**STATE TAX STRUCTURES: PAST TRENDS, FUTURE POSSIBILITIES**

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**Introduction**

How state governments were financed at the end of the 20th century bears little resemblance to their financing at the end of the 19th century. In 1900, over 50 percent of state tax revenue came from the property tax while much of the rest came from taxes imposed on banks and insurance companies. There were no sales taxes, no tobacco taxes, and no motor fuel taxes. While some states taxed income, the tax as we know it today did not exist.[[1]](#footnote-1) Currently, states get an inconsequential amount of revenue from the property tax, while in 2010, personal and corporate income taxes, sales taxes, motor fuel taxes, and tobacco taxes comprised 95.4 percent of total state tax revenue. What a difference 100 years makes!

 How will state taxes change over the rest of the 21st century? Rather than attempting to project that far into the future, this chapter presents how we think state tax structures are likely to change over the next couple of decades. The next section provides a historical context by discussing how the level and composition of state taxes have changed over the past 30 years, as well as the differences across states in their reliance on income and sales taxes. We then examine each major tax, how each has changed in the last 30 years, explanations for these changes, and the role of each expected in the future. The chapter closes with some conclusions about the future of state fiscal resources.

**Recent Trends in the Composition of State Tax Revenue**

Before discussing the future of state taxation, it is informative to consider changes to the composition and structure of state tax revenue since 1980. In 2010, total state taxes accounted for $702.2 billion, which is down from a historic high of $757.5 billion in 2007.[[2]](#footnote-2) Over the entire 30-year period, real total state taxes per capita increased by 25.8 percent, or by an annual average rate of increase of 7.7 percent.

Dividing state taxes by total personal income yields an average effective tax rate, that is, the percentage of total income that is paid out in state taxes. Figure 1 shows the annual average effective tax rate for the period 1980-2010; total state taxes were, on average, 6.2 percent of total personal income. Over this period, state taxes as a percentage of personal income ranged from a low of 5.7 percent in 2010 to a high of 6.4 percent in 1995, a difference of 0.7 percentage points. Had state taxes been 6.4 percent of personal income in 2010, state tax revenue would have been $86.6 billion larger.

[Insert Figure 1 here]

Figure 1 also displays the timing of the four recessions that the U.S. experienced during the 30-year period. Generally, the effective tax rate decreased during and in the years immediately succeeding each recession. This was followed by a return to effective tax rates that ranged between 6.2 percent and 6.4 percent, a relatively narrow band. However, state taxes as a percentage of personal income were generally higher in the years prior to the 2001 and 2007-2009 recessions than in those prior to the 1980 and 1991 recessions, suggesting that the average effective tax rate drifted up over this period.

Table 1 shows the distribution of total state tax revenue by type for 1980 and 2010, ranked by the tax’s share of total revenue in 1980. The table also shows the percentage point change in the relative importance of each tax.[[3]](#footnote-3) In 1980, the general sales tax was the most important tax revenue source, accounting for 31.5 percent of total state tax revenue. But by 2010, the personal income tax had replaced the sales tax as the most important tax; over the period personal income tax increased from 27.1 to 33.6 percent of total state taxes, a 6.5 percentage point increase, while the sales tax’s share remains virtually unchanged. Together, sales and personal income taxes accounted for 58.6 percent of total state tax revenue in 1980increasing to 65.5 percent by 2010.

[Insert Table 1 here]

Figure 2 plots the annual share of total taxes for the sales tax, the personal income tax, and for all other taxes. The sales tax share of total taxes is relatively flat, changing little from year to year. The personal income tax steadily increased from 1980 to 2001, reaching a peak of 37.2 percent of total state taxes in 2001. Its share decreased following the 2001 recession, then increased again until the Great Recession hit in 2007. Given relative increases in sales tax and personal income tax revenue, the relative importance of other taxes naturally fell. Between 1980 and 2001, other taxes fell from 41.4 percent of total tax revenue to 30.8 percent, but by 2010 the share of other taxes increased to 34.5 percent of total tax revenue. This decline is largely the result of the decrease in the relative importance of the corporate income and motor fuel taxes. In 1980, these two taxes accounted for 28.7 percent of other taxes, while in 2010 they accounted for only 15.9 percent. Each of the other taxes that make up this tax category account for a very small percentage of total taxes, that is, generally less than three percent.

[Insert Figure 2 here]

There are substantial variations across states in their tax revenue composition. Seven states (Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming) do not impose a personal income tax and two others (New Hampshire and Tennessee) only tax dividend and interest income. Five states (Alaska, Delaware, Montana, New Hampshire and Oregon) do not levy a general sales tax. Excluding the 12 states that either do not impose an income or a sales tax, the percentage of state tax revenue in 2010 derived from the sales tax ranges from 12.4 percent (Vermont) to 59.6 percent (Hawaii), while the percentage derived from the personal income tax ranges from 11.5 percent (North Dakota) to 54.4 percent (New York).[[4]](#footnote-4) The percentage of tax revenue from the total of income and sales taxes ranges from 31.9 percent (Vermont) to 80.4 percent (Georgia).

**Future Changes in State Taxes**

In this section we turn to a discussion of how state taxes are likely to change in the next couple of decades, considering likely changes of each tax separately. The changes in revenue for all states from a tax, in total and as a percentage of personal income, can be explained by changes in the size of tax bases, changes in tax rates and changes in the mix of taxes that states choose as revenue sources. The tax base will change due to fluctuations in the economy (for example, changes in consumption levels and patterns will affect sales tax revenue), and to legislative changes (for example, changes in what goods the state taxes as part of the sales tax). To project the future of each state tax, we first describe past changes and their causes. We then consider how these and other forces will likely change the tax going forward. We focus on those taxes that generated at least two percent of total tax revenue in 2010, with two exceptions. First, we do not discuss motor vehicle license taxes. While the U.S. Census Bureau classifies these as taxes, they are really charges imposed on owners or operators of motor vehicles for the right to use public highways, including charges for title registration and inspection of vehicles. Second, we ignore the other selective excise taxes category. This is a catch all category of excise taxes imposed on specific commodities or services, for example lubrication oil, fuel other than motor fuel, meals, margarine, and cement, that are not separately enumerated by the Census Bureau. Each individual excise tax accounts for a very small amount of revenue and so we do not explore the changes to these taxes.

**Personal Income Tax**

Between 1980 and 2001, real personal income tax revenue increased every year, although the rate of growth slowed during the two recessions of the 1980s and 1990s (see Figure 1). However, during the past decade real personal income tax revenue declined in five of ten years, dropping precipitously.

There has also been a decrease in the stability of real personal income tax revenue. McGranahan and Mattoon (2012) explored the increase in the sensitivity of personal income tax revenue to economic conditions since 2000. They attribute this increased instability to the non-wage and salary component of taxable income, and in particular, to investment income. This is consistent with the findings of Sjoquist, Stephenson, and Wallace (2011), who note the large increase in capital gains prior to 2001 and again prior to 2008, followed by their collapse as a result of the tech bust at the end of the 20th century and the housing market collapse in 2008, respectively.

Personal income tax revenue as a share of total personal income increased almost continuously over the last two decades of the 20thcentury, going from 1.6 percent of personal income in 1980 to 2.3 percent in 2001 (Figure 3). Since 2001, the share dropped significantly during the two recessions (2001 and 2007-2009), increased in the years between, but never regained to the 2001 level. The trend seen in Figure 3 is consistent with the findings of the U.S. Government Accountability Office (2010) that between 1977 and 2007, personal income tax revenue grew faster than personal income in all but four states.

[Insert Figure 3 here]

In the absence of legislative changes that may affect personal income tax revenue (discussed below), we expect that personal income tax revenue as a share of personal income will increase at a rate similar to that observed during the 1980s and early 1990s. While another investment related financial bubble is possible, such an event is unlikely over the next decade or two. Thus, the increased fluctuations in personal income tax revenue that were observed in the first decade of this century are not likely to repeat themselves. Whether the annual growth rates in real personal income going forward will also return to the levels seen in the 1980s and early 1990s will depend on the growth in personal income, which depends on increases in economic productivity.

The Congressional Budget Office forecasts that real gross domestic product (GDP) will grow at an annual rate of 3.2 percent over the period 2014 through 2022. The annual rate of increase is expected to be 4.4 percent over the period 2014-2016 and 2.6 percent from 2017-2022.[[5]](#footnote-5)For the period 1980-1995, real GDP increased an average of 2.8 percent per year, with the increases ranging from -0.3 percent to 7.2 percent.[[6]](#footnote-6) Thus, it appears likely that the increase in real personal income will grow at a rate similar to, if not somewhat greater than, the growth in the 1980-1995 period. This suggests that state personal income tax revenue will grow at a rate similar to that seen between 1980 and 2001.

On the other hand, this potential revenue growth ignores possible legislative actions, both at the federal and state levels. Regarding federal legislative changes, we note that all but five of the states with a personal income tax use federal adjusted gross income (AGI) or federal taxable income as their starting point for their individual income tax.[[7]](#footnote-7) Thus, federal changes to the definition of AGI or taxable income get reflected in state income taxes. Some of the observed changes to state personal income taxes between 1980 and 2010 are therefore due to changes in the federal personal income tax.

At the federal level, proposals have been made to substitute a tax on consumption for the personal and corporate income taxes. The “Fair Tax” is one such proposal to replace the federal income tax with a national sales tax (Boortz and Linder 2006, 2008).[[8]](#footnote-8) Hall and Rabushka (2007) have also proposed a simple way of taxing consumption, rather than income.[[9]](#footnote-9) The elimination of the federal personal income tax would have significant effects on state personal income tax. First, it would significantly increase the compliance cost to the taxpayers and increase the administrative cost for each state. Second, it would lead to increasingly divergent personal income tax structures as states adopt changes to their income tax system without the federal income tax serving as a common model. Some have suggested that without a federal income tax, states would likely repeal their own income taxes (Bucks 1995). However, given the magnitude of such change to the federal income tax, its elimination seems unlikely, certainly in the foreseeable future.

Rather than replacement, the federal income tax could undergo major reform, similar to that which occurred in 1986. That is, there have been increasing calls by academics, politicians, and editorial writers for the federal government to eliminate or reduce various exemptions, deductions, and special provisions associated with this tax in order to expand its base.[[10]](#footnote-10)Other reform proposals include reducing federal income tax rates and the number of tax brackets. Such changes at the federal level would result in an increase in taxable income for most states. States would respond by either collecting additional income tax revenue or reducing their tax rates, or some of both. But, the 1986 tax reforms came about because the context for change existed – public mood pressed for change and Congress and the President were able to agree on changes (Birnbaum and Murray 1987). Given the current inability of Congress to agree on much of anything, the probability of major federal tax reform seems very low.

Another major change in personal income tax revenue would occur if states without an income tax were to adopt one, or if states with an income tax were to scrap it. Four states added the personal income tax in the 1960s and four in the 1970s. Over the period 1980-2010, there were only two changes made by states with an income tax. In 1980, Alaska dropped its income tax and in 1992, Connecticut expanded its limited income tax on dividends and interest income to a full income tax. Two states without a personal income tax (Tennessee and Washington) recently considered adding one, but neither effort was successful. In Tennessee in the past, gubernatorial proposals to adopt a broad-based income tax have generated strong legislative opposition (Bourdeaux 2010). There is currently an effort in this state to hold a referendum in 2014 that would insert language into the state constitution that explicitly prohibits a tax on personal income.[[11]](#footnote-11) In Washington, a referendum to adopt a state personal income tax was held in 2010 and 64 percent voted against it.[[12]](#footnote-12) In 1999, the Tax Reform 2000 Committee in Wyoming proposed adding an income tax, but it was not adopted (Bourdeaux 2010). In light of these examples, it does not seem likely that any of the 11 states without a broad-based income tax will add one any time soon.

 In fact, there have been proposals in several states to eliminate the income tax. For example, the 2005-2007 Tax Review Commission in Hawaii suggested investigating the elimination of the income tax, while recent tax reform commissions in Oklahoma and Oregon also recommended getting rid of the tax. In Oregon, consideration was to replace the income with a sales tax (Bourdeaux 2010). None of these changes were enacted, however. Hamilton (2012a) reviewed gubernatorial proposals in play in March of this year (2012) and found four states (Idaho, Nebraska, New Jersey, and Ohio) in which the governor had proposed major one-time cuts in their state’s personal income tax rates. He also found three states (Kansas, Missouri, and Oklahoma) in which serious consideration was given for phasing out the personal income tax.

The chief concern with all proposals that reduce the reach of or eliminate the personal income tax is lost revenue; replacing revenue generated from a broad-based personal income tax is difficult. Most states without an income tax have a unique situation that would be hard or impossible for other states to duplicate; for example, tourism in Florida, gambling in Nevada, and energy in Alaska, Texas, and Wyoming. States without an income tax generally impose much higher sales taxes, and in general, all of the other taxes are higher (Sjoquist 2010).

Importantly, there is no evidence that eliminating the personal income tax would be seen to be politically popular. There have been periodic national surveys that ask citizens to rank a set of taxes in terms of which is “the worst tax–that is, the least fair?” In surveys conducted annually between 1972 and 1989, and then five times since (the last conducted in 2006) that offered choices of the federal income tax, the state income tax, the state sales tax, and the property tax, the state income tax was ranked the least unfair) in every one, with only about 10 percent of the respondents listing it as the least fair (Cole and Kincaid 2006). And, in a 2006 Gallup poll, 62 percent of respondents said that the state income tax was very or somewhat fair.[[13]](#footnote-13) We also note that North Dakota recently voted on eliminating the property tax, which is seen as the least liked tax, by a vote of 75 to 25 percent.[[14]](#footnote-14)

Generally, the state personal income tax has not generated a lot of political heat over time, other than a proposal for a state without the tax to adopt it, or that regarding any very large increase in the tax. For example, Brunori (1998, p. 199) explains that New Jersey Governor James Florio’s loss to Christine Todd Whitman in 1991and the changes in party control and recall of two state senators in Michigan in the early 1980s were likely due to large increases in these states’ income taxes. Nor has there been much significant litigation, or widespread demands for reform such as the Proposition 13 movement surrounding property taxes (Brunori 1998, p. 200).

Hamilton (2012a) points out that the states considering a reduction or elimination of the personal income tax have Republican governors and, in most cases, Republican state legislatures. He asks what the real agenda is for these policies: economic development, which is what the governors generally claim to be the purpose, or to “…hobble state fiscal systems and create a condition of ongoing fiscal imbalance…” (2012a, p. 967). Regardless of motivation, we expect that there will be continued efforts on the part of Republican governors, especially, to eliminate or significantly reduce the individual income tax. On the other hand, given the difficulties of replacing revenues lost by eliminating the income tax, we think it is very unlikely that more than a couple of states will abandon their income tax over the next 20 years. Also, given the strong opposition to adopting an income tax in those states currently without one, we doubt that any of those states will add an income tax.

Another way that the personal income can change is through state specific legislative changes to tax rates, exemptions and deductions, and credits. In the past three decades, many states changed their income tax rates, mostly reducing them. For example, of the 13 states whose top income tax rate in 1980 was ten percent or higher, 12 reduced their top rate to less than ten percent.[[15]](#footnote-15) Five other states also reduced their personal income tax rates. Another common change was to the number of tax brackets. In the same period, 18 states reduced the number of tax brackets; for example, New York went from 18 to eight brackets and West Virginia went from 24 to five. In addition, most states increased the income level that defines the top tax bracket. Two states, Colorado and Utah, adopted a flat tax, that is, a one tax rate structure, while three states (Nebraska, Rhode Island, and Vermont) shifted from a one rate system to a multi-rate system. These changes are consistent with recommendations of state tax commissions to lower tax rates and flatten the rate structure; state tax reform commissions in Georgia, Maine and Utah, for example, called for flattening their state’s income tax rate structures. Also, three of eight states whose personal income tax systems were not linked to the federal income tax system in 1980, became linked by 2012.

 If, as suggested above, real income tax revenue begins to again increase at sustained growth rates, we expect to see states reducing tax rates. This is what states indicate in the previous 30 years. And, for the period 1999-2008, Buschman and Sjoquist (2012) report that states cut income taxes, while increasing other taxes.

Buschman (2010) and Cordes and Juffras (2012) provide summaries of recent state personal income tax legislative changes; Buschman considers the period 1999 – 2010, while Cordes and Juffras consider a longer period. These scholars rely on data collected by the National Conference of State Legislatures. They find thatsome states (Connecticut, Hawaii, Maryland, New Jersey, New York and Oregon) have recently added new brackets that apply to taxpayers with very high incomes, although most of these changes are temporary increases and were made largely in response to the fiscal effects of the Great Recession. Oregon added two new tax brackets for tax years 2010 and 2011 on incomes over $250,000.

To the extent that states are concerned that tax rates on high incomes will cause higher income families to leave or avoid the state, state officials work to keep tax rates competitive. But exactly what effect personal income tax rates have on migration is unclear. There is a common belief among economists that states should not adopt tax systems that are very progressive because of the concern that this provides incentives for higher income families to migrate. This case is made by Oates (1972) and many others; however, this is not a universally held opinion (Pauly 1973; Goodspeed 1989; Chernick 1997, 2010). In fact, a report from the Institute on Taxation and Economic Policy (2012) suggests that the economic performance of states with high tax rates was better than other states. Tannenwald, Shure, and Johnson (2011), considering the effect of a 2004 increase in the tax rate on high income earners in New Jersey, conclude that the rates have had little effect on migration. On the other hand, a report prepared by Arduin, Laffer and Moore Econometrics (2011) for the Oklahoma Council of Public Affairs claims that eliminating the income tax in Oklahoma would result in a substantial increase in economic activity.

There have been some efforts to identify factors that explain differences in tax progressivity across states, though the results are mixed. Chernick (2005) finds that tax exporting through the deductibility of state and local taxes and greater inequality of pre-tax income distribution increase tax progressivity while Republican control reduces progressivity. Fletcher and Murray (2008) explore various provisions of state income taxes and attempt to identify factors that explain interstate differences in provisions. They do not find any effect of the provisions of neighboring states or that higher poverty rates are associated with states that have provisions benefiting low-income populations.

 Considering state histories and the aforementioned research, it is hard to determine whether state income tax systems will become more or less progressive. On the one hand, there are efforts to flatten rate structures, which should lead to less progressive tax systems. There is also concern that higher income families have become more mobile, which should put downward pressure on tax progressivity. However, states have taken steps to both increase the progressivity of the income tax and flatten the tax rate structure. For example, in 1986 Rhode Island became the first state to adopt a state version of the federal Earned Income Tax Credit (EITC). Since then, 22 other states have added an EITC; most of these states are in the Midwest and Northeast regions of the nation.[[16]](#footnote-16) It is possible that other states will add an EITC in the future, particularly when the growth in income tax revenue becomes strong.

 There are two trends that are likely to have negative effects on the growth in personal income tax revenue. The first is the growth in fringe benefits, which are not subject to income taxes. Fringe benefits as a share of worker compensation have grown, and an increasing percentage of worker compensation is not taxed. The second trend is the aging of the population. According to the national population projections of the Census Bureau, the percentage of the population 65 years of age and over will increase from 13.0 percent in 2010 to 19.3 percent in 2030, an almost 50 percent increase.[[17]](#footnote-17)Aging will have two effects on personal income tax revenue. First, income falls as an individual ages, so a larger share of elderly means lower income per capita. Second, states provide special tax provisions for the elderly (Edwards and Wallace 2004), and an increase in the population who qualify for these special provisions increase will result in slower growth in personal income tax revenue. The Iowa Department of Revenue (2006) predicted that revenue from the state’s personal income tax will actually decline as the state’s population ages. Conway and Rork (2012) document the increase in state income tax breaks that are targeted to the elderly; for example, between 1964 and 1994 the number of states that allow an exemption for pension income increased from one to 23.

The special provisions noted include exemption of certain sources of income such as Social Security and other sources of retirement income (Snell 2011). States have expanded these exemptions, and are likely to continue to do so. As the elderly become a larger share of voters, states will likely be pressured to increase exemptions of retirement income.

Regarding the personal income tax, we expect to see some states reduce their reliance on the tax, for tax rates to fall and tax rate structures to flatten. However, we would be surprised if any state completely eliminated its income tax. Nonetheless, over the next 20 years, we predict that the share of state tax revenue derived from the individual income tax will decline from its 2010 level.

**Sales and Use Tax**

Over the period 1980 to 2010, real sales tax revenue increased at an annual growth rate of 2.8 percent, for a total increase of almost 75 percent. But relative to revenue from the personal income tax, that from sales tax has grown very little; the annual average growth rate over the entire period was slightly less than zero, while over the period 1980-2006 it was 0.5 percent per year.

By 1980, all states that currently have a sales tax had adopted it; in 1969, Vermont became the last state to adopt the sales tax. There does not seem to be any sentiment among states with a sales tax to eliminate it, nor does there seem to be discussion of adding a sales tax in those states without such a tax. As noted above, the Oregon tax reform commission did recommend adding a sales tax as a replacement for the state’s income tax.

Compared to the personal income tax the sales tax is simple, consisting of setting the rate and determining what will be taxed. The most significant change over the past three decades has been the steady increase in sales tax rates, as shown in Table 2. In 1980, 78.3 percent of the states had sales tax rates of less than five percent. But by 2012, only 23.9 percent had tax rates that low. Over the 30-year period, the average state sales tax rate increased by 42.5 percent.

[Insert Table 2 here]

Sales tax revenues have not grown relative to the economy though sales tax rates increased, suggesting that the tax base has not grown, and probably declined, relative to the growth in personal income. To illustrate that, consider Figure 4, which shows sales tax revenue per $1,000 of personal income for the three states that did not change their sales tax rates over the entire period. For the period of interest, there has been a general decline in sales tax revenue as a share of personal income.

[Insert Figure 4 here]

There are three main reasons why the sales tax base has not kept up with the growth in personal income. When the sales tax was first adopted it applied to the purchase and lease of tangible personal property but not to purchases of services. While some states have added selective services to their sales tax base, services are still a relatively small part of the sales tax base. Since 1970, only one state, Iowa, significantly expanded its sales tax base by including a long list of services. But, services have grown significantly as a share of personal consumption; for example, services increased from 52.6 percent of total personal consumption expenditures in 1980 to 63.3 percent in 2011.[[18]](#footnote-18) Thus, the sales tax is being applied to a smaller share of consumer purchases. Mikesell (2012) conducted an extensive analysis of the decline in the state sales tax base relative to personal income; he attributes the absence of services in the tax base as the primary cause of the downward trend.

States differ in the extent to which they include services in their sales tax base. The Federation Tax Administrators (FTA) has conducted periodic surveys of the states regarding the services they tax.[[19]](#footnote-19) In its last survey, conducted in 2007, the FTA identified 168 individual services that at least one state included in its sales tax base. There is substantial variation in the number of services that states tax. While no state taxes all 168 services, three states tax more than 150 of the identified services. Between the 1990 and 2007 surveys, most states increased the number of services that they tax. In most cases, states added 10 or fewer services over the 17-year period, although five states added more than 20 services each.

Another reason that a sales tax base has not kept up with the growth in personal income is that states have increased their sales tax exemptions. When sales taxes were first adopted, exemptions were generally restricted to goods and materials that were used as inputs in manufacturing process and goods purchased for resale. Over time, states increased the list of exempt goods, and exempted certain sellers or buyers.[[20]](#footnote-20) States have been most aggressive in adding exemptions for businesses—adding exemptions for consumables used in agricultural, the purchase of industrial and agricultural machinery and equipment, and energy used in production.[[21]](#footnote-21) While these business exemptions have increased, the non-consumer share of sales taxes is still very significant (Ring 1999). States also added exemptions of consumer goods, with food-for-home consumption being the largest exemption in terms of tax revenue loss. In 1980, 25 states exempted food-for-home consumption, while one other state taxed food at a lower rate. By 2012, 31 states exempted food, while seven taxed food at a lower rate.[[22]](#footnote-22) The exemptions of consumer expenditures are generally adopted to enhance the equity of the sales tax.

 Another type of sales tax exemption is the sales tax holiday. New York is usually credited with the adoption of the first sales tax holiday in 1997, which exempted purchases of clothing over a period of eight specified days (Hawkins and Mikesell 2001).[[23]](#footnote-23) Since then, 24 states have held sales tax holidays.[[24]](#footnote-24) In 2012, only 15 states held sales tax holidays, as many cancelled these holidays for budgetary reasons. States have also begun to exempt certain sales or purchases made by particular non-profits.

 We expect the trend of decreasing sales tax base relative to the economy to continue. It is possible that states will add more services to their sales tax base, but we do not expect any to add services sufficient for the sales tax base to keep up with the growth in income. Nearly every recent state tax reform commission recommends adding services to the tax base and several have recommended removing the exemption for food-for-home consumption. But in the end, only a few services are added and all states that exempted food-for-home consumption in 1980 still exempted such goods in 2012. In 1987, Florida expanded its sales and use tax to include a very broad range of services. Hellerstein (1988) explains that this action “triggered an enormous storm of protest” (p.1) and the state quickly dropped the sales tax on most services. Florida’s experience is frequently cited when states consider a significant broadening of the sales tax. Also, Florida tried to impose the tax on services that were produced outside the state but used in-state, including advertising in magazines shipped into the state. In 2009, Maine passed legislation as part of a tax reform package that added more than 100 goods and services to its sales tax base, but in 2010, 61 percent of state citizens voted to repeal it.[[25]](#footnote-25)

Taxing many services, such as haircuts, is administratively difficult. Many haircutters operate as sole proprietors, so there are a very large number of establishments that have to be registered and for which tax collections have to be monitored. Expenditures on health care is a major component of service consumption, but given the federal government’s role in financing health services, any sales tax on health services is severely restricted. Although the pressure to add services to the sales tax base will continue to grow and states are likely to expand their sales tax base to include more services, evidence such as that noted above suggests that states are likely to do so in a piecemeal fashion. And, both because of federal funding of health care and the concern that taxing health care is unfair, health care services that are generally covered by health insurance are unlikely to be added to the sales tax base.

Economists have argued that the retail sales tax should be applied only to purchases by the final consumer and not to goods that are inputs to products consumed (McLure 2000). The principal reason is the issue of tax pyramiding, that is, the sales taxes on inputs becomes part of the price of the intermediate good or service produced, so that the cumulative sales tax on the final purchase will be larger than the nominal tax rate and will depend on the number of times the intermediate goods are sold. This argument seems to hold sway given the increase in sales tax exemptions of purchases by businesses. In addition, states appear to be using sales tax exemptions to make the state more competitive; for example exempting certain purchases by film producers. We expect to see states adding additional sales tax exemptions for business purchases.

 A third factor influencing state sales tax revenue is online sales. If a vendor does not have a physical presence (nexus) in a state, the state cannot require the vendor to collect sales taxes; this is the result of a federal Supreme Court ruling in the Quill case. While the consumer is obligated to pay a use tax, very little use tax is collected (Alm and Melnik 2012).[[26]](#footnote-26) Bruce, Fox and Luna (2009) estimated annual national state and local sales tax losses on e-commerce in 2012 to be $11.4 billion, or about five percent of sales tax revenue. States have attempted to find ways to force remote vendors to collect the sales tax. Toward that end, several states have passed so called Amazon laws in which states determine nexus based a remote vendor’s use of in-state affiliates. Not surprisingly, Amazon laws are opposed by firms such as eBay and Amazon, and have resulted in litigation and the cancelation of contracts with in-state affiliates. If the Supreme Court rules in favor of the states we will see a dent in the $11.4 billion revenue loss, and expect other states to adopt Amazon laws. Within the next decade there will probably be another case like Quill.

The other effort to force remote vendors to collect sales taxes is the Streamline Sales Tax Project (SSTP), which is a national effort of make collecting the sales tax by remote vendors simpler, for example, by having states use common definitions of products and the ability to determine what tax rate to apply in order to eliminate the risk of penalties from imposing an incorrect sales tax rate. The hope is that the SSTP will encourage remote vendors to voluntarily collect sales taxes and result in either Congress passing legislation that would require remote vendors to collect the sales tax or in the Supreme Court overturning Quill.

At least three bills have been introduced in Congress aimed at solving state problems with collecting sales tax revenue from remote sales. For example, the Main Street Fairness Act, S. 1452, has been introduced by U.S. Senator Richard J. Durbin. This legislation would codify the Streamlined Sales and Use Tax Agreement, thereby providing state governments with the authority to collect sales taxes on remote sales. Other legislation has been introduced by Senator Michael B. Enzi (Hamilton 2012b).A concern of Congress regards imposing additional administrative burden on the large number of small vendors who sell online, as these vendors account for a substantial percentage of online sales.

 Economists sing the mantra that states should adopt low tax rates applied to a broad tax base, but it is not clear that states are listening. We expect to see states continue to add to their sales tax exemptions, particularly for purchases by businesses, and to add services to the sales tax base, though not in great numbers. At the same time, we predict that sales tax rates will continue to increase. It is not clear how high states can raise sales tax rates, but given that voters seem inclined to support increases in sales tax rates in local referenda, states appear to have some wiggle room before voters strongly resist such increases. In summary, we expect sales taxes as a share of state tax revenue to increase in the future.

**Corporate Income Taxes**

Between 1980 and 2007, corporate income tax revenue in real terms increased from $39.9 billion to $57.0 billion, an increase of 43.0 percent. However, by 2010 real corporate income tax revenue had fallen to $36.8 billion. Relative to the U.S. economy, corporate income tax revenue fell by half over the 1980 to 2010 period, from about $6.00 per $1,000 of U.S. personal income to about $3.00 (Figure 5).

[Insert Figure 5 here]

Several reasons explain this trend, including the shift in organization form, more aggressive tax planning, reduced tax rates, and increased tax credits (see Fox and Luna 2002; Cornia, Edmiston, Sjoquist, and Wallace 2005).First, there has been a change in the legal structure of corporation from C-corporation to S-corporation and LLCs. The federal tax code distinguishes between two types of corporations, C-corporations and S-corporations. S-corporations and limited liability corporations (LLC) are “pass through” entities, so that profits are passed through to the owners of the firm and taxed under the personal income tax, not under the corporation income tax. The tax advantage of operating as an S-corporation or LLC, has resulted in many smaller corporations converting from a C-corporation to S-corporation and LLC status.

Second, corporations have engaged more aggressive tax planning that has reduced their taxable profits and state corporation tax receipts (Pomp 1998). There are several ways that multistate corporations can engage in tax planning to reduce their state tax burden. Luna (2004) and Mazerov (2007) examine tax planning devices, but do not provide empirical evidence regarding how extensive the use of tax shelters is or the effects of shelters on corporate tax revenue. One common tax planning device is to reclassify business income to non-business income (the former is apportioned to the several states in which the firm does business, while non-business income is allocated to the state in which the firm is domiciled). A second planning device is to establish a passive investment company (PIC), sometimes referred to as a Delaware Holding Company, as a wholly owned subsidiary. The parent corporation sells an intangible asset such as a trademark to the PIC, which it then leases back to the parent company. The result is to transfer profits to Delaware, which does not tax income from intangibles.

In addition, states have expanded the number and value of tax credits, particularly for economic development purposes. Between 1977 and 1988, the number of states that enacted exemptions for corporate income taxes for economic development purposes increased from 21 to 31 (Pomp 1998). Investment tax credits and job tax credits are now very common (Enrich 1998). A current inventory of economic development tax credits is hard to find, though the expansion of income tax credits aimed at the film and entertainment industry provides some indication of the general expansion of income tax credits. In 1992, Louisiana became the first state to adopt an income tax credit aimed at the film industry. By 2000, four states had incentive programs for the film industry. By 2009, 28 states had a film tax credit, and many states had other incentives aimed at this industry as well, such as sales tax exemptions. An additional 12 states in 2009 offered incentives to the film industry other than an income tax credit (Henchman 2011).

On the other hand, several states have reduced or eliminated film tax credits (Henchman 2011), and several state tax reform commissions have suggested eliminating or reducing economic development tax credits. Michigan completely restructured its economic development tax incentives by replacing the existing tax credit programs with an annual appropriation of funds to be used to provide economic development incentives.

There are 44 states that have a corporate income tax. Of the seven that do not impose a personal income tax, four (Nevada, South Dakota, Washington, and Wyoming) do not impose a corporate income tax either. During the last three decades, three states made significant changes in how they tax businesses. In 1976, Michigan adopted the Single Business Tax (SBT), essentially a form of a value added tax, replacing several taxes on businesses, including a corporate income tax. In 2008, Michigan replaced the SBT with the Michigan Business Tax (MBT), which is based on business income and gross receipts net of purchases from other firms. However, effective in 2012, Michigan replaced its MBT with a corporate income tax. While the Texas state constitution prohibits a state income tax, in 2006, Texas adopted a business tax, known as the margin tax, which is meant to mimic a tax on income. For the margin tax, corporations choose one of three tax bases: total revenue minus cost of goods sold; total revenue minus wages and benefits; or 70 percent of total revenue. In 2005, Ohio adopted the Commercial Activity Tax (CAT) as a replacement for its corporate franchise tax. Under the corporate franchise tax, a corporation would pay the higher of a net worth tax or a corporate income tax. The CAT is a tax on gross receipts rather than on net income.

Of the 45 states with a corporate income, 32 have a flat rate tax. For the 13 states with multiple brackets, the top marginal tax rate applies to income of less than $250,000, except for New Mexico, whose top rate applies to income of $1 million or more. Thus, the top rate applies to all but small corporations. Top marginal tax rates in 2012 range from four percent (Kansas) to 12 percent (Iowa), with 26 states having a top rate of between five and eight percent.[[27]](#footnote-27) Since 1980, 17 states increased and 17 states reduced their corporate income tax rates. Generally, states with lower than average marginal tax rates in 1980 raised their rates while many states with higher than average tax rates in 1980 lowered their rates. The result is that the variation in tax rates fell over this period.

A major feature of state corporate income taxes is the apportionment of the net income of multistate firms to the states. After states adopted corporate income taxes there were substantial efforts made to get states to use what is called the equally-weighted three-factor formula, the three factors being the firm’s share of its property, sales, and payroll located in the state.[[28]](#footnote-28) By 1981, 35 states used the equally-weighted three-factor formula in all cases, while four states double weighted the sales factor, one weighted the sales factor at 70 percent, one used only two factors, one used only the sales factor and four used a mix of formulas (Comptroller General of the United States 1982). However, by 2012, several states had moved away from the traditional three-factor formula and only ten still used the equally-weighted three-factor formula.[[29]](#footnote-29) Other states increased the weight on the sales factor, so that in 2012, 15 states double weighted the sales factor, six weighted the sales factor more than double, and ten used only the sales factor.

Tax reform commissions in several states have proposed reducing or eliminating their corporate income tax. For example, tax reform commissions in California, Hawaii, Oregon and Utah proposed eliminating their corporate income tax, and in the case of the first three the proposal was to replace the corporate income tax with a tax on receipts or value added. On the other hand, tax reform commissions in Washington and Wyoming proposed adding a corporate income tax.

The relative importance of the corporate income tax is likely to continue its decline. Interstate competition for jobs and the increased geographic mobility of capital will lead states to reduce their tax on mobile capital, mainly by reducing corporate income tax rates. Still, we expect some states will actually eliminate their corporate income tax and replace their business income taxes with gross receipts tax, following the model of Ohio. While there have been suggestions that states replace their corporate income tax with a value added tax, such as change would likely be seen as extreme, even though New Hampshire has adopted a value added tax (Kenyon 1996).

Tax credits will continue to play an important role in the corporate income tax (and the taxation of business, in general), but we expect states will reign in some of the credits by tailoring them to provide incentives that have a significant effect at the margin. Also, we predict that states will continue to increase the weight on the sales factor in their apportionment formulas.

**Fuel Taxes**

Fuel taxes are generally earmarked for transportation, and usually are restricted to expenditures on roads and bridges. State motor fuel tax revenue, combined with transportation grants financed by the federal motor fuel tax revenue (generated by an 18.4 cents per gallon federal tax), is the principal source of revenue for transportation. Some states, such as New York and Florida, have local fuel taxes, but they amount to only about 3.6 percent of total state plus local fuel taxes.

All 48 states adopted fuel taxes by 1930.[[30]](#footnote-30) Over the past 32 years, all but four have increased their tax rate on gasoline; Florida reduced its state fuel tax, shifting the tax to a local option. In 2012, state gasoline tax rates ranged from four cents per gallon in Florida to 38.9 cents per gallon in North Carolina; the gasoline tax rate for 39 states ranges between 15 and 30 cents per gallon. In 1980, the average tax on gasoline was 8.7 cents per gallon, while in 2012 the average tax rate was 22.2 cents per gallon.[[31]](#footnote-31) However, adjusting for inflation, the real tax rate declined over the period. In 1980 dollars, the current (2012) average gasoline tax rate is 8.06 cents per gallon. The real value of state fuel tax revenue has been decreasing. In the first decade of this century, fuel tax revenue in real terms decreased 15.9 percent, while in real per capita terms it decreased 23.4 percent.

The decrease in real fuel tax revenue per capita is due to the reluctance of states to increase fuel tax rates fast enough to accommodate inflation, and to improved fuel efficiency. At the same time vehicle miles traveled per person has increased. But the net result is that transportation funding has not kept up with the need to expand and maintain the transportation network. The decline in the real value of the gasoline tax per mile driven provides a strong incentive to increase the fuel tax rate.

Related to this is the substantial backlog of transportation infrastructure needs. A recent report from the Miller Center of Public Affairs (2010) estimates that an additional $134 to $262 billion must be spent each year through 2035 on roads, rail and air transportation. The American Society of Civil Engineers lists a price tag of $1.7 trillion for investments by 2020 for roads, bridges and water/sewage systems, while the Urban Institute put the cost at $2 trillion (Halsey April 23, 2012). Once the economy recovers from the Great Recession, the public is likely to place pressure on state governments to address the infrastructure backlog. Because many of these needs are in urban areas, it will be politically difficult for state governments to raise fuel taxes statewide, only to spend the bulk of the revenue in metropolitan areas. Because of this, states are likely to look for alternative revenue sources to support transportation-related expenditures.

Increasing fuel tax rates is politically unpopular. Most public opinion surveys find that only a minority of respondents support increases in the gasoline tax. Consider public mood regarding the national gasoline tax. A recent (December 2011) nationwide poll of 1200 adults conducted by Reason-Rupe found that 56 percent of the respondents strongly opposed such an increase and 21 percent somewhat opposed an increase.[[32]](#footnote-32) Similar results were obtained in an Associated Press/CNBC national survey, which found that 52 percent of respondents strongly opposed raising the tax on gasoline by 15 cents per gallon for the purpose of building and repairing roads and highways.[[33]](#footnote-33)However, the responses do differ depending on the context of the question. For example, when asked about increasing the federal gasoline tax if it would reduce U.S. dependence on foreign oil, 64 percent favored the increase in a 2007 poll, although a 2009 poll found that only 41 percent responded favorably.[[34]](#footnote-34)

Similar results are found in statewide surveys. In a 2012 poll, 62.1 percent of Iowans opposed an increase in the state gasoline tax of eight cents per gallon.[[35]](#footnote-35) A survey conducted in Georgia in 2011 found that 66 percent of the respondents opposed a 10 cents per gallon increase in the gasoline tax (Sjoquist, et al. 2011). Dill and Weinstein (2006) note that since 2000, surveys conducted in the San Francisco Bay Area, Connecticut, South Carolina, New Jersey, and Washington state found that less than 40 percent of the respondents supported an increase in gas taxes. Based on these public opinion results, the likelihood of significant increases in state fuel tax rates is low. Furthermore, opposition to increasing the fuel tax is probably strongest in periods of increasing gasoline prices.

Because of the increasing fuel efficiency and the rise of alternative fuel vehicles, there is concern that fuel tax revenue is not keeping pace with vehicle miles travelled, that is, with the demands placed on the transportation system. Thus, many students of transportation financing have suggested going to a tax based on vehicle miles traveled, or VMT tax. There is no example of a fully operational VMT tax, although there have been two successful demonstration programs in the U.S.—one in the Portland, Oregon area and one in the Puget Sound (Seattle) area.[[36]](#footnote-36) Technology exists to implement a VMT tax, however, because citizens are generally unfamiliar with a VMT tax and given concerns about confidentially there is currently little public support for the idea.

Another option for preventing inflation from eroding fuel tax revenue is to index the fuel tax to inflation.[[37]](#footnote-37) Rather than requiring state citizens to vote for an increase in the fuel tax, some states allow the fuel tax to increase with inflation, including Florida, Kentucky, and North Carolina.[[38]](#footnote-38) Florida ties its tax rate to increases in the consumer price index; Kentucky and North Carolina tie their fuel tax rate to the wholesale price of gasoline. Other states have indexed their fuel tax in the past, only to rescind it, including Michigan, Wisconsin, and Ohio. Others (Washington, Texas, and Nevada) considered indexing their fuel tax, but opted not to. Georgia’s recent Special Council on Tax Reform and Fairness for Georgians recommended it, but the idea was rejected by the state legislature. Given past experience, it is unlikely that we will see states indexing their fuel taxes.

As noted above, the federal gasoline tax is 18.4 cents per gallon, while the average state fuel tax rate is 22.2 cents per gallon. There have been suggestions to significantly reduce or eliminate the federal role in financing transportation. If that were to happen, states would be under tremendous pressure to raise their fuel taxes. However, the public generally supports maintaining the federal fuel tax, even if they oppose increasing the tax rate.[[39]](#footnote-39)Thus, while the federal fuel tax is not likely to increase, it is unlikely that the fuel tax will decrease in the near future. We expect that the pressure to expand and maintain transportation systems combined with the likelihood that the federal government transportation funding will be stagnate to likely lead to increases in-state fuel tax revenue per capita in real terms over the next two decades. We do not expect states to adopt a VMT tax or index fuel tax rates to inflation.

**Tobacco Taxes**

While states have not raised their gasoline tax rates to match inflation, they have substantially increased tax rates on tobacco products. The average tax on a pack of cigarettes was 12.8 cents in 1980, increasing to about $1.50 in 2012.[[40]](#footnote-40) In real terms, this amounts to more than a three-fold increase in the tax rate. State taxes on cigarettes range from 17.0 cents per pack (Missouri) to $4.35 per pack (New York). Thirty states impose a tax of more than $1.00 per pack and five have tax rates of over $3.00 per pack.[[41]](#footnote-41)

However, real per capita tobacco taxes increased by 10.2 percent between 1980 and 2010, implying a significant decrease in tobacco consumption. Between 1980 and 2002, real per capita tobacco taxes fell, so the increase in real per capita revenue occurred during the last eight years of the period. This later period saw substantial increases in tobacco tax rates; between 2000 and 2012, 47 states increased their cigarette tax, with many states increasing rates multiple times.[[42]](#footnote-42)

The opposition to increasing tobacco taxes comes from two primary sources, users and convenience stores, particularly those located on state borders. But users now account for a relatively small share of the public; in 2010, 23 percent of individuals 12 years of age and over smoked, down from 26percent in 2002 (Substance Abuse and Mental Health Services Administration 2011). Anti-tobacco campaigns, partly funded by revenue from the Tobacco Master Settlement Agreement, are likely to further decrease the use of tobacco. In light of this and given that there is room for most states to increase their cigarette tax rates and still be competitive, we expect states to continue to increase these tax rates. One caveat is that any increases will reflect rates in neighboring states so as not to drive customers out of state.

**Public Utility Taxes**

The Census Bureau defines public utility taxes as those imposed on the gross receipts, gross earnings, or units of service sold of public passenger and freight transportation companies, telephone, telegraph, and light and power companies, and other public utility companies. Meriwether, Kelly, and Curry (1989) provide a summary of utility taxes in selective states (and details of the public utility tax in Texas), Adams and Heidelmark (1984) summarizes the taxes on railroads and other transportation companies, and Howe and Reeb (1999) discuss utility taxes on electrical utilities.[[43]](#footnote-43) While the structure and components of these taxes differ substantially across states, generally public utility taxes are imposed on the gross receipts of public utilities at a fixed tax rate, and are imposed in lieu of income taxes. However, not all states impose these taxes or apply a common tax rate to all firms subject to the tax. These taxes were adopted a long time ago; for example, Texas’s tax dates back to 1905 (Meriwether, Kelly, and Curry 1989).

Public utility tax revenue as a share of personal income declined between 1980 and 2002 by 30 percent, but has held steady since. The major issue with public utility taxes is the changing nature of competition in these industries. These taxes were levied when utilities were regulated monopolies, but many of them now face significant competition.[[44]](#footnote-44) Walters and Cornia (1997) cite a study conducted by Deloitte and Touche (1996) for the National Council on Competition and the Electric Industry that finds that taxes (this is total taxes not just state taxes on gross receipts) on gas, electric, and telecommunication utilities are usually double the rate imposed on other industries. To the extent that new competitors are not subject to public utility taxes, the utilities are put at a competitive disadvantage. This leads to our expectation that states will slowly reduce their public utility tax rates, and thus revenue growth from this source will be slower in the future.

**Insurance Premium Tax**

The insurance premium tax is a gross receipts tax levied as a fixed percentage of the value of the premiums written in the state. But insurance premium taxes have two very unique characteristics. First, states can discriminate against out-of-state commerce by imposing higher tax rates on out-of-state carriers. A state can, but typically does not, impose a higher foreign tax rate compared to its domestic tax rate. Second, states impose retaliatory taxes that penalize companies domiciled in high-tax states but operating in other states. The result is that a company pays the higher of the premium tax in the state in which the insurance policy is written or of the state in which the company is domiciled.

Insurance premium tax revenue as a percentage of personal income has remained relatively constant over the period 1980-2010. Available evidence suggests that states have not significantly changed their insurance premium tax rates (Grace, Sjoquist, and Wheeler 2012).

There is nothing to suggest that states are going to dramatically change their insurance premium tax. For example, a recent Georgia tax reform commission proposed reducing Georgia’s very high premium tax rate, but the state legislature declined to consider it. However, as with the corporate income tax, competition for jobs may lead states to marginally lower their insurance premium tax rates, and perhaps even replace the tax with an income tax. This pressure to reduce insurance premium taxes may also be driven by the estimate that the premium tax is almost twice what a life insurance company would pay if it were subject to the state corporate income tax (Neubig, et al. 2002).

**Property, Severance, and Death and Gifts (Inheritance) Taxes**

The property tax is considered a local government tax, with state government property tax revenue now accounting for only about three percent of total property tax revenue, which is down from 4.2 percent in 1980. There are 14 state governments that report not having a property tax. Real per capita state property taxes increased about 20 percent between 1980 and 2009, while local property taxes (real per capita) increased almost 60 percent.[[45]](#footnote-45)

The property tax structure is largely determined by the state government, although in many states local governments have some control over the structure of the property tax as it applies in their jurisdiction. The state government defines what property will be taxed (including decisions regarding full and partial exemptions) and how (for example, fair market value, current use value, limitations on assessment increases, etc.). While these decisions do affect the state property tax revenue, they are not considered here.

The only state decision of concern examined in this chapter is the state property tax rate. Given state property tax revenue relative to local property tax revenue, the implication is that state property tax rates are very low relative to local property tax rates and that the state rates have not changed much. Perhaps more importantly, state governments have a significant set of revenue alternatives at their disposal compared with local governments. Coupled with the fact that there exists strong and continued voter resistance to property tax increases, we expect states will not increase their property tax rates. As the growth in other state revenues returns to healthier levels, some states are likely to reduce or even eliminate the state property tax, a move that Georgia is currently phasing in.

Severance tax revenue is likely to increase given the discovery of new energy sources in states like North Dakota and Ohio and the increases in the price of oil and other natural resources. The simple correlation coefficient between severance tax revenue and the consumer price index for energy over the period 1980 to 2010 is 0.88, suggesting that the price of natural resources is the principal driver of changes in severance tax revenue. Severance tax rates do not seem to change much, and with increasing nominal severance tax revenue from increases in the prices of natural resources, it is hard to imagine states increasing their severance tax rates.

Prior to the federal tax reforms of 2001, all states levied a tax on estates and all but seven coupled their inheritance tax with the federal estate tax. Under this arrangement, the federal government allowed a credit, up to some maximum, for state inheritance taxes paid.[[46]](#footnote-46)Typically, states set their inheritance tax level at the value of the credit. In 2001, the federal government phased in a repeal of that credit. Only 15 states that had been coupled with the federal estate tax decoupled, that is, they no longer set the tax at the value of the credit, and so continued to collect inheritance taxes. The other states that were coupled with the federal system lost all of their inheritance tax revenue. As a result, state inheritance tax revenue fell in the past decade, declining each year from $8 billion in 2000 to less than $4 billion in 2010.

The federal government seems unlikely to reinstate the credit provision, and it also seems unlikely that other states will take action to decouple from the federal system. Finally, at the federal level, the magnitude of estate that is exempt from the estate tax has increased, and is likely to continue to increase. To the extent that the states adopt the federal exemption level, inheritance tax revenue will fall for these states. We predict that state inheritance tax revenue will continue its slow decline.

**ConclusionS**

With the exception of the state corporate income tax, we do not expect major changes in the specific taxes that states employ. While there are proposals to eliminate certain taxes, we predict that aside from in a couple of states, it will be extremely difficult if not impossible to generate the political support among voters to enact major changes to state tax structures. We expect that individual income tax rates will go down and that sale and excise tax rates (on tobacco and fuel, for example) will increase. With the increased mobility of businesses and individuals, there will be pressure for states to keep tax rates similar to other states, especially to those of neighbors. Overall, we expect a reduction in state tax rate differences. We anticipate that in 2040 a table equivalent to Table 1 will look similar to what it looked like in 2010. The share of some taxes will be smaller—in particular, shares of the individual income tax, the corporate income tax, the inheritance tax, and the property tax, with the share for the corporate income tax being substantially smaller. On the other hand, the shares for the sales tax and excise taxes will increase. Finally, we expect that states will likely turn to greater use of fees and charges for revenue and to heavier reliance on minor tax revenue sources as other sources shrink in importance.

Certainly, state tax revenue suffered during the Great Recession, and as the economy has recovered, state tax revenues have been growing again. While we expect that the state tax structure will change over the next 20 years, in the absence of efforts to actually shrink the size of state government or greatly expand the scope of state government we expect that over the long-run states will be able to generate the revenue necessary to fund public services. While state government revenue as a share of state income has fluctuated over time, over the 1980 to 2010 period, the trend has been remarkable flat; in fact, a trend line for the data in Figure 1 is actually slightly positive.

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| Table 1.Tax as a Percent of Total Taxes, 1980 and 2010 |
|  |  **Year** |  |
|  | **1980** | **2010** | **Difference** |
|  General Sales Tax  | 31.5% | 31.9% | 0.4% |
|  Individual Income Tax  | 27.1% | 33.6% | 6.5% |
|  Corporate Income Tax  | 9.7% | 5.2% | -4.5% |
|  Motor Fuels Tax  | 7.1% | 5.2% | -1.9% |
|  Motor Vehicle License  | 3.6% | 3.0% | -0.6% |
|  Severance Tax  | 3.0% | 1.6% | -1.5% |
|  Tobacco Tax  | 2.7% | 2.4% | -0.3% |
|  Public Utility Tax  | 2.5% | 2.1% | -0.4% |
|  Insurance Premium Tax  | 2.3% | 2.2% | 0.0% |
|  Property Tax  | 2.1% | 2.0% | -0.1% |
|  Alcoholic Beverage Tax  | 1.8% | 0.8% | -1.0% |
|  Death and Gift Tax  | 1.5% | 0.6% | -0.9% |
|  Corporation License  | 1.0% | 1.4% | 0.4% |
|  Other Selective Excise Tax  | 1.0% | 3.4% | 2.4% |
|  Occupation and Business License Tax NEC  | 0.8% | 1.8% | 1.0% |
|  Document and Stock Transfer Tax  | 0.7% | 0.6% | -0.1% |
| Pari-mutuel Tax  | 0.5% | 0.0% | -0.5% |
|  Hunt and Fish License  | 0.3% | 0.2% | -0.1% |
|  Motor Vehicle Operation License  | 0.3% | 0.3% | 0.1% |
|  Amusement Tax | 0.2% | 0.9% | 0.7% |
|  Alcoholic Beverage License | 0.1% | 0.1% | -0.1% |
|  Public Utility License | 0.1% | 0.1% | 0.0% |
|  Other License Taxes  | 0.1% | 0.1% | 0.1% |
|  Amusement License  | 0.1% | 0.1% | 0.0% |
|  Taxes NEC | 0.0% | 0.3% | 0.3% |
|  **TOTAL**  | **100.0%** | **100.0%** |  |
| Source: U.S. Bureau of the Census, State Government Tax Collections [[http://www.census.gov//govs/statetax/historical\_data.html](http://www.census.gov/govs/statetax/historical_data.html)], accessed March 17, 2012NEC: Not elsewhere classified |

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| Table 2.Distribution of Sales Tax Rates |
|  | **Year** |
|  | 1980 | 1990 | 2000 | 2012 |
| 2.0% – 2.9% | 1 | 0 | 1 | 1 |
| 3.0% - 3.9% | 17 | 4 | 1 | 0 |
| 4.0% - 4.9% | 18 | 15 | 12 | 10 |
| 5.0% - 5.9% | 7 | 15 | 17 | 8 |
| 6.0% - 6.9% | 2 | 11 | 13 | 21 |
| 7.0% - 7.9% | 1 | 0 | 2 | 6 |
| 8.0% - 8.9% | 0 | 1 | 0 | 0 |
| Average | 3.95% | 4.88% | 5.17% | 5.63% |
| Source: 1980 and 1990 are from Table 2.3 of Due and Mikesell (1994); 2000 and 2012 are from the Urban Institute/Brookings Institution Tax Policy Center, [<http://www.taxpolicycenter.org/taxfacts/Content/PDF/state_sales_tax.pdf>], accessed May 1, 2012. |

1. Some states did impose taxes on certain types of income. Some states imposed taxes on property based on the income they could generate; Seligman (1914) classified these forms of property taxes as taxes on income. [↑](#footnote-ref-1)
2. All tax revenue data were provided to us by the U.S. Bureau of the Census, but are available on the Bureau’s State Government Tax Revenue division’s website [<http://www.census.gov/govs/statetax/>]. [↑](#footnote-ref-2)
3. The list of taxes is based on the classification of revenue sources used by the U.S. Bureau of the Census. [↑](#footnote-ref-3)
4. Washington has the largest percentage of tax revenue from the sales tax (59.6 percent) and Oregon has the largest percentage from the income tax (66.1 percent). [↑](#footnote-ref-4)
5. # Congressional Budget Office. (January 31, 2012), *The Budget and Economic Outlook: Fiscal Years 2012 to 2022.* Available at [<http://www.cbo.gov/publication/42905>], accessed May 17, 2012.

 [↑](#footnote-ref-5)
6. U.S. Bureau of Economic Analysis. “Table 1.1.1, Percent Change from Proceeding Period in Real Gross Domestic Product.” Available at [<http://www.bea.gov/iTable/iTable.cfm?ReqID=9&step=1>], accessed May 17, 2012. [↑](#footnote-ref-6)
7. Federation of Tax Administrators. (2012), “State Personal Income Taxes: Federal Starting Points (as of January 1, 2012).” Available at [<http://www.taxadmin.org/fta/rate/stg_pts.pdf>], accessed May 7, 2012. For a detailed description of each state’s personal income tax, see Olin and Swain (2011). [↑](#footnote-ref-7)
8. For more information, see the website for Americans For Fair Taxation at [http://www.fairtax.org]. [↑](#footnote-ref-8)
9. Hall and Rabushka call their tax a flat tax, which is not to be confused with the flat tax proposed by Steve Forbes. [↑](#footnote-ref-9)
10. See for example, Marron (2011), Weisman (2012), and Brooks (2012). [↑](#footnote-ref-10)
11. See Ballotnews.org, “Tennessee income tax proposal one step away from 2014 ballot” dated January 26, 2012, available at [<http://ballotnews.org/2012/01/26/tennessee-income-tax-proposal-one-step-away-from-2014-ballot/>], accessed May 17, 2012. [↑](#footnote-ref-11)
12. Ballotpedia.org, “Washington Income, Initiative 1098 (2010), available at [[http://ballotpedia.org/wiki/index.php/Washington\_Income\_Tax,\_Initiative\_1098\_%282010%29](http://ballotpedia.org/wiki/index.php/Washington_Income_Tax%2C_Initiative_1098_%282010%29)], accessed May 17, 2012. [↑](#footnote-ref-12)
13. Survey conducted by Gallop Organization in 2006 or 802 telephone interviews, obtained from the IPoll databank at the Roper Center for Public Opinion Research, accessed May 18, 2012. [↑](#footnote-ref-13)
14. See [<http://results.sos.nd.gov/resultsSW.aspx?text=BQ&type=SW&map=CTY>], accessed June 13, 2012. [↑](#footnote-ref-14)
15. The 1980 tax rates were taken from Table 82, Advisory Commission on Intergovernmental Relations (1980), while the 2012 tax rates were obtained from Federation of Tax Administrators, “State Individual Income Taxes, 2012,” [<http://www.taxadmin.org/fta/rate/ind_inc.pdf>], accessed May 7, 2012. [↑](#footnote-ref-15)
16. See Williams, Johnson, and Shure (2011) for a discussion of state EITCs. [↑](#footnote-ref-16)
17. U.S. Bureau of the Census. “National Population Projections,” Table 2. Available at [<http://www.census.gov/population/www/projections/summarytables.html>], accessed May 18, 2012. [↑](#footnote-ref-17)
18. ###  Bureau of Economic Analysis, National Income and Product Accounts, Table 2.3.5U. Personal Consumption Expenditures by Major Type of Product and by Major Function.

 [↑](#footnote-ref-18)
19. A summary of the most recent survey (2007) can be found at [<http://www.taxadmin.org/fta/pub/services/btn/0708.html#table>]. A summary of the 1990 survey can be found in Table 6.10 of Graser and Maury (1992). [↑](#footnote-ref-19)
20. For a discussion of sales tax exemptions, see chapters 3 and 4 of Due and Mikesell (1994). [↑](#footnote-ref-20)
21. There is no known document that reports the year that states adopted exemptions of business purchases. [↑](#footnote-ref-21)
22. Exemptions for 1980 were taken from Table 77, Advisory Commission on Intergovernmental Relations (1980), while the 2012 exemptions were obtained from Federation of Tax Administrators, “State Sales Tax Rates and Food & Drug Exemptions” [<http://www.taxadmin.org/fta/rate/sales.pdf>], accessed May 8, 2012. [↑](#footnote-ref-22)
23. Hawkins and Mikesell (2001) report that Michigan and Ohio had sales tax holidays for new vehicles in 1980. [↑](#footnote-ref-23)
24. The history of sales tax holidays is from: Urban Institute/Brookings Institution Tax Policy Center.“ States with Sales Tax Holidays, 1997-2008,” available at [<http://www.taxpolicycenter.org/taxfacts/Content/PDF/sales_tax_holiday_hist.pdf>], accessed April 25, 2012. Current sales tax holidays are from: Federation of Tax Administrators, “2012 State Sales Tax Holidays,” available at [<http://www.taxadmin.org/fta/rate/sales_holiday.html>], accessed May 7, 2012. [↑](#footnote-ref-24)
25. See [[http://ballotpedia.org/wiki/index.php/Maine\_Tax\_Code\_People%27s\_Veto,\_Question\_1\_%](http://ballotpedia.org/wiki/index.php/Maine_Tax_Code_People%27s_Veto%2C_Question_1_%25)

28June\_2010%29], accessed May 22, 2012. [↑](#footnote-ref-25)
26. Every state has a use tax as a companion to the sales tax. The use tax requires that if a purchase is made out of state and it is used in state, the individual or firm is required to pay the use tax. [↑](#footnote-ref-26)
27. Taken from “Range of State Corporate Income Tax Rates,” Federation of Tax Administrators, available at [<http://www.taxadmin.org/fta/rate/corp_inc.pdf>], accessed April 30, 2012. [↑](#footnote-ref-27)
28. See Hildreth, Murray, and Sjoquist (2005) for a discussion of the history of the efforts to adopt a common apportionment formula [↑](#footnote-ref-28)
29. Based on “State Apportionment of Corporate Income,” Federation of Tax Administrators, available at [<http://www.taxadmin.org/fta/rate/apport.pdf>], accessed May 8, 2012. [↑](#footnote-ref-29)
30. Hawaii adopted a fuel tax in 1932 and Alaska adopted it in 1946. [↑](#footnote-ref-30)
31. Tax rates in 1980 are from Table 98 of Advisory Commission on Intergovernmental Relations (1980), while the 2012 rates are from “State Motor Fuel Tax Rates,” Federation of Tax Administrators, available at [<http://www.taxadmin.org/fta/rate/mf.pdf>], accessed May 7, 2012. The tax rates do not include special fees per gallon or the state sales tax. [↑](#footnote-ref-31)
32. Reason-Rupe Public Opinion Survey, Winter 2011, available at [<http://reason.org/files/reason_rupe_transportation_poll.pdf>], accessed May 15, 2012. [↑](#footnote-ref-32)
33. Survey conducted by GfK Roper Public Affairs & Corporate Communications, November, 2010 based on 1000 telephone interviews, obtained from the IPoll databank at the Roper Center for Public Opinion Research, accessed May 15, 2012. [↑](#footnote-ref-33)
34. Surveys conducted by CBS News/New York Times, based on more than 1,000 telephone interviews, and obtained from the IPoll databank at the Roper Center for Public Opinion Research, accessed May 15, 2012. [↑](#footnote-ref-34)
35. Sioux City Journal February 13, 2012, available at [<http://siouxcityjournal.com/news/local/poll-iowans-oppose-gas-tax-increase/article_6923f8c0-368e-5240-9f2e-2d8766a79b88.html>], accessed May 15, 2012. [↑](#footnote-ref-35)
36. For a discussion of the Portland, Oregon VMT tax experiment see Rufolo and Kimpel (2008). [↑](#footnote-ref-36)
37. For a discussion of indexing fuel taxes see Sundeen and Reed (2006) and Ang-Olson, Wachs, and Taylor (1999). [↑](#footnote-ref-37)
38. GasBuddy.com/Tax.Info.aspx provides a description of the fuel taxes in each state, access May 14, 2012. [↑](#footnote-ref-38)
39. In a 2011 NBC News, Wall Street Journal survey, 47 percent of the respondents wanted their members of Congress to vote in favor of reauthorizing the fuel tax. When those who opposed the reauthorization were told what the tax revenue was used for, 43 percent of them changed their response to positive. A poll of 1,000 telephone interviews conducted by Hart and McInturff Research Companies, obtained from the IPoll databank at the Roper Center for Public Opinion Research, accessed May 15, 2012. [↑](#footnote-ref-39)
40. Tax rates in 1980 are from Table 99 of Advisory Commission on Intergovernmental Relations (1980), while the 2012 rates are from “State Excise Tax Rates on Cigarettes”, Federation of Tax Administrators, available at [<http://www.taxadmin.org/fta/rate/cigarette.pdf>], accessed May 7, 2012. [↑](#footnote-ref-40)
41. These are 2012 tax rates as reported by the Federation of Tax Administrators, available at [<http://www.taxadmin.org/fta/rate/cigarette.pdf>], accessed May 17, 2012. [↑](#footnote-ref-41)
42. Data from Federation of Tax Administrators, available at [<http://www.taxadmin.org/fta/rate/cig_inc02.html>],accessed May 17, 2012. [↑](#footnote-ref-42)
43. McHugh (1996) provides a description of the public utility tax in Ohio. [↑](#footnote-ref-43)
44. McHugh (1996) provides a discussion of the nature of the new competition public utilities now face. [↑](#footnote-ref-44)
45. The most recent Census Bureau data on local government revenue is for the year 2009. [↑](#footnote-ref-45)
46. For a discussion of state inheritance taxes, see McNichol (2012) and McNichol, Lav, and Llobrera (2003). [↑](#footnote-ref-46)