Texas Public Policy Foundation

Taxes

Legislator's Guide to the Issues 2017-18

Personal Income Tax

The Issue

Although no one likes to pay taxes, they are an inevitable part of funding core government functions. A policymaker's challenge is to develop an efficient tax system that provides necessary revenue while doing the least economic harm. A policymaker should take care, however, as not all methods of raising revenue are created equal.

While each tax affects behavior and distorts choices differently, the personal income tax is among the most pernicious because of the negative effects it has on earnings, productivity, and wage gains. As a consequence of these adverse effects, people are generally not able to save and consume as much as they would have otherwise. What's more, a personal income tax requires a particularly large bureaucratic apparatus for tax collection purposes, much more so than for the collection of a sales tax. With more bureaucracy comes additional costs for taxpayers which results in higher taxes and fees.

The absence of a personal income tax is ideal for state lawmakers as there are other ways to raise revenue without incurring such harmful economic effects or enlarging the bureaucracy. And to its credit, Texas is one of only nine states without a personal income tax.

While some argue that a broad-based personal income tax is needed to improve the state's overall outlook, this raises the question: How has Texas' economy performed without a personal income tax?

Texas' state and local tax burden ranks 46th nationally, according to the Tax Foundation's latest report, placing it among the very best states for taxpayers. Because of the state's comparatively friendly tax environment, Texas' private sector economy has surged forward, outperforming the nation as a whole in a number of key areas, such as:

Nine States with the Lowest and Highest Marginal Personal Income Tax (PIT) Rates (10-Year Economic Performance)

	1/1/15	2004-2014	2005-2014	2004-2014	2004-2014	2004-2014	2002-2012
State	Top Marginal PIT Rate**	Population	Net Domestic Migration†	Non-Farm Payroll Employment	Personal Income	Gross State Product	State & Local Tax Revenue‡
Alaska	0.0%	11.7%	-2.9%	11.2%	65.5%	60.7%	318.8%
Florida	0.0%	14.2%	4.4%	4.6%	43.1%	31.8%	44.0%
Nevada	0.0%	21.0%	7.0%	5.4%	35.9%	27.7%	65.1%
South Dakota	0.0%	10.7%	2.8%	10.3%	57.4%	49.0%	57.2%
Texas	0.0%	20.4%	5.4%	21.7%	75.9%	78.6%	65.7%
Washington	0.0%	14.3%	4.3%	12.3%	54.5%	57.2%	50.8%
Wyoming	0.0%	14.7%	4.9%	14.6%	76.4%	86.4%	111.5%
New Hampshire^	0.0%	2.8%	-0.3%	3.3%	43.0%	34.6%	46.5%
Tennessee^	0.0%	10.8%	4.5%	4.0%	45.6%	36.3%	54.0%
Average of 9 No Income Tax States*	0.0%	13.4%	3.3%	9.7%	55.3%	51.4%	90.4%
50-State Average*	**5.6%**	**8.8%**	**0.7%**	**6.1%**	**48.4%**	**43.6%**	**63.0%**
Average of 9 Highest Income Tax States*	10.4%	6.8%	-2.1%	4.7%	44.3%	40.1%	58.4%
Kentucky	8.2%	6.4%	1.3%	3.9%	42.7%	38.7%	39.4%
Maryland	9.0%	7.7%	-2.5%	4.0%	42.1%	40.9%	52.0%
Vermont	9.0%	1.1%	-1.5%	2.3%	41.8%	31.4%	63.6%
Minnesota	9.9%	7.3%	-1.3%	4.9%	41.7%	36.4%	52.3%
New Jersey	10.0%	3.5%	-6.0%	-0.9%	36.5%	29.5%	55.5%
Oregon	10.6%	11.2%	5.1%	7.2%	46.7%	51.3%	64.3%
Hawaii	11.0%	11.5%	-2.6%	7.2%	52.9%	45.2%	74.8%
New York	12.7%	3.0%	-7.5%	7.4%	47.3%	47.2%	70.7%
California	13.3%	9.1%	-3.4%	6.3%	47.1%	40.6%	52.5%

** Equal-weighted averages.*
*** Top marginal PIT rate is the top marginal tax rate on personal earned income imposed as of 1/1/2015 using the tax rate of each state's largest city as a proxy for the local tax. The deductibility of federal taxes from state tax liability is included where applicable.*
† Net domestic migration is calculated as the ten-year (2005-2014) sum of net domestic in-migrants divided by the mid-year (2010) population.
‡ 2002-2012 due to Census Bureau data release lag.
^ Tennessee and New Hampshire tax interest and dividend income but not ordinary wage income.

Source: Laffer Associates, U.S. Census Bureau, Bureau of Labor Statistics and Bureau of Economic Analysis

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- Texas' economy grows faster than the national average. In 2014, Texas' real gross domestic product grew by 5.2%, more than twice as fast as the national average of just 2.4%;
- Texas creates jobs at a faster rate than the rest of the nation. From 2000 to 2015, average annualized nonfarm employment increased by 1.6% in Texas while the U.S. average increased by only 0.6%;
- Texas creates a large share of U.S. jobs since the Great Recession. Texas replaced the total civilian jobs lost during the recession by December 2009; however, the rest of the U.S. did not reach its pre-recession level until January 2015 and did not surpass Texas' job creation until November 2015; and
- Texas has had a lower unemployment rate than the U.S. average. From 2000 to 2015, Texas' average unemployment rate of 5.8% was lower than the U.S. average of 6.3%, and through March 2016, Texas' rate had been at or below the U.S. average for 110 consecutive months.

Research finds clear differences among the nine states without a personal income tax compared to the nine with the highest marginal personal income tax rates and the 50-state average. The table on page 1 shows that in every category examined the states without an income tax performed better than those with the highest income tax rates. In addition, the nine states without a personal income tax outperformed the national average in every category, often by a wide margin. Based on economic principles and empirical data, Texas' economic prospects for its citizens are best served by its current low tax, pro-growth approach rather than a new income tax.

The Facts

- Texas is one of nine states without a personal income tax.
- Personal income taxes substantially damage a state's economy because they discourage savings, investment, productivity, job creation, and economic expansion.
- The nine states without a personal income tax outperformed the nine states with the highest marginal income tax rates and the 50-state average in nearly every important economic area from 2004 to 2014.

Recommendations

- Never create a personal income tax in Texas.
- Encourage economic growth by keeping taxes low and adopting pro-growth reforms.

Resources

A Labor Market Comparison: Why the Texas Model Supports Prosperity by Vance Ginn, Texas Public Policy Foundation (Oct. 2015).

Rich States, Poor States by Arthur B. Laffer, Stephen Moore, and Jonathan Williams, American Legislative Exchange Council (Oct. 2015).

How Big Government Hurts the Economy by Chuck DeVore, Nicholas C. Drinkwater, Arthur B. Laffer, and Stephen Moore, Texas Public Policy Foundation (Nov. 2013).