Designing a State Tax System for the 21st Century: A Difficult Path for Rescue and Restructure

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Never forget...

- **Raising revenue** is the unique role of the tax system in market economy

- Objective: Behave like a pickpocket, not a mugger.
Patriotism and Taxation – Never Easy

“We have shed our blood in the glorious cause in which we are engaged; we are ready to shed the last drop in its defense. Nothing is above our courage, except only (with shame I speak it) the courage to tax ourselves.” --James Madison, 1782
Impossible Dream? News Flash: There is a popular tax in Chinatown, NYC!
A pretty good guide for restructuring for 21\textsuperscript{st} Century...

- "Tax reform should also broaden the overall tax base by closing special interest loopholes that distort the marketplace, limit innovation, and waste time and resources." -- Fiscal 2017 Budget Resolution, U. S. House of Representatives

- Basic Guide for 21\textsuperscript{st} Century Rescue Mission: Pick sound bases, include broadly, and tax lightly.
## Where Are We? Some State – Local Tax Facts

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<th>Taxes Levied by State or Local Government</th>
<th>% Own Source General Revenue (2012-13)</th>
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<td><strong>States</strong></td>
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RST Problem: Disappearing Retail Sales Tax Base
(Graph is National Aggregate Base Relative to Total Personal Income)
That has required: Upward Creeping National Effective RST Rate (and no good comes from higher tax rates)
RST Objective

- **Broad** consumption base taxed at uniform and **low** statutory rate. Not a tax on “luxuries” that exempts “necessities.”
- Avoid distortion, discrimination
- Tax all household consumption purchases, exempt all business input purchases
- General tax on household consumption expenditure is goal (to base tax distribution on self-evaluated capacity to afford purchases from private sector)
Specific 21\textsuperscript{st} Century RST Rescues

- Tax food, clothing, medicine, other household consumption purchases (SNAP exempt)
- Tax household service expenditures
- Exempt business input purchases
- Tax nonprofit organization sales; exempt nonprofit organization purchases
- Eliminate tax holidays
- Collect use tax: distribution centers create nexus, affiliate relationship creates nexus (NY), require reporting by remote vendors (CO)
State Individual Income Tax Collections and National Personal Income Relative to 1970 Levels
National Real State Individual Income Tax Collections per Capita
Problems

- Cyclical sensitivity
- Political – adding preferences and quest to eliminate
- But – collections continue to increase faster than personal income
- With crippled RST, heavier IIT reliance probably necessary
Rescuing Individual Income Tax: Remove Non-revenue Objectives

- BROAD: Eliminate preferences built into the state structure: deductions, exclusions, etc.
- Eliminate graduated rate structure, use personal exemption to provide any progression
- Retain EITC if desired – it is targeted, use sales tax credit to reduce RST regressivity
- Progressivity is best left to the federal government and the federal tax is steeply progressive
State Motor Fuel Tax Collections Have Stopped Increasing in Real Terms (National Totals Adjusted to 2009 Prices)
Benefit logic is sound but old system is dying

Problems: tax on gallons, increased fuel economy, hybrid and all-electric vehicles, and political reluctance to increase fuel tax rate doom the traditional MFT

Technology permits direct charge system, probably only way to retain anything like a user-pays system of highway finance (Oregon system of using pay-at-pump as advance collection of mileage charge)

MFT in current form possibly not rescuable
Local Government Property Tax Revenue

Figure 1. Local Property and All Non-Property Tax Revenue, IV:1988 - II:2013 (12 months, $ Millions)
Rescuing the Real Property Tax

- Local fiscal viability is important for state government finances
- Real property tax is nearly ideal financing instrument for local government in 21st century. Immobile tax base!
- Why? Stability, visibility, flexibility, proxy charge for local services, collectable by localities
- Constraints preventing current market value assessment, ceilings on statutory rates, special assessment systems for certain property types, and exemptions prevent property tax from achieving its potential ← avoid all.
- Traditional circuit breakers and deferrals provide useful safety value for continued use of the tax
- BROAD and low
Rescuing / Revitalizing User Charges

- Service benefitting identifiable households and businesses are good candidates for charge finance (selling services)
- Relieve tax system of need to finance those services, relieves those not using the service from paying for them, collects from entities with tax exemption
- Technology can help
To do list:

- Stop RST disappearance
- Close individual income tax holes
- Find sustainable user-based system for highway finance
- Preserve real property tax for local governments
- Explore greater use of user charges
- Build “rainy day fund”
- Verify quality of tax expenditure budget – what is “normal?” Should be guide for broadening base.
- Reminder: heavy reliance on any single tax brings out the worst consequences from use of that tax