2019-20

LEGISLATOR'S GUIDE to the Issues

Personal Income Tax

The Issue

Although no one likes to pay taxes, they are an inevitable part of funding government. A policymaker's challenge is to develop an efficient tax system providing necessary revenue while doing the least economic harm. A policymaker should note that not all methods of collecting taxes are created equal.

While each tax affects behavior differently, a personal income tax is among the most pernicious because of the negative effects it has on earnings, productivity, and wage gains. Because of these adverse effects, people are generally unable 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, resulting in higher taxes and fees.

No personal income tax is ideal for state lawmakers, as there are other ways to collect taxes without incurring such harmful economic effects or enlarging 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 an income tax?

Texas' state and local tax burden ranks fifth lowest nationally, according to the Tax Foundation's latest report, placing it among the best states for taxpayers. Because of the state's comparatively friendly tax environment, Texas' private sector economy has surged forward. For example, Texas' employers created the largest share of U.S. jobs with 25% of all civilian jobs created nationwide from December 2007 to December 2017. Given the best path to prosperity is a job, Texas is certainly doing something right.

Research also finds major 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 **chart** on the following page shows that in every category examined, the states without a personal income tax performed better than those with the highest income tax rates and, except for gross state product, the U.S. averages, often by a wide margin.

Based on economic principles and empirical data, Texas' economic prospects for its residents are best served by the current low tax, pro-growth approach rather than a new personal income tax.

The Facts

- Texas is one of nine states without a personal income tax.
- Income taxes substantially damage a state's economy because they disincentivize 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 50-state average in most economic areas 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

Do Institutions Matter for Prosperity in Texas and Beyond? by Vance Ginn, Texas Public Policy Foundation (Sept. 2018).

Rich States, Poor States by Arthur B. Laffer, Stephen Moore, and Jonathan Williams, American Legislative Exchange Council (April 2017).

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

continued

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

	As of 1/1/2017	10-Year Growth				
		2006-2016				2004-2014
State	Top Marginal Earned PIT Rate†	Population	Employment	Personal Income	Gross State Product	State & Local Tax Revenue‡
Alaska	0.00%	9.9%	3.1%	48.8%	13.5%	135.1%
Florida	0.00%	13.5%	7.5%	34.2%	24.2%	22.9%
Nevada	0.00%	16.5%	9.1%	27.4%	14.9%	38.0%
South Dakota	0.00%	10.5%	4.5%	50.9%	48.0%	55.9%
Texas	0.00%	19.3%	17.6%	62.3%	48.6%	68.7%
Washington	0.00%	14.4%	9.2%	51.6%	48.3%	50.2%
Wyoming	0.00%	12.0%	5.2%	43.1%	15.9%	54.7%
New Hampshire§	0.00%	2.0%	2.9%	36.0%	29.9%	41.7%
Tennessee§	0.00%	9.2%	3.7%	43.8%	37.6%	34.6%
Average of 9 Zero Earned Income Tax Rate States*	0.00%	11.9%	7.0%	44.2%	31.2%	55.7%
50-State Average*	**5.60%**	**7.9%**	**4.2%**	**41.0%**	**32.6%**	**51.3%**
Average of 9 Highest Earned Income Tax Rate States*	10.31%	5.6%	3.6%	38.6%	32.9%	53.1%
Hawaii	8.25%	9.1%	6.9%	42.7%	35.2%	68.4%
Maryland	8.95%	6.9%	6.5%	35.1%	36.3%	50.6%
Vermont	8.95%	0.3%	-3.0%	36.6%	27.9%	51.9%
Minnesota	9.85%	6.9%	4.0%	41.4%	34.0%	58.5%
New Jersey	9.97%	3.3%	1.5%	32.3%	25.0%	45.7%
Maine	10.15%	0.6%	-0.8%	30.0%	22.7%	25.7%
Oregon	10.64%	11.5%	9.5%	44.7%	38.7%	55.4%
New York	12.70%	3.4%	0.5%	40.8%	38.0%	63.8%
California	13.30%	9.0%	7.6%	44.1%	38.5%	57.7%

**averages are equal-weighted*

† Top Marginal PIT Rate is the top marginal rate on personal earned income imposed as of 1/1/2017 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.

‡ State & Local Tax Revenue is the 10-year growth in state and local tax revenue from the Census Bureau's State & Local Government Finances survey. Because of data release lag, these data are 2004 to 2014.

§ New Hampshire and Tennessee tax interest and dividend income—so-called "unearned" income—but not ordinary wage income. Tennessee's unearned income tax, the Hall Tax, is being phased out.

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

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