State Tax Cut Roundup

2014 Legislative Session

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Center for State Fiscal Reform

Tax and Budget Solutions for Economic Growth

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The ALEC Center for State Fiscal Reform strives to educate those who share a commitment to our principles and shared goals. We also strive to educate our legislative members on how to achieve greater economic prosperity by outlining which policies work and which ones fail. This is done by personalized research, policy briefings in the states, and by releasing nonpartisan policy publications for distribution such as *Rich States, Poor States, The Unseen Costs of Tax Cronyism: Favoritism and Foregone Growth, Tax Myths Debunked, Keeping the Promise: State Solutions for Government Pension Reform,* and the *State Budget Reform Toolkit*.

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Tax Reform in the States

The 2014 legislative session is coming to a close and a notable number of states have made significant changes to their tax codes. Pro-growth tax reform was a key theme throughout the 2014 legislative session. In this past legislative session, 14 states made significant pro-growth tax changes. The 7th edition of *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index* is a great guide to which tax and fiscal policies lead states to prosper and others to fall behind. Overall, the economic evidence strongly suggests that states with lower tax burdens and more economic freedom regularly outperform their higher tax and more restrictive counterparts.

Creating a tax and fiscal policy climate that is conducive to economic growth should be a top priority for every state. Hopefully, the example set by these reforms, and their economic results over time, will persuade other states to pursue pro-growth tax reform in the coming legislative session.

To be listed in the *ALEC State Tax Cut Roundup*, a state must meet all of the following criteria:

- Substantially cut taxes at the state level
- Vote(s) occurred during the 2014 legislative session
- Tax cuts must result in a net decrease in taxes over the legislative session
- Tax cuts must apply broadly and neutrally, or otherwise conforms the state closer to ALEC's Principles of Sound Tax Policy

Principles of Sound Tax Policy

The proper function of taxation is to raise money for core functions of government, not to direct the behavior of citizens or close budget gaps created by overspending. This is true regardless of whether government is big or small, and this is true for lawmakers at all levels of government.

Taxation will always impose some level of burden on an economy's performance, but that harm can be minimized if policymakers resist the temptation to use the tax code for social engineering, class warfare and other extraneous purposes. A principled tax system is an ideal way to advance a state's economic interests and promote prosperity for its residents.

The fundamental principles presented here provide guidance for a neutral and effective tax system; one that raises needed revenue for core functions of government, while minimizing the burden on citizens.

Simplicity:

The tax code should be easy for the average citizen to understand, and it should minimize the cost of complying with tax laws. Tax complexity adds cost to the taxpayer, but does not increase public revenue. For governments, the tax system should be easy to administer, and should help promote efficient, low-cost administration.

Transparency:

Tax systems should be accountable to citizens. Taxes and tax policy should be visible and not hidden from taxpayers. Changes in tax policy should be highly publicized and open to public debate.

Economic Neutrality:

The purpose of the tax system is to raise needed revenue for core functions of government, not control the lives of citizens or micromanage the economy. The tax system should exert minimal impact on the spending and decisions of individuals and businesses. An effective tax system should be broad-based, utilize a low overall tax rate with few loopholes, and avoid multiple layers of taxation through tax pyramiding.

Equity and Fairness:

The government should not use the tax system to pick winners and losers in society, or unfairly shift the tax burden onto one class of citizens. The tax system should not be used to punish success or to "soak the rich," engage in discriminatory or multiple taxation, nor should it be used to bestow special favors on any particular group of taxpayers.

Complimentary:

The tax code should help maintain a healthy relationship between the state and local governments. The state should always be mindful of how its tax decisions affect local governments so they are not working against each other – with the taxpayer caught in the middle.

Reliability:

A high-quality tax system should be stable, providing certainty in taxation and in revenue flows. It should provide certainty of financial planning for individuals and businesses.

Pro-Growth:

A low tax burden can be a tool for a state's private sector economic development by retaining and attracting productive business activity. A high-quality revenue system will be responsive to competition from other states. Effective competitiveness is best achieved through economically neutral tax policies.

These *Principles of Sound Tax Policy* have been adopted by the ALEC Task Force on Tax and Fiscal Policy. [1]

Tax Cuts by State

The *Rich States, Poor States Economic Outlook Ranking* is a forward-looking measure based on a state's standing in the equally weighted average of 15 important state policy variables. These variables include tax policy, regulatory policy, and labor policy. Data reflects state and local rates and revenues and any effect of federal deductibility. (1=Best, 50=Worst)[2]

Arizona

Rich States, Poor States 2014 Economic Outlook Ranking: 7

The 2014 legislative session resulted in several good tax policy changes in Arizona. First, the legislature passed a measure that exempts the purchase of electricity or natural gas from the state sales tax for manufacturers and smelters.[3] Exempting business inputs, such as energy costs, from taxation is an important piece of sound tax policy. Exempting business inputs from taxation prevents additional layers of taxes from being added on at every level of production, a practice economists refer to as "tax pyramiding." A study done by the Council on State Taxation (COST) has demonstrated that by eliminating the tax burden on business inputs, consumers only pay the true cost of the sales tax once, at the point of sale, rather than paying hidden costs that result from tax pyramiding when goods in the chain of production are taxed in addition to the final consumer product.[4]

State leaders in Arizona also passed another measure that requires a one-time inflation adjustment to the state's five income tax brackets. While it would be ideal to permanently index income tax brackets to inflation, any adjustment that factors in the very real burden of inflation to taxes is a welcome policy change.[5]

Florida

Rich States, Poor States 2014 Economic Outlook Ranking: 16

In 2014, Florida passed legislation reducing motor vehicle license renewal fees. Drivers will save between $20 and $25 each and around $395 million in total annually.[6] Though the cut does not change economic incentives in a pro-growth fashion, it puts more money in the pockets of Florida citizens. Moreover, since the revenue the so-called fee generated largely went to the state's general revenue pool and not to fund specific government activities directly related to the levy of the fee, the fee is better considered as a general tax. As such, Florida deserves credit for lowering a tax faced by almost all Floridians, given the prevalence of driving in the state.

Indiana

Rich States, Poor States 2014 Economic Outlook Ranking: 3

Indiana passed a substantial reform legislation to lower the state's business personal property tax and the state's corporate business tax. Business personal property taxes are taxes on business capital, such as machinery and other equipment, while corporate income taxes are levied on corporate profits. All told, the legislation is expected to save Indiana job creators $185 million per year once the bill is fully implemented.[7]

The tax cut package will lower the corporate rate down to 4.9 percent by the end of the phase-in, and offers new exemptions for the business personal property tax directed at lowering the burden of the tax on businesses. Both taxes harm business and their employees—corporate by taxing the productive activities of business and business personal property tax by taxing business investment capital. The result of both taxes is to reduce the incentive for business expansion and hiring. Indiana's reduction in both taxes amounts to a substantial improvement in economic competitiveness and the state remains on the right track as they consider additional tax reforms in the coming legislative session.[8]

Kansas

Rich States, Poor States 2014 Economic Outlook Ranking: 15

Ever since a major tax overhaul in 2012, Kansas has been synonymous with fundamental tax reform. The 2014 legislative session is no exception to this excellent record. This time homebuyers were the recipients of a tax relief measure that phases out the state's mortgage registration fees. The measure will gradually phase-out the mortgage registration fees over the next five years. Once the measure is fully phased in, taxpayers in some counties are estimated to save about $2 million to $3.7 million.[9] This means that homebuyers that borrow money to buy a house will no longer be penalized for that decision through specific taxation. Like Florida's reduction in vehicle license renewal fees, Kansas deserves credit for reducing a fee for which the revenues fund general purposes of government rather than specific government activities related to the fee.

Maryland

Rich States, Poor States 2014 Economic Outlook Ranking: 34

After years of tax increases, Maryland took steps in 2014 to improve their estate tax by passing legislation that gradually increases the tax's general exemption from $1 million in assets up to match the federal exemption, which is currently $5.34 million and indexed to increase with inflation.[10] Although Maryland policymakers would have done better for their citizens by following in the footsteps of Indiana, Kansas, North Carolina, Ohio, Oklahoma and Tennessee, which have all ended their estate taxes in recent years, the step is still quite important for Maryland citizens.

As we have noted in our research and analysis, estate taxes are antiquated taxes "associated with huge costs and bad incentives, taking in almost no revenue, and without rational justification."[11] The exemption will reach full parity with the federal exemption by 2019, when the federal exemption is projected to be $5.9 million.

Michigan

Rich States, Poor States 2014 Economic Outlook Ranking: 12

Michigan took major steps to improve its tax policy environment for small business in 2014 by reforming the state's business personal property tax. Business personal property taxes are levied on business capital, such as machinery and other equipment. Given that these taxes fall on the value of business capital, they deter business investment into machines and equipment that improve business productivity. As such, business personal property taxes are a major drag on economic growth.

Michigan began the process of phasing out this harmful tax in 2012, but took additional measures in 2014 to improve and accelerate that phase-out, as well as to address concerns with local government revenue shortfalls created by the phase-out.[12] The legislation was first voted on the state legislature and then went to a general ballot referendum vote in the August 5th election. Voters approved the measure, certified as proposal 1, by a 69 percent to 31 percent margin.[13] The legislation creates new exemptions for business personal property, along with other tweaks to the business personal property tax code. All told, the net effect of the legislation is a tax cut worth $500 million for Michigan small businesses.[14]

Given that business capital investment generally allows businesses to improve their bottom lines while hiring more workers and/or improving worker wages, the reforms are a major pro-growth step. Coming on the heels of previous business personal property tax cuts, the repeal of the harmful Michigan Business Tax, and the passage of right-to-work legislation, Michigan continues its recent trend of pro-growth public policy reforms.

Minnesota

Rich States, Poor States 2014 Economic Outlook Ranking: 46

After major tax hikes in 2013, Minnesota passed several pro-growth tax changes in the 2014 legislative session. These include the repeal of three business taxes: one on the repair of electronic, farm, and commercial equipment; one on warehousing and storage; and one on telecommunications equipment. Some of the key provisions are eliminating the marriage penalty, eliminating business-to-business taxes, eliminating the gift tax, and raising the threshold for the estate tax from $1 million to $2 million.[15]

Overall, the tax cuts are estimated to save Minnesotans a total $443 million in the 2014-2015 fiscal year and $956 million in the 2015-2016 fiscal year.[16] However, it should be noted that these tax cuts follow $2.1 billion in tax hikes enacted during the 2013 legislative session.[17] Minnesota would do well to continue cutting taxes to get back to where they were prior to the tax hikes and become more competitive in a region where the competition for jobs, people and capital is particularly fierce.

Missouri

Rich States, Poor States 2014 Economic Outlook Ranking: 24

A tax cut proposal that almost landed Missouri a spot in the *2013 State Tax Cut Roundup* made a comeback in the 2014 legislative session. An income tax measure was passed by the Missouri Legislature in 2013 but was vetoed by Governor Jay Nixon. That veto was sustained by a narrow margin during the 2013 veto override session. Undaunted, proponents of pro-growth tax reform revised the 2013 proposal and re-introduced a similar measure this legislative session. The tax cut measure was again vetoed by Governor Nixon, but this time, the Legislature was able to override the veto.

For the first time in nearly 100 years, Missourians will enjoy a broad based income tax cut. The measure gradually phases down the state's income tax rate from the current 6 percent down to 5.5 percent over the next several years. It also includes a phased-in provision that allows pass-through businesses to deduct up to 25 percent of their non-wage income from taxation, similar, although less generous, to what Kansas had passed in 2012. Overall the tax cut will result in $620 million remaining with Missourians once it is fully phased-in.[18]

However, there are a few important caveats to an otherwise very positive tax change. First, the tax cuts will not begin until 2017 and will not be fully phased-in until 2022. Also, the tax cuts will not take effect unless aggressive revenue targets are met. The revenue required to trigger a tax cut is $150 million more than the highest point in the last three years.[19] Even with these tough requirements, a tax cut that keeps more money in the pockets of Missouri citizens and businesses is a strong step in the right direction.

Nebraska

Rich States, Poor States 2014 Economic Outlook Ranking: 35

For the second consecutive year, Nebraska has made pro-growth changes to its tax code that make the state more competitive while also setting the stage for much more comprehensive reform. The 2014 legislative session concluded with the passage of a measure indexing income tax brackets to inflation, ensuring that Nebraskans will not pay a higher amount in real dollars due to inflation.[20] Another pro-growth tax change was the exemption of repair and replacement of agricultural equipment from sales taxes.[21] These tax cuts, in addition to a few other small changes, add up to about $412 million in income, property, and sales tax cuts over the next five years.[22]

Both of these changes were recommended by the state's Tax Modernization Committee, which released findings late last year. The same commission estimated that Nebraska could accommodate as much as $500 million in tax relief over the next three years.[23] These estimates and the past couple years of cleaning up the tax code puts Nebraska in a perfect spot to tackle more fundamental tax reform in the near future.

New York

Rich States, Poor States 2014 Economic Outlook Ranking: 50

For years, New York has lost income and businesses to other states, as former New Yorkers leave in search of much needed tax relief. In fact, in the most recent edition of *Rich States, Poor States,* New York ranked dead last. However, the Empire State enacted pro-growth corporate tax reform measures as a part of this year's budget. For example, the four brackets in the corporate tax structure are reduced to three, and then finally two over time. The corporate tax rate drops from 7.1 percent to 6.5 percent.[24]

The budget also eliminates the state's onerous individual add on minimum tax. The estate tax exemption will recouple with the federal level estate tax over time, and the generation skipping transfer tax is also eliminated.[25] This year's budget also included a property tax freeze credit that reimburses qualifying New York homeowners for increases in local property taxes for the next two years. In order for New York homeowners to qualify, schools and municipalities must develop a plan to cut the property tax levy, and also stay within the property tax cap.[26] While there were some anti-growth measures in the budget, these pro-growth reforms represent positive steps towards a more competitive tax code in New York and the significance of these bold reforms in the state of New York should not be overlooked.

Ohio

Rich States, Poor States 2014 Economic Outlook Ranking: 23

Ohio continued their streak of pro-growth tax reform in the 2014 legislative session by accelerating the scheduled income tax rate cut for all brackets from what would have been a 9 percent cut in 2014 to a 10 percent cut in 2014. They had previously scheduled for the 10 percent rate cut to occur in 2015. Their top marginal rate is now 5.33 percent. Additionally, for tax year 2014, the personal income tax deduction on small business income in Ohio will be increased to 75 percent of the first $250,000 in net business income. (Under current law, the deduction does not affect the school district income tax base).[27]

Oklahoma

Rich States, Poor States 2014 Economic Outlook Ranking: 21

Oklahoma was the only state to make it into the 2013 *Tax Cut Roundup* based on the passage of income tax cuts only to be later removed due to a state supreme court decision. The court ruled that a tax measure reducing the state's personal income tax was void because the same bill also included provisions to repair the state capitol which violated the state's single subject rule on legislation.[28]

Despite this setback, Oklahoma leaders came together to pass a similar personal income tax cut package in the 2014 legislative session. The measure will reduce Oklahoma's top income tax rate from its current 5.25 percent down to 5 percent as early as 2016 if certain revenue triggers are met. Once the rate is at 5 percent, another round of revenue triggers are set to reduce the top tax rate further to 4.85 percent. Once fully phased-in, these changes are expected to save taxpayers about $250 million each year, which is estimated to translate to a savings of $135 per year for each taxpayer.[29]

Rhode Island

Rich States, Poor States 2014 Economic Outlook Ranking: 41

After years of having significantly higher taxes than the national average, Rhode Island is proving that it should not be counted out in the competition for economic growth. The Ocean State passed a pair of pro-growth tax reform proposals that will significantly improve its economic outlook. One measure was an increase of the exemption for the state's estate tax. The exemption was increased to $1.5 million from its current $922,000, giving families and small businesses filing through the personal income tax code a break from this onerous tax. This measure is estimated to save taxpayers up to $18 million by the 2015-2016 budget year when it is fully phased-in.[30]

Rhode Island also enacted a corporate income tax cut. The rate will drop to 7 percent from its current 9 percent rate. Despite this pro-growth change, the corporate income tax cut also includes implementing combined reporting requirements. Meaning corporations will now have to report taxable income to Rhode Island from all subsidiaries or affiliated businesses under common ownership, which will significantly raise the tax bill of some Rhode Island businesses.[31]

Wisconsin

Rich States, Poor States 2014 Economic Outlook Ranking: 17

Wisconsin began the 2014 legislative session with a significant budget surplus of $911 million. This surplus funded a major tax relief package that substantially reduced several of the state's taxes to the tune of $800 million. These include a $406 million cut in property taxes, a $98.6 million cut in income taxes, and a $322.6 million adjustment to state income tax withholding. The property tax cut is more than four times larger than Wisconsin's previous property tax cut and would reduce the typical homeowner's bill by $101.[32] The income tax cut reduced the state's lowest income tax bracket from 4.4 percent to 4 percent and are estimated to save a family earning $40,000 per year about $58 while the changes to withholding are estimated to save the average taxpayer about $520 for the year 2014. These reforms come as a complement to significant tax cuts in 2013 and add to a total tax reduction of about $2 billion since Governor Scott Walker took office.[33]

Trends in State Tax Reform

After experiencing some of the most fundamental state level tax reforms in the 2013 legislative session, it was no surprise that 2014's state level tax reforms were slightly more modest. However, we still saw significant tax reform in the 2014 legislative session and many of the states that made this year's roundup were states where tax reform was not expected.

One major state tax trend this legislative session was a mixture of both traditionally blue and red states cutting their taxes and improving their tax codes. Indeed, the 2014 tax changes in the states were a particularly bipartisan effort. This is evident from a number of traditionally blue-leaning states cutting corporate income taxes and raising exemptions for estate taxes.

New York, the state that ranked dead last in the most recent edition of *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index*, and Rhode Island are two states that successfully cut corporate income tax rates in 2014. New York reduced its corporate income tax for 2015 to 6.5 percent from the previous 7.1 percent.[34] Rhode Island reduced its corporate income tax rate to 7 percent from 9 percent, although the reduction included switching to a combined reporting method of tax collection that could result in some Rhode Island companies paying higher tax bills.[35] While their corporate income tax rates still remain some of the highest in the nation, the realities of increasingly mobile capital and businesses seem to be sinking in.

TABLE 7 | **The Eight States with the Lowest and the Highest Marginal Corporate Income Tax (CIT) Rates**

10-Year Economic Performance

State	2014	2003-2013					2001-2011
	Top Marginal CIT Rate**	Population	Net Domestic Migration†	Non-Farm Payroll Employment	Personal Income	Gross State Product	State & Local Tax Revenue‡
Nevada	0.00%	24.1%	9.1%	8.0%	44.9%	46.2%	66.7%
South Dakota	0.00%	10.6%	2.6%	10.2%	62.3%	63.0%	50.9%
Wyoming	0.00%	15.7%	5.6%	16.2%	76.8%	113.5%	121.1%
Texas	2.65%	20.1%	4.5%	19.5%	74.1%	81.7%	63.3%
Ohio	3.62%	1.2%	-3.1%	-2.7%	35.0%	32.6%	28.2%
Alabama	4.23%	7.3%	2.1%	1.5%	44.5%	42.4%	45.1%
North Dakota	4.53%	13.2%	4.3%	33.5%	118.6%	149.4%	169.3%
Colorado	4.63%	16.3%	5.0%	10.6%	54.1%	51.3%	60.7%
Avg. of 8 Lowest Corporate Income Tax Rate States*	2.46%	13.6%	3.8%	12.1%	63.8%	72.5%	75.7%
50-State Avg.*	**7.08%**	**9.1%**	**0.8%**	**5.9%**	**51.3%**	**51.0%**	**56.5%**
Avg. of 8 Highest Corporate Income Tax Rate States*	11.81%	7.2%	-0.9%	5.1%	48.8%	51.6%	75.1%
Alaska	9.40%	13.4%	-2.1%	12.9%	62.6%	84.7%	232.8%
Illinois	9.50%	2.6%	-4.8%	-0.2%	38.2%	35.6%	45.4%
Minnesota	9.80%	7.3%	-1.1%	4.5%	45.7%	42.8%	46.5%
Iowa	9.90%	5.0%	-0.6%	6.2%	58.9%	54.8%	54.1%
Delaware	10.41%	13.2%	4.7%	2.9%	43.7%	38.1%	53.5%
Oregon	11.25%	10.8%	4.3%	6.4%	47.9%	71.4%	53.3%
Pennsylvania	17.05%	3.2%	-0.5%	2.3%	43.3%	40.3%	50.3%
New York	17.16%	2.5%	-7.5%	6.1%	49.8%	45.2%	64.7%

*Equal-weighted averages

**Top marginal CIT rate is the top marginal rate on corporate income imposed as of 1/1/14 using the tax rate of each state's largest city as a proxy for local taxes. In the case of gross receipts, margins, or business franchise taxes, a comparable tax rate is derived. See the appendix for details. The deductibility of federal taxes from state tax liability is included where applicable.

†Net domestic migration is calculated as the ten-year (2004-2013) sum of net domestic in-migrants divided by the mid-year (2009) population.

‡2001-2011 due to Census Bureau data release lag.

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

These corporate tax reductions come on the heels of corporate income tax rate cuts in 2013. North Carolina, as part of a much larger tax code overhaul, lowered its corporate income tax rate from 6.9 percent to 6 percent in 2014, 5 percent in 2015, with the possibility of the rate dropping to 4 percent in 2016 and 3 percent in 2017 if certain revenue targets are achieved. Texas, which does not levy a corporate income tax on businesses, but instead utilizes the more economically damaging margin tax, lowered the amount that state businesses must pay in the 2013 legislative session by raising the deduction for businesses paying the margin tax to $1 million in revenue. The result was a cut of more than $1 billion in taxes for state businesses. New Mexico was another highlight of the 2013 *Tax Cut Roundup*. Republican Governor Susana Martinez reached a deal with the state's Democratic legislature to reduce the state's corporate income tax to 5.9 percent from 7.6 percent.[36]

Corporate income taxes are an extremely important piece of state tax policy. A recent report from the Council on State Taxation noted that in FY2013 more than $53.3 billion was collected in state and local corporate income taxes.[37] The tax burden on businesses can make or break new and growing businesses, affecting their success and location. As noted in the chart above, from 2003 to 2013 the eight states with the lowest corporate income taxes experienced a cumulative job growth rate of 12.1 percent, more than double the 5.1 percent experienced by the eight states with the highest corporate income taxes over the same time period. This trend continues in the categories of net domestic migration, gross state product growth, and growth in personal income.[38]

Another interesting trend from the 2014 legislative session was a substantial number of states reducing the burden of their estate or inheritance taxes. Here again, New York and Rhode Island enacted reforms to reduce their estate taxes. They were joined by Maryland and may also be joined by New Jersey in the very near future. New York is phasing in a recoupling of the state's estate tax exemption to the federal exemption which is currently at $5.34 million (indexed to inflation) by 2019 and immediately raising the exemption from the current $1 million to $2 million.[39] Rhode Island raised its estate tax exemption from $922,000 to $ 1.5 million beginning at the end of calendar year 2014. It will also only tax estate income above $1.5 million, eliminating the "cliff" where the tax is levied on the entire estate once the income exemption is met or exceeded.[40]

Maryland is also raising its estate tax exemption over time to match the federal exemption. The exemption will rise from its current $1 million to $1.5 million in 2015 and continue to gradually rise until it is matched with the federal exemption by 2019.[41] Ongoing budget discussions in New Jersey also show a likely chance of achieving an increased estate tax exemption. While it remains unclear which plan, if any, will ultimately be enacted, almost all the plans will raise New Jersey's estate tax exemption higher than its current $675,000 threshold.[42]

Estate and inheritance taxes, also known as death taxes, are among the most economically damaging of taxes. More than half of businesses in the United States are pass-through entities, meaning they file taxes under the personal income tax code.[43] Most of these pass through entities are small businesses. This means that many family businesses are subject to paying state death taxes. These estates are taxed on the value of assets, including equipment, machinery, and land. This is especially an issue for family farms that might have a large value in terms of assets, namely land, but are taxed as if they are completely liquid. This leads to many family businesses being broken up because of their death tax bill.

Additionally, the amount of revenue that state death taxes typically bring in is extremely low. As the chart below demonstrates, Pennsylvania is the state that raises the most revenue from its estate tax and it only accounts for 2.4 percent of the total state revenue.[44]

State	Total Death and Gift Tax Revenue	Percent of Total State Revenue	Number Days Death and Gift Tax Funds State Govt. Operations
Connecticut	$227,237,000	1.7%	6.2 days
Delaware	$16,229,000	0.5%	1.8 days
Hawaii	$6,899,000	0.1%	0.4 days
Illinois	$122,241,000	0.3%	1.1 days
Iowa	$65,535,000	0.9%	3.3 days
Kentucky	$41,351,000	0.4%	1.5 days
Maine	$49,323,000	1.3%	4.7 days
Maryland	$216,033,000	1.3%	4.7 days
Massachusetts	$309,638,000	1.4%	5.1 days
Minnesota	$161,309,000	0.8%	2.9 days
Nebraska	$1,551,000	Less than 0.1%	0.1 days
New Jersey	$642,182,000	2.3%	8.4 days
New York	$1,219,248,000	1.8%	6.6 days
Oregon	$76,250,000	0.9%	3.3 days
Pennsylvania	$778,597,000	2.4%	8.8 days
Rhode Island	$21,127,000	0.7%	2.6 days
Vermont	$35,880,000	1.3%	4.7 days
Washington	$122,740,000	0.7%	2.5 days

Source: Governing Institute and Census Bureau

Rather than taxing estates that have already been taxed at some point (and occasionally at a few points) states should focus on creating a tax policy environment that promotes economic growth.

The Impact of Taxes on Economic Growth

Creating a tax and fiscal policy climate that is conducive to economic growth ensures that the economic pie is growing for everyone. People, businesses, and even government revenues benefit when people are free to save and invest more of their money. Taxes fundamentally create a barrier between work and reward, and while tax revenue is needed to fund the core functions of government, the tax system should burden people and businesses as little as possible.

But not all taxes are equally damaging to the economy. According to the Organization for Economic Cooperation and Development (OECD)[45], taxes on capital and income are the most economically damaging, while taxes on consumption and property are less economically damaging. The economic history of tax systems in the states is a helpful guide for states striving to achieve a higher level of economic growth. States that rely primarily on income taxes routinely underperform their counterparts who choose not to levy taxes on personal income.

TABLE 6 | The Nine States with the Lowest and Highest Marginal Personal Income Tax (PIT) Rates

10-Year Economic Performance

State	2014	2003-2013					2001-2011
	Top Marginal PIT Rate**	Population	Net Domestic Migration†	Non-Farm Payroll Employment	Personal Income	Gross State Product	State & Local Tax Revenue‡
Alaska	0.00%	13.4%	-2.1%	12.9%	62.6%	84.7%	232.8%
Florida	0.00%	15.0%	5.1%	4.8%	50.1%	37.0%	50.3%
Nevada	0.00%	24.1%	9.1%	8.0%	44.9%	46.2%	66.7%
South Dakota	0.00%	10.6%	2.6%	10.2%	62.3%	63.0%	50.9%
Texas	0.00%	20.1%	4.5%	19.5%	74.1%	81.7%	63.3%
Washington	0.00%	14.2%	3.8%	10.6%	55.2%	57.3%	48.6%
Wyoming	0.00%	15.7%	5.6%	16.2%	76.8%	113.5%	121.1%
Tennessee^	0.00%	11.1%	4.4%	3.3%	48.0%	39.2%	50.2%
New Hampshire^	0.00%	3.4%	0.2%	3.7%	43.6%	35.0%	54.5%
Avg. of 9 No Income Tax States*	0.00%	14.2%	3.7%	9.9%	57.5%	61.9%	82.0%
50-State Avg.*	**5.66%**	**9.1%**	**0.8%**	**5.9%**	**51.3%**	**51.0%**	**56.5%**
Avg. of 9 Highest Income Tax States*	10.39%	6.8%	-2.0%	4.3%	47.8%	47.0%	54.3%
Kentucky	8.20%	6.8%	1.4%	3.0%	44.7%	42.4%	38.9%
Maryland	8.95%	7.9%	-2.4%	4.4%	48.9%	48.9%	52.2%
Vermont	8.95%	1.4%	-1.1%	2.3%	45.7%	38.8%	63.5%
Minnesota	9.85%	7.3%	-1.1%	4.5%	45.7%	42.8%	46.5%
New Jersey	9.97%	3.5%	-5.6%	-1.0%	40.5%	34.6%	57.6%
Oregon	10.62%	10.8%	4.3%	6.4%	47.9%	71.4%	53.3%
Hawaii	11.00%	12.2%	-2.4%	8.8%	61.0%	54.9%	57.6%
New York	12.70%	2.5%	-7.5%	6.1%	49.8%	45.2%	64.7%
California	13.30%	8.7%	-3.7%	4.1%	46.0%	43.5%	54.0%

*Equal-weighted averages

**Top marginal PIT rate is the top marginal tax rate on personal earned income imposed as of 1/1/2014 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 (2004-2013) sum of net domestic in-migrants divided by the mid-year (2009) population.

‡2001-2011 due to Census Bureau data release lag.

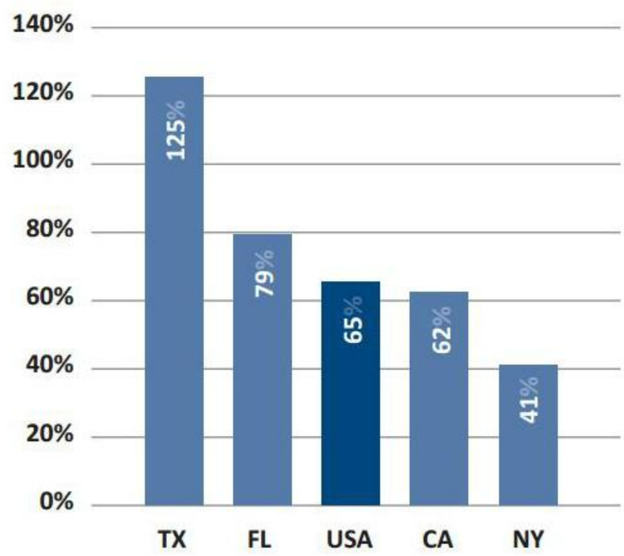
^Tennessee and New Hampshire tax interest and dividend income but not ordinary wage income.

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

As shown above, the nine states that do not levy a personal income tax experienced a cumulative job growth rate of 9.9 percent from 2003 to 2013 while the nine states with the highest personal income tax rates experienced less than half of that at just 4.3 percent over the same time period. The no income tax states also experienced much better rates of net domestic migration, personal income growth, and gross state product growth than their high tax counterparts.[46]

Another example of this disparity is the shocking divide in personal income growth among the four largest US states. By population, California, Texas, New York, and Florida are the four largest states and account for about one third of the entire United States population. Both Texas and Florida choose not to tax personal income whatsoever, while California and New York have the two highest personal income taxes in the nation at 13.3 percent and 12.7 percent respectively. The results of this natural experiment are clear. Both Texas and Florida have experienced much higher rates of personal income growth from 1990 to 2014.[47]

Figure 6 | **Growth in Real Personal Income**
(1990-2014)



Source: Federal Reserve Bank of St. Louis, Federal Reserve Economic Data (FRED), and Bureau of Economic Analysis

The statement "taxes negatively affect economic growth" is almost universally agreed upon by mainstream economists, even if the degree to which this is true enjoys less consensus. A Tax Foundation survey of peer-reviewed studies on the relationship between taxes and economic growth found that of 26 peer-reviewed studies since 1983, 23 found a negative relationship between taxes and economic growth. It is also worth noting that the three studies that did not find a negative relationship between taxes and economic growth found no measureable positive relationship.[48]

Christina Romer, formerly head of President Obama's Council of Economic Advisors, and her husband David Romer, have found similar results. Their study found that every 1 percent increase in taxation lowers real GDP by 2 to 3 percent. They also found that corporate income taxes were the most damaging to economic growth, followed by personal income taxes, and finally consumption taxes.[49]

While the academic and empirical results show that lower taxes contribute to higher rates of economic growth, there are always some that will not be convinced. Fortunately, economic reality factors into state tax policy and has led to 15 states cutting taxes in 2014 and is likely to lead to more tax reductions in the future.

Conclusion

States are on the forefront of breaking down barriers to economic growth. The federal government is in constant gridlock while the laboratories of democracy are actively pursuing real reforms. Increasingly, tax reform is becoming a bipartisan effort in the states and the result has been 15 more states reducing the tax burden in the 2014 legislative session. While these states have moved in the right direction, as have many others in the past few years, there are still many reforms that states can enact to maximize their potential for economic growth.

There is a competition for people, income, and capital among the states. Whenever a state enacts a tax policy change (good or bad), it affects other states in the country and especially in the region. Some are leading the pack while others trail behind, but the success or failure of a tax policy reform reverberates not just within that state, but throughout the other 49. Fortunately, states need not compete blindly. Economic history provides a clear guide to what states can do to foster economic growth. States with lower tax burdens and more economic freedom are the clear leaders over the high tax states. This lesson is being picked up by more states every year, and that fact should be a rallying call for states to stop letting archaic tax systems hold them back from achieving their true economic potential.

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