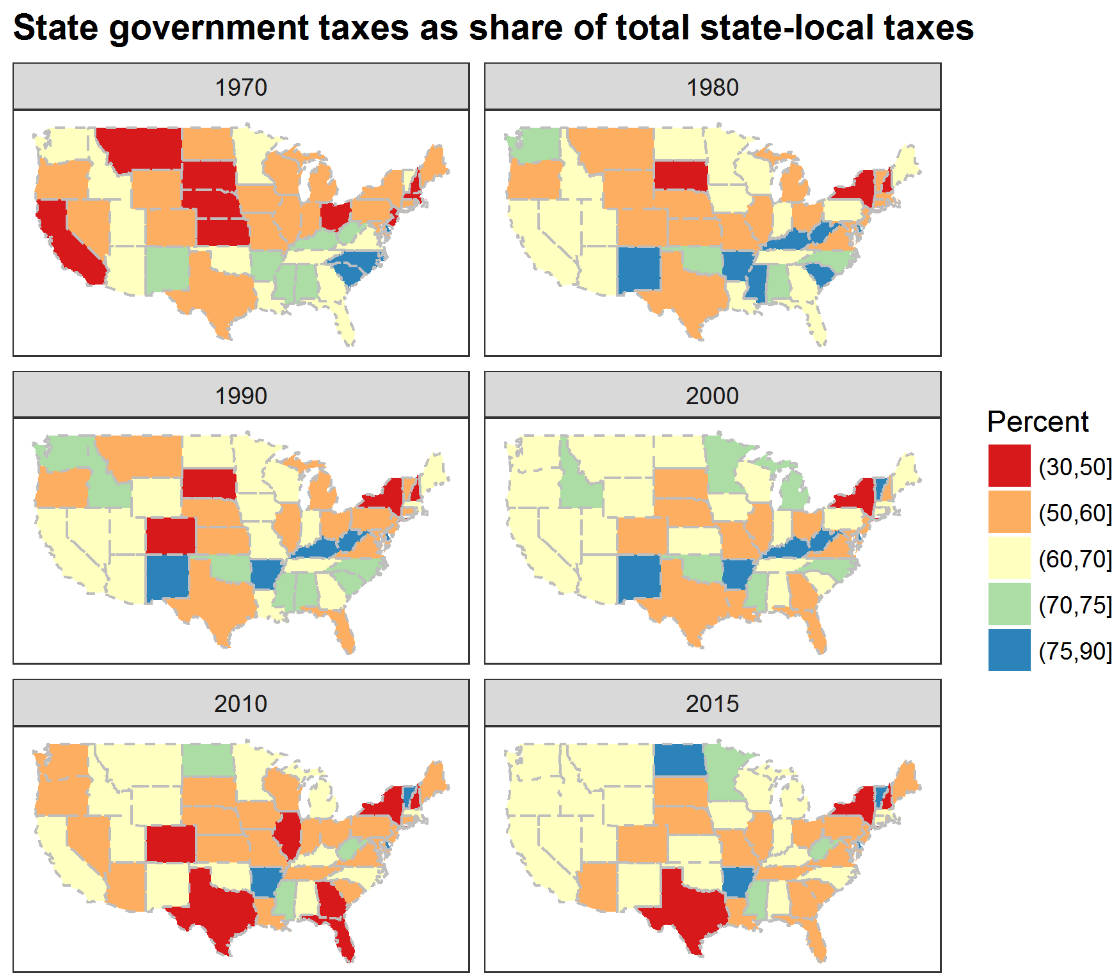
- Great variation in burdens (tax / PI as proxy for burden)
- Recent trend toward lower burdens
- South still low-tax, less so than decades before



Source: Rockefeller Institute analysis of data from U.S. Bureau of the Census

State & local splits of responsibility

- Great variation in how states & locals split taxing and spending
- Trend had been toward greater share of taxation at state level
- Some movement in other direction in last decade
- Implications, especially, for school funding

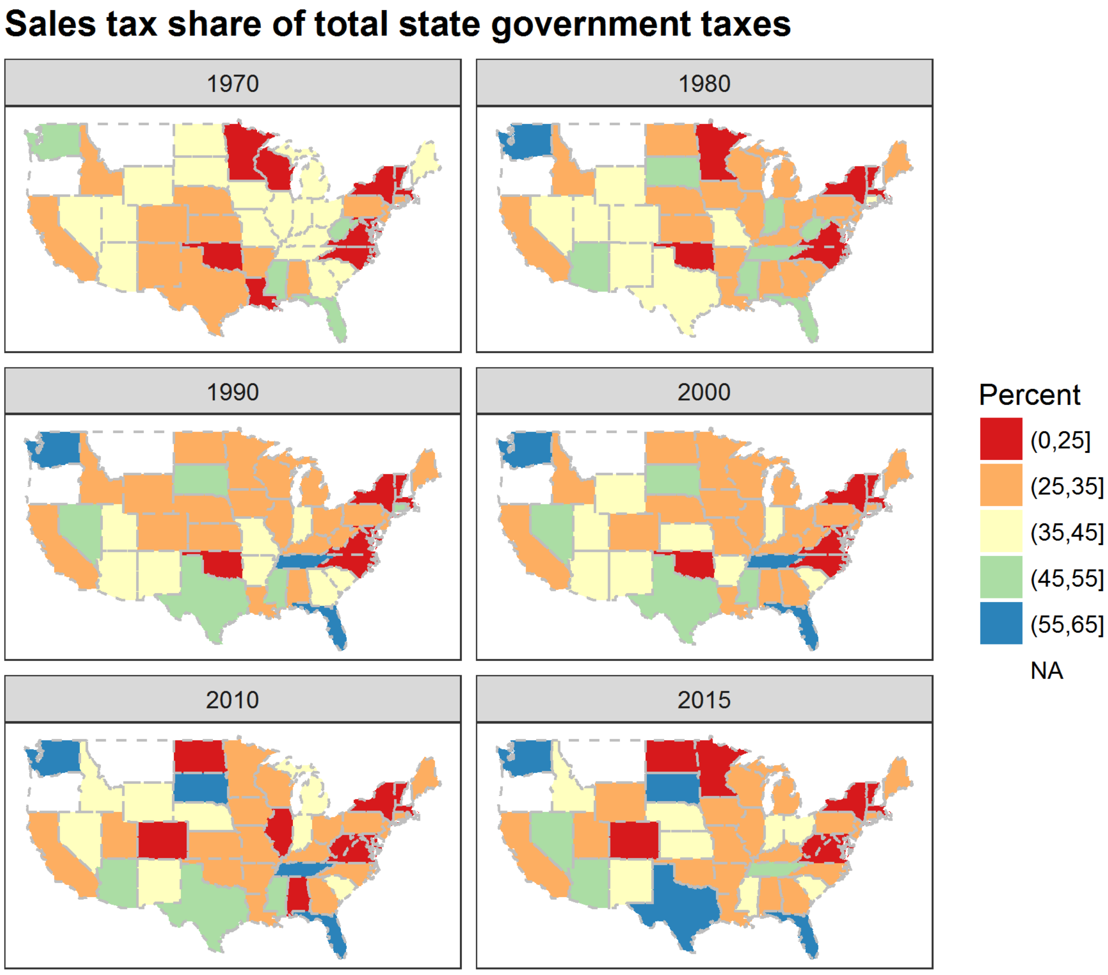


Source: Rockefeller Institute analysis of data from U.S. Bureau of the Census

State government sales tax reliance

- Generally greater in the south and southwest

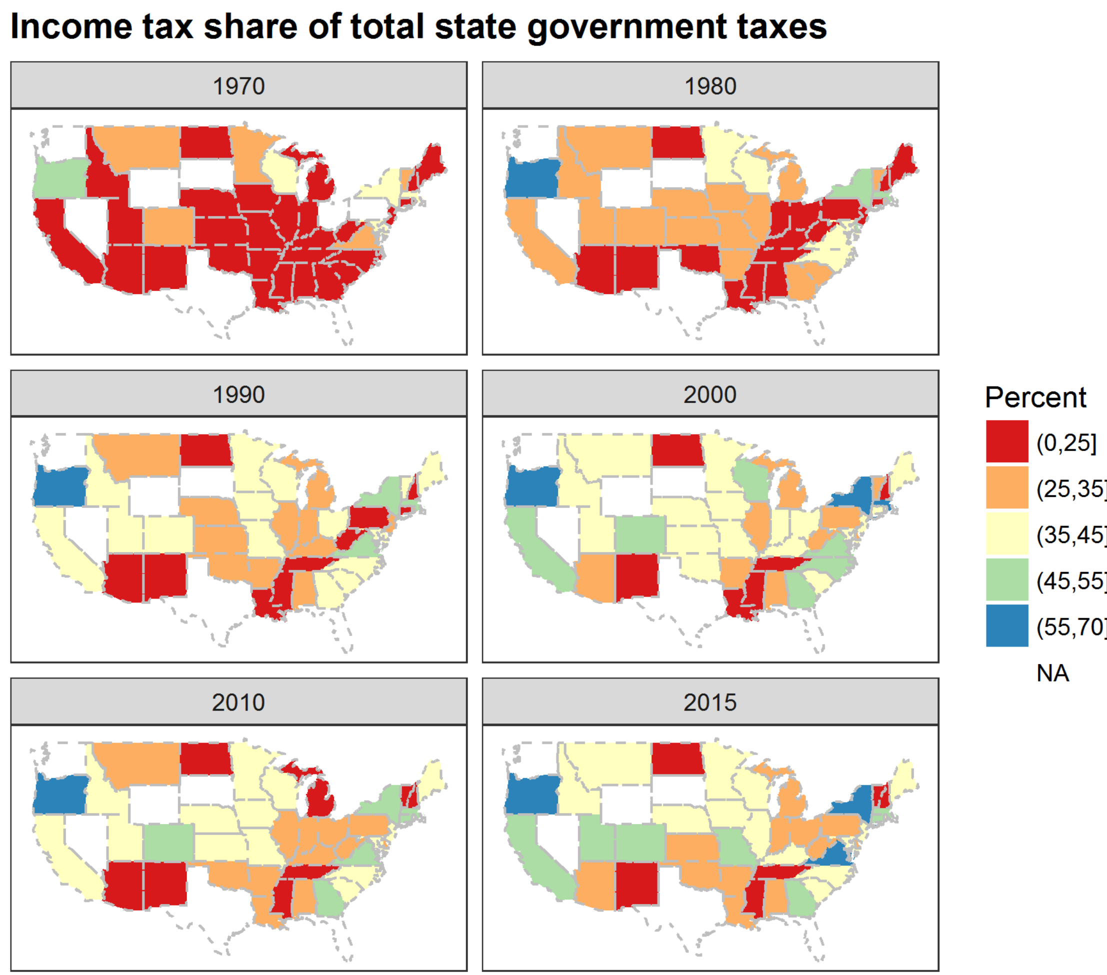
- Not big changes in recent decades



Source: Rockefeller Institute analysis of data from U.S. Bureau of the Census

State government income tax reliance

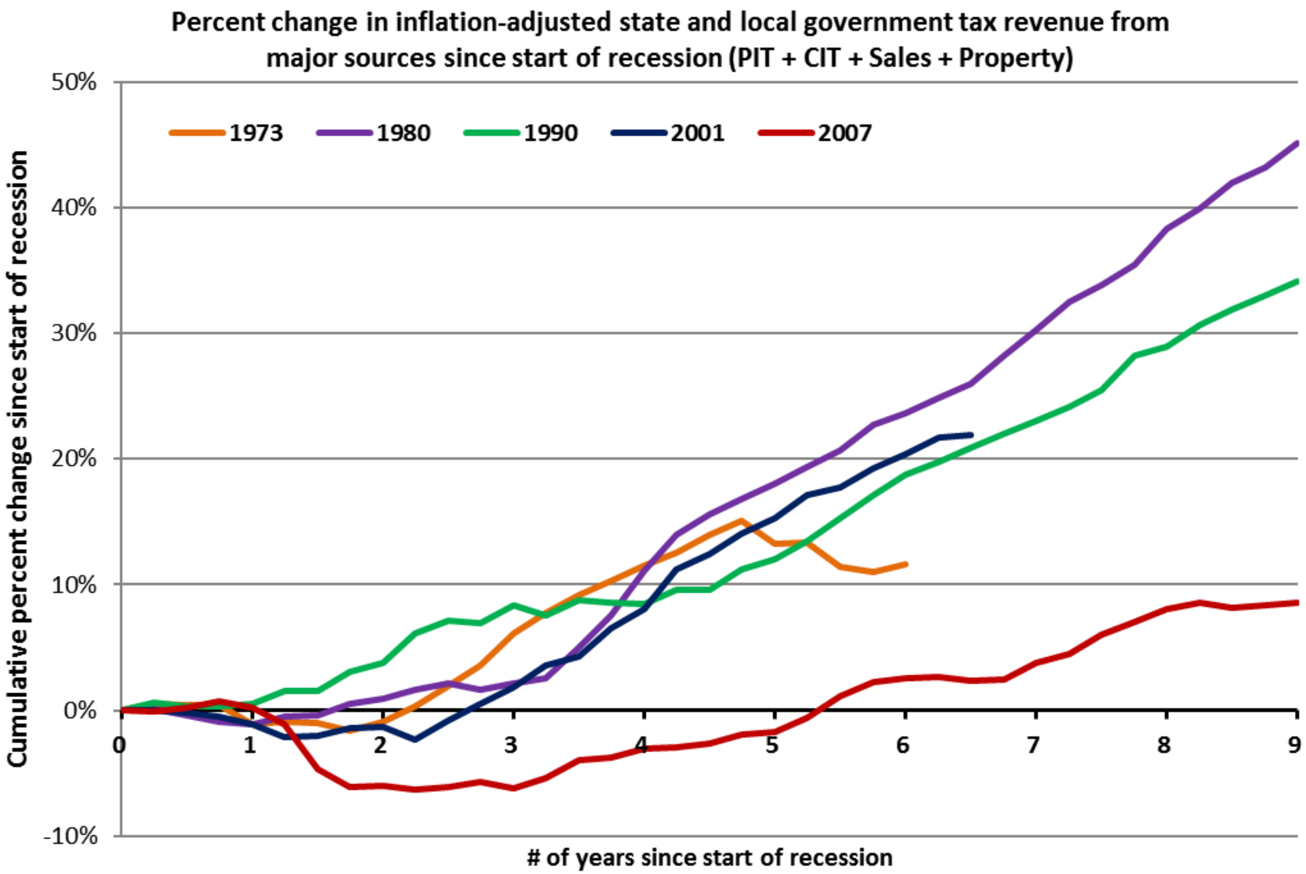
- Generally more on the coasts.
- Increasing shares, driven in part by economy.



Source: Rockefeller Institute analysis of data from U.S. Bureau of the Census

Selected issues

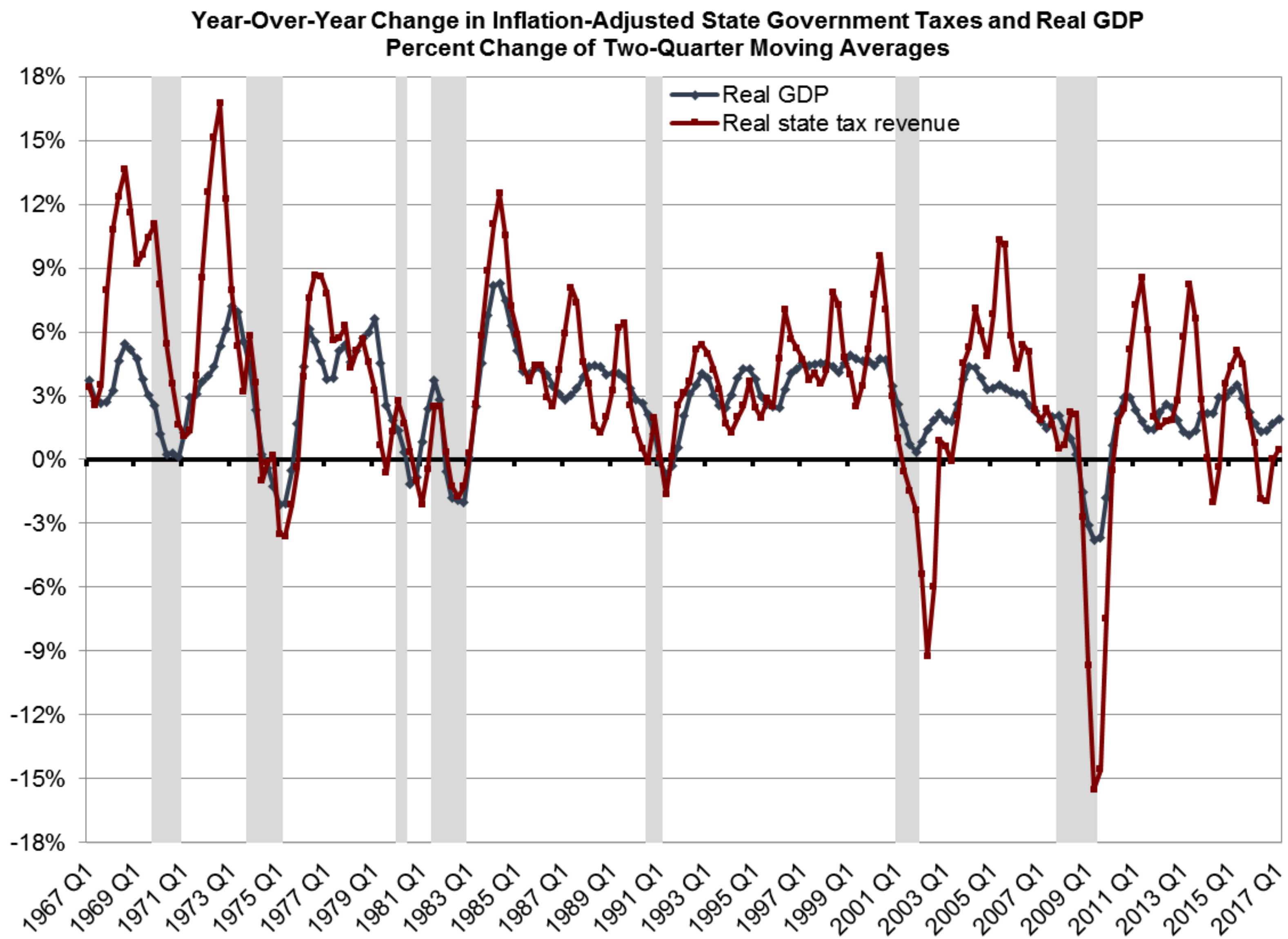
Growth in/after latest recession has been slow



Source: Rockefeller Institute analysis of data from U.S. Census Bureau.

Notes: Data are shown only until the start of the next recession; 1980 & 1981 recessions are treated as single recession.

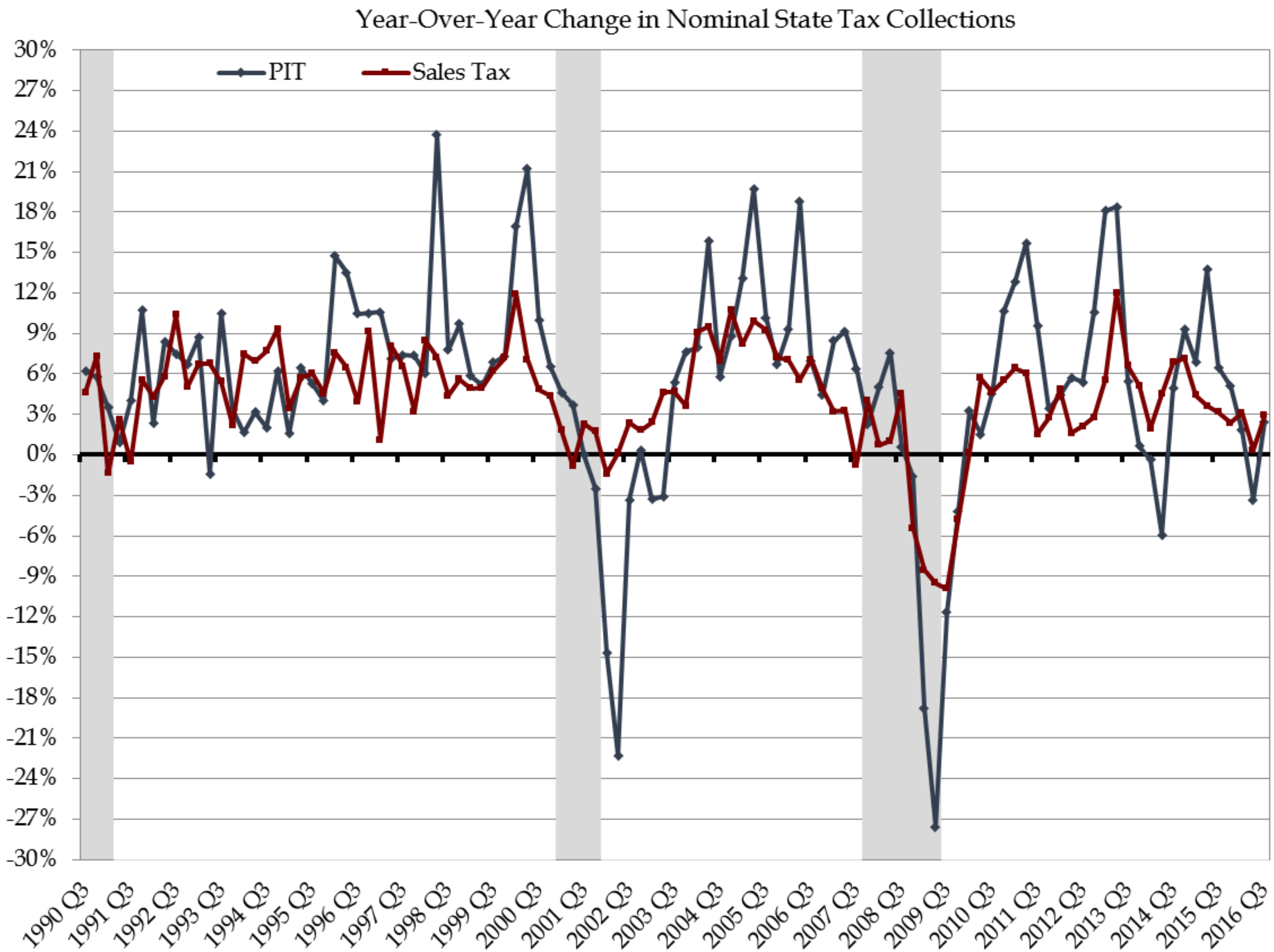
State taxes more volatile than economy, more volatile than before



Sources: U.S. Census Bureau (tax revenue) and Bureau of Economic Analysis (GDP).

Notes: (1) Percentage change of two-quarter moving averages; (2) No legislative adjustments; (3) Recession periods are shaded.

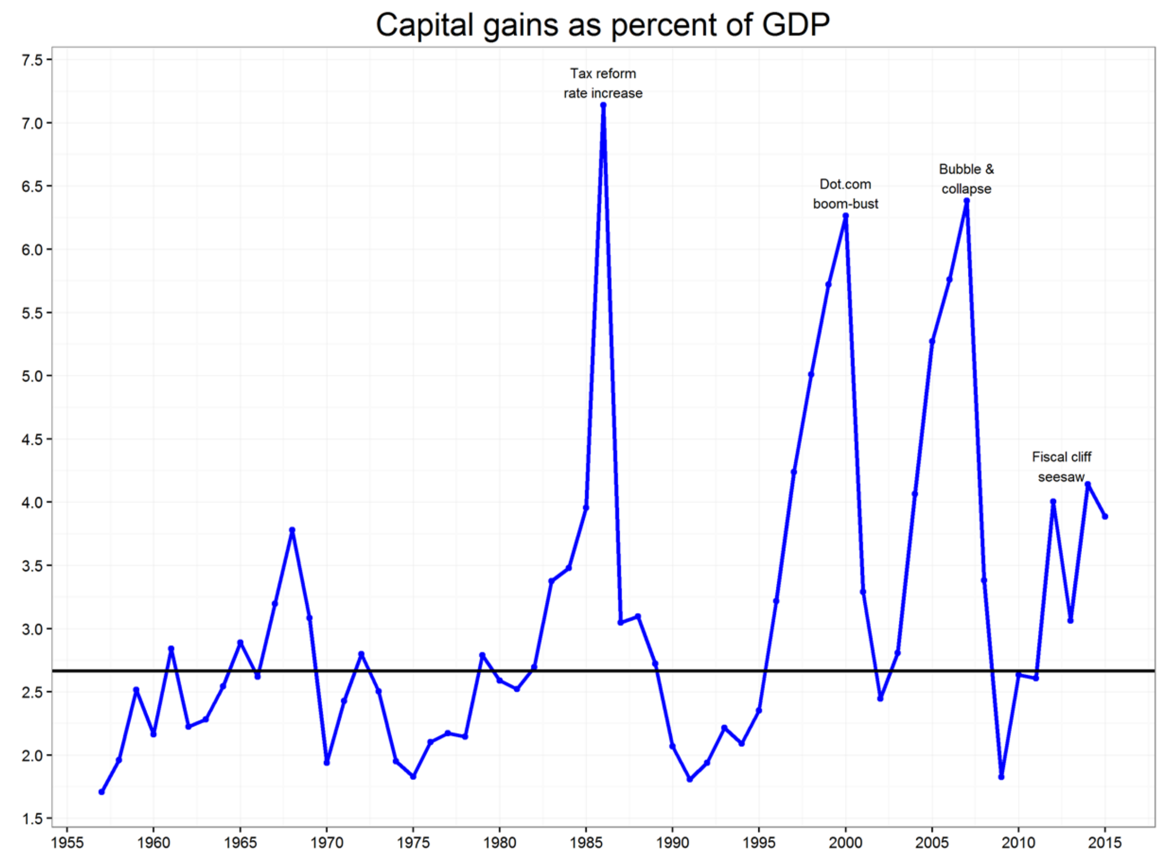
Income tax is much more volatile than before



Sources: U.S. Census Bureau, Quarterly Summary of State & Local Government Tax Revenue.
Notes: Data for the most recent quarter reflect adjustments by the Rockefeller Institute.

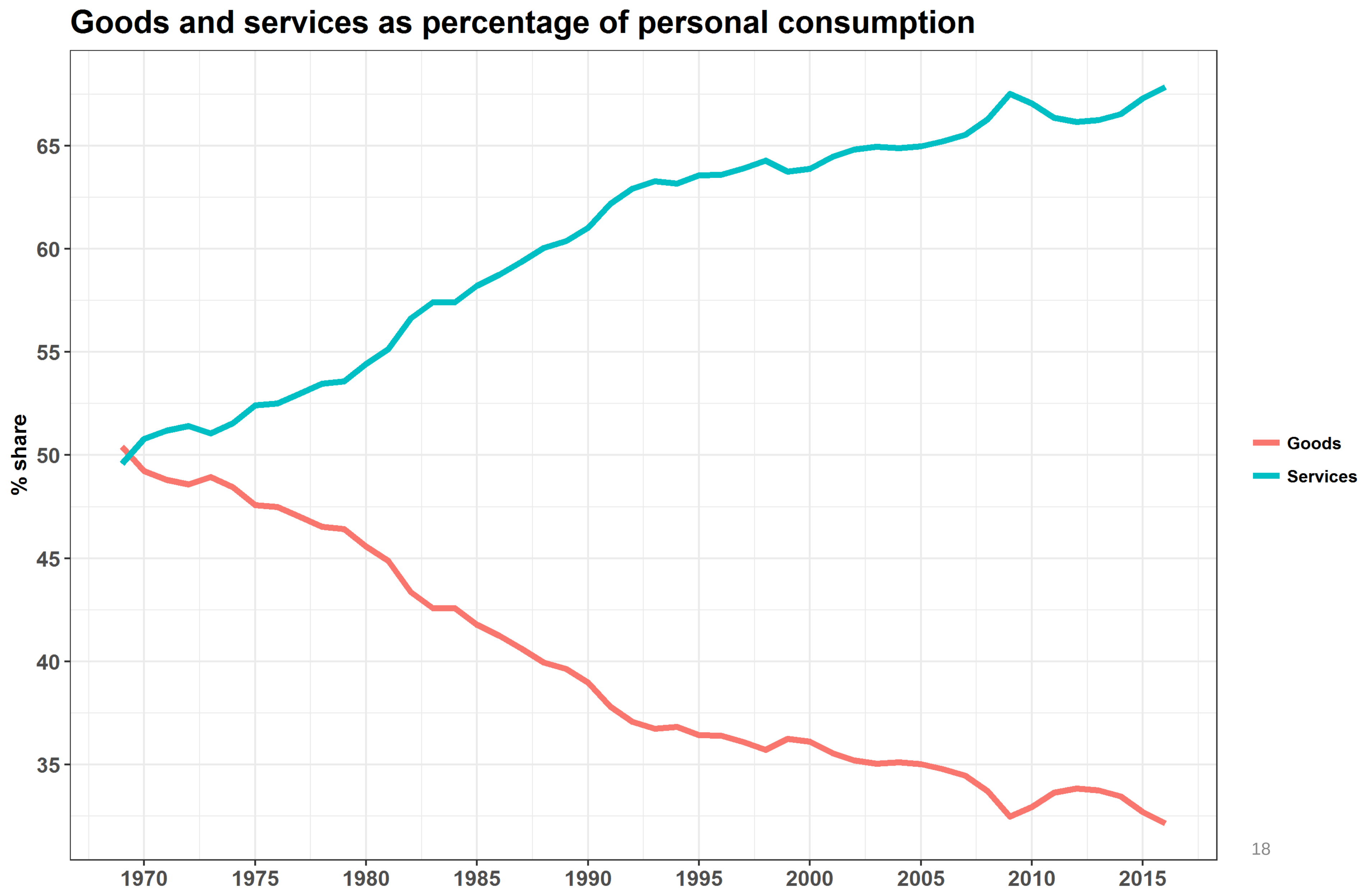
Capital gains is a big contributor to volatility

- Bubbles in 1990s and 2000s, followed by bursts
- Proposed and actual federal tax reforms led to huge volatility in 1986-1987, and to lesser volatility in 2012-plus.
- Depending on what feds do, could happen again.

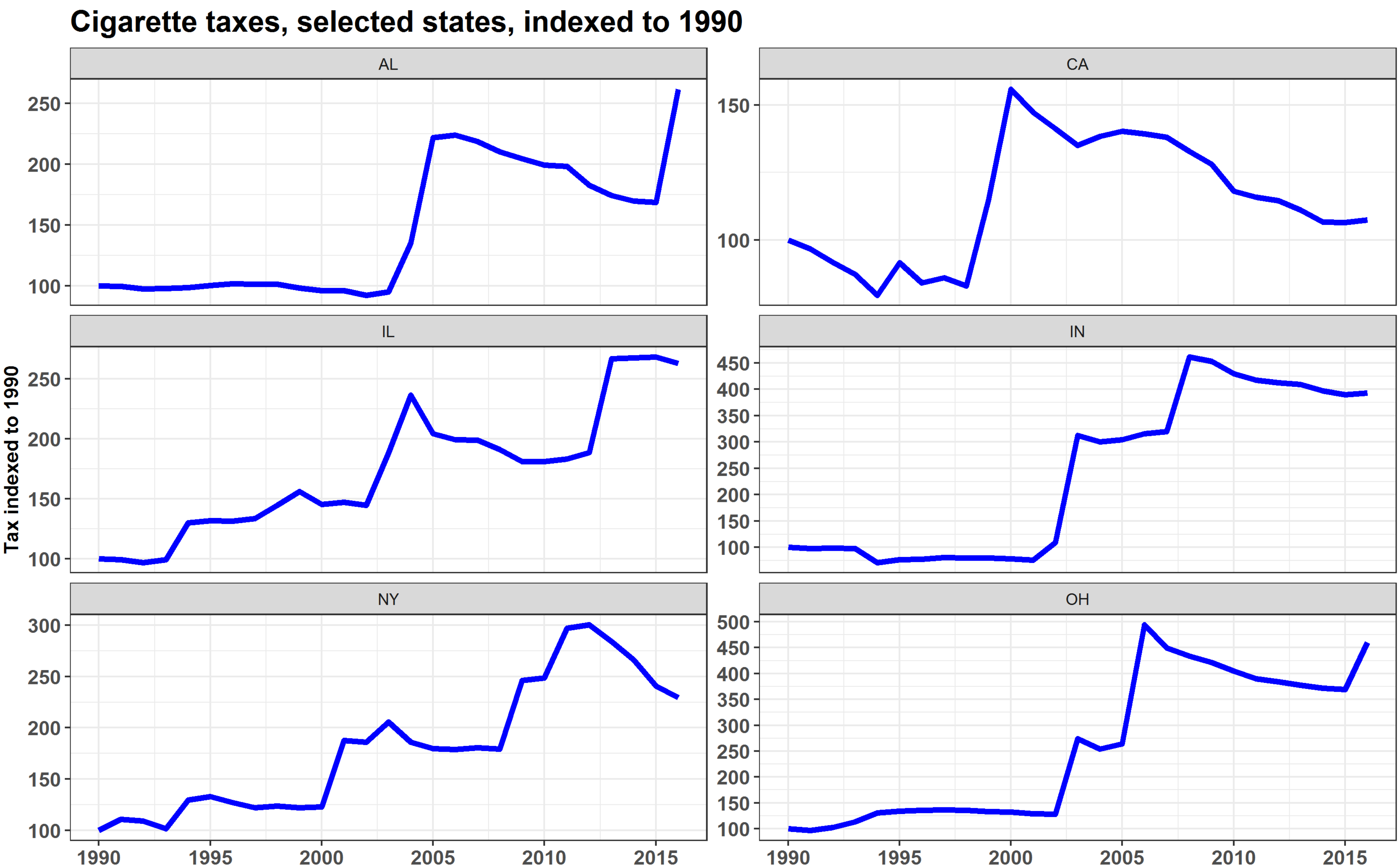


Sources: U.S. Department of the Treasury, Bureau of Economic Analysis, Congressional Budget Office
Note: Horizontal line shows long-run median

Sales tax base and collections: Declining because of (1) shift to services, (2) e-commerce



Cigarette taxes: They fall except when you raise 'em



Demographic change – selected issues

Two main reasons income tax is lower for older individuals

- Total income falls for older individuals – retirement income usually less than pre-retirement earnings. (Aggregate retirement income is growing rapidly, but total income of retirees is lower than before retirement.)
- Tax breaks! For example:
  - Exclusion of Social Security income, public pensions, private pensions, IRA/401(k) withdrawals.
  - Additional personal exemptions and credits for the elderly

Federally taxable retirement income is growing rapidly and will continue to do so

Retirement Income in Federal Adjusted Gross Income

Billions of dollars

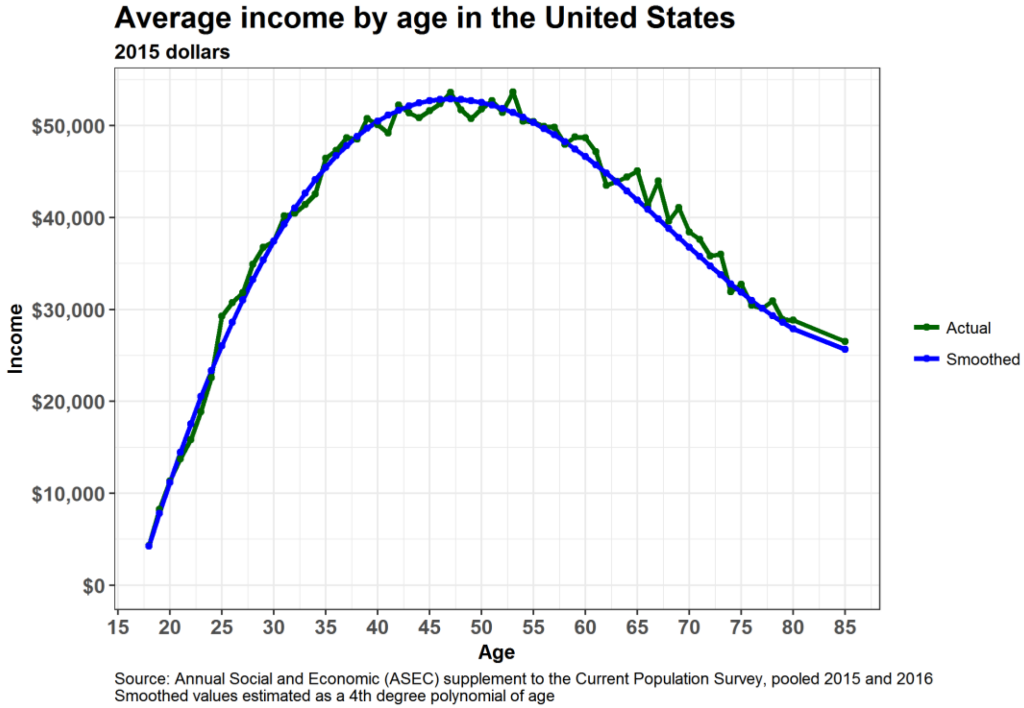
				Change from 2009 to 2014	
	2009	**2014**	**% share of AGI in 2014**	**Dollar change**	**Percent change**
Adjusted gross income	$ 7,801.0	$ 9,706.0	100.0%	$1,905.0	24.4%
Salaries and wages	5,710.9	6,729.6	69.3%	1,018.7	17.8%
Net capital gains less loss	224.1	696.6	7.2%	472.5	210.9%
Taxable pensions	516.5	659.6	6.8%	143.2	27.7%
Taxable Social Security	171.3	260.4	2.7%	89.1	52.0%
Taxable IRA distributions	133.9	236.4	2.4%	102.5	76.6%
Retirement income	821.7	1,156.5	11.9%	334.8	40.8%
All other non-retirement income	1,044.4	1,123.4	11.6%	79.0	7.6%

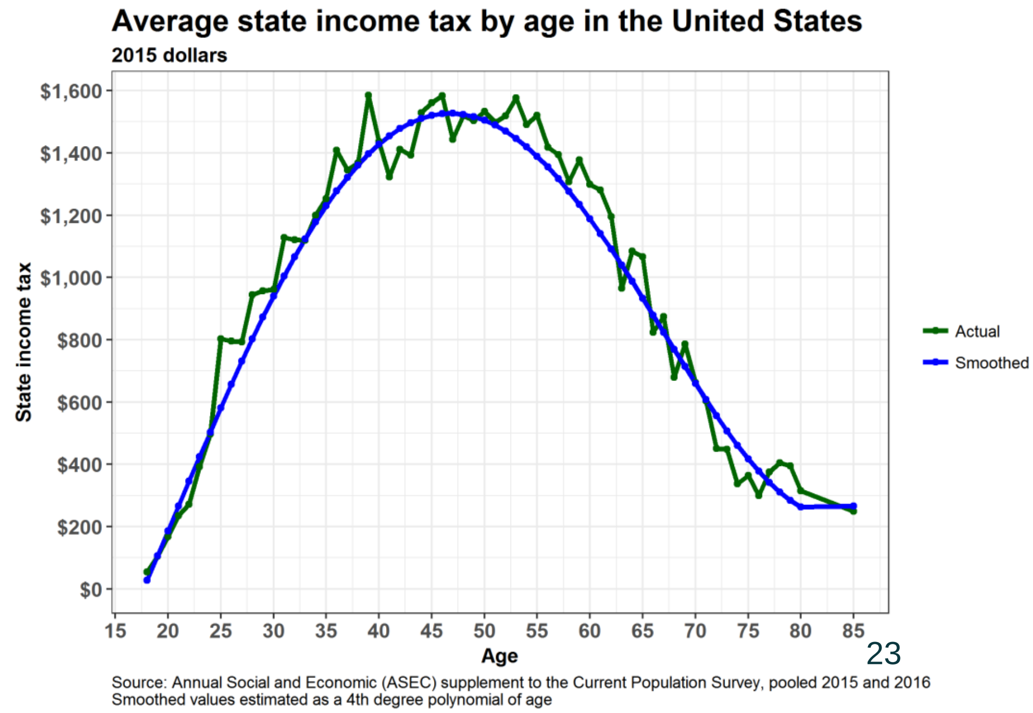
Source: IRS Statistics of Income, 09in54cm.xls and 14in54cm.xls

- In the U.S., and in most states, average incomes fall in cohorts older than about age 50. ("Average" in all of these graphs is the mean.)

- State income taxes fall, too, but much more sharply

Note: I show "smoothed" values in addition to the raw data because they will make comparisons across states easier in later slides.





State retirement income tax policies

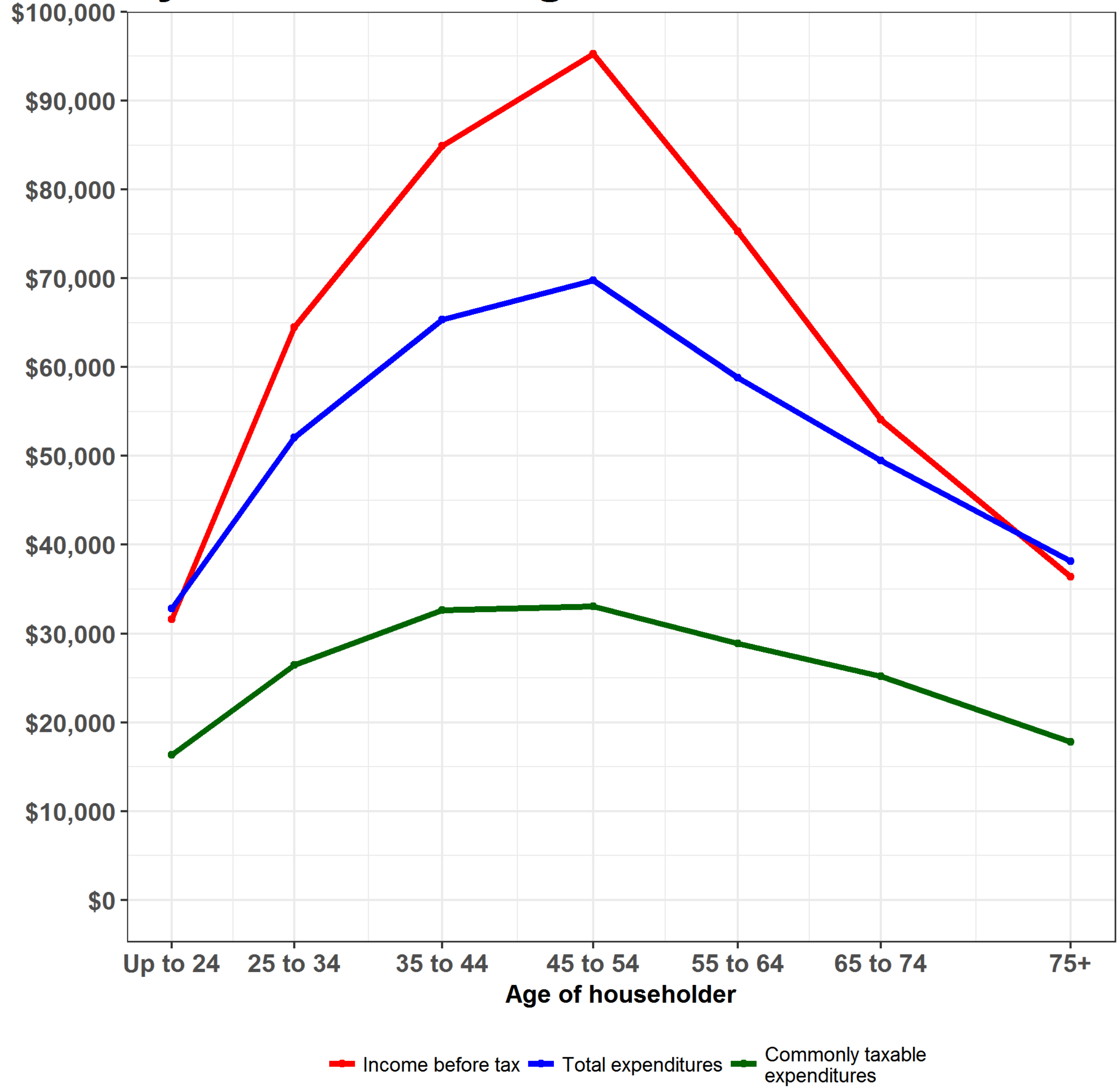
- 36 of 41 states with broad-based income tax provide exclusion for some retirement income (beyond Social Security), or elderly tax credit.
- NOT: CA, NE, ND, RI, VT

- Expenditures fall in older cohorts of households, but not as sharply as income falls

- Expenditures commonly taxed by states do not fall as sharply across cohorts as do total expenditures.

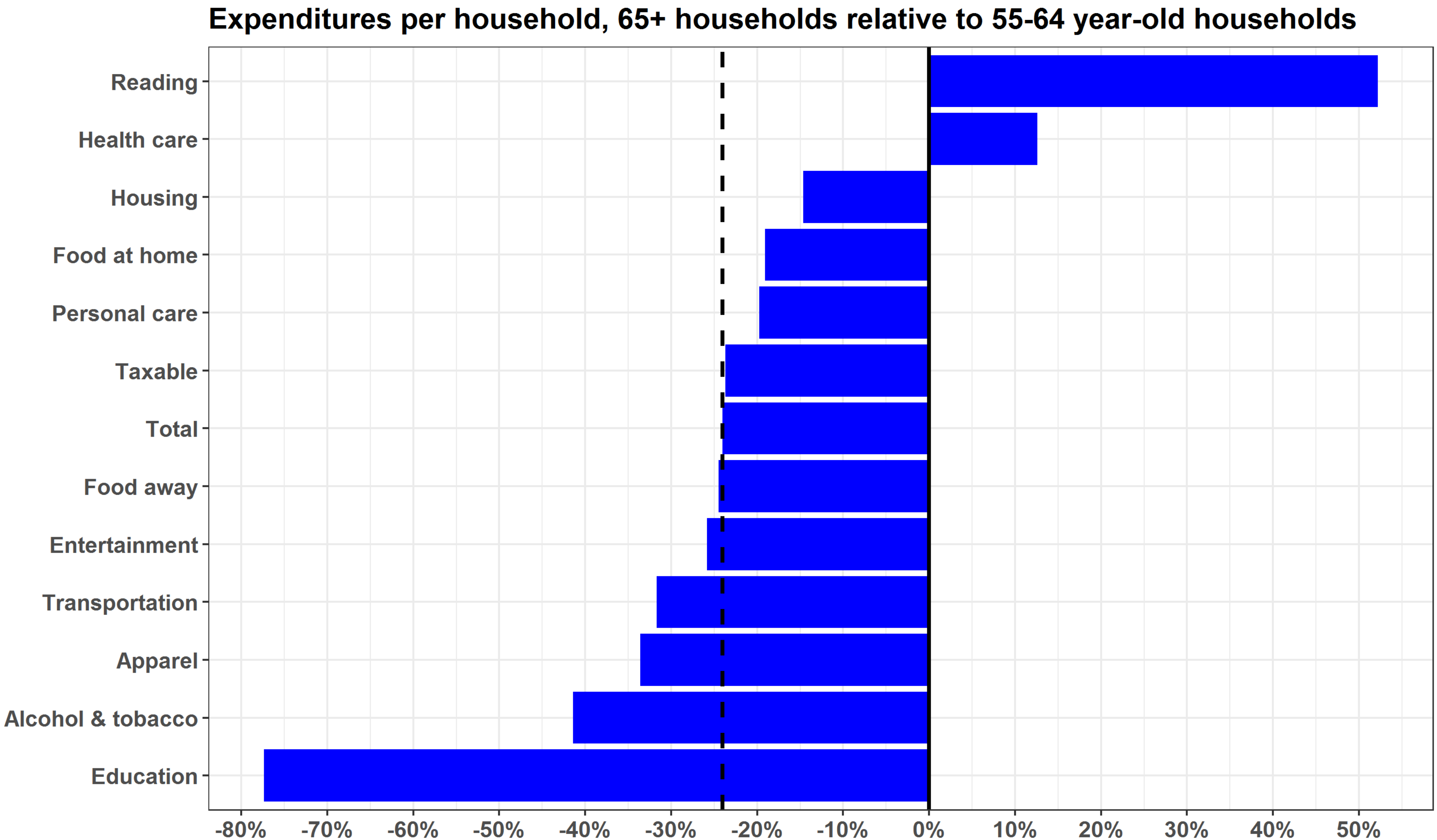
- Research that follows people over time suggests that people do reduce expenditures after they retire – they do not fully “smooth” consumption over their lives. (e.g., Hurd and Rohwedder 2006, Banerjee 2015)

Household income and expenditures by householder age



Source: U.S. Bureau of the Census, Consumer Expenditure Survey 2015
Table 1300 plus author's calculations

Age 65+ cohort spends less per household than age 55-64 households on most expenditure categories



Source: U.S. Bureau of the Census, Consumer Expenditure Survey 2015 Table 1300, plus author's calculations

Potential sales tax impact

- Felix & Watkins (2013) calc'd change in per-capita sales-taxable spending*, comparing projected 2030 age distrib to 2011 distribution. Assumed spending within age cohorts per 2011 Consumer Expenditure Survey (CEX). They found declines in 49 states, ranging from -3.3% in HI to +0.2% in ID. Average -0.5%.
- I updated with newer pop projections and with 2015 CEX.** Declines in 49 states, ranging from -2.1% in NC to +0.3% in ND. Average -1.3%.
- These impacts seem pretty small, given that they would occur over ~20 years.

* Apparel, transportation, entertainment, personal care products, food away from home, alcohol, tobacco products, reading material, housing costs except shelter and miscellaneous expenditures

** Slight difference: I compared 2030 to 2010, not 2011.

Selected observations about taxes

Tax	Observation	Why
Sales tax	Long run decline in base	Consumption moving increasingly to hard-to-tax services Purchases moving increasingly to hard-to-collect-from venues (Internet), away from bricks & mortar
Income tax	Short run – increasingly volatile	Greater reliance on capital gains, greater volatility in markets
Income tax	Long run – you have to cut it to stay even	Progressive taxes ordinarily are elastic – grow faster than economy
Excise taxes	Long run – for several, you have to increase them to stay even	Most are based on quantity, not value of sales – do not benefit from price increases. For some (e.g., tobacco, motor fuel) long-run consumption is declining or static
Corporate taxes	Long run decline	Reasons hard to pin down. LLCs. Smart corporate tax managers.
Property tax	A great local tax	Easier to implement in small geographic areas than income, sales, excise, corporate taxes. Not so easy to move real property. Still, lots of administrative and political problems.

Conclusion: You have great and challenging jobs

- State taxes always present interesting challenges for analysts.
- There's room for great technical work. In your jobs, often you have to communicate technical results clearly to policymakers. This is a special and important skill.
- You have big challenges ahead:
  - Fiscal strains
  - Federal tax reform; State and Local Tax deductibility issues
  - Income tax volatility
  - Long-term decline of the sales tax base and sales tax collections, and politically difficult policy responses
  - Demographic changes and taxes
  - Almost never met a tax anyone likes
- It's a good time to be a tax analyst

Appendix

Table 12

Dates of Adoption of Major State Taxes

Individual Income*

Before 1911	1911-20	1921-30	1931-40	1941-60	Since 1961
Hawaii, 1901	Wisconsin, 1911	North Carolina, 1921	Idaho, 1931	District of	West Virginia, 1961
Total, 1	Mississippi, 1912	South Carolina, 1922	Tennessee, 1931[1]	Columbia, 1947	Indiana, 1963
	Oklahoma, 1915	New Hampshire, 1923[1]	Utah, 1931	Alaska, 1949	Michigan, 1967
	Massachusetts, 1916	Arkansas, 1929	Vermont, 1931	**Total, 2**	Nebraska, 1967
	Virginia, 1916	Georgia, 1929	Alabama, 1933		Connecticut, 1969[2]
	Delaware, 1917	Oregon, 1930	Arizona, 1933		Illinois, 1969
	Missouri, 1917	**Total, 6**	Kansas, 1933		Maine, 1969
	New York, 1919		Minnesota, 1933		Ohio, 1971
	North Dakota, 1919		Montana, 1933		Pennsylvania, 1971
	Total, 9		New Mexico, 1933		Rhode Island, 1971
			Iowa, 1934		New Jersey, 1976
			Louisiana, 1934		**Total, 11**
			California, 1935		
			Kentucky, 1936		**Repealed**
			Colorado, 1937		Alaska, 1979
			Maryland, 1937		
			Total, 16		**Broad-based tax, 42**
					Narrow-based tax, 2
					Grand Total, 44

* States without an individual income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming. States with limited tax: New Hampshire (interest and dividends) and Tennessee (interest and dividends).

Corporation Income*

Before 1911	1911-20	1921-30	1931-40	1941-60	Since 1961
Hawaii, 1901	Wisconsin, 1911	Mississippi, 1921	Idaho, 1931	District of	Indiana, 1963
Total, 1	Connecticut, 1915	North Carolina, 1921	Oklahoma, 1931	Columbia, 1947	Michigan, 1967
	Virginia, 1915	South Carolina, 1922	Utah, 1931	Rhode Island, 1947	Nebraska, 1967
	Missouri, 1917	Tennessee, 1923	Vermont, 1931	Alaska, 1949	West Virginia, 1967
	Montana, 1917	Arkansas, 1929	Alabama, 1933	Delaware, 1957	Illinois, 1969
	New York, 1917	California, 1929	Arizona, 1933	New Jersey, 1958	Maine, 1969
	Massachusetts, 1919	Georgia, 1929	Kansas, 1933	**Total, 5**	New Hampshire, 1970
	North Dakota, 1919	Oregon, 1929	Minnesota, 1933		Florida, 1971
	Total, 8	**Total, 8**	New Mexico, 1933		Ohio, 1971
			Iowa, 1934		**Total, 9**
			Louisiana, 1934		
			Pennsylvania, 1935		
			Kentucky, 1936		**Repealed**
			Colorado, 1937		Michigan, 1976
			Maryland, 1937		
			Total, 15		**Grand Total, 45**

* States without a corporation income tax: Nevada, South Dakota, Texas, Washington, and Wyoming. Michigan repealed the corporate income tax in 1976 and replaced it with a single business tax, which is a modified value-added tax. The District of Columbia has a franchise tax.

General Sales*

1930-40	1941-50	1951-60	Since 1961
Mississippi, 1930–Arizona, 1933	Connecticut, 1947	Georgia, 1951	Texas, 1961
California, 1933–Illinois, 1933	Maryland, 1947	Maine, 1951	Wisconsin, 1961
Indiana, 1933–Iowa, 1933	Rhode Island, 1947	South Carolina, 1951	Idaho, 1965
Michigan, 1933–New Mexico, 1933	Tennessee, 1947	Pennsylvania, 1953	New York, 1965
North Carolina, 1933	District of	Nevada, 1955	Massachusetts, 1966
Oklahoma, 1933–South Dakota, 1933	Columbia, 1949	Kentucky, 1960	New Jersey, 1966
Utah, 1933–Washington, 1933	Florida, 1949	**Total 6**	Virginia, 1966
West Virginia, 1933	**Total, 6**		Minnesota, 1967
Missouri, 1934–Ohio, 1934			Nebraska, 1967
Arkansas, 1935–Colorado, 1935			Vermont, 1969
Hawaii, 1935–North Dakota, 1935			**Total, 10**
Wyoming, 1935–Alabama, 1936			
Kansas, 1937–Louisiana, 1938			
Total, 24			**Grand Total, 46**

* States without a general sales tax: Alaska, Delaware, Montana, New Hampshire, and Oregon.

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