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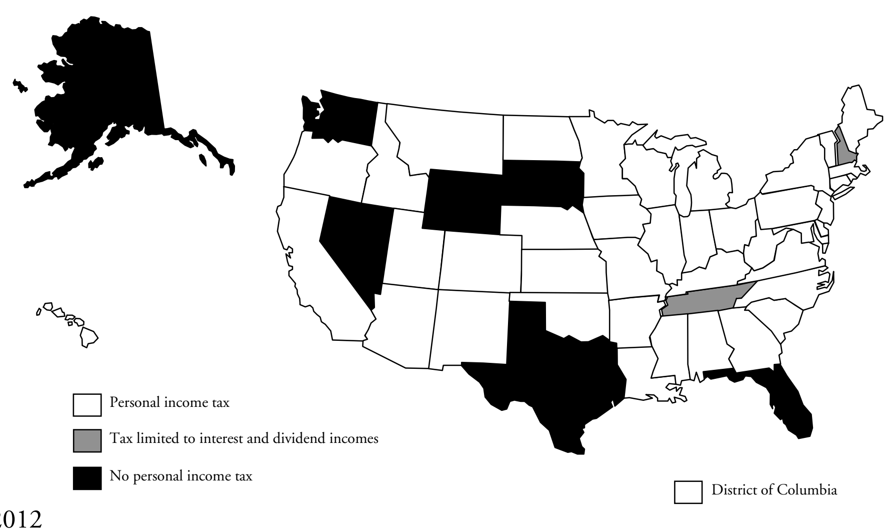
The Forum for America's Ideas

State Personal Income Taxes—2012

The personal income tax is the largest source of state tax revenues, providing 34 percent of tax revenue in 2010. The role of the personal income tax in the state tax mix has increased dramatically since 1970, when it provided only 19 percent of state revenues. Part of this growth in state reliance is explained by enactment of income taxes in Ohio (1971), Pennsylvania (1971), Rhode Island (1971), New Jersey (1976) and Connecticut (1991). In addition, economic growth and stock market gains are reflected in state personal income tax revenues.

The map below shows the states that levied a personal income tax in 2012. New Hampshire and Tennessee have a limited income tax on interest, dividends and capital gains but do not tax wages and salaries. All but six of the 41 states with broad-based income taxes use a graduated rate structure, with income taxed at higher marginal rates as income increases. Colorado, Illinois, Indiana, Michigan, Pennsylvania and Utah have a single, flat tax rate on all income. Massachusetts levies a flat tax of 5.25 percent on wages and salaries, 12 percent on short-term capital gains, and 5.30 percent on other classes of capital gain income. Table 2 provides additional details about state income tax structures.

Figure 1. States and Other Jurisdictions that Levy Personal Income Taxes



Source: NCSL, 2012

Seventeen states have statutory provisions for automatic adjustment of tax brackets, personal exemption or standard deductions to the rate of inflation. Massachusetts, Michigan and Nebraska index the personal exemption amounts only and Oregon does not index the income brackets for $125,000 and over. Although inflation has been relatively low for the past decade, bracket creep—the effect of inflation pushing taxpayers into higher tax brackets—has been a major concern in times of high inflation. States with progressive income taxes that do not index for inflation tend to experience automatic growth in income tax revenues over time, even when wages are increasing more slowly than inflation.

The personal income tax is a reliable and stable source of state revenue. It is responsive to economic growth, which also helps explain why state income tax reliance has increased over time. Consumption taxes, particularly excise taxes, tend to grow more slowly than the economy. Lawmakers must pass rate increases to ensure that consumption tax revenues keep pace with economic growth. The political process is biased toward revenue sources that produce revenue growth without lawmakers voting to increase the tax rate or expanding the base to keep revenues growing at the same rate as the economy.

The personal income tax is the only state tax that is progressive by design, meaning taxpayers with higher incomes are taxed at higher rates so that they pay proportionally more. Income taxes achieve progressivity either through a graduated rate structure or with a flat rate structure that includes personal exemptions and standard deductions that remove low-income taxpayers from the tax rolls. In addition, 25 states and the District of Columbia have earned income tax credits—targeted toward low-income working taxpayers—that offset income tax liability and actually may provide refunds in excess of tax liability.

Most state income tax systems are closely linked to the federal tax code. Thirty-six of the 41 states with a broad-based individual income tax conform to the federal tax base in some fashion. Thirty states use federal adjusted gross income as a starting point to apply state tax rates. Five states—Colorado, Minnesota, North Dakota, South Carolina and Vermont start with federal taxable income and Massachusetts uses federal gross income as a starting point. Only five states do not use the federal tax code as a starting point for calculating state tax liability. (see table 1).

Table 1. Personal Income Taxes: Federal Starting Points, 2012

State/Jurisdiction	Federal Adjusted Gross Income	Federal Gross Income	Federal Taxable Income	No State Income Tax	Doesn't Conform	Only Certain Interest and Dividends Are Taxed
Alabama					x	
Alaska				x		
Arizona	x					
Arkansas					x	
California	x					
Colorado			x			
Connecticut	x					
Delaware	x					
Florida				x		
Georgia	x					
Hawaii	x					
Idaho	x					
Illinois	x					
Indiana	x					
Iowa	x					
Kansas	x					
Kentucky	x					
Louisiana	x					
Maine	x					
Maryland	x					
Massachusetts		x				
Michigan	x					
Minnesota			x			
Mississippi					x	
Missouri	x					
Montana	x					
Nebraska	x					
Nevada				x		
New Hampshire						x
New Jersey					x	
New Mexico	x					
New York	x					
North Carolina	x					
North Dakota			x			
Ohio	x					
Oklahoma	x					
Oregon	x					
Pennsylvania					x	
Rhode Island	x					
South Carolina			x			
South Dakota				x		
Tennessee						x
Texas				x		
Utah	x					
Vermont			x			
Virginia	x					
Washington				x		
West Virginia	x					
Wisconsin	x					
Wyoming				x		

Table 1. Personal Income Taxes: Federal Starting Points, 2012

State/Jurisdiction	Federal Adjusted Gross Income	Federal Gross Income	Federal Taxable Income	No State Income Tax	Doesn't Conform	Only Certain Interest and Dividends Are Taxed
District of Columbia		x				
Total	30	2	5	7	5	2

Source: Compiled by NCSL from the Commerce Clearing House, *State Tax Guide*, 2012

States that link personal income tax closely to the federal code gain efficiency in administration and reduce compliance costs for businesses and individuals. However, states also lose a measure of control over their income tax systems because any changes in federal law that increase or decrease federal revenue also will affect state revenues.

A common criticism of the federal income tax is the tremendous complexity of the system and the significant compliance costs imposed upon taxpayers. At the state level, conformity with the federal tax code minimizes compliance costs because taxpayers are already required to maintain records and calculate figures for federal tax forms. State administrative costs are reduced through joint federal/state audit programs that allow the Internal Revenue Service to share the results of audits and enforcement actions with states. If the federal government abandoned the income tax, as has been periodically proposed in Congress, administrative and compliance costs would become major issues for the states.

The personal income tax is also a factor in interstate competition for retirees and corporate headquarters. In recent years, some states have reduced income taxes on retirement income to compete with Florida (no income tax) for retirees. Some executive recruiting firms also claim that businesses that are seeking to relocate corporate headquarters look closely at top marginal income tax rates, which are of concern to highly compensated executives. However, the relative importance of personal income tax rates in economic development decisions is debatable.

Like other taxes, the personal income tax is not economically neutral. The very existence of the tax, in theory, can influence individual decisions about whether and how much to work, save and invest. The higher the marginal rate, the stronger the work disincentive provided by state income taxes. High capital gains tax rates also can discourage investment. However, the effect of state income taxes on work and investment decisions is dwarfed by the federal income tax. State income taxes may be a factor in decisions about work effort, but they probably are not the deciding factor for most taxpayers.

Most state income tax preferences are specifically designed not to be economically neutral. Some state policymakers favor using the income tax code to provide incentives for certain behavior (saving for retirement, attending college) and disincentives for other behavior. Massachusetts has a high tax rate on short-term capital gains, but the tax rate falls as assets are held for longer periods of time. The provision discourages short-term, speculative gains, while rewarding investors who hold assets over a longer period. Other states have exempted interest earned in college savings plans from state income taxes to encourage taxpayers to set up these plans.

The following table shows individual income tax rates by state.

Table 2. State Individual Income Taxes
(Tax Rates for Single Taxpayers for Tax Year 2012)

State/ Jurisdiction	Tax Rates Lowest	Tax Rates Highest	Number of Brackets	Income Brackets Lowest	Income Brackets Highest	Comments
Alabama	2%	5 % minus $40	3	$500	$3,001	
Alaska	No state income tax					
Arizona	2.59%	4.54% minus $1,039	5	$10,000	$150,001	
Arkansas	1.0%	7.0% minus $889.44	6	$3,999	$33,200	Brackets indexed for inflation annually. Rates shown are for 2011 because 2012 rates not currently available.
California	1.0%	9.3% minus $2,396.78	6	$7,455	$48,943	Brackets indexed for inflation annually. An additional 1 percent tax is imposed on taxable income in excess of $1 million.
Colorado	4.63%		1	Flat rate		Subject to an alternative minimum tax equal to the amount by which 3.47 percent of CO alternative minimum taxable income exceeds CO normal tax.
Connecticut	3.0%	6.7% minus $2,450	6	$3,000	$250,000	Resident estates and trusts are subject to 6.7 percent rate on all income.
Delaware	2.2% minus $44	6.75% minus $1,106.50	7	$5,000	$60,001	5.95 percent on taxable income of more than $60,000 for tax years beginning after 2013.
Florida	No state income tax					
Georgia	1.0%	6.0% minus $190	6	$750	$7,001	
Hawaii	1.4%	11% minus $5,621.40	12	$2,400	$200,000	
Idaho	1.6%	7.4% minus $237.99	7	$1,379	$10,350	Brackets indexed for inflation annually.
Illinois	5%		1	Flat rate		
Indiana	3.4%		1	Flat rate		
Iowa	0.36%	8.98% minus $1,758.97	9	$1,211	$54,495	Brackets indexed for inflation annually. An alternative minimum tax of 6.7 percent of alternative minimum income is imposed if the minimum tax exceeds the taxpayer's regular income tax liability. The minimum tax is 75 percent of the maximum regular tax rate.
Kansas	3.5%	6.45% minus $472.50	3	$15,000	$30,001	New, lower tax rates go into effect in tax year 2013.
Kentucky	2.0%	6.0% minus $334	6	$3,000	$75,001	
Louisiana	2.0%	6 .0% minus $1,250	3	$12,500	$50,001	
Maine	2.0%	8.5% minus $686.44	4	$5,099	$20,350	Brackets indexed for inflation annually. New tax rate schedules based on rates of 6.5 percent and 7.95 percent apply for tax years after 2012.
Maryland	2.0%	5.75% minus $1,615	8	$1,000	$250,000	

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State/ Jurisdiction	Tax Rates Lowest	Tax Rates Highest	Number of Brackets	Income Brackets Lowest	Income Brackets Highest	Comments
Massachusetts	5.25%		1	Flat rate		Short term capital gain income is taxed at 12 percent. Income from interest and dividends and gains from the sale of capital assets held for more than one year are taxed at a rate of 5.3 percent.
Michigan	4.35%		1	Flat rate		Rate goes to 4.25 percent on October 1, 2012.
Minnesota	5.35%	7.85% minus $1,024.23	3	$23,670	$77,731	Brackets indexed for inflation annually. A 6.4 percent alternative minimum tax is imposed.
Mississippi	3.0%	5.0% minus $150	3	$5,000	$10,001	
Missouri	1.5%	6.0% minus $225	10	$1,000	$9,001	
Montana	1.0%	6.9% minus $512	7	$2,700	$16,001	Brackets indexed for inflation annually. Rates shown are for 2011 because 2012 rates not currently available.
Nebraska	2.56%	6.84% minus $759.89	4	$2,400	$27,001	New rates take effect in 2013
Nevada	No state income tax					
New Hampshire	State income tax of 5 percent on interest and dividend income only					
New Jersey	1.4%	8.97% minus $15,126.25	6	$20,000	$500,001	
New Mexico	1.7%	4.9% minus $279.50	4	$5,500	$16,001	Qualified nonresident taxpayers may pay alternative tax of 0.75 percent of gross receipts from NM sales.
New York	4.0%	8.82% minus $20,567	8	$8,000	$1,000,000	Brackets indexed for inflation annually.
North Carolina	6.0%	7.75% minus $557.50	3	$12,750	$60,001	
North Dakota	1.51%	3.99% minus $3,019.91	5	$35,350	$388,351	Brackets indexed for inflation annually.
Ohio	0.587%	5.925% minus $2,877	9	$5,200	$208,501	Brackets indexed for inflation annually.
Oklahoma	0.5%	5.25% minus $210.25	7	$1,000	$8,701	
Oregon	5.0%	9.9% minus $1,265	4	$2,000	$125,001	Brackets indexed for inflation annually except for taxable income of $125,000 or more.
Pennsylvania	3.07%		1	Flat rate		
Rhode Island	3.75%	5.99% minus $2,182.25	3	$57,150	$129,901	Brackets indexed for inflation annually.
South Carolina	3.0% minus $84	7% minus $476	6	$2,801	$14,001	Brackets indexed for inflation annually.
South Dakota	No state income tax					
Tennessee	State income tax of 6 percent on interest and dividend income only					
Texas	No state income tax					
Utah	5.0%		1	Flat rate		
Vermont	3.55%	8.95% minus $4,374.40	5	$35,350	$388,351	Amount of tax increased by 24 percent for certain types of income.
Virginia	2.0%	5.75% minus $257.50	4	$3,000	$17,001	
Washington	No state income tax					

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State/ Jurisdiction	Tax Rates Lowest	Tax Rates Highest	Number of Brackets	Income Brackets Lowest	Income Brackets Highest	Comments
West Virginia	3.0%	6.5% minus $1,125	5	$10,000	$60,001	
Wisconsin	4.6%	7.75% minus $2,960.64	5	$10,570	$232,661	Brackets indexed for inflation annually. Economic development surcharge imposed on individuals with gross receipts of $4 million or more at greater of $25 or 0.2 percent of net business income attributable to state sources, up to a maximum of $9,800.
Wyoming	No state income tax					
District of Columbia	4.0%	8.95% minus $1,380	4	$10,000	$350,001	

Source: Commerce Clearing House, *State Tax Guide, 2012.*