

SPR

VOLUME 27

ISSUE 8

In This Issue

Sales Tax Slippage

2

State tax collections are tanking, and sales taxes are showing weakness not seen for many years. This is a big problem for both state and local governments, as the sales tax is widely used by both. As states look to improve their revenue streams without raising taxes, the option of expanding the sales tax base to include more services might become increasingly appealing.

Technical Notes

9

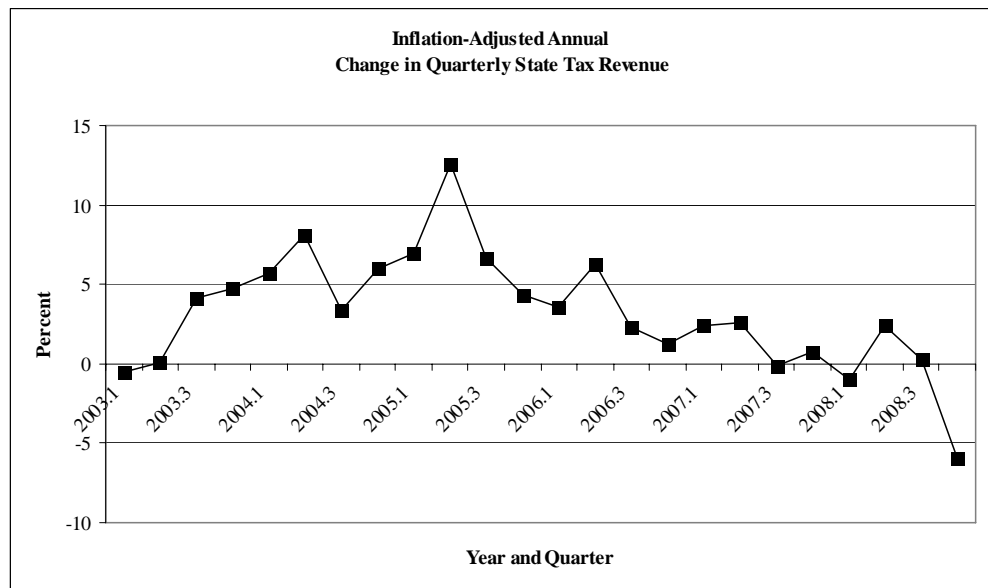
Please do not make unauthorized copies of *State Policy Reports*. Your subscription permits you to print your PDF version one time and route it, or route your hard copy. Forwarding or photocopying for other users is not permitted unless you have made prior arrangements with FFIS. FFIS offers rewards for information about unauthorized copying or distribution of *State Policy Reports*. FFIS also offers volume discounts for organizations that wish to purchase multiple copies of *State Policy Reports* for their employees. Please call 202-624-5849 for information.

STATE POLICY REPORTS

Sales Tax Slippage

The Rockefeller Institute has been tracking state revenue performance for many years, so the headline on its recent *State Revenue Report*, “Sales Tax Decline in Late 2008 Was the Worst in 50 Years,” carries some weight. Moreover, as the chart below shows, state revenues generally are in pretty bad shape, plunging unambiguously into negative growth territory in the final calendar quarter of 2008.

The chart shows total state tax revenue collections. The growth rates are adjusted for inflation; for example, the -5.9% growth rate shown for the final quarter of 2008 reflects the combined effect of a nominal decline of 4% and a 2% inflation rate.



Rockefeller Institute, April 2009

Among the three major state revenue sources, the personal income tax declined by 1.1% in nominal terms, the corporate income tax declined by 15.5% and the sales tax by 6.1%. This is the first time since the first quarter of 2002 that all three taxes registered year-over-year negative growth rates, and it is the first decline for the personal income tax since mid-2003.

Amidst all this bad news, the sales tax decline is the headline grabber. Why? The obvious answer is the one stated in the headline: the decline was the worst in 50 years. Beyond that, however, is the important role the sales tax plays in public finance, and the implications of its weakness for fiscal conditions among state and local governments.

The next table puts that importance into context. It shows the major sources of state and local own-source revenues in 2006, and lists each component’s share of the total. Among the seven categories, sales taxes represent the highest share of state and local revenues, nearly 24%.

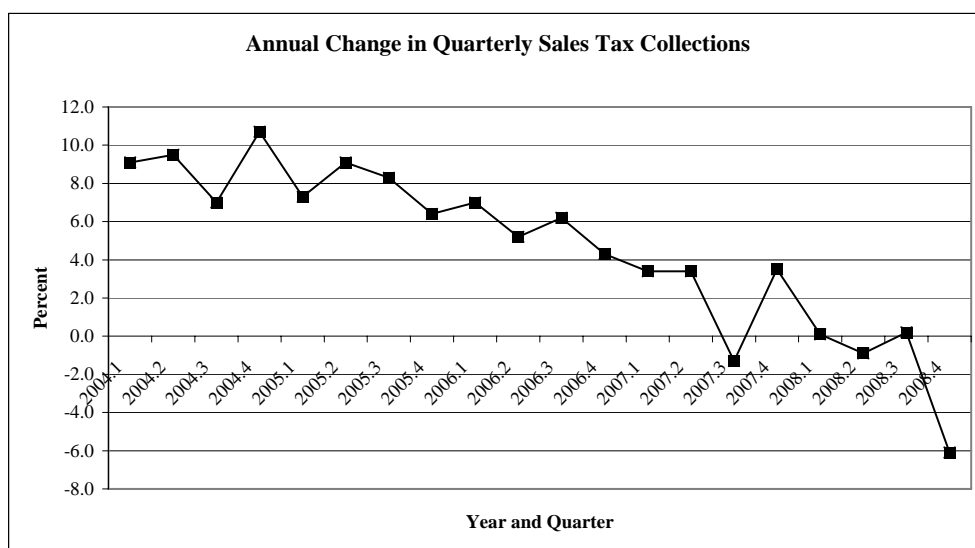
Major Revenue Sources as a Percent of State and Local Own-Source General Revenues, FY 2006

State	Property Taxes	Sales and Gross Receipts Taxes	Individual Income Taxes	Corporate Income Taxes	Licensing & Other Taxes	Charges	Miscellaneous General Revenue	Total
U.S. Average	20.7%	23.8%	15.5%	3.1%	5.9%	19.3%	11.7%	100.0%
Alabama	8.8	28.0	13.1	2.6	5.8	30.8	10.9	100.0
Alaska	11.2	5.1	0.0	9.5	16.7	11.2	46.3	100.0
Arizona	20.0	33.8	11.8	3.2	3.3	16.0	12.0	100.0
Arkansas	10.4	36.6	15.9	2.9	3.2	21.1	9.8	100.0
California	15.7	22.0	21.6	4.4	5.5	20.2	10.6	100.0
Colorado	19.3	22.8	15.6	1.7	3.7	23.1	13.8	100.0
Connecticut	31.1	20.4	23.7	2.6	3.8	10.0	8.3	100.0
Delaware	8.9	7.4	18.0	4.9	21.3	19.3	20.1	100.0
District of Columbia	19.9	20.6	20.2	3.6	10.2	9.4	16.2	100.0
Florida	23.1	32.4	0.0	2.4	8.9	21.0	12.3	100.0
Georgia	20.1	27.1	18.1	2.0	2.5	20.3	9.9	100.0
Hawaii	11.6	37.5	18.3	1.8	4.1	17.7	9.0	100.0
Idaho	18.0	21.7	17.7	2.9	5.0	25.1	9.6	100.0
Illinois	27.3	25.0	12.1	3.4	5.1	17.0	10.1	100.0
Indiana	21.9	20.0	13.0	2.7	2.2	29.4	10.8	100.0
Iowa	21.0	20.7	15.4	1.8	4.7	26.3	10.2	100.0
Kansas	22.0	25.7	16.2	2.6	3.9	18.9	10.7	100.0
Kentucky	12.4	26.0	20.0	5.7	5.2	18.8	11.9	100.0
Louisiana	10.5	37.3	10.6	2.2	6.3	20.4	12.7	100.0
Maine	28.2	21.3	17.4	2.4	4.7	14.2	11.8	100.0
Maryland	17.6	18.3	29.0	2.5	8.6	15.1	9.0	100.0
Massachusetts	25.5	14.3	24.7	4.4	3.2	13.7	14.3	100.0
Michigan	24.9	21.9	12.3	3.5	3.8	22.2	11.4	100.0
Minnesota	16.6	23.1	21.3	3.3	5.5	19.3	10.8	100.0
Mississippi	16.2	31.1	9.8	2.5	4.2	28.3	8.0	100.0
Missouri	18.5	26.3	17.9	1.4	4.0	20.1	11.8	100.0
Montana	22.5	11.0	16.4	3.3	11.1	19.9	15.8	100.0
Nebraska	21.7	21.2	15.0	2.5	6.3	18.5	14.8	100.0
Nevada	17.7	40.5	0.0	0.0	10.6	18.3	12.9	100.0
New Hampshire	43.2	11.0	1.3	8.4	6.3	16.5	13.4	100.0
New Jersey	33.3	17.2	17.0	4.1	5.1	13.7	9.6	100.0
New Mexico	8.5	28.4	10.0	3.3	11.6	14.7	23.4	100.0
New York	22.0	19.1	23.3	5.5	4.8	13.6	11.7	100.0
North Carolina	15.9	23.5	21.5	3.0	4.4	23.1	8.7	100.0
North Dakota	17.4	22.9	7.6	3.3	13.8	21.1	14.0	100.0
Ohio	20.0	20.6	21.9	1.8	4.4	19.9	11.4	100.0
Oklahoma	10.6	24.8	16.2	1.8	12.7	21.7	12.2	100.0
Oregon	18.3	5.4	27.5	2.4	8.0	24.3	14.2	100.0
Pennsylvania	20.5	20.6	17.8	3.1	8.8	17.8	11.5	100.0
Rhode Island	29.7	22.1	16.0	2.7	3.1	12.0	14.4	100.0
South Carolina	17.9	20.3	12.3	1.3	4.4	32.5	11.2	100.0
South Dakota	22.2	35.2	0.0	1.8	5.7	16.3	18.9	100.0
Tennessee	15.1	36.9	0.7	3.4	6.9	21.4	15.6	100.0
Texas	28.5	30.0	0.0	0.0	8.0	19.4	14.1	100.0
Utah	14.1	25.0	17.2	2.6	3.5	26.1	11.5	100.0
Vermont	30.6	21.6	14.4	2.3	4.4	15.7	11.0	100.0
Virginia	20.9	18.3	20.6	2.0	6.3	20.8	11.1	100.0
Washington	18.6	41.4	0.0	0.0	7.6	23.1	9.3	100.0
West Virginia	11.4	24.2	14.0	5.7	8.0	18.1	18.5	100.0
Wisconsin	25.7	20.1	18.9	2.6	4.1	18.5	10.1	100.0
Wyoming	19.8	19.0	0.0	0.0	24.2	21.4	15.7	100.0

Source: U.S. Census Bureau

This reflects the fact that among the three major state and local taxes—sales, personal income and property—sales taxes are the only one used widely at both the state and local levels. Personal income taxes are primarily state taxes, with states accounting for 91.5% of total personal income tax collections in 2006, and local use is limited to 14 states. Most states report state-level property tax collections, but at levels so low they are dwarfed by local collections. State collections represented just 3% of property tax collections in 2006. For sales taxes, however, 36 states allow local sales taxes, and such taxes accounted for about 19% of total sales tax collections in 2006.

The table shows that sales taxes are particularly important in eight states where they make up more than one-third of total state-local own-source general revenues: **Arizona, Arkansas, Hawaii, Louisiana, Nevada, South Dakota, Tennessee and Washington**. For these states, the sales tax trend shown in the following chart is particularly troublesome.



Rockefeller Institute, April 2009

The decline is remarkable. Four years ago, the sales tax registered year-over-year growth of 10.7%, producing a 16.8 percentage-point swing between then and now. Moreover, there are only five quarters since the beginning of 1999 in which sales tax collections declined relative to their year-ago levels, and the largest of those declines—prior to this one—was -1.4% in the first quarter of 2002. The tax is now in territory that is as uncharted as it is unwelcome.

As ever, the national trend masks wide state-by-state variations, as shown in the next table. At the extremes, **Iowa** reported a 19.5% increase in sales tax collections, while **Utah** reported a 19.9% drop.

Annual Change in Quarterly Sales Tax Revenue, 2007.4-2008.4

Rank	State	Percent	Rank	State	Percent
1	Iowa	19.5%	27	Nevada	-5.3%
2	North Dakota	12.9	28	Illinois	-6.1
3	Maryland	12.7	28	New Mexico	-6.1
4	Nebraska	12.5		U.S. Average	-6.1
5	Indiana	12.4	30	New York	-6.3
6	West Virginia	11.6	31	South Carolina	-6.7
7	Oklahoma	11.2	32	Hawaii	-7.0
8	Wyoming	4.5	33	North Carolina	-7.5
9	Texas	4.0	33	Tennessee	-7.5
10	Georgia	1.6	35	New Jersey	-7.9
11	Wisconsin	0.8	36	Washington	-8.0
12	Arkansas	-0.1	37	Ohio	-8.1
13	Kentucky	-0.2	38	Alabama	-8.5
14	Mississippi	-0.8	39	Florida	-11.1
14	Vermont	-0.8	40	Arizona	-12.7
16	South Dakota	-1.2	40	Idaho	-12.7
17	Louisiana	-1.6	42	Connecticut	-13.3
18	Maine	-3.3	43	Michigan	-14.1
19	Minnesota	-3.5	44	California	-16.4
20	Pennsylvania	-3.6	45	Utah	-19.9
21	Kansas	-3.8		Alaska	NA
22	Missouri	-4.2		Delaware	NA
23	Rhode Island	-4.3		Montana	NA
24	Virginia	-4.4		New Hampshire	NA
25	Colorado	-5.2		Oregon	NA
25	Massachusetts	-5.2			

Source: Rockefeller Institute, April 2009

Only 11 of the 45 states that levy a general sales tax reported collection gains. The Rockefeller Institute notes that **Iowa** and **Maryland's** strong results are due to legislated tax increases. **North Dakota** is widely considered to be among the most economically sound states currently, and its collections support that assessment. Two of the 10 most-populous states—**Texas** and **Georgia**—are among those with positive sales tax growth.

In contrast, six of the 10 most-populous states are among those with growth rates below the national average: **California, Michigan, Florida, Ohio, North Carolina** and **New York**. Also, among the eight states listed on page 4 that rely heavily on sales taxes to finance their state and local governments, **Arizona, Hawaii, Tennessee** and **Washington** are among the states with below-average collections. For these states, the decline in collections is especially bad news.

Reducing Volatility State sales tax collections are unlikely to be strong when the state economy is weak, and most of the states with positive changes in their collections are states with comparatively good state economies. Others may well be states where the economy is bad, but not as bad as it was a year ago, leading to some improvement in year-over-year collections.

While sales tax slippage in a recession is inevitable—people naturally consume less when they have less disposable income to spend—states have an interest in keeping the tax as productive as possible. To that end, many analysts recommend that states expand their sales tax bases to capture the full range of consumption that occurs. State sales tax bases include most goods (except food, medicines and—in some states—clothing, which frequently are exempted), but they are notoriously bad at taxing the consumption of services, as shown below.

Number of Services (of 162) Taxed by States, 2007

Rank	State	Number	Rank	State	Number
1	Hawaii	160	26	Maryland	39
2	New Mexico	158	27	Alabama	37
2	Washington	158	28	Georgia	36
4	South Dakota	146	29	South Carolina	35
5	Delaware	143	30	Oklahoma	32
6	West Virginia	105	30	Vermont	32
7	Iowa	94	32	North Carolina	30
8	Texas	83	33	Idaho	29
9	Connecticut	79	33	Rhode Island	29
10	Nebraska	77	35	Kentucky	28
11	Wisconsin	76	36	Michigan	26
12	Kansas	74	36	Missouri	26
12	New Jersey	74	36	North Dakota	26
14	Arkansas	72	39	Maine	25
14	Mississippi	72	40	Indiana	24
16	Ohio	68	41	California	21
17	Tennessee	67	42	Massachusetts	18
18	Minnesota	66	42	Nevada	18
19	Florida	63	42	Virginia	18
20	Utah	58	42	Montana	18
20	Wyoming	58	46	Illinois	17
22	New York	57	47	Colorado	14
23	Arizona	55	48	New Hampshire	11
23	Louisiana	55	49	Alaska	1
23	Pennsylvania	55	50	Oregon	0

Source: Federation of Tax Administrators, 2008

The table lists the number of services out of 162 that each state includes in its tax base. Many of the states atop the list—including **Hawaii**, **New Mexico**, **Washington** and **Delaware**—levy a gross receipts tax that captures services in its base.

As the table shows, most states include relatively few services in their tax bases. Utilities and business services are among the more widely taxed, while professional services are untaxed in virtually every state. For the vast majority of states, there is ample room to expand the sales tax base to include more services and thereby improve the tax's productivity.

The next table shows each state's sales tax collections in per capita terms.

State General Sales and Gross Receipts Tax Revenues Per Capita, 2007

Rank	State	Amount	Rank	State	Amount
1	Hawaii	\$1,997	26	Utah	\$748
2	Washington	1,691	27	Wisconsin	744
3	Wyoming	1,349	28	South Carolina	740
4	Nevada	1,270	29	Pennsylvania	698
5	Florida	1,198	30	Ohio	679
6	Tennessee	1,106	31	Georgia	676
7	Mississippi	1,085	32	Kentucky	667
8	Arkansas	1,029	33	Massachusetts	633
9	New Jersey	962	34	West Virginia	624
10	New Mexico	942	35	Maryland	615
11	Arizona	909	36	Illinois	610
12	South Dakota	898	37	Iowa	599
13	California	897	38	North Carolina	580
14	Connecticut	866	39	New York	564
15	Minnesota	864	40	Missouri	559
15	Texas	864	41	Oklahoma	546
17	Idaho	862	42	Vermont	538
18	Indiana	858	43	Alabama	494
19	Nebraska	839	44	Colorado	461
20	Rhode Island	826	44	Virginia	461
21	Louisiana	816	46	Alaska	0
22	Kansas	811	46	Delaware	0
23	Maine	801	46	Montana	0
24	Michigan	791	46	New Hampshire	0
	U.S. Average	787	46	Oregon	0
25	North Dakota	758			

Source: Tax Foundation and U.S. Census Bureau

Per capita tax yields are a function of more than just the breadth of the tax base: the rate is crucial, as is the ability of a state to have non-residents bear some of the burden. For example, tourist-rich states such as **Hawaii**, **Nevada** and **Florida** transfer some of their tax burden to visitors. Also important is the extent to which states tax business purchases of inputs used in production; many states include at least some such purchases, and they significantly increase the tax's productivity.

Because gross receipts tax have a much broader base than most retail sales taxes, states with such taxes generate relatively high revenues from them. Most of the states at the top of the previous table either levy a gross receipts tax or have large tourist sectors, or, in **Hawaii's** case, both. Others—such as **Tennessee** and **Mississippi**—have relatively high tax rates, as shown in the next table.

State General Sales Tax Rates, as of January 1, 2009

Rank	State	Percent	Rank	State	Percent
1	California	7.25%	26	Nebraska	5.5%
2	Indiana	7	26	Ohio	5.5
2	Mississippi	7	28	New Mexico	5.375
2	New Jersey	7	29	Kansas	5.3
2	Rhode Island	7	30	Maine	5
2	Tennessee	7	30	Massachusetts	5
7	Minnesota	6.5	30	North Dakota	5
7	Nevada	6.5	30	Virginia	5
7	Washington	6.5	30	Wisconsin	5
10	Illinois	6.25	35	North Carolina	4.5
10	Texas	6.25	35	Oklahoma	4.5
12	Arkansas	6	37	Missouri	4.225
12	Connecticut	6	38	Alabama	4
12	Florida	6	38	Georgia	4
12	Idaho	6	38	Hawaii	4
12	Iowa	6	38	Louisiana	4
12	Kentucky	6	38	New York	4
12	Maryland	6	38	South Dakota	4
12	Michigan	6	38	Wyoming	4
12	Pennsylvania	6	45	Colorado	2.9
12	South Carolina	6		Alaska	NA
12	Vermont	6		Delaware	NA
12	West Virginia	6		Montana	NA
24	Utah	5.95		New Hampshire	NA
25	Arizona	5.6		Oregon	NA

Source: Tax Foundation

Among the states without gross receipts taxes, **South Dakota** is widely credited with having the broadest sales tax base. The table on page 6 confirms its robust base, and the table on page 7 underscores the tax's resulting productivity. South Dakota has a very low state tax rate (4%) and is limited in the extent to which it can export its sales tax burden to tourists and other non-residents. It does, however, tax many business purchases, including both business services and goods, such as farm and manufacturing machinery. These business-to-business transactions are not favored by most economists, but they unarguably help to explain the state's ability to generate \$898 per capita in sales tax revenues.

Such per capita revenues, with a state tax rate of only 4%, could be the envy of many other states. For example, **New York** has the same state rate and a high level of tourism, meaning it should be able to generate a fair amount of revenue from its sales tax. But it includes only 57 out of 162 services in its tax base and manages to generate just \$564 per capita. Many other states are similarly situated.

In this period of fiscal stress, states are experiencing serious erosion in their tax receipts, and there is no end in sight. Raising taxes in such an environment is not ideal—it tends to worsen their economic situations—but many analysts believe that tax increases are not as damaging as spending cuts. In any case, virtually every state is cutting spending, and many are now facing the need to look at tax increases. As they scan the horizon for options, expanding the sales tax base to include more services may have a certain appeal: it can level the playing field between goods and services, but more importantly, can improve the sales tax's yield without an increase in tax rates.

Technical Notes

Sales Taxes. The Rockefeller Institutes reports can be found at www.rockinst.org. Data on state and local tax collections can be found at the Census Bureau website, www.census.gov. The Tax Foundation compiles a wide variety of state-by-state tax data, available at www.taxfoundation.org. The Federation of Tax Administrators collects data on the number of services include in state tax bases. It is available at www.taxadmin.org.

State Policy Reports (ISSN #8750-6637) is published by Federal Funds Information for States (FFIS) at an annual subscription rate of \$420. Editor: Marcia Howard, 444 North Capitol Street, NW, Suite 642, Washington, DC 20001 (phone: 202-624-5848, fax: 202-624-7745, e-mail: mhoward@ffis.org, website: www.ffis.org). For ordering and subscription services, contact Carol Ryder at FFIS (phone: 202-624-5849, e-mail: ryder@ffis.org).

State Policy Reports
c/o Federal Funds Information for States
444 N. Capitol St., NW, Suite 642
Washington, DC 20001