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THE RISING REGRESSIVITY OF STATE TAXES

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Summary

Many states over the course of the last business cycle made their tax systems less progressive. In the economic slump of the early 1990s, when states raised taxes to meet budget shortfalls, much of the added burden was borne by low- and moderate-income families. But later in the decade and into 2001, when a stronger economy allowed taxes to be reduced, states did not reverse the increases of the early 1990s. Rather, states during the economic expansion frequently targeted tax cuts to higher-income families. As a result, taxes in many states have become relatively more burdensome to low- and moderate-income families, and relatively less burdensome on the affluent, than they were before the last recession.

- In the last eight years, states have cut personal income taxes, which are the major tax paid by upper-income families, and other progressive taxes by nearly $28 billion, an amount equal to about 6.5 percent of annual state tax revenues. Those reductions far exceed the increases in progressive taxes states enacted in the early 1990s, which totaled about 3.7 percent of state revenues.

- By contrast, most of the sales and excise tax increases enacted in the early 1990s have remained in place. The sales and excise tax reductions of the last eight years have totaled just over $1 billion or about 0.3 percent of state tax revenue — just a small fraction of the 4.1 percent of state revenues by which sales and excise taxes were increased in the early 1990s.

As states enter their 2002 legislative sessions, the fiscal climate has changed once again, and states again face significant budget problems. Most states have responded initially by cutting spending but, as in the early 1990s, many states are likely to consider raising revenue by increasing taxes to balance their budgets. Given the trends of the last decade detailed

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in this report, it will be particularly important for states to assess the impact on different income groups as they consider raising taxes.

The tax systems of most states already are significantly regressive — that is, they take a larger proportion of the income of lower-income families than the income of more affluent families. This is largely because states derive about half of their revenues, 47 percent in 2000, from general sales taxes and excise taxes on items such as gasoline and tobacco products. These consumption taxes impose a disproportionate burden on lower-income families who must consume most or all of their income and less of a burden on higher-income families that can save or invest some of their income. States in 2000 derived about 36 percent of their revenues from the personal income tax, the major state tax that can have a progressive effect; corporate income taxes and estate taxes, which are also generally progressive, totaled another 7.5 percent of state tax revenue. Regressive taxes not only burden families that can least afford to pay these taxes — particularly in an economic downturn — but also can hamper other policies states are pursuing to make families self-sufficient and less dependent on state assistance such as welfare.

Taking into account inflation and other economic changes in state tax bases, the aggregate net tax cuts of 1994-2001 were approximately equivalent in scale to the tax increases of the early 1990s. An analysis of the contents of those tax cuts and increases, however, shows the trend toward greater reliance on regressive taxes.

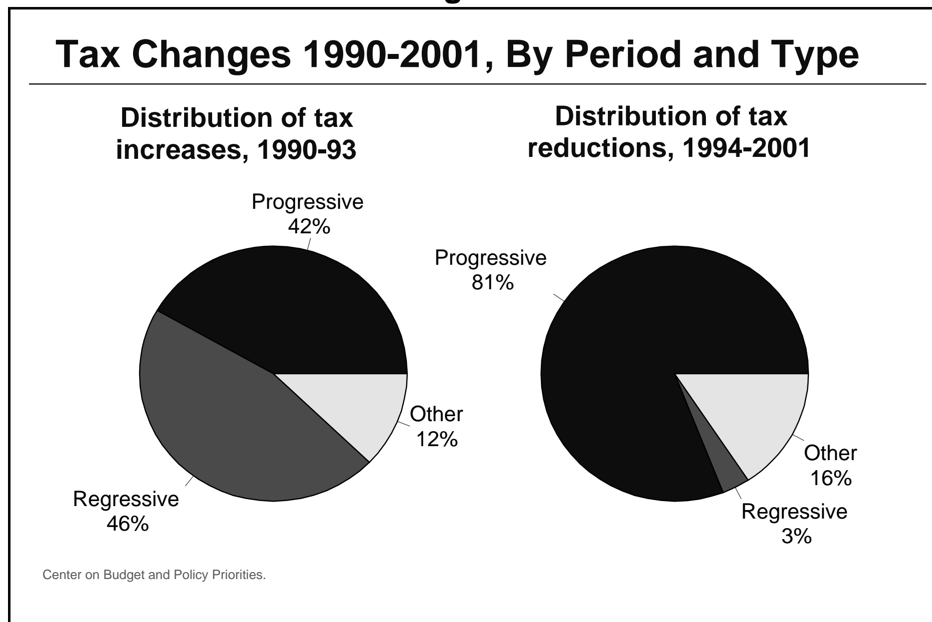
- In the recession-induced fiscal crises of the early 1990s, when 44 states raised taxes to balance their budgets, nearly half the additional revenues — about 46 percent — came from increases in regressive sales and excise taxes.

- As some 36 states cut taxes in response to the strong economy of the last eight years, few reductions were made in the sales and excise taxes that were boosted in the earlier part of the decade. Less than 4 percent of the tax cuts enacted during the economic expansion from 1994 through 2001 were net reductions in sales and excise taxes.

- Personal income tax hikes and increases in other progressive taxes accounted for about two-fifths — 42 percent — of the tax increases enacted in the early 1990s. But as states cut taxes under healthy fiscal conditions, some four-fifths of the cuts — 81 percent — were reductions in personal income taxes, corporate income taxes, and estate taxes.

- In 2001 alone, states enacted approximately $1.6 billion in net reductions in personal income and other progressive taxes. At the same time, largely responding to early indications of fiscal slowdown, they enacted about $700 million in net sales and excise tax *increases*, which similarly increases regressivity. Another $1.4 billion in sales tax cuts and rebates were allowed to expire.

Figure 1



In the period from 1990 through 2001, about three-fourths of the states changed either their top personal income tax rate, their general sales tax rate, or both. The differing patterns of these rate changes confirm the trend toward more regressive taxation in many states.

- While personal income taxes can be reduced in ways that largely benefit moderate-income taxpayers by targeting credits and deductions on families with lower incomes, many states — including all ten of the states with the largest income tax cuts in the years 1994 through 2001 — chose to cut top tax rates or cut all tax rates in ways that in many cases made their income taxes less progressive.

- In the early 1990s, 17 states raised top personal income tax rates, but even more states — about 21 — cut their rates in the ensuing eight years. Today, of the 41 states with income taxes, 17 have *lower* top income tax rates than they did in 1989, while 12 have higher rates.

- By contrast, sales tax rates rose in many states in the early 1990s and still remain above their 1989 level in 19 states. In only three states — Colorado, Maine, and Utah — have sales tax rates declined.

- Average gasoline and cigarette tax rates rose both during the recession of the early 1990s and during the healthy conditions of the mid- and late-1990s. Average state cigarette tax rates rose from 22 cent a pack in 1989 to 28 cents a pack in 1993 to

42 cents a pack in 2001. Average rates for gasoline taxes levied by states rose from 16 cents a gallon in 1989 to 18 cents a gallon in 1993 to 20 cents a gallon by 2001.

Excise tax increases may be enacted for socially desirable reasons other than raising revenues — such as discouraging smoking or protecting the environment. They nevertheless place a disproportionate burden on lower-income households. Increasing excise tax burdens is particularly troublesome in combination with the other trends discussed in this report, because low-income families in many states also are feeling the pinch of sales tax increases. In addition, while states could adopt specific targeted measures to offset excise and sales tax increases through their income taxes, most have not done so.

The general trend toward more regressive taxation is made up of varying combinations of tax changes in specific states. (See Table 1.) The following are examples of ways in which states appear to have shifted tax burdens onto lower-income taxpayers.

- In **Arkansas, Idaho, Iowa, Texas,** and **Wisconsin**, the fiscal gaps of the early 1990s were closed by raising regressive sales taxes and excise taxes. When fiscal conditions turned around, however, these states reduced progressive taxes, while leaving the earlier regressive increases in place.

- **Delaware, Florida, Kansas, Kentucky, Maryland, Massachusetts, Montana, Nebraska, New Jersey, North Carolina, Ohio, Oklahoma, Pennsylvania** and **Rhode Island** raised both regressive taxes and progressive taxes in the early 1990s. Once the economy turned around, these states focused their tax cuts on progressive taxes. The more regressive sales and excise tax increases enacted early in the decade in those states have largely or entirely remained in place.

- **Illinois, Michigan** and **Utah** reduced progressive taxes throughout the decade. None of those states enacted significant net reductions to regressive taxes.

- **Alabama, Alaska, Louisiana, North Dakota, Tennessee, Washington, West Virginia** and **Wyoming** have enacted significant increases in regressive taxes over the last 12 years without significant net increases in progressive taxes.

- In a few states, the increases in regressive taxes and the reductions in progressive taxes have occurred within the same period of time. During the eight years of the economic expansion, **Arizona, Arkansas, Idaho, Kentucky, Oregon, Rhode Island, South Dakota** and **Wisconsin** raised consumption taxes while cutting progressive taxes.

In the last few years, some states have made efforts to moderate the trend toward rising regressivity. These efforts, however, have been generally quite modest.

- Net reductions in sales and excise taxes in the late 1990s were greater than they had been in the middle part of the decade. **Colorado** and **Maine** cut sales tax rates, **Connecticut** reduced motor fuels taxes and **New York** exempted many clothing purchases from the sales tax; earlier in the 1990s, only two states made significant sales tax reductions, as **Georgia** and **Missouri** both exempted grocery purchases from taxation. **North Carolina** also exempted food from the sales tax, but later increased the overall sales tax rate, which largely offset the benefit of the exemption.

- Since 1997, 12 states — **Colorado, Illinois, Kansas, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oklahoma, Oregon,** and **Vermont** — have enacted or expanded Earned Income Tax Credits, which provide important tax relief for low- and moderate-income working families. (Other states that offer state EITCs include **Iowa, Rhode Island,** and **Wisconsin**.) Additional states have taken other steps to target tax relief to lower-income families. Such efforts, however, were typically small portions of large tax packages that in many cases disproportionately benefitted higher-income families.

- Most tax cuts enacted in the last 12 years were permanent, that is, they did not have a set expiration date. But in the late 1990s and 2000, several states enacted *temporary* tax relief provisions such as one-time reductions or rebates. Compared with the permanent cuts, these provisions were much more likely to take the form of sales tax reductions. Such temporary measures in states like **Colorado, Minnesota,** and **Wisconsin** provided significant relief for some low-income families while they were in place. Most such measures, however, have been eliminated or reduced since states began to encounter fiscal problems, and few if any are likely to be reinstated in the foreseeable future.

The fiscal difficulties in which many states find themselves entering the 2002 legislative sessions suggest that a substantial number of states will consider raising taxes. States have several options for avoiding the experience of the early 1990s and ensuring that such tax increases are not borne disproportionately by the poor.

- States can avoid increasing sales and excise taxes. Instead, they can raise revenue from other sources, such as the personal income tax, corporate taxes, inheritance and estate taxes, or other taxes on income or wealth. They may even choose to reverse – temporarily or permanently – some of the tax cuts enacted in the last 12 years that have disproportionately benefitted higher-income families.

- In addition, states can act to prevent federal tax changes such as repeal of the estate tax from carrying over into state tax codes. For example, states presently receive more than $5 billion per year from estate taxes that are linked to the

Table 1: Significant state tax changes, by type of tax and period of enactment.

	1990-93		1994-2001	
	Change in progressive taxes	Change in regressive taxes	Change in progressive taxes	Change in regressive taxes
Alabama		Increase		
Alaska				Increase
Arizona	Increase		Decrease	Increase
Arkansas		Increase	Decrease	Increase
California	Increase	Increase	Decrease	*
Colorado	Increase		Decrease	Decrease
Connecticut	Increase	Decrease	Decrease	Decrease
Delaware	Increase	Increase	Decrease	
Florida	Increase	Increase	Decrease	
Georgia			Decrease	Decrease
Hawaii		Increase	Decrease	Decrease
Idaho		Increase	Decrease	Increase
Illinois			Decrease	
Indiana			Decrease	
Iowa		Increase	Decrease	
Kansas	Increase	Increase	Decrease	
Kentucky	Increase	Increase	Decrease	Increase
Louisiana		Increase		
Maine	Increase	Increase	Decrease	Decrease
Maryland	Increase	Increase	Decrease	
Massachusetts	Increase	Increase	Decrease	
Michigan			Decrease	
Minnesota	Increase	Increase	Decrease	Decrease**
Mississippi		Increase	Decrease	
Missouri	Increase	Increase	Decrease	Decrease
Montana	Increase	Increase	Decrease	
Nebraska	Increase	Increase	Decrease	
Nevada		Increase		
New Hampshire		Increase	Increase	Increase
New Jersey	Increase	Increase	Decrease	
New Mexico	Increase	Increase	Decrease	Decrease
New York	Increase	Increase	Decrease	Decrease
North Carolina	Increase	Increase	Decrease	
North Dakota		Increase		
Ohio	Increase	Increase	Decrease	

(continued)

Table 1 (continued)

	1990-93		1994-2001	
	Change in progressive taxes	**Change in regressive taxes**	**Change in progressive taxes**	**Change in regressive taxes**
Oklahoma	Increase	Increase	Decrease	
Oregon	Increase		Decrease	Increase
Pennsylvania	Increase	Increase	Decrease	
Rhode Island	Increase	Increase	Decrease	Increase
South Carolina				
South Dakota			Decrease	Increase
Tennessee		Increase		
Texas		Increase	Decrease	
Utah			Decrease	
Vermont	Increase	Increase		Increase
Virginia	Increase			
Washington		Increase		Increase*
West Virginia		Increase		
Wisconsin		Increase	Decrease	Increase
Wyoming		Increase		Increase
Number of increases	**26**	**37**	**1**	**13**
Number of decreases	**0**	**1**	**37**	**9**

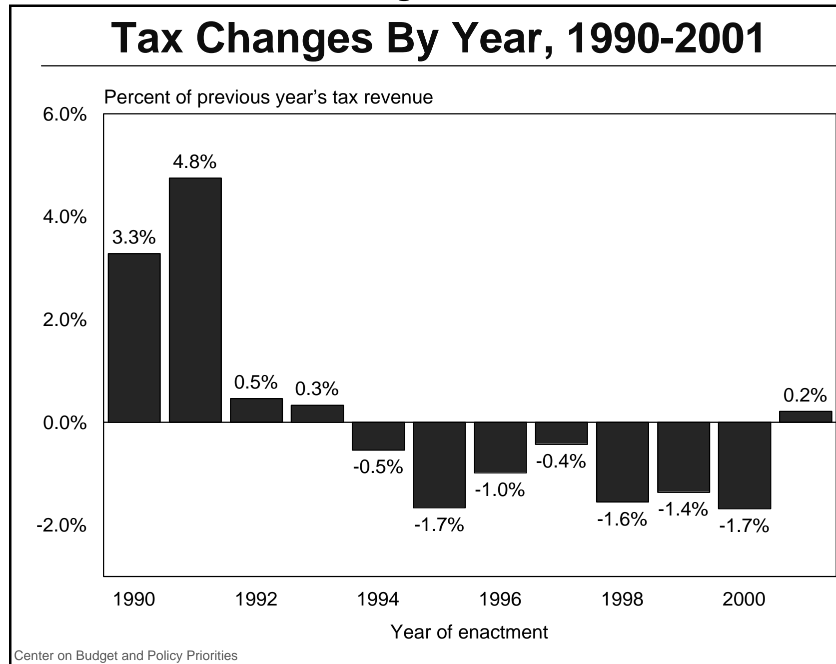
Note: For more detail, see Appendix III.
*Does not taken into account reduction in vehicle taxes in California and Washington; see page 18.
**Minnesota sales tax rebate is temporary; see page 19.

federal estate tax. Most states will lose that revenue, largely to the benefit of their wealthiest residents, unless they explicitly sever the link to the federal tax.

- If states are compelled to increase sales and excise taxes, they can offset such tax increases with new or expanded tax credits targeted to low-income families. Examples include state EITCs, sales tax credits or rebates, and property tax circuit breakers. At a minimum, states can make sure to protect and maintain existing low-income tax credits, which in the past often have been reduced or eliminated when states experienced fiscal problems.

- States can do more to ensure that policymakers understand the distributional implications of tax decisions. Only about a half-dozen states have the capacity to analyze how proposed changes in their tax laws would affect the amount of taxes owed by different income groups in their populations. Even fewer states — only **Maine, Minnesota,** and **Texas** — actually mandate that policymakers be informed of the distributional consequences of tax decisions before they act.

Figure 2



The Twelve-year Trend Toward Rising Regressivity

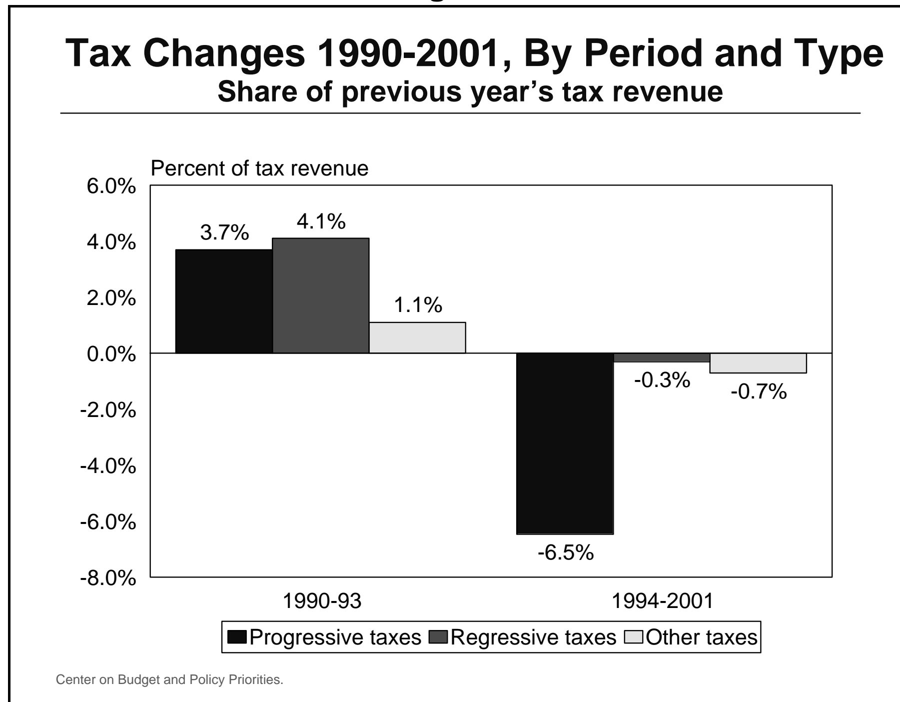
In aggregate, state tax changes from 1990 through 2001 roughly mirrored the business cycle. A recession hit the national economy in 1990, depressing tax revenue and increasing the costs of social programs. Largely in response to that national recession and the resulting budget shortfalls in many states, states in 1990, 1991, 1992 and 1993 enacted more than $25 billion in net tax increases.[1]

As the economy recovered from the recession of the early 1990s, state tax revenue began to grow at a rate faster than projected, leaving states with surplus revenues. These surpluses prompted states to enact tax *cuts* in 1994 through 2001 totaling some $35 billion. Taking into account inflation and other economic changes in state tax bases over that time, the aggregate tax cuts of 1994-2001 were approximately equivalent in scale to the tax increases of the early 1990s.

But this simple picture of taxes — up in the early 1990s, down since then — disguises dramatic differences in the specific taxes that were raised or lowered and thus masks the impact on different population groups.

[1] Tax increases were not states' only response to the fiscal crisis of the early 1990s; states also reduced spending sharply, in part by cutting programs for low-income residents.

Figure 3



- Personal income taxes, corporate taxes, and estate and inheritance taxes accounted for 42 percent of the net increases enacted in 1990 through 1993 but 81 percent of the net decreases enacted in 1994 through 2001.

- By contrast, sales and excise taxes accounted for 46 percent of the tax increases in the early 1990s but just 4 percent of the net tax cuts in the rest of the 1990s and into 2000 and 2001.

In the early 1990s, sales and excise taxes were increased by $12 billion, personal income taxes by $8.2 billion, corporate income and other business taxes by $2.4 billion, and other taxes by $3.2 billion; inheritance taxes were slightly reduced. In other words, when states needed new revenue in the early 1990s, they spread those tax increases roughly proportionately over consumption taxes and personal and corporate income taxes to provide the extra revenue.

When states decided to cut taxes beginning in the middle 1990s, they cut personal income taxes by some $19 billion. Corporate income taxes and other corporate taxes were cut $4.8 billion, and inheritance and estate taxes were cut approximately $3.6 billion. But states only reduced sales and excise taxes by a net of about $1.0 billion, a figure that includes about $3.4 billion in net sales tax cuts and $2.4 billion in net excise tax increases. Other tax cuts, including reductions in state vehicle property taxes, totaled about $5.8 billion. In other words, when states

Tax Cuts and Revenue Collections

One might suspect from the tax-change trends described in this paper that states today get more of their revenue from regressive taxes and less from progressive taxes than they did in 1989. In fact, available data from the U.S. Census Bureau show that the reverse is true: in aggregate, states today receive slightly more of their tax revenue from progressive taxes and less from regressive taxes.

If collections of progressive taxes are rising, how can it be the case — as this paper contends — that state tax systems are becoming more regressive? The explanation lies largely in the fact that over the last several years, the incomes of high-income families have risen far faster than the incomes of low-income families. From 1989 to 1997, the incomes of the lowest fifth of the population did not change, while the incomes of the highest fifth of the population rose 17 percent; the very wealthiest 1 percent of households saw their incomes rise 36 percent. The nonpartisan Congressional Budget Office, which issued those findings, also found that the same disparities in income growth continued at least through 1999.

This rapidly rising income inequality has contributed to particularly strong growth in the personal income tax over the last several years, because in most states the personal income tax is the major state tax that is paid by high-income families. This growth in tax revenue has been partially, but not entirely, offset by the legislated tax cuts described in this report. On the other hand, since sales taxes more than income taxes tend to be paid by families with lower incomes, the growth in sales tax revenue has been constrained. Moreover, in most states, a large and growing portion of consumption — consumption of services — is generally not subject to sales taxation.

The fact that personal income tax revenue is rising faster than sales tax revenue is irrelevant to whether tax systems are becoming more progressive or regressive. As the incomes of families at the top have risen rapidly, the total dollars that they pay in taxes (mostly progressive taxes) have also risen rapidly. Because states are cutting the rates at which they levy progressive taxes, however, those families are paying less in taxes than they otherwise would have, and their taxes *relative to their incomes* have declined. That is, they are paying a smaller percentage of their income in taxes. At the same time, for the large portion of lower-income families whose incomes have changed little, their total tax burdens (largely sales and excise taxes) and the ratio of taxes to income are likely to have stayed constant, or perhaps risen.

This phenomenon is seen clearly in Massachusetts. Like many other states, during the 1990s Massachusetts enacted some $3 billion in tax cuts, nearly all of them reductions in progressive taxes. By the end of the decade, income tax rates (particularly rates on investment income) had been reduced, and both estate and corporate taxes also had been cut sharply. During that time, there was very little change in the state's consumption taxes. Because of the cuts in progressive taxes, the tax environment for higher-income families was clearly more favorable than it had been at the beginning of the decade. A microsimulation analysis by the Institute on Taxation and Economic Policy, based largely on actual tax records, found that the tax changes enacted from 1991 to 1998 reduced taxes for the wealthiest taxpayers by an average of $16,000 per year, or 1.6 percent of their incomes, but cut taxes for poor and middle-income taxpayers by just 0.2 percent to 0.6 percent of their incomes per year, or as little as $7 annually for the poorest one-fifth of taxpayers.

But because personal incomes in Massachusetts were rising fastest for the state's wealthiest taxpayers, for whom progressive taxes were the major taxes paid, total revenue from those taxes — personal and corporate income taxes and the state's estate tax — rose at an annual rate of 7.1 percent, compared with a 5.9 percent growth rate for sales and excise taxes. In other words, the state's tax system became more regressive at the same time that the share of total tax revenue it received from progressive taxes rose. Since income inequality in most states has risen over the last decade, it is likely that other states experienced the same phenomenon.

began cutting taxes they focused those cuts overwhelmingly on personal income taxes and other progressive taxes, with minimal cuts in consumption taxes.[3]

The dollar figures from the early 1990s are not strictly comparable to those of the later period because they are not adjusted for inflation or other economic changes during the decade. One way to make such adjustment is to compare the tax changes in a given state in a given year to that state's total tax collections in the previous year. Such an adjustment shows that increases in personal income taxes, corporate taxes, and inheritance and estate taxes equaled 3.7 percent of total state tax collections in the early 1990s, while cuts in those taxes in the 1994-2001 period equaled 6.5 percent of collections. By contrast, states raised sales and excise taxes by an amount equal to 4.1 percent of total state tax collections in the early 1990s but cut them by just 0.3 percent of tax collections in the later period.

Personal Income Tax Rate Changes

Many of the tax changes of the last 12 years, both increases and decreases, were accomplished by raising or lowering tax rates. Since 1990, about 30 states have raised or lowered their top personal income tax rates and 23 states have raised or lowered their sales tax rates. (About 14 states have done both. The remaining 11 states changed neither their top income tax rates or their sales tax rates.) As with the aggregate tax changes of the 1990s, however, the patterns of rate changes varied dramatically by type of tax.

In this report, cuts in personal income taxes are considered reductions that largely benefit higher-income taxpayers. It is possible, of course, for states to target the benefits of personal income tax cuts to families with lower incomes. States can raise the income level at which families must first pay income taxes, for example. States can create or increase tax credits for expenses that are particularly burdensome for low- and moderate-income working families, such as child care costs. Or states can provide

How Did State Taxes Change in the 1980s?

State tax changes enacted in the 1980s followed a similar pattern as in the 1990s: Both regressive and progressive taxes were raised in the recessionary early years of the decade, but only progressive taxes were cut in the economic expansion of the middle and later years.

Sales tax rates, and other regressive taxes on consumption, were systematically raised throughout the 1980s. From 1980 to 1989, the average state sales tax rose from about 3.9 percent to about 4.8 percent; gasoline and cigarette tax rates also increased during the 1980s. While taxes paid by lower-income taxpayers were rising throughout the 1980s, the personal income tax rates paid by the highest-income taxpayers rose only during the recession of the early 1980s and then returned to pre-recession levels — or lower — by the end of the decade. The average top personal income tax rate rose from 6.3 percent in 1980 to 6.8 percent in 1985, then dropped to 6.2 percent in 1989. In short, by the end of the 1980s, average sales tax rates were higher, and personal income tax rates were lower, than at the beginning of the decade — a pattern largely repeated in the 1990s.

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[3] This analysis does not consider changes in local property taxes or other local taxes. For methodological details, see Appendix II.

Upper-Income Taxpayers Benefit the Most from an Income Tax Rate Reduction

An "across-the-board" personal income tax cut may appear equitable. But typically such a tax reduction provides the largest dollar benefits *and* the largest benefits as a share of income to the state's wealthiest taxpayers. This is because high-income taxpayers, for whom other types of state and local taxes are quite low relative to their incomes, pay relatively more in income taxes.

Consider, for example, a hypothetical state in which taxpayers are exempt from income tax on their first $15,000 of income and pay a five percent tax on all income above $15,000. Under this system, a taxpayer with income of $10,000 pays no income tax, a taxpayer with income of $20,000 pays income tax of $250, a taxpayer with income of $40,000 pays tax of $1,250, and a taxpayer with an income of $100,000 pays tax of $4,250.

A 10 percent income tax rate reduction would reduce the five percent rate to 4.5 percent; the first $15,000 of income would still be exempt. With this change, the taxpayer with income of $10,000 would receive no tax reduction at all. The taxpayer with income of $20,000 would receive a tax cut of $25 or 0.13 percent of income. The taxpayer with income of $40,000 would receive a tax cut of $125 or 0.31 percent of income. And the taxpayer with the income of $100,000 would receive a tax cut of $425 or 0.42 percent of income.

In this example, the taxpayer with $100,000 income receives a tax cut equal to 0.42 percent of income, more than three times as great as the 0.13 percent of income tax cut received by the taxpayer with the $20,000 income.

The difference between the tax cuts for upper-income and lower-income taxpayers is more dramatic if the state has a graduated income tax rate structure. For instance, consider a state in which taxpayers are exempt from tax on their first $15,000 of income but pay a three percent tax on their next $15,000 of income, a five percent tax on their next $30,000 of income, and a seven percent tax on all income over $60,000. A 10 percent across-the-board rate reduction would reduce those rates to 2.7 percent, 4.5 percent and 6.3 percent respectively.

With that rate reduction, a taxpayer with income of $20,000 would receive a tax break of $15 or 0.08 percent of income. A taxpayer with income of $100,000 would receive a tax break of $475 or 0.48 percent of income. As a percentage of income, the higher-income taxpayer's tax reduction is eight times as great.

refundable tax credits for low- and moderate-income families that offset the burden of state and local sales and property taxes. Although a number of states have included such provisions in their tax packages in recent years, as described below on page 19, few states have chosen to provide the *bulk* of their tax relief in this fashion.

Eight of the 10 states with the largest personal income tax cuts enacted in 1994 through 2001 centered those cuts around reductions in top tax rates. The reductions ranged from four-tenths of a percentage point to nearly two percentage points. A ninth state, Oregon, provided

refunds that were similar in effect to rate reductions. The tenth state, Wisconsin, reduced top tax rates by a more modest margin, with most of its income tax cuts taking the form of increased deductions and exemptions.[4] When top income tax rates are lowered, or when income tax rates are cut across-the-board, higher-income taxpayers tend to get the largest tax reductions, measured either as dollar amounts or as a percent of income. (See box on page 12.) In the absence of other tax reforms, such rate reductions shift the burden of state taxes onto less well-off taxpayers.

Table 2: Change in State Tax Rates since 1989

	Top PIT Rate (40 states)	**Sales Tax Rate (45 states)**
Rate is higher now than 1989	12	19
Rate is lower now than 1989	17	3
Rate is same as in 1989	11	23

Some of the rate reductions enacted during the economic expansion have been, in part, reversals of rate increases enacted in the early 1990s. The average top state income tax rate has returned from its 1993 high to about the same level it was in 1989 — about 6.29 percent for tax year 2002, compared with 6.75 percent in 1993 and 6.20 percent in 1990.

But many states have gone further, reducing top tax rates *below* where they stood at the beginning of the 1990s. Of the eight states described above that enacted particularly large income tax cuts, seven have cut their rates below what they were in 1989. Nationwide, 17 states now have top personal income tax rates that are lower than they were in 1989; only 12 have top personal income tax rates that are higher than they were in 1989.[5]

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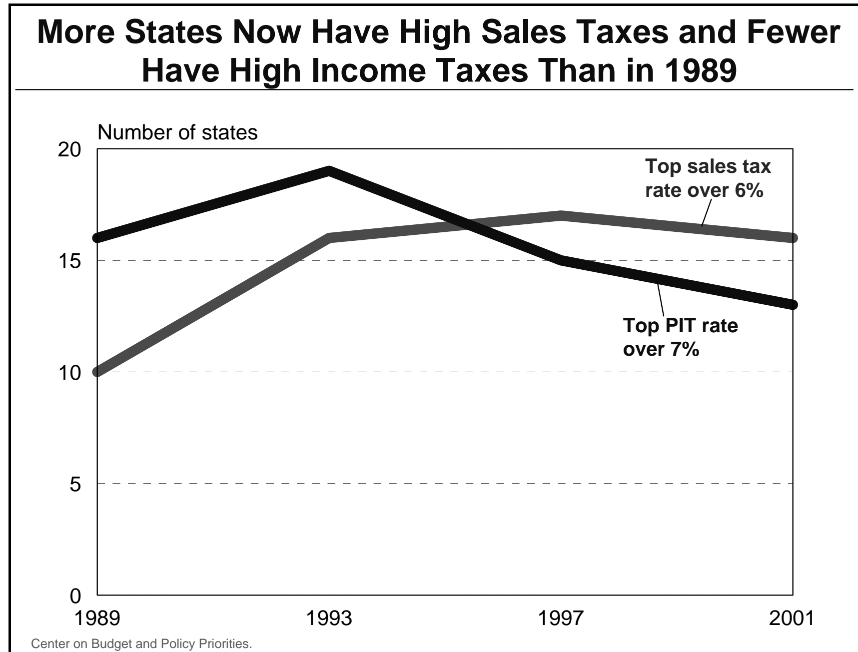
[4] The eight states with the large income tax rate cuts, along with the amount of reduction in percentage points, were Arizona (1.96 percentage points), Colorado (0.37), Delaware (1.75), Iowa (0.6), Maryland (1.25), Massachusetts (0.95), New Jersey (0.63), and New York (1.02). Oregon is in a special category. Oregon's major tax cuts were refunds in 1995, 1997, 1999 and 2001 that were distributed under the provisions of the state's "kicker" law. Although the refunds were not technically rate reductions, they had a similar distributional effect as rate reductions because the refunds were proportional to the previous year's tax liability.

[5] These figures, and those in the accompanying table, reflect top personal income tax rates for married couples filing jointly in states that have income taxes. New Hampshire and Tennessee, which tax only investment income, are excluded, as is Connecticut, which had only a tax on investment income in 1989 but converted to a broad-based income tax in 1991. Some states have lower rates on certain types of income, such as capital gains; this table does not account for those reduced rates. In states where federal income taxes are deductible, the state rates were adjusted to reflect the actual marginal state tax rate on income. Similarly, state income taxes levied as a percent of federal tax liability are counted at the equivalent state rates. As a result of the increases in the federal top rate between 1989 and 1993, the income tax rates in three states rose. The increase in the federal rate also had the effect of reducing top rates in six states that allowed federal taxes to be deducted.

Figure 4



Not surprisingly, most of those rate reductions have occurred since the end of the last recession. The number of states with top income tax rates of 7 percent or higher rose from 16 before the last recession to 19 in 1993, then fell to 13 in 2001.

Sales and Excise Tax Rate Changes

In contrast to the up-and-down movement of personal income tax rates, sales and excise tax rates have risen throughout the 1990s. General sales tax rates rose in a number of states from 1990 to 1993, and there has been little change since then.

- In the early 1990s, 17 states raised their sales tax rates above the 1989 level. The average state rate rose from 4.8 percent in 1989 to 5.1 percent in 1993.

- During the economic expansion of 1994-2001, most states did not reverse the sales tax rate hikes of the early 1990s. In fact, states were as likely to raise sales tax rates as to lower them during this period. The average state sales tax rate rose slightly from 1994 to 2001, to about 5.2 percent.

- By the end of the business cycle in 2001, 19 states had higher sales tax rates than they had in 1989. Just three states — Colorado, Connecticut, and Utah — levied sales taxes at lower rates than they had in 1989.[6]

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[6] Connecticut's sales tax rate reduction was enacted as part of an overall revenue-raising package in the early
(continued...)

- The number of states with a general sales tax rate of six percent or higher increased from 10 states in 1989 to 16 states in 1993. Unlike the personal income tax rate hikes, which were reversed as the economy and fiscal conditions grew healthy, the number of states with sales tax rates exceeding six percent did not decline. By 2001, 16 states still had general sales tax rates of at least six percent.

There are ways to lower sales taxes other than reducing rates, of course. For example, during the economic expansion of the 1990s, three states — Georgia, Missouri, and North Carolina — repealed or dramatically reduced their state sales taxes on groceries, and New York and Vermont exempted many items of clothing from the sales tax. Those tax reductions provided significant benefits to families across the economic spectrum in much the same way that a rate cut would have. No other state, however, took similar action.[7] And it is worth noting that in each of those states — Georgia, Missouri, New York, North Carolina and Vermont — the net fiscal impact of reductions in sales and excise taxes during the economic expansion was far less than the net effect of reductions in personal and corporate income taxes and inheritance taxes.

Examples from Individual States

The national trend of falling personal income taxes but stagnant or rising consumption taxes is reflected in the legislative decisions made by many individual states.

- In the early 1990s, some 26 states raised personal income taxes and/or corporate taxes significantly (by at least 1 percent of total state tax collections). During the same period, 37 states raised sales and/or excise taxes significantly.

- From 1994 to 2001, by contrast, 37 states enacted significant reductions in personal income taxes, corporate taxes, or inheritance/estate taxes, while just 9 states enacted net sales and excise tax reductions.

- During the period of economic expansion, when most states were experiencing substantial budget surpluses and cutting taxes, 13 states nonetheless enacted significant net sales and excise tax increases. Of those 13 states that increased regressive taxes from 1994 to 2001, eight states also cut progressive taxes during that same period.

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[6] (...continued)
1990s that also included enactment of a state income tax in place of the state's tax on dividends, interest, and capital gains.

[7] During the 1994-2001 period, several states briefly reduced sales tax rates or provided temporary or conditional sales tax rebates. The shortcomings of such temporary approaches are discussed below.

The specific patterns of tax changes vary from state to state. For instance, some states raised mostly consumption taxes in the early 1990s but then mostly cut personal income taxes in the middle and late 1990s. The result was a higher tax burden on the poor and a lower tax burden on the wealthy, relative to what burdens would have been under the tax structure of the late 1980s.

- For example, Iowa responded to the fiscal crisis of the early 1990s primarily by raising its sales tax from 4 percent to 5 percent in 1992. When Iowa cut taxes in the middle and late 1990s, by contrast, it did so primarily with an across-the-board income tax rate reduction. While across-the-board rate reductions sound equitable, they provide greater benefit to higher-income taxpayers. (See box on page 12.) Iowa also reduced its estate tax. With a higher sales tax rate and lower income tax rates compared to the beginning of the decade, Iowa has reduced tax burdens on higher income taxpayers and raised burdens on lower-income families.

- Other states that followed this pattern of raising consumption taxes in the early 1990s and cutting progressive taxes in the middle and late 1990s include Arkansas, Idaho, Mississippi, Texas, and Wisconsin.

Other states have reversed some or all of the personal income tax increases they enacted the early 1990s, but not the sales tax increases that were enacted at the same time.

- For instance, in 1992, Maryland broadened its sales tax base, raised gasoline and cigarette taxes, and added a top personal income tax rate of 6 percent on the wealthiest taxpayers. Two years later, Maryland allowed the new top income tax rate to expire, and shortly thereafter cut personal income taxes further. The state has also cut corporate and inheritance taxes. The sales tax increases, however, have remained mostly intact.

- Similarly, Massachusetts increased its personal income tax rates in the early 1990s, but in a combination of legislative actions and voter initiatives has since reduced the rates to below the 1990 levels. The state has also made large cuts to corporation and estate taxes. Excise tax increases from the early 1990s, however, have remained in full effect.

- States that have followed similar patterns include California, Delaware, Florida, Kansas, Kentucky, Montana, Nebraska, New Jersey, North Carolina, Ohio, Oklahoma, Pennsylvania and Rhode Island.

Some states have enacted both net consumption tax increases and net reductions in progressive taxes since 1994. In other words, as these states were taking advantage of the fiscal prosperity of the last eight years to cut taxes largely for higher income taxpayers, they were raising the tax burden on poorer families.

- For example, over the last eight years, the personal income tax rate in Arizona has been cut from 7 percent to 5.04 percent. At the same time, the state has enacted major increases to its cigarette tax and, most recently, increased its sales tax from 5 percent to 5.6 percent.

- Similarly, Arkansas has enacted a variety of personal income tax cuts, including a reduction in its capital gains tax rate, while approving sales tax increases that have raised the rate from 4.5 percent in 1993 to a current level of 5.15 percent.

- Other states following this pattern include Idaho, Kentucky, Oregon, Rhode Island, South Dakota, and Wisconsin.

Some states have made increases in regressive taxes their only significant tax changes in the last 12 years. As a result, their state tax systems almost certainly have become more burdensome on low-income families.

- For example, Tennessee raised its sales tax rate from 5.5 percent to 6 percent in 1992, the only tax change in the state that affected state tax revenue by more than 1 percent during the last 12 years.

- Other states following this pattern include Alabama, Alaska, Louisiana, North Dakota, Washington, West Virginia and Wyoming.[8]

A few states acted to reduce progressive taxes throughout the decade, without net cuts in regressive taxes. Illinois and Utah cut income taxes, but did not change net consumption taxes by more than 1 percent of total tax collections. Michigan cut both income taxes and estate taxes, and actually raised sales and excise taxes to pay for school property tax reform.[9]

Recent State Actions to Make Tax Changes Fairer

In the face of generally increasing state tax burdens on low-income families, several states have taken positive steps to make tax systems fairer. Particularly in the last few years, these states have targeted at least a portion of the benefits from tax reductions to low- and moderate-income families — the families that generally were most burdened by the tax increases

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[8] Alabama and Louisiana enacted both substantial increases and substantial decreases in progressive taxes at various times during the 1994-2001 period. The net effects of these changes, however, were less than one percent of state tax revenue.

[9] The Michigan consumption tax increases were enacted as part of a broader school finance reform. They are excluded from this analysis because to include them would require an analysis of the distributional impacts of the changes in local taxation that were also part of school finance reform in Michigan, which is beyond the scope of this analysis.

of the early 1990s. Such actions included enacting or expanding low-income tax credits, exempting essential items like food or clothing from the sales tax, or sending surpluses back to taxpayers in the form of sales tax rebates. But while several of those steps have been of significant benefit to low- and moderate-income families, it seems unlikely that many of them have halted or reversed the trend toward greater regressivity.

Reductions in Sales and Excise Taxes

Toward the end of the 1990s, it appears that states became slightly more likely than they had been previously to enact reductions in regressive taxes.

- As states emerged from the recession and began cutting taxes from 1994 to 1997, there were virtually no net reductions in regressive taxes. Some 93 percent of tax cuts were in progressive taxes — personal income taxes, corporate taxes, and inheritance and estate taxes — while sales and excise tax reductions equaled less than 2 percent of tax cuts. Indeed, ten states actually *increased* net sales and excise taxes during this time, while five states reduced them significantly.

- From 1998 to 2001, the pattern shifted slightly. Net sales and excise tax reductions rose to $1.1 billion, or about 7 percent of the total tax cuts during this period. In addition, California and Washington together spent an additional $2.6 billion to reduce vehicle property taxes; such taxes are sometimes considered regressive. If the vehicle property tax cuts were combined with the sales and excise tax reductions, then 20 percent of the tax reductions in 1998-2001 could be considered cuts to regressive taxes. Even excluding California and Washington, as many states enacted significant reductions in regressive taxes as enacted increases. States reducing sales taxes included New York and Vermont, which exempted many items of clothing from the sales tax; Colorado and Maine, which cut their sales tax rates; Connecticut, which reduced its gasoline tax; and North Carolina, which repealed its sales tax on groceries.[10]

- Even so, reductions in regressive taxes from 1998 to 2001 were far exceeded by reductions in progressive taxes. Cuts in progressive taxes from 1998 to 2001 totaled $15 billion, including nearly $10 billion in personal income tax cuts, $3 billion in corporate tax cuts, and about $2 billion in reductions to inheritance and estate taxes. Altogether, cuts in progressive taxes represented about 71 percent of all tax cuts from 1998 to 2001. Even in Colorado, Connecticut, New York, North

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[10] Two other states, Hawaii and Minnesota, may be viewed as having enacted significant cuts in sales and excise taxes during this period. However, most of Hawaii's reduction was in the form of lower rates for business-to-business sales, and the Minnesota reduction, as described later in this paper, was largely a temporary rebate of surplus revenue that did not have a permanent impact on the tax structure. North Carolina is unique in that it repealed its sales tax on food in 1998 but, faced with a fiscal crunch in 2001, raised its overall sales tax rate.

Carolina, and Vermont — the states that cut sales and excise taxes during this period — the reductions in progressive taxes exceeded the reductions in regressive taxes.

Temporary Tax Cuts

As the economic recovery matured, other states made reductions in regressive taxes, but they were unwilling to make these reductions permanent. In the late 1990s and into 2000, a number of states enacted temporary sales tax reductions or sales tax rebates. Examples include California's one-year, quarter-cent reduction in its state sales tax that expires January 1, 2002; a one-year, one-cent sales tax rate cut in Nebraska in the late 1990s; a series of sales tax rebates in Colorado and Minnesota; one-time sales tax rebates in Connecticut and Wisconsin; four- to six-month suspensions of sales taxes on gasoline purchases in Illinois and Indiana in 2000; and about a dozen states' "sales tax holidays" in which sales taxes were suspended for specific items, typically for about a week. Although most of these temporary changes do not show up in the aggregate measurements of tax changes presented above, some of them represented significant savings for consumers during the limited period of time they were in effect. (Others, such as the holidays, were much more modest in impact.) In 1999, for instance, state sales tax rebates in Colorado, Connecticut, Minnesota and Wisconsin distributed close to $3 billion to taxpayers in rough proportion to their actual sales tax liability.[11]

Nearly all of those rebates, reductions, suspensions and holidays were intended only to last as long as states continued to experience strong revenue growth and budget surpluses. Most either have expired or are expected to expire by 2002. To the extent that such measures forestalled or slowed the trend toward increasing regressivity, their expiration has the opposite effect. The contrast with the treatment of progressive taxes in this period is instructive. The great majority of the reductions in progressive taxes enacted from 1994-2001 are now a permanent part of state law. Only three states — Colorado, Ohio, and Oregon — chose to make a portion of their reductions in progressive taxes temporary or conditional.[12]

Low-income Tax Relief

Several states over the last four years have taken an additional step toward mitigating the regressiveness of their tax systems: enacting or expanding income tax credits or other provisions specifically designed to benefit low- and moderate-income families.

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[11] An explanation of why these temporary tax changes do not for the most part show up in the aggregate tax changes presented in this report may be found in Appendix III.

[12] A fourth state, Oklahoma, reduced income tax rates permanently but provided that the rate cut would be suspended in any year in which revenues are projected to decline. Under that provision, the rate cut will be suspended in 2002, but likely will be restored automatically for future years.

- A dozen states in the last four years have enacted or expanded state Earned Income Tax Credits. Such credits are based on the federal EITC, a tax credit for poor and near-poor working families that lifts several million children out of poverty each year. Since 1997, existing EITCs in Maryland, Minnesota, New York and Vermont have been increased substantially, and eight other states have enacted new EITCs; the total number of states offering EITCs has risen from seven to 15. Taken together, state EITCs now provide slightly over $1 billion in annual state tax relief to poor and near-poor working families.[13]

- Other state tax actions in recent years providing specific benefits to low- and moderate-income families include new child care tax credits in New York, Ohio and Oregon; expanded income tax exemptions for low-income families in New Jersey and Pennsylvania; higher grocery-tax credits in Idaho, Kansas, and Oklahoma; a new sales tax credit in Arizona; increases in New Mexico's Low-Income Comprehensive Tax Rebate; and increased property tax "circuit breakers" in various states. In addition, California enacted a child-care tax credit that is available to low-income families as well as middle-income families.

Even the most generous of such provisions typically were add-ons or adjuncts to other income tax cuts, the bulk of whose benefits went to higher-income families in the form of rate cuts or other provisions. For example, the expansion of Maryland's EITC, although significant, accounted for less than one-tenth of its roughly $600 million in income tax cuts enacted over the last several years. Similarly, the less than $100 million that Massachusetts spent to enact an EITC and expand other low-income provisions pales in comparison to the more than $3 billion in other tax cuts that the state enacted since the early 1990s.

A few states in the late 1990s and into 2000 and 2001 enacted significant reductions in progressive taxes without any accompanying tax relief targeted to low-income families and without general reductions in regressive taxes. These states included Connecticut, Delaware, Iowa, Kentucky, Michigan, Nebraska, Rhode Island, South Dakota, and Texas. In most of those states, the benefits of those tax cuts are going primarily to higher-income families.

Tax Changes in the Worsening Fiscal Environment of 2001 and 2002

The recession that officially began in March 2001 and the aftermath of the September 11 terrorist attack changed the fiscal environment dramatically in virtually every state. Declines in the stock market, falling tourism, and rising joblessness have led to slower-than-expected revenue collections in most states. In addition, health care costs which represent a large share of state budgets are rising more quickly than states had planned for, and states are facing new and

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[13] For more information on state EITCs, see the Center on Budget and Policy Priorities publication *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty*, 2001 Edition, October, 2001.

North Carolina's Budget-Balancing Tax Package

In September, 2001, North Carolina became the first state to enact a large package of tax increases in response to the economic slowdown. The changes included increases in both progressive and regressive taxes, including a half-cent rise in the state sales tax; an income tax increase of one-half of one percent on married couples with taxable incomes over $200,000 and single filers with taxable incomes over $100,000; broadening the sales tax base to include more services and broadening telecommunications taxes; and other smaller items.

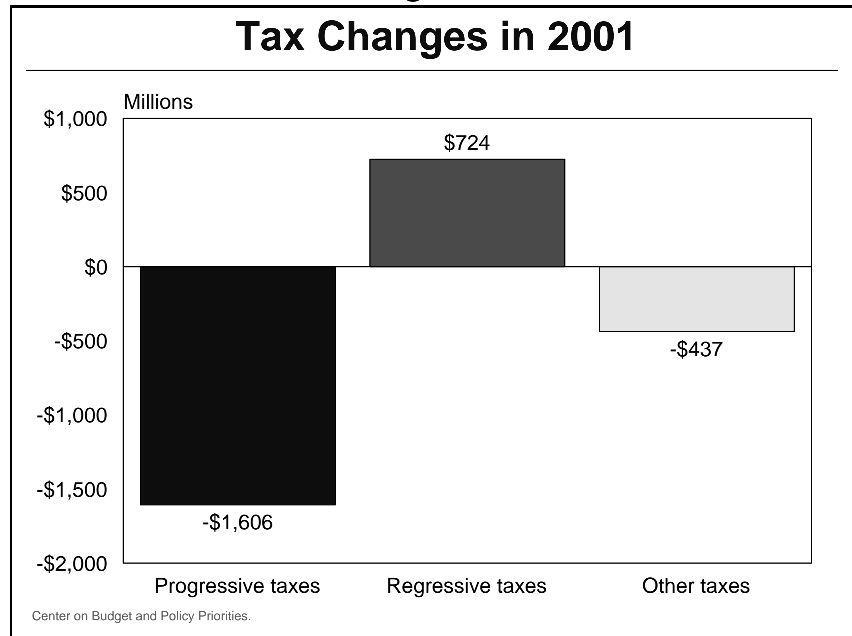
Although two-thirds of the new revenue came from the expansion of the sales tax, the increase in the top income tax rate helped improve the overall fairness of the package. Indeed, the equity of the package appears to have been a significant concern of legislators, and the final package included some tax *reductions* that help offset some of the regressivity, including an increase in the state's child tax credit for families with incomes below $100,000 and an increase in the standard deduction for married couples.

The version of the tax package that was proposed by the governor and passed by the state House of Representatives Finance Committee also included a state Earned Income Tax Credit. Such a credit would have offset the sales tax increase for low-income working families with children and allowed the state to balance its budget without increasing taxes on those families least able to pay. The final deal did not include the EITC. North Carolina's governor has indicated that he may propose such a credit for consideration in the next legislative session.

unanticipated security-related costs. By December 2001, the National Governors Association estimated that state deficits for the 2001-02 fiscal year had reached $40 billion, and the National Conference of State Legislatures reported that 36 states had planned or implemented mid-year budget cuts.

As a result of this fiscal stress, the leaders of many states are openly discussing raising taxes, or at least postponing scheduled tax cuts, to balance their budgets. (All states but one are required by statute or constitution to balance their budgets, even in recession.) In the last few months of 2001, North Carolina enacted a large package of tax increases, a combination of income tax and sales tax changes that is expected to raise $800 million per year. (See box.) Also in late 2001, Alabama and Ohio closed some corporate loopholes, while Connecticut, Florida and Virginia postponed the phase-in of previously enacted tax cuts. Alabama also raised taxes on cell phones and interstate phone calls. Oklahoma temporarily rescinded a previously enacted income tax cut due to low revenues. Other states where tax increases, or postponement of scheduled tax cuts, have been suggested by governors or leading legislators include Arkansas, Illinois, Indiana, Iowa, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, and Tennessee. Still other states, such as California and Virginia, may see tax-increase proposals on the ballot in 2002.

Figure 5



The evidence so far in the current economic slowdown is limited, but it suggests that states may again look at least as favorably on regressive tax increases as on progressive tax increases. A number of states during the 2001 legislative sessions allowed previously enacted reductions in progressive tax cuts to go forward, while freezing or reversing reductions in sales and excise taxes. Along with some newly enacted changes, the net effect was to raise regressive taxes while cutting progressive taxes.

- A number of states in 2001 allowed previously scheduled reductions in progressive tax cuts to go forward, or enacted new ones. Significant such reductions occurred in Hawaii, Idaho, Maryland, Massachusetts, Michigan, New York, Oregon, Pennsylvania, and Rhode Island. The impact of these reductions on fiscal year 2002 budgets totaled about $2.4 billion. Against those reductions, Indiana, Nevada, New Hampshire, New Jersey, and North Carolina increased progressive taxes to varying degrees; increases totaled $800 million, for a net reduction of $1.6 billion.

- Several states, most notably North Carolina, raised regressive taxes. The net increase totaled about $700 million.

In other words, during 2001 legislative sessions, states as a whole cut progressive taxes by about $1.6 billion while they increased regressive taxes by about $700 million.[14] This

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[14] In addition, some $600 million in temporary income tax cuts and $1.4 billion in temporary sales tax reductions (continued...)

disparity between the treatment of progressive taxes and regressive taxes provides a very preliminary indication that states may be inclined to follow the same path in this recession as they have over the last 12 years.

Options to Raise Taxes Without Increasing Regressivity

State tax increases need not be a burden on poor families. States have a number of other ways to raise the revenue they need to balance their budgets. They can reverse the cuts of the last several years in progressive taxes, or postpone scheduled reductions in such taxes. Alternatively, they can offset any increases in regressive taxes with targeted tax credits or other provisions that provide relief to low-income families.

Reversing or Slowing the Reductions in Progressive Taxes

Since the bulk of the tax reductions enacted over the last eight years has been cuts in progressive taxes, it seems reasonable to expect states to turn to those taxes to make up lost revenue. Increases in progressive taxes could take any number of forms.

- States could raise top income tax rates or impose a surcharge on income taxes for higher-income families most able to bear the increased burden, as North Carolina has done. Income tax rates have been reduced in 21 states over the last eight years; those states in particular could reverse some or all of those cuts.

- Alternatively, states could raise more money from their corporate income taxes, perhaps by closing corporate tax loopholes, as both North Carolina and Ohio did in 2001. State corporate income tax payments, as a share of total corporate profits, have declined dramatically over the last decade, in part because multi-state corporations increasingly are able to exploit shortcomings in state tax law to minimize their tax payments.[15] By updating their tax codes, states can ensure that corporations continue to bear their share of the state tax burden.

- States could take steps to protect their estate taxes by "decoupling" from the federal estate tax changes, as Rhode Island has done. (See box on page 25.)

- In a few states, there is an opportunity to cancel or postpone a scheduled reduction in progressive taxes. Louisiana, Maryland, Massachusetts, Michigan, and

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[14] (...continued)
or rebates were allowed to expire; if those are added to the totals, states may be said to have reduced progressive taxes by a net of $1 billion and increased sales taxes by a net of $2.1 billion.

[15] Steve Maguire, *Average Effective Corporate Tax Rates*, Congressional Research Service, February 29, 2000.

Pennsylvania all have planned reductions in personal income, corporate, or estate taxes scheduled to take effect in 2002 or later that could be postponed or canceled. Such postponements are under active consideration in several of those states. Already, Connecticut has postponed a scheduled inheritance tax cut, and Florida has postponed for 18 months a reduction in its intangibles tax that had been scheduled to take effect January 1, 2002.

Offsetting Regressive Tax Increases with Low-income Tax Relief

If policymakers are unable to avoid raising consumption taxes, they can target tax relief to offset the added burden of those taxes to poor families. Such targeted relief could easily be structured to provide substantial relief to low-income families, sufficient to balance the increased burden of consumption taxes, without greatly reducing the amount of revenue available from a consumption-tax package. Examples of such targeted tax relief include state Earned Income Tax Credits, state sales tax credits or general refundable credits, and property tax circuit breakers. Many states already have one or more such credits in place that can be easily expanded; in many other states, creating such a credit would be straightforward.

Arizona's recent sales tax increase provides an example of how a state can offset a regressive tax increase with low-income relief. In 2000, Arizona enacted a sales tax increase to finance education improvements. Aware that such a tax increase would most heavily burden low-income families, policymakers earmarked $25 million of the estimated $400 million raised by the tax increase to pay for a new, refundable tax credit for families with income below $25,000 or single filers with income below $12,500. The credit will equal $25 per family member, up to a maximum of $100 per family. For many families, this credit will be sufficient to offset much of the tax increase.[16]

A few states took similar action in the early 1990s, pairing sales tax increases with low-income tax relief. One notable example is Minnesota, which enacted a state EITC to offset partially a sales tax increase in 1991. Other examples of low-income tax relief paired with regressive tax increases in the early 1990s occurred in Arkansas, Georgia, Iowa, Kentucky, and Oklahoma.

Times of fiscal stress can also threaten low-income tax provisions. In the early 1990s, for instance, California suspended its renter's credit, two tax credits in New Mexico that were intended to compensate for sales taxes on food and medical services were repealed, and Hawaii's

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[16] A key shortcoming of this credit, as with many other low-income tax relief programs, is that it contains no automatic adjustment for inflation. Over time, both the income limit and the value of the credit will be eroded by inflation, so that its adequacy in offsetting the burden of the sales tax increase will be reduced. (By contrast, most Earned Income Tax Credits do not have this flaw because they are adjusted automatically for inflation.)

Preserving State Estate Taxes

The federal Economic Growth and Tax Relief Reconciliation Act of 2001 included a provision that phases down and eventually repeals the federal estate tax in 2010. It also gradually eliminates between 2002 and 2005 what is known as the state estate tax credit. All states closely tie their own estate taxes to this state estate tax credit.

Prior to enactment of the new law, taxpayers received a dollar-for-dollar credit against their federal estate tax liability for state estate and inheritance tax payments, up to the specified amount of the state estate tax credit. These state estate taxes, commonly referred to as "pick-up" taxes, imposed no additional burden on taxpayers. The pick-up taxes provided revenue to states without increasing the estate tax payment the heirs must make beyond that which they would otherwise make under the federal estate tax. States typically reference the amount of the state estate tax credit in their own laws as the means by which estates calculate the pick-up tax owed to the state.

As a result of the elimination of the state estate tax credit, most states will begin losing revenue in state fiscal year 2003. States stand to lose $1.4 billion in fiscal year 2003, rising to $6.5 billion in fiscal year 2006 when the state estate tax credit will be completely eliminated. The benefits of this tax cut would accrue to a state's wealthiest households.

States can, however, take actions that will preserve most of the revenue they currently receive from the pick-up tax. There are three options states have for retaining their state estate taxes in the face of the elimination of the federal credit.

- States can decouple from the federal change by freezing their link to the federal estate tax provisions at 2001 law, before the reductions in the state credit begin to take effect. Estates would then calculate the full amount of estate tax they would have owed the state (that is, the full amount of the credit) if 2001 law had remained in effect.

- States can decouple by freezing their link to the federal estate tax provisions at 2001 law, but only tax estates that have a federal tax liability under current federal law. Under this option, taxpayers that have become exempt from federal estate tax as a result of other phasing-in changes in federal estate tax law — such as the increase in the minimum size of an estate that is taxable — would also be exempt from state estate taxes.

- Some 13 states have their own estate or inheritance taxes that they levy in addition to their links to the federal estate tax. States can expand or institute such taxes to replace their pick-up taxes.

grocery tax credit was reduced by half.[17] It is all too easy for policymakers to raise revenue in tight fiscal times by repealing tax credits or other provisions that assist low-income families.

[17] The California and Hawaii credits each were fully or partially restored several years later.

States that already have low-income tax provisions in place, therefore, need to be especially vigilant in protecting them because of their importance to low-income families.

Improving States' Capacity to Analyze Tax Incidence

It is possible that the trend toward more regressive state tax systems might be slowed or even reversed if policymakers had a better understanding of the impact of their tax decisions on families of various income levels. Today in most states, tax reductions or increases are considered without much information or debate over the extent to which various income groups would benefit or be harmed by the proposed tax changes. The types of trends detailed in this report, which may have gone unnoticed in individual states as well as across states, highlight the need for states and legislatures to produce such information in a consistent, timely manner.

In a recent survey, only six states reported having the capacity to analyze the economic incidence of most state taxes on taxpayers of different income levels; six other states reported that they were in the process of developing this capacity. Of the states that have the capacity to do so, only three states actually conduct this type of analysis on pending legislation on a routine basis: Maine, Minnesota, and Texas. Those three states require either legislative staff or the state revenue department to analyze the distributional impact before any major revenue changes can be enacted.[18]

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[18] See Michael Mazerov, *Developing the Capacity to Analyze the Distributional Impact of State and Local Taxes: Issues and Options for States*, Center on Budget and Policy Priorities, forthcoming.

Appendix I

State Tax Systems Are Already Regressive

State tax systems in general already rely more heavily on regressive taxes than on progressive taxes.

- Nearly half (47 percent) of all state tax revenue nationwide in 2000 came from taxes on consumption. These taxes — which include general sales taxes as well as excise taxes on cigarettes, gasoline, alcohol and other items — are consistently regressive. The chief reason for their regressivity is that lower-income families spend more of their incomes and save less than upper-income families.

- About one-third (36 percent) of state tax revenue nationwide in 2000 came from personal income taxes. This tax is the major progressive tax states use. Some state income taxes have progressive rate structures in which the tax rate paid on each additional dollar of income increases as a taxpayer's income rises. Even state income taxes that have only one tax rate are usually at least mildly progressive because personal exemptions, deductions, or credits may provide a proportionally greater tax benefit to taxpayers with lower incomes.

- About 6 percent of state tax revenue nationwide came from corporate income taxes, which are generally viewed as at least somewhat progressive. It is generally thought that the federal tax on corporate income is borne primarily by the owners of corporations and other forms of capital investment. Since these owners are disproportionately higher-income, and since the tax has been shown to primarily reduce their profits, the tax is quite progressive. There are differences of opinion, but little research, on whether the state corporate income tax is as progressive as the national tax; it likely that corporate employees and consumers share a portion of the burden along with corporate owners, but the tax is still generally regarded as progressive.

- About 1.5 percent of state tax revenue nationwide came from estate, inheritance, and gift taxes. Because these taxes are levied on wealth at time of death, because wealth in the United States is highly concentrated among high-income families, and because smaller estates are often exempt from such taxes, these taxes are also progressive. Another progressive tax on financial wealth is the intangibles tax, a property tax on such items as stocks and bonds that is an important revenue source in Florida and also levied in a few other states.

- The remaining share of state tax revenue — about 10 percent — comes from other taxes or tax-like fees. Some of these, like statewide property taxes that are common in some Western states, may be flat or progressive; others, like flat motor vehicle license fees, are clearly regressive; the incidence of others, such as

taxes on the extraction of natural resources, are difficult to determine. The effect on the distribution of the tax burden resulting from these taxes, whether positive or negative, is relatively small.

- In addition, state law typically establishes the structure of taxes levied by localities. Although local taxes are excluded from this analysis, it is worth noting that localities generally rely mostly on property taxes and sales taxes that are most burdensome on low-income families. In particular over the last several years, states have increasingly authorized states to enact or increase "local-option" sales taxes; these local-option taxes usually have the same effect on families as a statewide sales tax. Since local sales taxes are rising in popularity, they are further contributing toward the trend toward more regressive state tax systems.

The net effect of these various taxes is generally believed to be regressive. A nationwide study based on the 1995 tax returns of non-elderly married couples estimated that low-income families pay about 12.5 percent of their incomes in state and local taxes, while families at the top of the income scale pay about 7.9 percent of their incomes in state and local taxes.[19]

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[19] Citizens for Tax Justice and the Institute on Taxation & Economic Policy, *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States,* June 1996.

Appendix II

About the Data in This Report

The primary sources for the aggregate dollar amounts of tax changes in the years 1990 through 2000 are a series of annual reports issued by the National Conference of State Legislatures (NCSL) entitled *State Tax Actions* (prior to 1993, *State Budget and Tax Actions*). NCSL collects its estimates of the effects of tax changes from state legislative fiscal offices, and reports these changes by state and by type of tax. The 2001 data in this report are based on preliminary data from NCSL's forthcoming report for this year, combined with information collected directly from state legislative fiscal offices.

The NCSL data generally reflect the effects of tax changes implemented in the fiscal year following the one in which the change was enacted. For instance, the aggregate tax changes reported in 2000 State Tax Actions are based on estimates of revenue impacts for fiscal year 2000-01 (the 12-month period which in most states ended June 30, 2001).

The dollar totals in this analysis do not exactly equal the total tax changes reported by NCSL in each of the years covered. Adjustments were made for a variety of reasons. Most of the adjustments are consistent with principles outlined in a series of analyses produced by the Nelson A. Rockefeller Institute of Government from 1991 to 1995.[20]

- NCSL has changed its method of accounting for tax changes since 1990. In the early 1990s, NCSL followed what it called the "baseline method." Under this method, when a state postponed a scheduled tax reduction, it was counted as a tax increase. The expiration of a temporary tax was not counted at all. And the out-years of a multi-year phased-in tax change were not counted either. NCSL now favors the "taxpayer liability" method, which focuses on year-to-year changes to actual taxes paid. Under this method, the postponement of a scheduled tax cut does not count, but the expiration of a temporary tax change and the out-years of a phased-in tax change are both counted when they take effect. The NCSL data from the early 1990s were adjusted in this report to conform to the "taxpayer liability" method NCSL now uses. In addition, to maintain consistency, the expiration of a one-time tax reduction or tax rebate is counted in this report as a tax increase; in other words, the tax-reducing impact of one-time tax cut or rebate is offset by the tax-increasing impact of its expiration the following year.

[20] Steven D. Gold, "1995 Tax Cuts: Widespread But Not Revolutionary," December 1995; "State Tax Cuts: 1994 as Prelude to 1995," January 1995; "Tax Increases Shriveled in 1993," December 1993; "The Anatomy and Magnitude of State Tax Increases in 1992," January 1993; and "How Much Did State Taxes Really Go Up in 1991?", February 1992. All published by the Center for the Study of the States (now the Fiscal Studies Program), Nelson A. Rockefeller Institute of Government, Albany, N.Y.

- Unlike NCSL, this report excludes changes in local taxes even when those changes were mandated or financed at the state level. For example, state-mandated, state-financed reductions in vehicle property taxes in Indiana, Rhode Island and Virginia are excluded. The 1994 consumption tax changes in Michigan, which financed local property tax reductions, are also excluded.

- Health care provider taxes, which many states increased or decreased in the 1990s in response to technical issues surrounding the financing of Medicaid programs, are not included in this report. NCSL includes such taxes.

- In states where major tax changes went into effect partway through a fiscal year, the revenue estimates are adjusted to reflect the impact of the change in the first full year following implementation.

Unemployment insurance taxes, motor vehicle license fees and other types of fees, and revenues from state lotteries, none of which are included in the NCSL tax data, are also excluded from this analysis.

Appendix III

Selected Major State Tax Changes, by Type of Tax and Period of Enactment

This table describes some major changes to progressive taxes (personal and corporate income, estate, and intangibles taxes) and regressive taxes (sales and excise taxes) during the 1990-93 and 1994-2001 periods. *The list of changes is not intended to be comprehensive, but rather to provide examples of major components of changes to those taxes in each state where significant changes were made.* Tax changes shown in **bold** are reductions; tax changes shown in *italics* are increases; tax changes in plain font indicate reductions and increases of approximately equivalent size. Where no change is shown, either there were no changes to tax law or the changes that were enacted did not have a net impact equal to more than 1 percent of state tax revenue.

	Selected tax changes, 1990-93		Selected tax changes, 1994-2001	
	Change in progressive taxes	Change in regressive taxes	Change in progressive taxes	Change in regressive taxes
Alabama		*1992: gasoline tax increase*		
Alaska				*1997: cigarette tax increase*
Arizona	*1990: restructured income tax (lower rate, broaden base)*		**Multiple years: reduced personal income tax rates, other changes**	*1994: cigarette tax increase; 2000: sales tax increase*
Arkansas		*1991 and 1993: sales, cigarette, gasoline tax increases*	**1997: reduced personal income tax; 1999: reduced capital gains tax rate**	*Multiple years: sales tax increases, gasoline tax increases*
California	*1991: increased top personal income tax rate, other changes*	*1991: raised sales tax rate and broadened base; multiple years: raised gasoline tax*	**1996: top income tax rates expired; 1997: increased dependent credit**	See note*
Colorado	*1992: repealed deduction for state income taxes paid*		**1999 and 2000: reduced personal income tax rate and other changes**	**2000: reduced sales tax rate**
Connecticut	*1991: enacted state income tax to replace tax on dividends, interest, and capital gains*	**1991: reduced state sales tax rate, broadened base**	**Multiple years: reduced personal and corporate income taxes and inheritance taxes**	**Multiple years: reduced motor fuel taxes**
Delaware	*1991: increased corporate franchise tax*	*1990: raised cigarette and alcohol taxes*	**1998 and 1999: reduced personal income tax rates and other changes**	
Florida	*1990 and 1992: increased intangibles tax*	*1990: increased gasoline, cigarette, alcohol taxes*	**1999 and 2000: reduced intangibles tax**	

	Selected tax changes, 1990-93		Selected tax changes, 1994-2001	
	Change in progressive taxes	Change in regressive taxes	Change in progressive taxes	Change in regressive taxes
Georgia			**1994 and 1998: reduced personal income taxes**	**1996: eliminated sales tax on groceries**
Hawaii		*1991: increased gasoline tax*	**1998: reduced personal income taxes**	**2000 and 2001: reduced sales tax on business-to-business sales**
Idaho		*1991: increased gasoline tax*	**2001: reduced personal income tax rates**	*1996: increased gasoline tax*
Illinois			**1998-2000: increased personal income tax exemption, cut corporate taxes by changing apportionment formula**	
Indiana			**1999: reduced personal income tax by increasing deductions**	
Iowa		*1992: raised sales tax rate*	**1997: reduced personal income tax rates and inheritance tax**	
Kansas	*1992: raised personal income tax rates*	*1992: raised sales tax rate*	**1998: repealed inheritance tax, increased personal income tax deduction, and new corporate tax credits**	
Kentucky	*1990: repealed deduction for federal income taxes*	*1990: raised sales tax rate*	**Multiple years: adopted pension exclusion from personal income tax**	*1994: raised gasoline tax; 2000: broadened sales tax base*
Louisiana		*1990: raised sales tax on groceries*		1997: reduced sales tax on groceries and utilities; 2000: raised sales tax on groceries and utilities
Maine	*1991: raised corporate income taxes*	*1991: raised sales and gasoline tax rates*	**1998: increased personal exemption**	**1998 and 2000: reduced sales taxes;** *1997 and 2001: increased cigarette tax*
Maryland	*1992: raised personal income tax top rate*	*1992: broadened sales tax base, raised gasoline and cigarette taxes*	**1994, 1997-2001: reduced personal income tax rates**	

	Selected tax changes, 1990-93		Selected tax changes, 1994-2001	
	Change in progressive taxes	Change in regressive taxes	Change in progressive taxes	Change in regressive taxes
Massachusetts	*1990: increased personal income tax rates*	*1990: increased gasoline tax*	**Multiple years: reduced personal income tax rates and corporate income taxes; completed estate tax repeal**	
Michigan			**1994, 1999-2001: reduced personal income tax rates**	
Minnesota	*1991: increased personal income tax top rate*	*1991 and 1992: raised sales tax*	**1999 and 2000: reduced personal income tax rates**	**Multiple years: sales tax rebates (temporary)**
Mississippi		*1992: increased sales tax rate*	**Multiple years: reduced personal income taxes**	
Missouri	*1993: increased personal and corporate income taxes*	*1992: raised gasoline tax*	**1998 and 1999: reduced personal income taxes**	**1997: reduced sales tax on groceries**
Montana	*1993: raised personal and corporate income taxes*	*1992 and 1993: raised gasoline tax*	**1995: reduced personal income tax; 2000: repealed inheritance tax**	
Nebraska	*1990: raised personal and corporate income tax rates*	*1990: raised sales tax rate*	**1997 and 1998: reduced personal income taxes**	
Nevada		*1991: raised sales tax rate*		
New Hampshire		*1990 and 1991: raised gasoline and cigarette taxes*	*Multiple years: increased business taxes*	*Multiple years: increased cigarette taxes*
New Jersey	*1990: raised personal income tax rates*	*1990: broadened sales tax base (rate increase reversed in 1992)*	**1994-95: reduced personal income tax rates**	
New Mexico	*Multiple years: raised personal income taxes*	*Multiple years: raised sales taxes*	**1998: reduced personal income tax rates**	**Multiple years: reduced gasoline tax**
New York	*1990: increased corporate income taxes*	*1990: increased sales and gasoline taxes*	**1995-97: reduced personal income tax rates; 1999-2001: reduced estate tax; multiple years: reduced corporate income tax rates**	**1999: repealed sales tax on clothing**

	Selected tax changes, 1990-93		Selected tax changes, 1994-2001	
	Change in progressive taxes	Change in regressive taxes	Change in progressive taxes	Change in regressive taxes
North Carolina	*1991: increased personal and corporate income taxes*	*1991: increased sales tax*	**1995: reduced personal income taxes, repealed intangibles tax**	1998: repealed sales tax on groceries; 2001: raised sales tax rate
North Dakota		*1993: increased tobacco taxes*		
Ohio	*1991: increased corporate income tax; 1992: increased personal income tax*	*1990: increased gasoline tax; 1992: broadened sales tax base*	**Multiple years: reduced personal and corporate income taxes and estate tax**	
Oklahoma	*1990: increased personal and corporate income tax rates*	*1990: increased sales tax rate*	**1998 and 2001: reduced personal income tax rates**	
Oregon	*1991: increased personal income tax*		**Multiple years: reduced personal and corporate income taxes**	*1996: tobacco tax increase*
Pennsylvania	*1991: increased personal and corporate income tax rates*	*1991: broadened sales tax base*	**1994-2001: reduced corporate income and franchise taxes**	
Rhode Island	*1991: increased income tax rate*	*1990: increased sales tax rate*	**1998-2001: phased down personal income tax rate**	*Multiple years: increased tobacco taxes*
South Carolina				
South Dakota			**2000: repealed inheritance tax**	*Multiple years: increased sales and gasoline taxes*
Tennessee		*1992: increased sales tax rate*		
Texas		*1990: increased sales tax rate; 1991: increased gasoline tax*	**2000: enacted tax credits against corporate franchise tax**	
Utah			**1996: reduced personal income tax rate**	1997: reduced sales tax rate, increased gasoline and cigarette taxes
Vermont	*1990 and 1991: increased personal income tax rates*	*1991: increased sales tax rate*	1997: raised corporate income tax rate; 1999: reduced personal income tax rate	*1995: increased tobacco tax; 1997: increased gasoline tax*

	Selected tax changes, 1990-93		Selected tax changes, 1994-2001	
	Change in progressive taxes	**Change in regressive taxes**	**Change in progressive taxes**	**Change in regressive taxes**
Virginia	*1990: increased personal income tax*			
Washington		*1990: increased gasoline tax*		*1995 and 2001: increased cigarette tax**
West Virginia		*1993: increased gasoline tax*		
Wisconsin		*1991-93: increased gasoline and tobacco taxes*	**1997-2000: reduced personal income taxes**	*Multiple years: increased gasoline and tobacco taxes*
Wyoming		*1993: increased sales tax rate*		*1998: increased gasoline tax*
Number of increases	*26*	*37*	*1*	*13*
Number of decreases	**0**	**1**	**37**	**9**

Note: *California in 1998-2000 and Washington in 1999 enacted significant reductions in motor vehicle property taxes. Such taxes are not shown in this table, but they are sometimes considered regressive.

Among democratic welfare states, the closest thing to a demonstrable reversal against Robin Hood is the slight retreat in Sweden since the early 1990s. Globally, the most dramatic swing since the late 1970s has been Chileâ€™s record-setting return toward progressivity after the regressivity of Pinochet.Â People are supposedly taxed on their incomes without deciding to engage in less or more of the income-generating behavior. People in need are assumed to go on working or not working the same amount regardless of any social assistance they receive.Â The Rise of Redistribution. (A.) The latest fiscal snapshots We can now compare inequalities in yearly incomes before and after taxes and. transfers, and thus the net fiscal redistribution, for 53 countries around the world, in or. They include historical states that have since been enveloped by larger states, such as the Republic of Vietnam or East Germany, as well as large historical states that have since fragmented, such as Great Colombia, Czechoslovakia and Yugoslavia. 3. Note that small UN member states such as Andorra or Antigua and Barbuda are included in COW/TID even though they have populations substantially smaller than 500.000.Â Low income caps tend to increase the regressivity of SSCs, high caps tend to lower it (Ganghof 2007, 1075). 12.Â Mann, M. (1993). The Sources of Social Power: Volume 2, The rise of classes and nation-states, 1760â€“1914. Cambridge University Press. Mares, I., & Queralt, D. (2015). State-Dedicated Gas Tax. Motor fuels taxes have been an important source of dedicated transportation funding since before the creation of the federal Highway Trust Fund in 1956 (Brown 2003). Like other taxes based on consumption, state or local gasoline taxes are regressive with respect to income (Pechman 1985;Johnson and Tenny 2002). Such taxes may also be viewed as inequitable by some because, although they are related to use of the highway system, they bear no relation to use of public transit. At a national level, statededicated property tax and state-dedicated income tax revenues are relatively modest components of the typical agency's operating budget, and likely to remain so. A progressive tax is characterized by a more than proportional rise in the tax liabilityÂ The taxes that are generally considered progressive include individual income taxes and estate taxes.Â This difficulty of determining who bears the tax burden depends crucially on whether a national or a subnational (that is, provincial or state) tax is being considered.Â Average income tax rates commonly rise with income, both because personal allowances are provided for the taxpayer and dependents and because marginal tax rates are graduated; on the other hand, preferential treatment of income received predominantly by high-income households may swamp these effects, producing regressivity, as indicated by average tax rates that fall as income rises.