Tax Revenue Options for the States

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NEA Research Department
Ronald D. Henderson, Director

February 2011

The views expressed in this report are those of the author.
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Abstract

This report illustrates how state and local governments in the United States could raise additional revenue by reforming their respective income, sales, property, and excise tax laws.

Executive Summary

In 1993, the late Steven Gold published a seminal report for the National Education Association on revenue-raising opportunities for the states. *Tax Options for States Needing More School Revenue* addressed many issues, including state/local distinctions, a framework for comparing taxes, a discussion of tax politics, and issues concerning earmarking. Most importantly, however, Gold's report detailed revenue-generating opportunities for each of the 50 states.

This report updates the Gold paper and identifies what individual states could do to raise additional tax revenue.[1] It should be noted that this report is being prepared during the lingering economic crisis facing the United States. Any proposals to raise revenue, particularly from broad-based taxes, must be evaluated in the context of the current (2010–2011) political and economic climate. In general, though, the net effect on a local economy of raising taxes and investing tax revenues in people and infrastructure is positive.

It should also be noted that the proposals discussed herein all comport with established principles of sound tax policy. That is, the proposals enhance—or at least do not diminish—adequacy, equity, efficiency, and economic development. Thus, not all possible state and local revenue raising options are discussed. For example, this report does not advocate the adoption or expansion of gambling. While such taxation can and does raise revenue, it does not meet the requirements of good tax policy.

The following sections briefly discuss the current environment of state and local public finance, with particular emphasis on the major types of taxes being utilized. The report then discusses the particular tax areas that have the most potential for increasing revenue. Those areas include personal income, corporate income, sales, property, and excise taxes. The report concludes with an analysis of how each state can increase its respective tax revenue.

[1] This report does not discuss intergovernmental aid from either federal or state governments. While such aid can and often does result in significant revenue, that discussion is beyond the scope of this work. User fees and charges are also not discussed, as they present little opportunity for significant revenue growth.

Sources of State and Local Revenue

State and local governments raise revenue from a variety of sources, including taxes, fees, licenses, and intergovernmental aid. Personal income and sales taxes have been the dominant sources of revenue for state governments for most of the last 75 years. Similarly, the property tax has long been the main source of local government tax revenue.

In 2009, state governments raised $715 billion in taxes.[2] This included $245 billion in personal income taxes, $228 in general sales and gross receipts taxes, $40 billion in corporate taxes, and $114 billion in various excise taxes. The 2009 census data for local government finances is not available at this time. In 2008, local governments raised $548 billion in taxes (excluding intergovernmental aid and fees). This amount included $397 billion in property taxes, $63 billion in local option sales taxes, and $26 billion in local option income taxes.

Raising Additional Revenue

The ability to raise additional revenue is largely limited to adjusting existing taxes either through base broadening or rate increases. Virtually all state and local governments have the ability to modify their major taxes in such a way as to substantially increase revenue. This section discusses some of the methods that can be used to increase revenue from personal income, sales, corporate income, excise, and property taxes.[3]

Personal Income Taxes

In 2010, 41 states and the District of Columbia levied personal income taxes. The states raised $245 billion, or 34 percent of total tax revenue, from personal income taxes. It is the single largest source of tax revenue for the states. The personal income tax is the only state tax that is progressive by design, so including personal income taxes in the overall mix of state taxes helps strengthen progressivity of the entire system. For the nine states that do not levy broad based personal income taxes, adoption of such levies would not only raise significant amounts of revenue but also would lead to a fairer tax system.

Strengthen Progressivity

For the 41 states taxing personal income, the most obvious and efficient method of increasing revenue is to increase the rates on upper-middle-income and wealthy taxpayers. Increasing rates on the wealthy can raise revenue and reduce the tax obligation of low-income taxpayers.

The progressivity of income tax systems varies widely from state to state. Income taxes achieve progressivity through graduated rate structures and/or personal exemptions and standard deductions. Furthermore, 23 states and the District of Columbia make use of earned income tax credits aimed at low-income, working taxpayers.

State income tax regimes are only mildly progressive (Rosenberg 2007, ITEP 2009). Most states have few designated brackets. A study by Lav, McNichol, and Zahradnik (2005) found that 23 states had top tax brackets starting at $30,000 or more.

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[2] Unless otherwise referenced, all data has been compiled from the United States Census Bureau.

[3] Estate and severance taxes are not discussed because the former will be greatly influenced by federal estate tax legislation. The latter is uniquely dependent on a state's natural resources. Moreover, insurance taxes, which raise substantial revenue, are not discussed because of expected changes resulting from federal health care reform.

In recent years, as a result of the economic crisis, states have turned to higher and more progressive income taxes to raise new revenue. Top rates were increased and/or capital gains breaks were scaled back by several states. In FY 2009, tax increases contributed $10.6 billion in net tax increase or 43.5 percent of total net change in state tax revenue (NCSL 2009). To cite some examples, Oregon added new top marginal tax rates of 10.8 percent and 11 percent to raise $243 million, while California raised income tax rates by 0.25 percent and reduced the dependent credit. The result of such actions is to increase the overall progressivity of the tax system. But even in the states that increased rates on the very wealthiest taxpayers, there is still the ability to raise additional revenue from income taxes.

Enhancing the progressivity of the personal income tax advances good tax policy and leads to additional revenue. Virtually every state has the ability to raise additional revenue through increasing rates on high-income citizens.

Minimize Use of Deductions and Exclusions

State governments can raise significant revenue by minimizing the use of deductions and exclusions from personal income. Such tax expenditures have long been criticized by public finance experts because they distort markets and complicate administration and compliance. But they also cost state governments billions of dollars. States could identify all exclusions, deductions, and credits that significantly reduce revenue and assess their benefits against their enormous cost.

For example, Oregon and North Dakota allow full deductions for medical and dental expenses. All other states with an income tax disallow such deductions, as they have already been accounted for on the federal return. Moreover, nine states (Alabama, Iowa, Louisiana, Missouri, Montana, North Dakota, Oklahoma, Oregon, and Utah) allow taxpayers to deduct some or all of their federal income taxes from state taxable income.

Nine states allow personal and/or corporate income tax credits and deductions for payments either to private schools or programs that provide scholarships to private schools. The nine states are Arizona, Florida, Georgia, Illinois, Iowa, Louisiana, Minnesota, Pennsylvania, and Rhode Island. Such deductions are widely criticized as amounting to disguised vouchers for private schools. In addition to costing the states revenue, they undermine support for public education (see Brunori 2001).

One area, in terms of revenue loss, is blanket college tuition deductions. In 2009, 28 states and the District of Columbia offered deductions for college tuition payments or payments to Section 529 plans. These deductions provide benefits to parents with college-age children, but they are not generally tied to income. These blanket deductions cost the states substantial amounts of revenue, and yet most parents who use them would send their children to college even without the tax break. The chart on the next two pages details the deductions offered by the states.

Annual Cap on the Tax Break

Colorado	Unlimited deductions up to the amount of your taxable income.*
Connecticut	$5,000 deduction; $10,000 for married couple filing jointly.
District of Columbia	$3,000 deduction; $6,000 for married couple filing jointly; a couple with one child must have two accounts to get the full $6,000.
Georgia	$2,000 deduction per beneficiary; declines above $50,000 in income or $100,000 for married couple filing jointly.
Idaho	$4,000 deduction; $8,000 for married couple filing jointly.
Illinois	$10,000 deduction; $20,000 for married couple filing jointly.
Indiana	$1,000 tax credit (20% of deposit up to $5,000) starting in 2007.
Iowa	$2,500 deduction per beneficiary; $5,000 for married couple filing jointly.
Kansas	$3,000 deduction for each beneficiary; $6,000 for married couple filing jointly.
Louisiana	$2,400 deduction per beneficiary per year; $4,800 for married couples filing jointly; state matches deposits on up to 14% of deposit, depending on income.
Maine	$250 deduction per beneficiary starting in 2007 if income is below $100,000 (or $200,000 for married couple filing jointly).
Maryland	$2,500 per account holder per beneficiary (or $10,000 if each parent maxes out the deduction in both of the state's 529 plans).
Michigan	$5,000 deduction; $10,000 for married couple filing jointly.
Mississippi	$10,000 deduction; $20,000 for married couple filing jointly.

Missouri	$8,000 deduction; $16,000 for married couple filing jointly (both spouses must have income and separate accounts).
Montana	$3,000 deduction; $6,000 for married couple filing jointly.
Nebraska	$1,000 deduction per household.
New Mexico	Unlimited deductions up to the amount of your taxable income.*
New York	$5,000 deduction; $10,000 for married couple filing jointly.
Ohio	$2,000 deduction per beneficiary per household.
Oklahoma	$10,000 deduction; $20,000 for married couple filing jointly.
Oregon	$2,000 deduction per household.
Rhode Island	$500 deduction; $1,000 for married couple filing jointly.
South Carolina	Unlimited deductions up to the amount of your taxable income.*
Utah	$1,560 deduction per beneficiary; $3,120 for married couple filing jointly.
Vermont	$100 tax credit (5% of deposit up to $2,000) per beneficiary; $200 for married couple filing jointly.
Virginia	$2,000 deduction per year, per account. Multiple accounts are fine, up to certain limits.
West Virginia	Unlimited deductions.*
Wisconsin	$3,000 deduction per beneficiary per household.

Source: United States Department of Education and Greenstein, Rogoff, Olsen, & Co.

*Limit the total amount you can have deposited in a 529 plan at any one time.

Wallace and Edwards (1999) found that "the growth in the number of exemptions and exclusions from income taxation are potentially reducing its stability as a long-run revenue source for state and local governments." Again, minimizing the use of deductions and exclusions is both good tax policy and an effective means of raising additional revenue. And every state has the ability to broaden its personal income tax base and collect substantially more revenue.

Corporate Income Taxes

In the United States, 45 states and the District of Columbia levy corporate income taxes. In 2009, this tax accounted for $40 billion or about 5 percent of total state tax revenue. The state corporate income tax has a controversial history. It raises relatively little revenue yet consumes an inordinate amount of resources. Still, as long as the corporate tax is being levied, it has the potential to raise significantly more revenue.

Require Combined Reporting

The most effective and efficient way of increasing corporate tax revenue is to require combined reporting. Indeed, as a matter of good tax policy, states could require combined reporting to counter the tax-avoidance strategies of corporations. Combined reporting treats the parent and most or all of its subsidiaries as a single corporation for state income tax purposes. States could require unitary-based combined reporting for all related corporations. Under this requirement, all related corporations would apportion their respective state tax returns as a single business. Combined reporting would severely limit corporations' ability to avoid state corporate tax responsibility through a variety of tax-avoidance strategies that are based on artificially shifting profits to subsidiaries located in no- or low-tax states. It would also add billions of dollars to state tax revenue.

There is growing recognition that states that do not mandate combined reporting are vulnerable to a variety of corporate tax-avoidance strategies. Sixteen states have mandated combined reporting for at least two decades. Vermont enacted the policy in 2004, and it went into effect there in 2006. New York enacted a combined reporting law in April 2007, retroactive to the beginning of the year. Texas and West Virginia implemented combined reporting in 2008 and 2009, respectively. Combined reporting is also included in a "Michigan Business Tax" that went into effect in 2008. As of 2009, a total of 23 states now require combined reporting. But 22 states still do not.

States Could Use the Three-Factor Formula

States could use the three-factor formula as it is the most fair and effective way of allocating multi-state business income. More importantly, most public finance experts agree that using the three-factor formula will raise additional corporate tax revenue. As of 2010, only 13 states and the District of Columbia use the three-factor formula.

The Uniform Division of Income for Tax Purposes Act (UDITPA) recommends an apportionment rule that relies equally on three different factors in determining the share of a corporation's profits that can be taxed by a state. These factors are as follows:

- The percentage of a corporation's nationwide property that is located in a state.
- The percentage of a corporation's nationwide sales made to residents of a state.
- The percentage of a corporation's nationwide payroll paid to residents of a state.

The main rationale for using these three factors to determine taxable income is that companies benefit from a state's public services in a variety of ways, including owning property in a state, making sales within a state, and having an in-state employee base. The three-factor formula ensures that corporate tax responsibility reflects the benefits received by each type of corporation.

Using the apportionment rule UDITPA recommends would be an important step toward ensuring that all corporate profits are subject to taxation. However, over the past 20 years many states have chosen to reduce the importance of the property and payroll factors and increase the importance of the sales factor. The majority of states now use apportionment formulas that give "double weight" or greater to the sales factor: in such formulae, a corporation's in-state sales are at least twice as important as each of the other factors. At the extreme, more than a dozen states now rely entirely on the sales factor in determining at least some corporations' tax liabilities. This approach is known as the "single sales factor" or SSF. Returning to a more uniform set of apportionment rules is an important first step in preventing widespread tax avoidance and ensuring that state corporate income taxes are applied fairly.

Decouple from the Domestic Production Deduction

The federal government created a tax break known as the "domestic production deduction" in 2004. Since most states base their own tax codes on federal law, the tax break was carried over into many states without specific legislative scrutiny or a vote. It is costing the federal government and 25 states a large and growing amount of money. By 2011, it will cost these states over $500 million per year.

The deduction—enacted as Section 199 of the federal Internal Revenue Code—allows companies to claim a tax deduction based on profits from "qualified production activities," a sweeping category that goes well beyond manufacturing to include a substantial share of states' corporate income tax base.

The revenue loss to states that still allow the deduction increased steeply in 2010 because of how the federal credit is designed. Initially, the cost was relatively modest because the deduction was limited to 3 percent of qualifying income. As of January 1, 2007, the percentage rate rose to 6 percent. The final increase to 9 percent took effect in the 2010 tax year. Federal estimates suggest that allowing this deduction will reduce the revenue yield of corporate taxes by roughly 3.1 percent in 2011 and also reduce individual income taxes somewhat.

States are not required to allow this deduction. Since 2008, Connecticut, New York, Wisconsin, and the District of Columbia have joined 18 other states in disallowing the deduction and thereby reducing their current budget shortfalls and benefiting their states' economies. But another 25 states continue to permit it. If they continue to do so, a conservative estimate suggests the tax break will cost those states almost $505 million in 2011 (Johnson and Singham 2010).

Throwback/Throwout Rules and Nowhere Income

States could consider implementing "throwback" or "throwout" rules to deal with "nowhere income." Ideally, all of a company's sales would be attributed to the states in which it operates. But, due to differences among states' corporate income tax rules, this is not always the case. In some instances, a portion of a business' sales are not attributed

to any state, either because that state does not levy such a tax or because the company doesn't have sufficient level of activity in the state to warrant the tax. This means that a corresponding portion of its profits go untaxed, a phenomenon often referred to as "nowhere income." Corporations are aware that they can significantly reduce their corporate tax responsibilities by careful planning. Such planning often entails little more than creating subsidiaries with few or no assets or business activity in low- and no-tax states.

One remedy for the problem of nowhere income is enacting a "throwback rule," which mandates that sales into other states that are not taxable will be "thrown back" into the state of origin for tax purposes. Twenty-seven states use the throwback rule, but the following 18 states that tax corporate income do not: Arizona, Connecticut, Delaware, Florida, Georgia, Iowa, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Nebraska, New York, North Carolina, Pennsylvania, South Carolina, Tennessee, and Virginia.

One alternative to the throwback rule is the "throwout" rule. Rather than seeking to assign all sales to the states in which the company operates, the throwout rule simply excludes from overall sales any sales that are not assigned to any states. West Virginia and New Jersey are the only states with a throwout rule, although New Jersey's throwout rule is scheduled to be repealed in 2011.

Companies aggressively pursuing tax avoidance strategies can reduce their state tax bill far below what they ought to pay—and far below the taxes paid by competing companies. Allowing companies to minimize their tax responsibility through these strategies distorts economic incentives, puts other businesses at a disadvantage, and drains tax revenue that could be used to finance vitally important long-term public investments. Throwback and throwout rules can help to level the economic playing field among all businesses and reduce state fiscal stress by simply ensuring that all of the profits companies earn are subject to taxation in the states in which they do business.

Minimize Use of Tax Incentives to Corporations

The granting of tax incentives to corporations has proliferated in the past quarter century. Every state offers some form of tax benefit to corporations that relocate to or remain in its jurisdiction. And most states offer tax incentives for particular types of investment. States could minimize the granting of tax incentives to corporations. In addition to forgoing significant amounts of revenue, such actions violate every principle of sound tax policy by shrinking the tax base, undermining equity, and undermining efficiency.

There is an abundance of research that has found corporate tax incentives to be largely unnecessary (the corporation would have taken the desired action even without the tax break). Thus, tax incentives cost states tremendous amounts of revenue (see Brunori 2005 for an in-depth discussion).

States have given out far more corporate tax incentives than can be listed here, bBut some examples illustrate the size of the lost revenue. Under the threat of moving facilities and jobs elsewhere, Citigroup has received a total of at least $285.9 million from 1989 to 2007 in subsidies just in New York, New Jersey, Kentucky, and Texas combined (Stecker and Steinberg 2007). It is no surprise for one commentator to conclude that "[a]ll the evidence points to a single conclusion: state tax incentives are a thoroughly unproven tool for promoting economic development" (Enrich 1996).

Sales and Use Taxes

In 2010, 45 states and the District of Columbia levied sales and use taxes. The only states that do not levy sales and use taxes are New Hampshire, Oregon, Montana, Alaska, and Delaware. In 2009, the sales tax raised about $228 billion, which accounted for 31 percent of total state tax revenue. The state sales tax is among the most efficient and effective means of raising revenue.

All Final Consumption Could be Taxed, Minimize Exemptions

So that the base is as broad as possible and the tax is easy to administer, all final consumption could be subject to a broad-based sales tax. The use of exemptions could be kept to a minimum.

Many exemptions to sales tax are well-intentioned: they reduce the tax responsibility of poorer citizens who spend a greater portion of their income on consumption goods than do the wealthy or ease the administration of the tax. To help lessen the regressivity of the tax on the poor, 32 states fully or partially exempted food designated for home consumption from the tax; all 45 states exempted prescription medicine, and 12 states exempted non-prescription medicine.

There are two main problems associated with the abundance of exemptions. First, excessive exemptions force states to forgo revenue. Indeed, sales tax revenue would probably double if all consumption were taxed (Brunori 2005). Second, the widespread use of exemptions results in higher tax rates on products and services that are subject to taxation (Mikesell 1992). It is estimated that, from 1979 to 1997, 21 percent of total sales tax revenue was the result of rate increases, despite an anti-tax fever spreading through the states (Fox 1997). As exemptions became more commonplace, rates had to be increased on the remaining tax base to maintain existing revenues.

States could consider adding items deemed necessities back to the tax base to broaden the tax base. While such exemptions are often intended to reduce the tax responibility of the poor, the evidence is mixed, at best, as to whether such exemptions accomplish their goal (Brunori 2005). Furthermore, these exemptions cost states substantial revenue because middle- and upper-income individuals enjoy the exemptions as well. If states are serious about helping the poor, they could look into refundable income tax credits and other direct payments instead of a plethora of exemptions to the sales tax, which reduces and narrows the base.

Remote Sales Could be Taxed

Internet and mail order catalogue sales could be taxed by the state in which the consumer resides. The inability to do so costs the states billions of dollars in lost revenue. It is estimated that 25 percent of taxes due on e-commerce go uncollected (Bruce, Fox, and Luna 2009).

The *Quill* Supreme Court decision requires that a business have a physical presence in a state before it is legally obligated to collect sales tax. Most remote sales are made by vendors with no physical presence in the market state. But states face significant revenue losses as a result. From 2010 to 2012, Internet sales are projected to jump from $3 trillion to $4 trillion, while the loss in state sales tax revenue will grow from $8.6 billion to $11.4 billion over the same time period. The expected state losses as a result of their

inability to tax e-commerce in 2010 are as high as $1.4 billion in California, $654 million in New York, and $153 million in New Jersey (Bruce, Fox, and Luna 2009).

The most viable way of collecting taxes on remote sales is through the Streamlined Sales Tax Project (SSTP). The SSTP is a multistate project with the objective of establishing a voluntary, streamlined system for administering and collecting sales and local government sales and use taxes. The Project's main goal is to reduce the complexity and administrative responsibility currently borne by businesses in collecting use taxes in interstate transactions. As of July 1, 2009, 23 states have passed legislation to bring state sales tax laws into compliance, or at least partial compliance, with the Streamlined Sales and Use Tax Agreement.[4]

Services Could be Taxed

The most immediate policy change that would greatly increases sales tax revenue is the expansion of the tax to include all services purchased by individuals. Services could be taxed to account for the changing makeup of personal consumption from that of mostly goods to that of mostly services. Taxing services would raise considerable additional revenue. Taxing services would reduce the year-to-year volatility of sales tax collections.

There is general consensus that services—particularly, consumer services—could be taxed (Fox 1998, Mikesell 1998). Nonetheless, most services are exempt in most states that levy the sales tax (Federation of Tax Administrators 2005). There is no special reason that services remain largely untaxed; it is simply due to historical trends. When sales taxes were first implemented in the 1930s, services were a small fraction of the national economy, so states did not miss much revenue from not taxing them.

However, not taxing services nowadays results in a significant loss of revenue for the states. Services now account for nearly 60 percent of personal consumption. Even though states have broadened the tax base to include more services in the past decade, many services that would yield the most revenue (e.g., health care, construction, legal, and accounting) go untaxed.

With a great percentage of consumption exempt from sales taxation, broadening the base would result in significant additional revenue for the states. Mazerov (2009) estimates that if all services besides health care, education, housing, and a few others were to be taxed, $87 billion of additional tax revenue could be realized annually on a nationwide basis. In Georgia alone in 2006, $1.6 billion in extra revenue could have been collected had household services been taxed (Matthews, Sjoquist, and Winters 2007). States that do not tax services to any significant degree currently—such as California, Illinois, Massachusetts, and Virginia—probably could increase their sales tax revenue by more than one-third if they taxed a wide range of services (Mazerov 2009).

Taxing services would also lead to a more elastic tax base. One of the virtues of the sales tax is that it is a relatively stable source of revenue. It neither rises nor falls as quickly as personal income. But that stability is dependent on a broad base, and it is challenged when large segments of potentially taxable consumables are removed from that tax base. The sales tax base is not nearly as stable as it was designed to be or could be. And the most viable policy for broadening the base is to tax services (Hendrix and Zodrow 2004).

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[4] The 23 states that have passed legislation are: Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming.

Excise Taxes

Various excise taxes are levied by every state. Total excise taxes raised approximately $114 billion, or 15 percent of total tax revenue. The excise taxes most commonly in use in 2009 were on tobacco products ($16 billion), fuel ($35 billion), and alcohol ($5 billion).

Excise taxes present interesting issues for states seeking to raise revenue. Their only legitimate tax policy rationale is to compensate society for the externalities caused by the use of particular products. Yet, with the exception of fuel excise taxes, states have rarely earmarked excise revenue for particular externalities. States have raised cigarette taxes significantly (and often) over the past quarter century. States, however, have not significantly raised taxes on alcohol or gasoline during that time.

There is potential to raise additional revenue from certain excise taxes. The medium rate for cigarette taxes in the United States is $1.18/pack. The medium rates for alcohol taxes in the United States are $0.19/gallon for beer; $0.67/gallon for wine; and $3.75/gallon for distilled spirits. Those states with rates significantly below the medium could consider increases.

Property Taxes

The property tax has been the main source of tax revenue for local governments since the beginning of the nation. In 2008, local governments in the United States raised $397 billion in property tax revenue, which accounted for 72 percent of all local tax revenue. The per capita property tax responsibility in the United States (for 2007) was $1,278, but many states levy property taxes far below that figure. While the tax has been under siege for decades, it presents significant opportunities for revenue growth. There are several policies that states can undertake to greatly increase property tax revenue.

First, the public's perception of the property as "the worst tax" must be changed. Many of the problems that have plagued this tax in the past have been addressed. Yet many people persist in characterizing the tax as unpopular. Political leaders and, more importantly, the public must be shown the positive aspects of the tax: it provides a steady stream of revenue to pay for local public services; compliance and administrative costs are minimal; there is virtually no opportunity to avoid it, a fact that honest taxpayers will appreciate; and it is visible—the citizens know what they are paying and can evaluate what they are getting in return. Most important, the public must realize that property taxes support what are arguably the most important services they receive, and citizens can control the quantity and quality of those services if they control the property tax. True property tax reform is possible only when the tax is viewed in a more positive light.

To complement this effort, the excesses of the property tax revolts must be reversed. What is needed is essentially a property tax "counter-revolt." There is no economic or tax policy justification for rate and assessment limitations. Such limits keep property tax revenue artificially low and merely shift responsibility for paying for government to other types of taxes and to other taxpayers. Moreover, many rate and assessment limitations are effectively undemocratic because they cannot be overturned by a majority of voters or elected officials. Under a principled tax system, taxes serve one goal: to raise adequate revenue to pay for government services demanded by the people through their elected representatives.

As of August 2010, 36 states have some form of rate limit on property taxation. Twenty states enacted assessment limits on property taxes. The limits range from 2 percent

in California to 15 percent in South Carolina. And 30 states enacted some form of property tax levy limits.

Such a suggestion may appear politically unfeasible. After all, not many leaders will call for a reversal of the property tax revolts. It will take the kind of political courage rarely seen in the tax arena to initiate meaningful reforms. But the call to reverse the excesses of the property tax revolts need not be couched in negative terms. Rather, the call to end rate and assessment limitations could be made in the name of ensuring that people have control over their local governments.

State and local governments must also address the significant problem of exempt properties. Exemptions for economic development and charitable organizations cost local governments billions of dollars and shift responsibility for paying for public services to other taxpayers. Both types of exemptions, however, are politically popular. The perception that incentives spur economic development and the desire to assist cherished nonprofit organizations are powerful forces.

Despite their proliferation, economic development incentives are increasingly viewed as an inefficient means of creating jobs or spurring growth. There is a small but growing movement to curb the use of development incentives. Increased media coverage and the adoption of disclosure laws will shed light on some of the problems associated with targeted tax incentives.

The issue of exemptions for nonprofit organizations presents more difficult problems. Religious, educational, and charitable organizations hold a special place in American society. Repealing property tax exemptions benefiting such organizations would be extremely difficult, if not impossible. But there are ways in which state and local governments can minimize the financial impact of such exemptions. For example, stricter qualification standards can be set for nonprofits receiving exemptions. Localities can also insist that their state governments grant expanded authority to collect payments in lieu of taxes.

Other Local Taxes

In addition to property taxes, local governments have long levied a variety or other taxes. In 2010, 36 states allow local governments to levy local option sales taxes, although not all local governments choose to do so. In 2010, 16 states allowed local governments to levy local option income or wage taxes. Although once again, not all authorized governments choose to levy this tax. In 2008, local governments raised $63 billion in local option sales taxes (about 11% of local tax revenue) and $26 billion in local option income taxes (about 4% of total local taxes.)

Local governments could be given the option of levying either sales or income taxes to raise additional revenue. Allowing such taxes would further several good tax policy objectives. First, it would allow local governments to raise additional revenue to insure adequate funding of public services. Second, it would diversify the tax base, mitigating the effects of economic cycles. Third, allowing the imposition of sales and/or income taxes takes pressure off the property tax. It allows local governments to rely less on property taxes to raise revenue—policies which have proven politically advantageous.

State Analysis: Options to Raise Tax Revenue

The following section provides a state-by-state analysis of tax-revenue raising options for each of the 50 states.

Alabama

Alabama taxes income, sales, and tobacco products at rates far below national averages. The state could immediately increase state tax revenue by expanding its sales tax to services. In fact, Alabama could raise an estimated $836 million by extending its sales tax to all services consumed by households (Mazerov 2009).[5] Smaller amounts (approximately $3.5 million) of additional revenue can be raised by eliminating the sales tax holiday.

Alabama could also substantially increase corporate tax revenue. The state could eliminate or lessen the use of tax incentives as a means of spurring economic development. The modern day proliferation of tax incentives began in Alabama, and the state has expended billions of dollars in tax breaks to multi-national corporations. In addition, the state could increase revenue by adopting combined reporting. It could also raise additional revenue ($15 million a year) by decoupling from the federal domestic production deduction.

With respect to excise taxes, Alabama levies only a 42.5 cent per pack tax on cigarettes (sixth lowest in the nation). Additional revenue can be raised by increasing the tobacco tax to the U.S. median of $1.18 per pack.

Alabama has a constitutionally levied one percent of fair market value limitation for property taxes.

The state does allow local option sales tax, and it allows local option wage taxes in Jefferson County. Additional local revenue would be possible by expanding the number of jurisdictions that can levy the wage tax.

Alaska

With the ability to raise revenue from severance taxes and natural resource licensing, Alaska does not levy sales or personal income taxes. Alaska does levy modest corporate income taxes. But Alaska could raise additional revenue ($11 million a year) by decoupling from the federal domestic production deduction.

Obviously, Alaska could adopt a general sales tax and begin levying personal income taxes as a means of raising revenue.

Alaska has statutorily mandated property tax limits. Alaska allows local option sales taxes. It does not allow local taxation of income.

Arizona

Arizona personal and corporate income tax responsibilities are comparatively low. Revenue can be significantly increased by increasing the relatively low personal (4.5%) and corporate (6.968%) tax rates.

In May 2010, Arizona voters approved a temporary one percent sales tax rate increase (from 5.6% to 6.6%). That increase is expected to raise an additional $1 billion a year, but it expires in 2013. Revenue could be increased in the long term by making the

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[5] All references to a state's ability to raise additional sales tax revenue from services are from Mazerov (2009).

one percent rate increase permanent. Arizona could raise an estimated $1.6 billion by extending its sales tax to all services consumed by households. Arizona could also raise additional revenue by levying its sales tax on all food purchased in the state.

Arizona allows corporations to elect to use a single sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. Arizona could raise additional revenue by adopting a throwback rule and ($21 million a year) by decoupling from the federal domestic production deduction.

With respect to excise taxes, Arizona taxes beer (16 cents per gallon) below the U.S. median of 19 cents per gallon. It also taxes distilled spirits ($3.00/gallon) below the U.S. median of $3.75/gallon.

Arizona constitutionally limits property taxes to one percent of value. It also statutorily limits assessment increases to 10 percent a year. Arizona allows local jurisdictions to levy sales taxes. It does not, however, authorize local option income taxes.

Arkansas

Arkansas could raise additional revenue by adopting a combined reporting requirement for its corporate taxes. Arkansas currently uses a double-weighted sales apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

Revenue could be enhanced substantially ($714 million) by expanding the sales tax base to household services. Additional sales tax revenue could be attained by fully taxing food (currently food is taxed at 2% while the general sales tax is 6%). This tax could be made progressive by providing refundable tax credit to low-income individuals.

Arkansas limits property tax rates and assessment increases through its constitution. Arkansas allows local jurisdictions to levy sales taxes. It does not, however, authorize local option income taxes.

California

California has one of the most dysfunctional tax systems among the states. It relies heavily on personal and corporate income taxes but relies much less than average on consumption taxes. The state effectively eliminated the property tax as a significant revenue source with the passage of Proposition 13 in 1978. California has been mired in large budget deficits for several years resulting in severe budget cuts and temporary tax increases.

In 2009, California enacted a temporary 0.25 percentage point increase in each of the state's income tax brackets, effective for tax years 2009 and 2010. A tax credit for dependents was also temporarily reduced. Income tax measures were expected to increase tax revenue by more than $5 billion for 2010. Obviously, if these changes were made permanent, the additional revenue would continue.

California could raise an estimated $13 billion by expanding its sales tax to all household service purchases. It could also raise substantial revenue by applying its sales tax to food for home consumption (with a refundable tax credit for low-income individuals).

California temporarily suspended the net operating loss deduction in 2008, a suspension which began phasing out in 2009; the state had a net increase of more than $600 million over the two-year period. Starting in 2010, California will permit net operating

losses to be applied to prior years, as is permitted under federal law. California recently adopted a single sales tax formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

In addition, California taxes tobacco products at rates far below the national average. Additional revenue could be raised by increasing the current tax on cigarettes (87 cents a pack) to the U.S. medium of 1.18/pack. It taxes distilled spirits ($3.30/gallon) and wine ($0.20) below the U.S. medium as well.

Proposition 13 prevents the property tax from raising adequate amounts of revenue for local governments. The state allows local jurisdictions to levy sales taxes. It only allows Los Angeles and San Francisco to levy wage taxes. Additional revenue is possible by expanding the number of local jurisdictions that can tax wages/income.

Colorado

Colorado's income and sales tax responsibilities are far below national averages. The state sales tax rate is set at 2.9 percent. A modest one percent increase in the sales tax (which would still leave a rate far below the national average) would raise significant revenue.

In 2009, Colorado ended taxpayers' ability to deduct capital gains income derived from assets or businesses located within the state. This change will generate about $15.8 million per year in new income tax revenue. Colorado still allows unlimited deductions for tuition/529 payments without regard to income level.

Colorado could raise an estimated $806 million of additional revenue by expanding its sales tax to all household services. It could raise additional revenue by levying its sales tax on all food purchases and at the same time provide a refundable tax credit to low-income individuals. The Colorado legislature temporarily extended the sales tax to the sale of tobacco products, which is estimated to raise $32 million in FY 2011. That temporary expansion could be made permanent.

On the corporate side, Colorado could raise additional revenue ($20 million a year) by decoupling from the federal domestic production deduction. The state uses the single sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

Colorado also levies a cigarette tax rate of $0.84/pack far below the national average. It taxes distilled spirits ($2.28) and wine ($0.28) far below the U.S. median as well.

Colorado has significant constitutionally mandated property tax and assessment limitations. However, the state does allow local governments to levy both sales and wage taxes.

Connecticut

In 2009, Connecticut enacted permanent changes to its brackets and rates. A new top bracket starts at $500,000 for single filers, $800,000 for heads of households, and $1 million for married couples filing jointly. The tax rate on incomes above those thresholds increased to 6.5 percent from 5 percent and took effect for tax year 2009. This change is estimated to raise $400 million.

Connecticut also allows deductions for tuition/529 payments without regard to income level.

Connecticut could raise substantial revenue by expanding its sales tax to household services (an estimated $1.6 billion a year). Connecticut could raise additional (albeit

in smaller amounts) revenue by eliminating its sales tax holiday and by levying its sales tax on food for home consumption with appropriate refundable tax credit for low-income individuals.

Connecticut levied a 10 percent surcharge for companies that make at least $100 million and pay at least $250 in taxes. This increase expires in 2013. While Connecticut permits combined reporting on a voluntary basis, the state levies a "preference tax" on companies that so elect. In 2009, Connecticut doubled the maximum preference tax. Along with other smaller changes, Connecticut will have a net increase of about $84 million in 2010.

Connecticut could also raise significantly more revenue by requiring combined reporting for its corporate taxpayers. The state uses a double weighted sales apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. The state could also raise substantial revenue by adopting a throwback rule.

Connecticut could raise additional revenue by increasing its excise tax on wine (currently $0.60/gallon).

Connecticut does not authorize the use of local option income or sales taxes. Significant revenue could be raised by adopting one or both.

Delaware

Delaware has long refrained from levying a general sales tax. Assuming it could raise sales tax revenue on par with the national average, adoption of a general sales tax would result in several billions of dollars in new revenue. There have been no attempts to adopt a sales tax in recent years.

Delaware temporarily increased the top marginal tax rate by one percentage point to 6.95 percent on income over $60,000. This change will generate about $70 million in new revenue in 2010. Also, Delaware eliminated an exemption from taxes for lottery winnings. Making these changes permanent would allow the state to continue to raise the additional revenue.

Delaware does not tax income from corporate holding companies. Delaware also does not require combined reporting. Neither of these laws is likely to change. But Delaware could raise additional revenue ($7 million a year) by decoupling from the federal domestic production deduction. The state could also raise substantial revenue by adopting a throwback rule.

Delaware could raise additional revenue by increasing its excise tax on beer (currently $.016/gallon).

Delaware does not allow local option sales taxes. It does, however, authorize local governments to levy a 1.25 percent wage tax.

Florida

Florida does not levy personal income taxes and thus relies very heavily on sales taxes to fund state services. The state only modestly taxes corporate income and levies strict limits on the use of property taxes.

There are several ways Florida could raise substantial additional revenue. While politically very difficult, adoption of a personal income tax would raise tens of billions of dollars.

Florida levies one of the lowest corporate tax responsibilities in the nation. The state could raise significantly more revenue by adopting combined reporting. It could also raise additional revenue ($55 million a year) by decoupling from the federal domestic production deduction. Finally, Florida uses a double weighted sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. The state could also raise substantial revenue by adopting a throwback rule.

Florida could also expand its sales tax base to include household services. That would raise an estimated $5.6 billion a year. In addition, Florida could raise smaller amounts from eliminating its sales tax holiday and by levying its sales tax on all food purchases.

Florida has significant property tax limitations on both rates and assessments. Florida allows local governments to levy sales taxes but not income taxes.

Georgia

Georgia's sales tax rate (4%) is among the lowest in the nation. Georgia could raise an estimated $1.17 billion of additional revenue by expanding its sales tax to household services. More revenue could be raised by levying the state sales tax to all food purchases with appropriate refundable tax credit for low-income individuals.

Georgia allows deductions for tuition/529 payments without regard to income level.

Georgia would likely raise significantly more revenue if it required corporate taxpayers to use combined reporting. Georgia also uses a single sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. The state could also raise substantial revenue by adopting a throwback rule.

Another area in which Georgia could raise additional revenue is with respect to tobacco taxes. The state levies an excise tax on cigarettes of only $0.37/pack.

Georgia places property tax limits for school taxes. Georgia authorizes local governments to levy sales taxes. It does not, however, allow local option income or wage taxes.

Hawaii

Hawaii adopted a measure temporarily creating three new state income tax brackets. Beginning in tax year 2009, for married couples the rates will be 9 percent on income between $300,000 and $350,000, 10 percent between $350,000 and $400,000, and 11 percent above $400,000. The previous top tax rate was 8.25 percent on all income over $96,000. These changes are expected to increase tax revenue by nearly $100 million during the fiscal 2010–2011 biennium and are set to expire after tax year 2015. Making these changes permanent could allow the state to continue to raise the additional revenue.

Hawaii taxes income and sales at or near the national averages in terms of per capita responsibilities. Still, Hawaii can raise additional revenue (about $279 million a year) by expanding its sales tax base to household services.

In 2009, Hawaii temporarily capped the use of various economic development credits for a $75 million revenue increase. That revenue stream could be continued if the cap were made permanent.

Hawaii does not allow local governments to levy either income or sales taxes. Additional local revenue could be raised by authorization of one or both.

Idaho

Idaho has a well balanced tax system relying on income, sales, and property taxes to fund government services.

Idaho allows deductions for tuition/529 payments without regard to income level.

Idaho could raise additional revenue (about $398 million a year) by expanding its sales tax base to household services. Idaho could raise additional revenue ($7 million a year) by decoupling from the federal domestic production deduction. Idaho uses a double weighted sales apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

Idaho could raise additional revenue by increasing its relatively low cigarette tax ($0.57/pack). It also has room to increase its excise taxes on beer ($0.15/gallon) and wine ($0.45/gallon).

Idaho has significant property tax rate limitations on local governments. The state authorizes local option sales taxes, but not local income/wage taxes.

Illinois

Illinois levies all the major taxes, but the state could increase the rate on its personal income tax. Moving to a graduated rate system would allow Illinois to provide tax breaks to low-income citizens and raise substantially more revenue from wealthy citizens. Illinois allows deductions for tuition/529 payments without regard to income level.

Illinois could raise significant revenue (about $4.5 billion a year) by expanding its sales tax base to household services. Illinois could also increase revenue by taxing all food purchases at the regular sales tax rates, with appropriate refundable tax credit for low-income individuals. For example, in 2009 Illinois began taxing soda, energy drinks, certain candies, and personal hygiene products at 6.25 percent rather than at the food tax rate of one percent. This is estimated to raise about $100 million a year.

Illinois uses the single sales factor formula for corporate taxes. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. Illinois could raise significant additional revenue ($103 million a year) by decoupling from the federal domestic production deduction. The state could also raise substantial revenue by adopting a throwback rule.

Illinois could raise additional revenue by increasing its relatively low cigarette tax ($0.98/pack).

Illinois authorizes local option sales taxes but not local income/wage taxes.

Indiana

In 2009, Indiana increased its sales tax rate to 7 percent from 6 percent for a revenue increase of almost $1 billion. Indiana could raise an estimated $1.7 billion a year in additional revenue by expanding its sales tax on household services. Additional revenue could be raised by levying the state sales tax to all food purchases, with appropriate refundable tax credit for low-income individuals.

Indiana allows deductions for tuition/529 payments without regard to income level.

Indiana capped the Media Production Expenditure Income Tax Credit for a revenue increase of nearly $10 million in fiscal 2009. Indiana could raise significant additional revenue by adopting combined reporting. Indiana will use the single sales

factor apportionment formula beginning in 2011. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

Indiana could raise additional revenue by increasing its relatively low cigarette tax rate ($0.99½/pack). It could also raise additional revenue by increasing its excise tax on wine ($0.41/gallon) and beer ($0.11/gallon).

Indiana has statutorily mandated property tax rate limits for all local governments. Indiana authorizes local option income taxes but not local sales taxes.

Iowa

Iowa could raise an estimated $726 million a year by expanding its tax base to include household services. It could also raise additional revenue by eliminating its sales tax holiday and by levying its sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Iowa allows deductions for tuition/529 payments without regard to income level.

Iowa could raise significant additional revenue by adopting combined reporting. Iowa could also raise additional revenue ($12 million a year) by decoupling from the federal domestic production deduction. Iowa has always used the single sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

Iowa has statutorily mandated property tax rate and assessment limits for all local governments. Iowa authorizes counties and municipalities to levy local option sales taxes. It allows school districts to levy local option income taxes.

Kansas

Kansas could raise additional revenue (about $749 million a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases with appropriate refundable tax credit for low-income individuals.

Kansas allows deductions for tuition/529 payments without regard to income level.

Kansas could raise additional revenue ($17 million a year) by decoupling from the federal domestic production deduction.

Kansas does tax tobacco products at a rate ($0.79/pack) well below the national medium. Additional revenue could be obtained by increasing cigarette taxes. It could also increase its excise tax on distilled spirits ($2.50/gallon), wine ($0.30/gallon), and beer ($0.18/gallon).

Kansas allows local governments to levy sales taxes. It does not, however, authorize the use of local option income taxes.

Kentucky

Kentucky could raise an estimated $1 billion by expanding its sales tax to all household services. It can raise additional revenue by levying the sales tax on all food purchased, with appropriate refundable tax credit for low-income individuals.

Kentucky could raise significant additional revenue by adopting combined reporting. The state uses the double weighted sales apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. It could also raise additional revenue ($4 million a year) by decoupling from the

federal domestic production deduction. The state could also raise substantial revenue by adopting a throwback rule.

Kentucky taxes tobacco products at a rate ($0.60/pack) well below the national average. Additional revenue is possible by increasing cigarette taxes. It also has room to increase its excise tax rates on beer ($0.80/gallon), distilled spirits ($1.92/gallon), and wine ($0.50/gallon).

Kentucky does not allow local option sales taxes. It does, however, allow local option income taxes.

Louisiana

Louisiana relies heavily on severance taxes and fees from its natural resource industries, which allows it to maintain lower levels of income and sales taxation. As a result, Louisiana taxes personal income and retail sales at levels below national averages.

Louisiana allows deductions for tuition/529 payments without regard to income level.

Louisiana could raise an estimated $856 million a year if it expanded its sales tax base to include household services. It could raise additional revenue by eliminating its sales tax holidays and expanding its sales tax to all food purchases, with appropriate refundable tax credit for low-income individuals.

Louisiana could raise significant additional revenue by adopting combined reporting. Louisiana uses a single sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. It could raise additional revenue ($25 million a year) by decoupling from the federal domestic production deduction. The state could also raise substantial revenue by adopting a throwback rule.

More significantly, given its large tourist industry, Louisiana could raise additional revenue by increasing its excise taxes on distilled spirits ($2.50/gallon) and wine ($0.11/gallon). It also levies very low cigarette taxes ($0.36/pack).

Louisiana allows local option sales taxes. It does not, however, allow local option income taxes.

Maine

Maine could raise $312 million a year by expanding its sales tax to household services. It can raise additional revenue by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Maine allows deductions for tuition/529 payments without regard to income level.

Maine currently uses the single sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

Maine has some ability to increase its excise tax on wine ($0.60/gallon).

Maine does not allow local governments to levy either income or sales taxes. Additional local revenue could be raised by authorization of one or both.

Maryland

In Maryland, a new top rate of 6.25 percent took effect in 2008 on income greater than $1 million, regardless of filing status. The increase is scheduled to expire in 2011. Maryland also added three new rates ranging from 5 to 5.5 percent, with no expiration date, on income from $150,000 to $1 million for single filers and $200,000 to $1 million for joint filers. This is estimated to raise $113 million per year. Making the rate increase permanent will allow the state to continue to raise the additional revenue.

Maryland allows deductions for tuition/529 payments without regard to income level.

Maryland could raise significant revenue (about $1.8 billion a year) by expanding its sales tax base to household services.

Maryland could raise significant additional revenue by adopting combined reporting. Maryland currently uses a double weighted sales factor to calculate corporate taxes. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. The state could also raise substantial revenue by adopting a throwback rule. Maryland could raise additional revenue by curtailing tax incentives. For example, Maryland tightened the cap on corporate income tax credits for mined coal, which increased business tax revenue by $5 million in fiscal 2010.

Maryland could raise additional revenue by increasing its excise tax on distilled spirits ($1.50/gallon), wine ($0.40/gallon), and beer ($0.04/gallon).

Maryland grants a local option to limit assessment increases. Maryland does not allow local option sales taxes. The state does allow counties and municipalities to levy local option income taxes.

Massachusetts

Massachusetts raised about $900 million in fiscal 2010 by increasing the sales tax rate by 1.25 percentage points to (6.25%). Massachusetts could raise significant additional revenue (about $2.2 billion a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals. About $23 million could be raised by eliminating the sales tax holiday.

Massachusetts currently uses a double weighted sales factor to calculate corporate income taxes. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. The state could also raise substantial revenue by adopting a throwback rule.

Massachusetts could raise additional revenue by increasing its excise tax rates on beer ($0.11/gallon) and wine ($0.55/gallon).

Massachusetts has significant property tax limitations levied by Proposition 2 ½. It does not allow local governments to levy either income or sales taxes. Additional local revenue could be raised by authorization of one or both.

Michigan

While Michigan relies much more heavily on sales than income taxes, it could raise significant revenue (about $2.89 billion a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Michigan allows deductions for tuition/529 payments without regard to income level.

Michigan could raise additional revenue ($15 million a year) by decoupling from the federal domestic production deduction. Michigan currently uses a single sales factor for calculating its business tax. Requiring the traditional three-factor formula would likely raise substantial additional tax revenue.

Michigan does not allow local option sales taxes. The state does, however, allow local option income taxes.

Minnesota

Minnesota could raise significant revenue (about $1.9 billion a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Minnesota will use the single factor apportionment formula in 2011. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. The state could also raise substantial revenue by adopting a throwback rule.

Minnesota could raise additional revenue by increasing its excise tax rates on wine ($0.30/gallon) and beer ($0.15/gallon).

Minnesota statutorily limits property tax assessment increases. Minnesota allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Mississippi

Mississippi could raise additional revenue by increasing both its personal and corporate income taxes. Mississippi could raise an estimated $813 million in additional revenue by levying its sales tax on household services. It could raise additional revenue by eliminating its sales tax holiday.

Mississippi allows deductions for tuition/529 payments without regard to income level.

Mississippi could raise significant additional revenue by adopting combined reporting.

Mississippi taxes tobacco products at a rate ($0.68/pack) far below the national average. It could also increase revenue by raising its excise tax on wine ($0.35/gallon).

Mississippi allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Missouri

Missouri taxes income and consumption at levels far below national averages. Missouri could raise an estimated $1.1 billion a year by expanding its sales tax to household services. It could raise additional revenue by eliminating its sales tax holiday and taxing all purchases of food at the regular rate, with appropriate refundable tax credit for low-income individuals.

Missouri allows deductions for tuition/529 payments without regard to income level.

Missouri could raise additional revenue by requiring its corporate taxpayers to use combined reporting. It could also raise additional revenue ($20 million a year) by decoupling from the federal domestic production deduction.

Missouri has the second lowest cigarette tax in the nation ($0.17). Substantial revenue could be raised by simply increasing the rate to the national medium. It could raise additional revenue by increasing its excise tax rates on distilled spirits ($2.00/gallon), beer ($0.06/gallon), and wine $0.30/gallon).

Montana

Montana is atypical in its revenue raising. It does not levy a general sales tax. Montana has relatively high personal income taxes. The state relies heavily on severance taxes and fees from its natural resources.

Montana allows deductions for tuition/529 payments without regard to income level.

Montana could raise additional revenue ($6 million a year) by decoupling from the federal domestic production deduction.

Montana could raise additional revenue by increasing its excise tax on wine ($0.14/gallon).

Montana limits property tax assessment increases. Montana does not authorize local governments to levy either sales or income taxes.

Nebraska

Nebraska could raise additional revenue (estimated at $493 million a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Nebraska allows deductions for tuition/529 payments without regard to income level.

Nebraska uses the singles sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. Nebraska could raise additional revenue ($9 million a year) by decoupling from the federal domestic production deduction. The state could also raise substantial revenue by adopting a throwback rule.

Nebraska taxes cigarettes at rates far below the national averages ($0.64/pack). If rates were increased to national norms, Nebraska could raise substantial additional revenue.

Nebraska has statutorily enacted property tax limitations. Nebraska allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Nevada

Nevada is atypical in its revenue raising. The state does not tax personal or corporate income. It relies heavily on sales and gambling taxes. Obviously, Nevada could raise substantial revenue by taxing personal and corporate income.

In 2009, Nevada temporarily increased its sales tax rate to 6.85 percent (from 6.5%). This change raised revenue by $280 million over the following two years. The state could make the rate increase permanent. Nevada could raise significant revenue (about $922 million a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low income individuals.

Given its tourist industry and the ability to export tax responsibilities, it is

surprising that Nevada taxes both alcohol and cigarettes ($0.80/pack) at rates far below national averages. If rates were increased to national norms, Nevada could raise substantial additional revenue.

Nevada has constitutionally mandated property tax rate limits. Nevada allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

New Hampshire

New Hampshire does not levy a broad based personal income tax (taxing only interest and dividends). It does not levy a traditional broad based corporate income tax. And the state does not levy a sales tax. Obviously, New Hampshire could raise billions of dollars by adopting one or more of these broad based types of taxes.

The interest and dividends tax was extended to include profits of limited liability companies and other types of entities. The state's business profits tax filing threshold was changed; all businesses, regardless of their income level, are now required to file a return. These changes will increase business tax revenue by about $21 million each year.

New Hampshire does not authorize local government sales or income taxes.

New Jersey

New Jersey increased income taxes on households with incomes above $400,000. For one year, the tax rate on joint filers with incomes between $400,000 and $500,000 rose to 8 percent from 6.37 percent; the rate on income between $500,000 and $1 million increased to 10.25 percent from 8.97 percent; and a 10.75 percent rate applied to income over $1 million. These changes generated about $1 billion in fiscal 2010. The rate increase could be made permanent to allow the state to continue to collect the additional revenue. Additionally, New Jersey began taxing lottery winnings over $10,000 beginning in 2009. This action is estimated to increase revenue by $8 million.

New Jersey could raise significant revenue (about $4.1 billion a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

New Jersey could raise significant additional revenue by adopting combined reporting. New Jersey currently uses a double weighted sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. It could also raise additional revenue by decoupling from the federal domestic production deduction.

New Jersey has some room for raising its excise tax rate on beer ($0.12/gallon).

In July 2010, New Jersey enacted statutorily mandated property tax limits (property tax revenue cannot increases more than two percent a year). The state does not authorize local government sales or income taxes. Significant revenue could be raised by allowing one or both of these.

New Mexico

New Mexico could raise an additional $420 million a year by expanding its sales tax to all household services. The state could raise additional revenue by eliminating its sales tax holiday and levying its sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

New Mexico allows deductions for tuition/529 payments without regard to income level.

New Mexico could raise significant additional revenue by adopting combined reporting. It could also raise additional revenue ($6 million a year) by decoupling from the federal domestic production deduction.

New Mexico levies cigarette taxes at rates below the national average ($0.91/pack). If rates were increased to national norms, New Mexico could raise additional revenue.

Due to statutory rate and assessment limitations, New Mexico allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

New York

In 2009, New York enacted two new temporary income tax rates for the highest-income filers. For households with taxable income above $500,000, regardless of filing status, the tax rate rises to 8.97 percent from 6.85 percent; for those with taxable income below $500,000 but above $200,000 for single individuals, $250,000 for heads of households, and $300,000 for married couples filing joint returns, the rate increases to 7.85 percent from 6.85 percent. These rates are in effect for three years. The rate increases could be made permanent to allow the state to continue to collect the additional revenue.

New York placed limits on itemized state income tax deductions for taxpayers making over $1 million and reduced a state-funded credit on New York City's personal income tax. The changes are projected to raise more than $4 billion a year.

New York allows deductions for tuition/529 payments, even for taxpayers with high levels of income.

New York could raise significant revenue (about $5 billion a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

On the corporate side, New York currently uses a single sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. The state could also raise substantial revenue by adopting a throwback rule.

New York could raise revenue by increasing its excise tax rates on wine ($0.30/gallon) and beer ($0.14/gallon).

North Carolina

In 2009, North Carolina placed a temporary surcharge on upper-income taxpayers, effective for tax years 2009 and 2010. This surcharge was added to the filer's tax responsibility. Married filers with income over $250,000 and single filers with income over $150,000 calculated their tax under previously existing law and then increased it by 3 percent. For married filers with income between $100,000 and $250,000, and single filers with income

between $60,000 and $150,000, the surcharge was 2 percent. This was estimated to raise revenue by $177 million in 2009. The rate increases could be made permanent to allow the state to continue to collect the additional revenue.

In 2009, North Carolina temporarily increased its sales tax rate by one percent, raising an additional $1 billion. That rate increase could be made permanent. North Carolina could raise an estimated $1.8 billion in additional revenue by expanding its sales tax to all household services. Additional revenue could be raised by eliminating the sales tax holiday and by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

In 2009, North Carolina levied a temporary surcharge on corporate taxpayers, but also expanded business tax credits, which offset the revenue increase. Additional revenue could be raised by making the surcharge permanent and eliminating the expanded tax credits. North Carolina could raise significant additional revenue by adopting combined reporting. North Carolina currently uses a double weighted sales factor formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. The state could also raise substantial revenue by adopting a throwback rule.

North Carolina levies cigarette taxes at rates far below the national average ($0.45/pack). If rates were increased to national norms, North Carolina could raise substantial additional revenue.

North Carolina allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

North Dakota

North Dakota has traditionally relied heavily on severance taxes and fees generated by natural resources to fund public services. The state also relies much more heavily on consumption taxes than personal and corporate income taxes.

North Dakota could raise additional revenue (about $160 million a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

North Dakota levies cigarette taxes at rates far below the national average. If rates were increased to national norms, North Dakota could raise substantial additional revenue. It could also raise additional revenue by increasing rates on wine ($0.50/gallon), beer ($0.16/gallon), and distilled spirits ($2.50/gallon).

North Dakota allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Ohio

Ohio could raise significant revenue (about $3 billion a year) by expanding its sales tax base to household services. Additional revenue can be raise by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Ohio allows deductions for tuition/529 payments without regard to income level.

In recent years, Ohio repealed its corporate income tax. In its stead, the state adopted a gross receipts tax. Still, it could raise additional revenue ($23 million a year) by decoupling from the federal domestic production deduction from its personal income tax.

Ohio could raise additional revenue by increasing its rates on wine ($0.30/gallon) and beer ($0.18/gallon).

Ohio has both constitutional and statutory property tax rate limits. Ohio authorizes local governments to levy both sales and income taxes.

Oklahoma

Oklahoma relies heavily on severance taxes. The state levies personal income and sales taxes at levels far below national averages.

Oklahoma could raise an additional $792 million by expanding its sales tax to all household services. It could raise additional revenue by eliminating its sales tax holiday.

Oklahoma allows deductions for tuition/529 payments without regard to income level.

Oklahoma could raise significant additional revenue by adopting combined reporting. It could also raise additional revenue ($15 million a year) by decoupling from the federal domestic production deduction.

Oklahoma levies cigarette taxes at rates below the national average ($1.03/pack). If rates were increased to national norms, Oklahoma could raise substantial additional revenue.

Oklahoma allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Oregon

Oregon does not levy a sales tax. Adoption of a sales tax could raise billions of dollars in additional revenue. Oregon enacted a temporary measure adding two brackets at the top of the state's income tax structure. Married couples will pay 10.8 percent on income between $250,000 and $500,000 and 11 percent on income over $500,000. These rates will be in effect through 2011. After 2011, the top rate will fall to 9.9 percent for joint filers with income over $250,000. These changes are projected to generate more than $230 million in each of the next two fiscal years. The rate increases could be made permanent to allow the state to continue to collect the additional revenue.

Oregon allows deductions for tuition/529 payments without regard to income level.

Oregon increased the corporate income tax rate for corporations with taxable income above $250,000 to 7.9 percent (from 6.6%). This rate was in effect for 2009 and 2010. It is slated to fall by 1 percent for 2011 and 2012. After 2012, the higher rate will be applied only to taxable income over $10 million. The minimum corporate income tax was increased, based on the amount of sales in Oregon. For a firm with more than $100 million in Oregon sales, the minimum tax is now $100,000; previously, the minimum tax was $10. These changes will increase business tax revenue by more than $200 million in the fiscal 2010-2011 biennium. Even with the rate increases, Oregon still levies very low corporate income taxes. The rate increases could be made permanent—ensuring the additional revenue will continue. Oregon currently uses the single sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

Oregon could also raise additional revenue by increasing its excise tax rate on beer ($0.08/gallon).

Oregon has constitutionally mandated property tax rate and assessment limits for all local governments. Oregon authorizes local option income taxes. Oregon is unlikely to authorize local option sales taxes unless the sales taxes are levied at the state level first.

Pennsylvania

Pennsylvania relies more heavily on sales taxes than on personal income taxes to fund public services. Pennsylvania can raise significant revenue (about $4 billion a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Pennsylvania could raise significant additional revenue by adopting combined reporting. It could raise additional revenue ($55 million a year) by decoupling from the federal domestic production deduction. Moreover, Pennsylvania currently uses a heavily weighted (90%) sales factor formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. The state could also raise substantial revenue by adopting a throwback rule.

Pennsylvania could raise additional revenue by increasing its excise tax rate on beer ($0.08/gallon).

Pennsylvania has statutory property tax rate limits. Pennsylvania authorizes local governments to levy both sales and wage taxes.

Rhode Island

Rhode Island could raise additional revenue (about $409 million a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Rhode Island allows deductions for tuition/529 payments without regard to income level.

Rhode Island could raise significant additional revenue by adopting combined reporting. It could raise additional revenue ($5 million a year) by decoupling from the federal domestic production deduction.

Rhode Island could raise additional revenue by increasing its rates on wine ($0.60/gallon) and beer ($0.10/gallon).

Rhode Island does not allow local governments to levy sales taxes or income/wage taxes. Significant revenue could be raised by authorizing one or both of these.

South Carolina

South Carolina relies more heavily on sales taxes than income taxes. Additional sales tax revenue (estimated at $955 million) could be raised by expanding the tax to all household services. More revenue is available if the state would eliminate its sales tax holidays and levy the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

South Carolina allows deductions for tuition/529 payments without regard to income level.

South Carolina could raise significant additional revenue by adopting combined reporting. South Carolina currently uses the double weighted sales factor formula.

Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue. The state could also raise substantial revenue by adopting a throw-back rule.

In May 2010, South Carolina increased its lowest-in-the-nation cigarette tax from $0.07/pack to $0.57/pack). Even with the increase, South Carolina's cigarette tax remains far below the nation medium. The state has some ability to increase its excise tax on distilled spirits ($2.72/gallon).

South Carolina limits property tax assessments through its constitution. It allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

South Dakota

South Dakota has a relatively small state budget financed almost exclusively by the general sales tax. Unlike most states, South Dakota levies the sales tax on a very broad base. Yet South Dakota could still raise an additional $159 million a year by expanding its sales tax to all household services.

South Dakota does not levy personal or corporate income taxes. The state could raise substantial additional revenue by taxing income.

South Dakota allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Tennessee

Tennessee relies on the general sales tax for most of its revenue. The state does not levy a broad based personal income tax. The state taxes certain interest and dividend income of individuals. Substantial revenue could be raised by taxing all income, including wages.

Despite its heavy reliance on the sales tax, Tennessee could raise additional revenue by expanding its base to include household services. The additional revenue could be as much as $2 billion a year. For example, in 2009, the state extended the sales tax to include software maintenance contracts and limited a sales tax exemption on computer software. These changes will generate about $10.5 million per year in new revenue. Tennessee could also increase revenue by eliminating its sales tax holiday and by subjecting all food purchases to the full sales tax rate.

The state made some revenue changes in 2009 with respect to business taxes. Tennessee increased franchise and excise tax revenue by eliminating an exemption on rental income earned by certain non-corporate businesses. This change increased revenue by more than $25 million per year. Tennessee could raise significant additional revenue by adopting combined reporting. It could also require the traditional three-factor formula to raise additional corporate tax revenue. The state could also raise substantial revenue by adopting a throwback rule.

Additional revenue could be obtained by raising tobacco taxes ($0.62/pack). It could also raise some additional revenue by increasing its tax on beer ($0.14/gallon).

Tennessee allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Texas

Texas does not levy personal income taxes. Adoption of a personal income tax would result in both billions of dollars in additional revenue and the opportunity to reduce sales tax responsibilities. Adoption of a personal income tax would require amending the state constitution.

Despite its heavy reliance on sales taxes, Texas could raise an estimated $7.7 billion in additional revenue by expanding its sales tax to all household services. Still more revenue could be raised if the state eliminated its sales tax holiday and levied the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Texas uses a single factor apportionment formula to calculate its business tax. Requiring the three-factor formula would likely raise substantial additional revenue.

The state could raise more revenue by increasing the excise tax on wine ($0.20/gallon) and distilled spirits ($2.40/gallon).

Texas allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Utah

In 2008, the Utah Legislature increased the sales tax rate to 4.7 percent (from 4.65%). That rate remains below national and regional averages. Utah could raise additional revenue (about $527 million a year) by expanding its sales tax base to household services. Additional revenue could be raise by levying the entire sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Utah allows deductions for tuition/529 payments without regard to income level.

Utah could raise additional revenue ($11 million a year) by decoupling from the federal domestic production deduction.

Utah levies very low cigarette taxes ($0.69½/pack) and could raise some additional revenue through an increase.

Utah has statutory property tax rate limits. It allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Vermont

Vermont enacted a budget that includes several major changes to the state's income tax structure. Although all income tax rates were lowered, net revenue will increase. The package eliminated a 40 percent exemption on capital gains income, replacing it with a flat exemption of $2,500. This new exemption rose to $5,000 beginning in tax year 2011. Lawmakers capped the amount of state and local income taxes that can be deducted from federal adjusted gross income at $5,000. On net, income tax provisions in Vermont raised $9 million in new revenue in fiscal 2010.

Vermont allows deductions for tuition/529 payments without regard to income level.

Significant additional revenue ($195 million a year) could be raised by expanding the sales tax to household services. Additional revenue could be raised if the sate eliminated its sales tax holiday and levied the tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

Vermont could raise additional revenue ($4 million a year) by decoupling from the federal domestic production deduction. Vermont currently uses the double weighted

sales factor formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

Vermont allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Virginia

Virginia could raise additional revenue (estimated to be $1.7 billion a year) by expanding the sales tax base to include household services. Additional revenue could be raised by eliminating the sales tax holiday and by levying the full sales tax rate on all food purchases with appropriate refundable tax credit for low income individuals.

Virginia allows deductions for tuition/529 payments without regard to income level.

The state could adopt combined reporting for its corporate income tax. It could also change to the traditional three-factor formula (currently using a double weighted sales formula) to raise additional revenue. It could raise additional revenue ($55 million a year) by decoupling from the federal domestic production deduction. The state could also raise substantial revenue by adopting a throwback rule.

Additional revenue could be raise by increasing the tax on tobacco products ($0.30/pack), which is far below national averages in terms of rate and per capita responsibilities.

Virginia allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Washington

Washington does not levy personal or corporate income taxes. Thus, substantial revenue could be raised by taxing income.

Currently, Washington relies heavily on its gross receipts tax. The state can substantially increase revenue (estimated $2.4 billion a year) from its gross receipts tax by expanding its base to include household services. The state could raise additional revenue by levying its gross receipts tax to all food purchases.

Washington has constitutionally mandated property tax limits. Washington allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

West Virginia

West Virginia could raise additional revenue (as much as $445 million a year) by expanding its sales tax base to household services. Additional revenue is possible if the state eliminated its sales tax holiday and levied the tax at its full rate on all food purchases, with appropriate refundable tax credit for low income individuals.

The state allows deductions for tuition/529 payments without regard to income level.

West Virginia currently uses the double weighted sales factor. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

The state also levies tobacco taxes at rates ($0.55/pack) below the national average.

West Virginia has enacted property tax rate limits for every local government. West Virginia allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes. Several cities, however, can levy a fee per employee.

Wisconsin

Wisconsin enacted a new 7.75 percent income tax bracket on all income over $300,000 for married couples and $225,000 for individuals and heads of households. The exclusion for capital gains income was lowered to 30 percent (from 60%). These changes generated about $280 million in fiscal 2010.

There are, however, opportunities for raising revenue. Wisconsin could raise significant revenue (about $1.4 billion a year) by expanding its sales tax base to household services. Additional revenue could be raise by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

The state allows deductions for tuition/529 payments without regard to income level.

Wisconsin uses the single sales factor apportionment formula. Requiring the traditional three-factor formula would likely raise substantial additional corporate tax revenue.

Wisconsin could raise additional revenue by increasing its excise tax rates on beer ($0.06/gallon) and wine ($0.25/gallon).

Wisconsin has enacted property tax rate limits for every local government. Wisconsin allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

Wyoming

Wyoming relies heavily on severance taxes to fund state services. The state does not levy personal or corporate income taxes. Obviously, Wyoming could adopt personal and corporate income taxes and greatly increase revenue.

Wyoming could raise additional revenue (about $137 million a year) by expanding its sales tax base to household services. Additional revenue could be raised by levying the sales tax on all food purchases, with appropriate refundable tax credit for low-income individuals.

The state levies tobacco taxes at rates far below the national average ($0.60/pack). Wyoming also levies beer taxes ($0.02/gallon) at a rate far below the national average.

Wyoming has enacted property tax rate limits for residents in every local government. Wyoming allows local governments to levy sales taxes. It does not allow local governments to levy wage/income taxes.

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About David Brunori

David Brunori is a journalist, author, educator, and lawyer specializing in tax and government issues. He is a frequent speaker at conferences on state and local tax policy. Brunori is a contributing editor of *State Tax Notes* magazine and the author of "The Politics of State Taxation," a weekly column on state tax and budget politics. He serves as a research professor of public policy at The George Washington University, where he also teaches state and local tax law at the law school.

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