

The State of State (and Local) Tax Policy

How do state and local sales taxes work?

SPECIFIC STATE AND LOCAL TAXES

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Q. How do state and local sales taxes work?

A. Forty-five states and the District of Columbia levy general sales taxes that apply (with some exemptions) to all goods and certain services. Thirty-seven states (including, Alaska, which has no state tax) also allow general sales taxes at the local level. Most states apply separate sales taxes to particular goods, including tobacco, alcohol, and motor fuels.

HOW MUCH REVENUE DO STATE AND LOCAL GOVERNMENTS RAISE FROM SALES TAXES?

States rely on sales taxes more than local governments do. States collected \$441 billion from sales taxes in 2016, or 35 percent of own-source state general revenue (table 1). "Own-source" revenue excludes intergovernmental transfers. Nearly two-thirds (\$291 billion) of that total came from general sales taxes, while the other one-third (\$150 billion) came from selective sales taxes (or excise taxes) on tobacco, alcohol, and the like. Local governments collected \$118 billion from sales taxes in 2016, or 11 percent of local government own-source general revenue. Of that total, \$85 billion came from general sales taxes and \$32 billion came from selective sales taxes. (Census includes the District of Columbia's revenue in the local total.)

Nevada relied on sales tax revenue more than any other state in 2016, with sales and selective sales taxes accounting for 46 percent of combined state and local own-source general revenue. Sales and selective sales

TABLE 1

State and Local Sales Tax Revenue 2016



	General Sales Tax		Selective Sales Tax		Total Sales Tax	
	Revenue (billions)	Percentage of own source general revenue	Revenue (billions)	Percentage of own source general revenue	Revenue (billions)	Percentage of own source general revenue
State and local	377	16	182	8	559	24
State	291	23	150	12	441	35
Local	85	8	32	3	118	11

Source: Urban-Brookings Tax Policy Center, "State and Local Finance Initiative Data Query System."

Note: Own-source general revenue does not include intergovernmental transfers.

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taxes also represented 30 percent or more of combined state and local revenue in Arizona, Arkansas, Florida, Hawaii, Louisiana, New Mexico, South Dakota, Tennessee, Texas, and Washington. Among the states with a general sales tax, Massachusetts (15 percent of revenue) relied least on sales and selective sales tax revenue as a percentage of combined state and local own-source revenue.

Every state and the District of Columbia collected some revenue from selective sales taxes in 2016. The average revenue from these taxes was 8 percent of state and local own-source general revenue, but 17 states collected 10 percent or more from selective sales taxes. Nevada's 17 percent from selective sales taxes was the highest revenue share of any state, while Wyoming's 4 percent was the lowest.

HOW DO GENERAL SALES TAX RATES DIFFER ACROSS STATES?

Among states with general sales taxes, Colorado has the lowest rate (2.9 percent) (figure 1). No other state with a general sales tax has a rate below 4.0 percent, but the state general sales tax rate is 4.0 percent in Alabama, Georgia, Hawaii, New York, and Wyoming. In addition to California, four states (Indiana, Mississippi, Rhode Island, and Tennessee) have rates at or above 7.0 percent. Alaska, Delaware, Montana, New Hampshire, and Oregon have no state general sales taxes.

Thirty-seven states (including Alaska, which has no statewide tax) allow local governments to impose their own general sales taxes. The maximum sales tax rates levied by local governments range from 0.5 percent in Hawaii to 8 percent in Colorado.

WHAT PURCHASES ARE SUBJECT TO THE GENERAL SALES TAX?

General sales taxes typically apply to most tangible goods. One notable exception is food purchased for use at home: only 13 states tax such purchases, and 6 of these states tax food at a lower rate than their general sales tax rate. Five of the 13 states that tax food for home consumption provide income tax credits to low-income residents to help offset the tax. In contrast, food bought for immediate consumption at restaurants is taxed in most states, and sometimes at a higher rate than the general sales tax rate.

Many states also exempt prescription and nonprescription drugs, textbooks, and clothing from general sales taxes. Some states have sales tax holidays, periods in which specific purchases—for example, clothes and school supplies right before the start of a new school year—are sold tax-free.

The taxation of services (e.g., dry cleaning, carpentry work, barbershops) is more complicated. All states tax some services, but exemptions are common. Very few states tax professional services, such as doctors and lawyers. Hawaii and New Mexico are exceptions to that rule, taxing nearly all services.

DO SALES TAXES APPLY TO ONLINE PURCHASES?

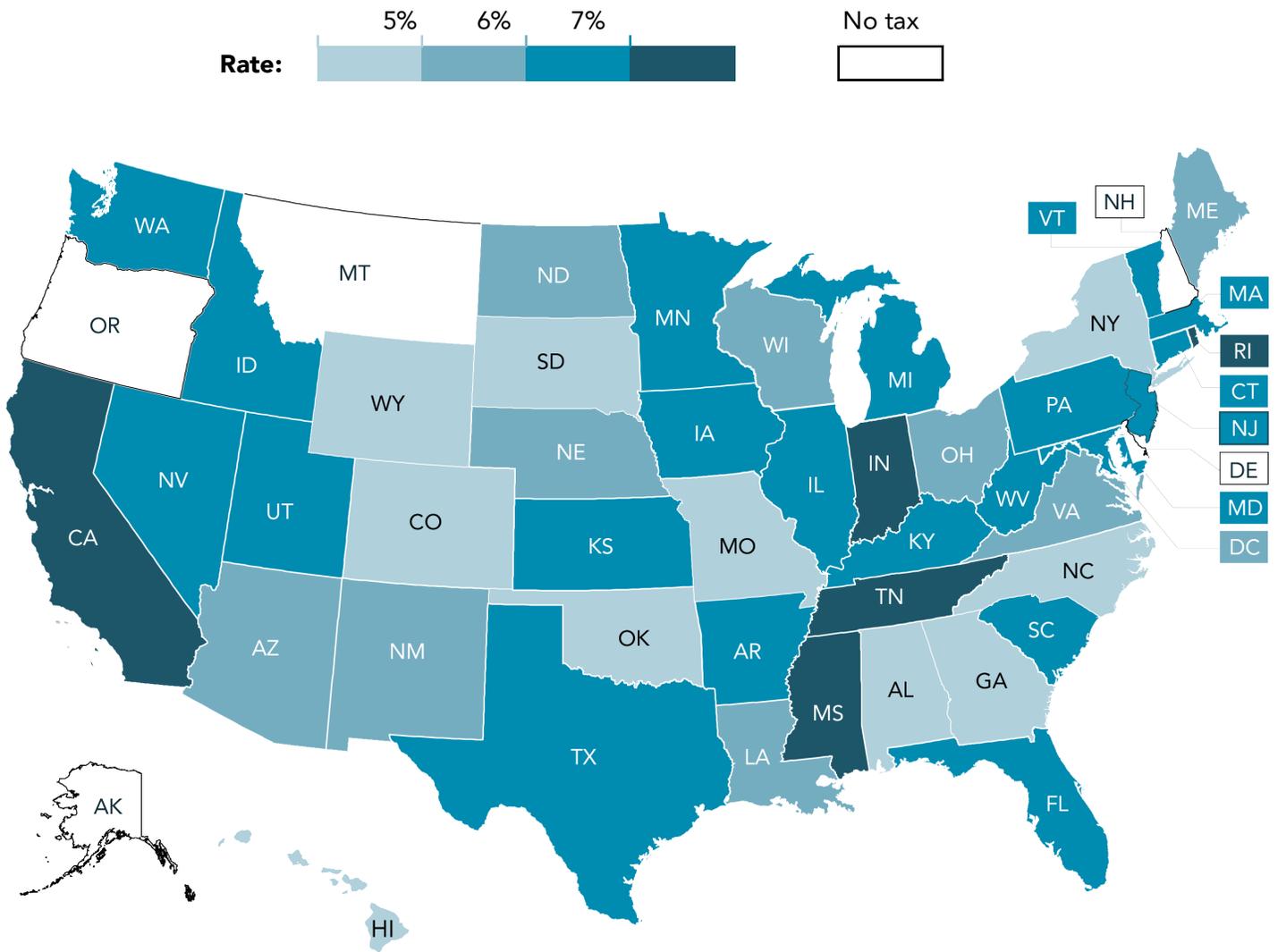
The treatment of online and other remote sales (e.g., catalog sales) is complex. In 1992, the Supreme Court ruled (*Quill Corp. v. North Dakota*) that under the commerce clause of the US Constitution, a retailer with no physical presence in the online purchaser's state of residence (technically called a "nexus" requirement) is not required to collect a state or local sales tax from the consumer.

However, the Supreme Court revisited this issue in 2018 in *South Dakota v. Wayfair, Inc.*, overturned *Quill*, and gave states broad authority to collect the tax. The Supreme Court upheld a South Dakota law requiring any entity with sales of \$100,000 or more or with at least 200 transactions in South Dakota to collect and

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FIGURE 1
State General Sales Tax Rates
 2018



Source: Federation of Tax Administrators, "State Sales Tax Rates and Food & Drug Exemptions (As of January 1, 2018)."

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remit the state's sales tax. Other states have quickly begun enacting similar laws.

Taxing online sales is not completely new, though. Many large retailers had already begun voluntarily collected the tax even before *Quill*. Most notably, Amazon has collected taxes in every state with a general sales tax since April 2017.

Further, states levy use taxes in addition to sales taxes. Consumers are subject to use taxes on goods purchased outside their state for use in their home state—if they did not pay a sales tax. This includes online purchases. The use tax rate is the same as the sales tax rate, but few consumers know it exists and actually pay it. Many states with both a sales tax and an individual income tax (such as California, Kentucky, Virginia, and Utah) give taxpayers a chance to declare liability and pay use taxes on their income tax returns.

WHAT TAXES DO STATES LEVY ON TOBACCO, ALCOHOL, AND MOTOR FUELS?

All states levy “selective” sales taxes—with different rates than the general sales tax—on some goods and services. Three of the best known are taxes on cigarettes (and other tobacco products), alcohol, and motor fuels. Those products are also subject to a federal tax. For cigarettes and alcohol, the taxes are sometimes called sin taxes because one purpose of the tax is to discourage consumption. Marijuana and soda are also increasingly taxed by states and localities.

Tobacco Taxes

Cigarette taxes are typically levied per pack. Missouri has the lowest rate (17 cents per pack) and Connecticut and New York have the highest (\$4.35). In six states (Alabama, Illinois, Missouri, New York, Tennessee, and Virginia), some local governments levy an additional cigarette tax. Local cigarette tax rates range from 1 cent per pack in Alabama and Tennessee to \$4.18 per pack in Chicago (a Cook County tax of \$3.00, plus a city tax of \$1.18).

Some states and cities levy their general sales taxes on the prices of cigarettes inclusive of the excise tax, while others include the general sales tax in the excise tax rate. Taxes are also levied on other tobacco products, including cigars and loose tobacco. There is new discussion about whether other nicotine delivery devices such as e-cigarettes should be taxed. The District of Columbia, California, Kansas, Louisiana, Minnesota, and North Carolina have already passed such taxes. State and local governments collected \$18 billion in revenue from tobacco taxes in 2016.

Alcohol Taxes

Alcohol taxes are generally paid at the wholesale level, so the cost is incorporated into the retail price. The excise taxes are levied per gallon (not as a percentage of the price), and beer, wine, and distilled spirits have different tax rates. In addition to the excise tax, many states also levy a general sales tax on the final purchase price of alcohol, and some states and cities have special sales tax rates for alcohol.

Some states, such as New Hampshire and Pennsylvania, collected most of their revenue from government-run liquor stores instead of traditional alcohol taxes, generating revenue through various fees, price mark-ups, and net profits. In total, 21 states collected revenue from government-owned liquor stores. State and local governments collected \$16 billion in revenue from alcohol in 2015—\$7 billion from alcohol taxes and \$9 billion from government-owned liquor stores.

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Motor Fuel Taxes

Motor fuel taxes are typically per gallon taxes. That is, consumers pay tax based on how much gas they purchase, not as a percentage of the final retail price of gasoline. However, 20 states and the District of Columbia tie at least a portion of their gasoline tax rate to the retail price. The lowest gasoline tax rate is in Alaska (8.95 cents per gallon) and the highest is in Pennsylvania (57.6 cents per gallon).

States earmark much of their motor fuel tax revenue for transportation spending, which has meant funding gaps for transportation as gasoline has recently stagnated. States are considering options like tying the gas tax rates to inflation or population, taxing based on price, and taxing miles traveled instead of gas (as more drivers use hybrid or electric cars). State and local governments collected a combined \$44 billion in revenue from motor fuel taxes in 2015.

Some cities (e.g., Boston, San Francisco, and Washington, DC) also have special tax rates for specific goods and services (e.g., restaurant meals, hotel accommodations, rental cars, and parking) that are higher than their general sales tax rates. These higher tax rates are often designed to collect a significant share of their revenue from visitors, who use and benefit from city services and presumably have less political clout than local voters.

Data Sources

Urban-Brookings Tax Policy Center. "[State and Local Finance Initiative Data Query System](#)."

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Further Reading

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