

The State of State (and Local) Tax Policy

How do state and local individual income taxes work?

SPECIFIC STATE AND LOCAL TAXES

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Q. How do state and local individual income taxes work?

A. Forty-one states and the District of Columbia levy broad-based taxes on individual income. New Hampshire and Tennessee tax only individual income from dividends and interest. Seven states do not tax individual income of any kind. Local governments in 13 states levy some type of tax on income in addition to the state income tax.

State governments collected \$344 billion from individual income taxes in 2016, or 27 percent of state own-source general revenue (table 1). "Own-source" revenue excludes intergovernmental transfers. Local governments—mostly concentrated in Maryland, New York, Ohio, and Pennsylvania—collected just \$33 billion from individual income taxes, or 3 percent of their own-source general revenue. (Census includes the District of Columbia's revenue in the local total.)

TABLE 1

State and Local Individual Income Tax Revenue 2016



	Revenue (billions)	Percentage of own-source general revenue
State and local	\$376	16%
State	\$344	27%
Local	\$33	3%

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

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

Forty-one states and the District of Columbia levy a broad-based individual income tax. New Hampshire taxes only interest and dividends, and Tennessee taxes only bond interest and stock dividends. (Tennessee is phasing its tax out and will completely eliminate it in 2022.) Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not have a state individual income tax.

For combined state and local revenue, Maryland relied the most on the individual income tax in 2016, with the tax accounting for 29 percent of its revenue. The District of Columbia and nine states—California, Connecticut, Kentucky, Massachusetts, Minnesota, Montana, New York, Oregon, and Virginia—also collected 20 percent or more of their own-source revenue from individual income taxes in 2016.

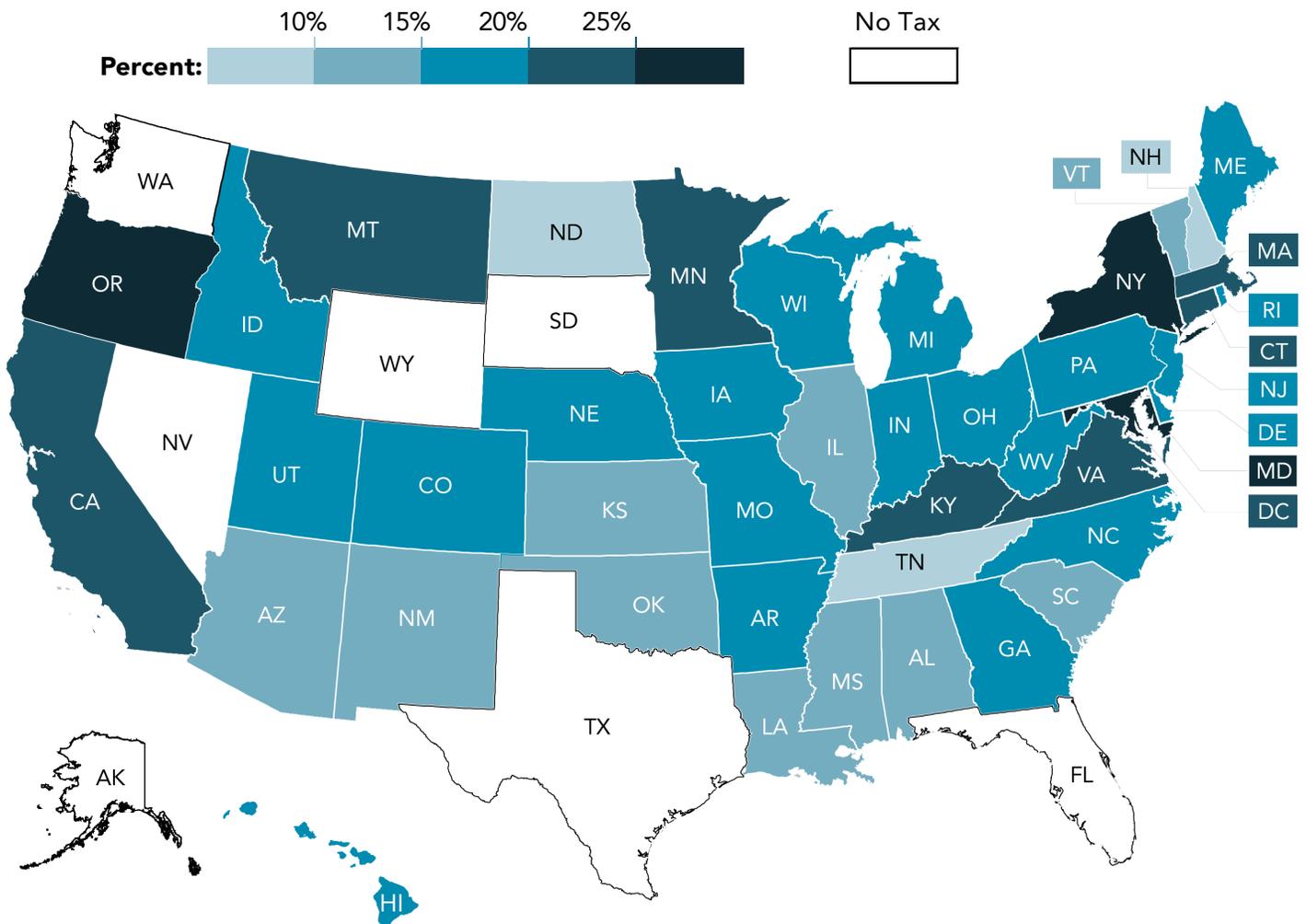
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North Dakota's 5 percent of revenue from individual income taxes was the least of any state with a broad-based individual income tax. In every other state with a broad-based income tax, the tax provided at least 10 percent of own-source general revenue. New Hampshire and Tennessee, which levy a far more limited individual income tax, each collected about 1 percent of own-source revenue from their taxes.

FIGURE 1

Individual Income Tax as a Percentage of State and Local Own-Source General Revenue
2016



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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Local governments levy their own individual income taxes in 13 states. Localities in Indiana, Iowa, Maryland, and New York levy an individual income tax that piggybacks on the state tax. That is, local taxpayers in these states file their local tax on their state tax return and receive state deductions and exemptions when paying the local tax. Michigan localities also levy an individual income tax but use local forms and calculations.

Meanwhile, localities in Alabama, Delaware, Kansas, Kentucky, Missouri, Ohio, Oregon, and Pennsylvania levy an earnings or payroll tax. These taxes are separate from the state income tax. Earnings and payroll taxes are typically calculated as a percentage of wages, withheld by the employer (though paid by the employee) and paid by individuals who work in the taxing locality, even if the person lives in another city or state without the tax. Separately, localities in Kansas only tax interest and dividends (not wages).

In 2016, individual income taxes as a percentage of own-source local revenue ranged from less than 1 percent in Kansas and Oregon to 26 percent in Maryland. Local governments in Kentucky, Ohio, and Pennsylvania also collected more than 10 percent of own-source revenue from individual income taxes (or payroll taxes) in 2016.

WHAT INCOME IS TAXED?

The individual income tax base in most states is similar to the federal tax base. Most states start with federal adjusted gross income but a few start with federal taxable income (which is adjusted gross income minus certain deductions and exemptions). Alternatively, a handful of states use their own definition of income, but even these states rely heavily on federal rules when establishing their tax base.

Even the states that start with the federal tax base, however, often apply different rules for certain types of income. For example, unlike the federal government, states often tax municipal bond interest from securities issued outside that state, and many allow a full or partial exemption for pension income. In many states, but not all, taxpayers who itemize their federal tax deductions and claim deductions for state and local taxes cannot deduct those income taxes from their state income tax.

The 2017 Tax Cuts and Job Act created a new federal deduction for pass-through business income (income earned by sole proprietors, partnerships, and certain corporations). As such, states that use federal taxable income as their tax base had to decide whether to conform with the new federal deduction or establish separate treatment of pass-through income. For example, Idaho accepted the deduction as a part of its tax system while Oregon decoupled and rejected it. Critically, the deduction will not apply to state income taxes in states that use federal adjusted gross income, unless states pass legislation to adopt it.

Ohio already exempted a portion of pass-through business income from its income tax. Kansas exempted all pass-through income from its tax in 2012, but after budget problems it reversed course and ended the exemption in 2017.

HOW DO INDIVIDUAL INCOME TAX RATES VARY ACROSS STATES?

Most state income taxes are fairly flat, even in those states that apply graduated rates. Eight states impose a single tax rate on all income, while Hawaii has the most with 11 tax brackets. Top marginal rates for state income tax in 2018 ranged from 2.9 percent in North Dakota to 13.3 percent in California—including a 1 percent surcharge on incomes over \$1 million (figure 2).

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In some states with multiple tax brackets, the top tax bracket often begins at a low taxable income. Alabama, for example, has three rates, but the top tax bracket applies to taxable income over \$3,000, making it essentially a flat tax. In other states, the difference between the lowest and the highest tax rates is small: about 2 percentage points in Arizona and Mississippi, for example.

While most states in the 1980s followed the federal government's lead in reducing the number of income tax brackets, some have increased the number of rates since then. California and New York have imposed new brackets (often called millionaire's taxes) for high-income taxpayers. California approved a millionaire's tax in 2004 that adds 1 percentage point to the rate applied to incomes over \$1 million, and further increased the progressive bracket structure with another ballot measure in 2012. Similarly, New York's top tax rate of 8.82 percent applies to income above about \$1 million.

At the start of 2018, California, Hawaii, Minnesota, and Oregon had top rates above 9 percent and another eight states had top income tax rates above 7 percent.

HOW DO STATES TAX CAPITAL GAINS AND LOSSES?

Eleven states and the District of Columbia treat capital gains and losses the same as under federal law. They tax all realized capital gains, allow a deduction of up to \$3,000 for net capital losses, and permit taxpayers to carry over unused capital losses to subsequent years. However, most states tax capital gains at the same rate as ordinary income, while the federal government provides a preferential rate.

New Hampshire fully exempts capital gains, and Tennessee taxes only capital gains from the sale of mutual fund shares. Arizona exempts 25 percent of long-term capital gains, and New Mexico exempts 50 percent. Massachusetts has its own system for taxing capital gains, while Hawaii has an alternative capital gains tax. Pennsylvania and Alabama only allow losses to be deducted in the year that they are incurred, while New Jersey does not allow losses to be deducted from ordinary income.

The remaining 25 states that tax income generally follow the federal treatment of capital gains, with the exception of various state-specific exclusions and deductions.

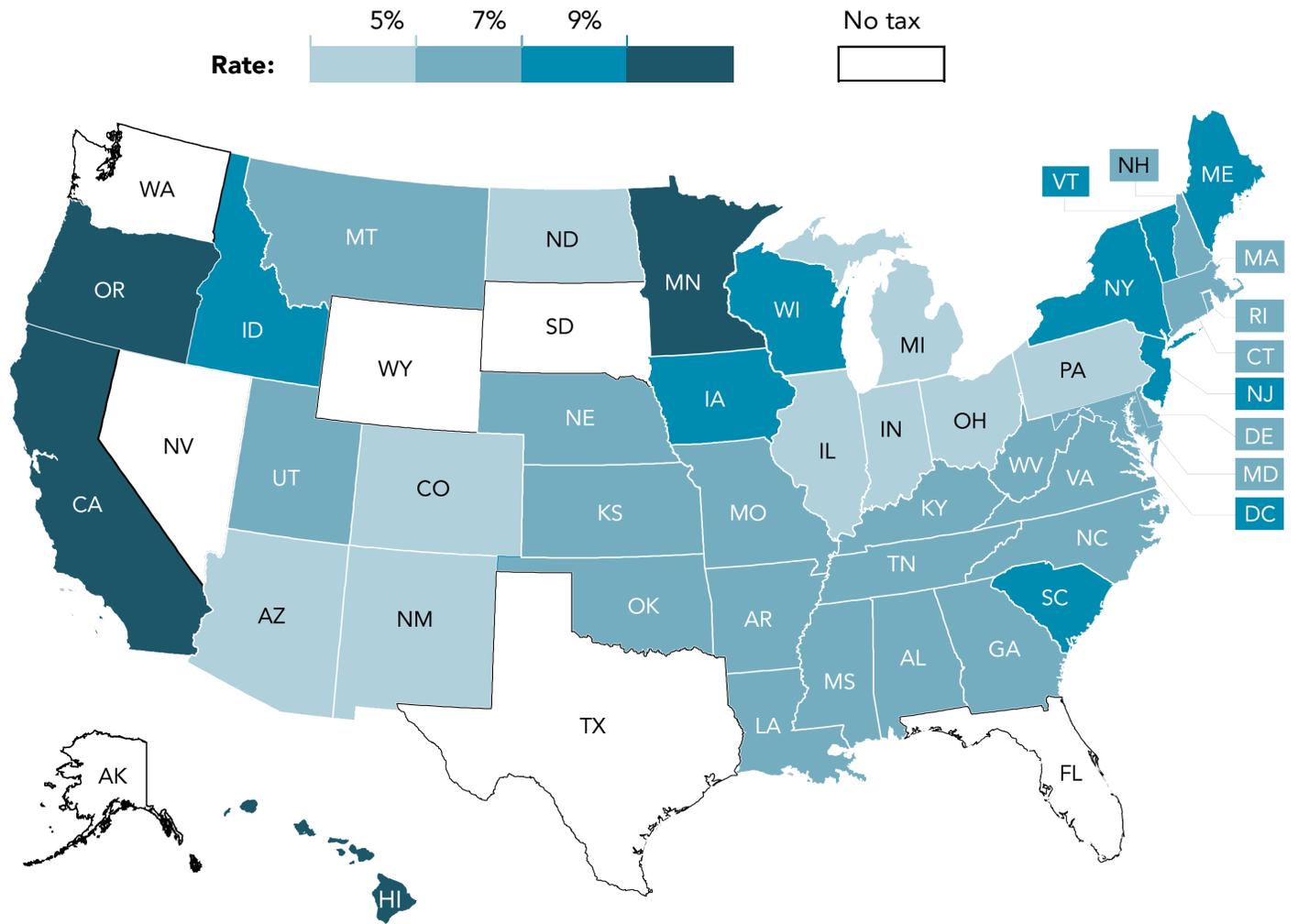
HOW DO STATES TAX INCOME EARNED IN OTHER JURISDICTIONS?

A state income tax is generally imposed by the state in which the income is earned and not the state where the earner lives. Some states, however, have entered into reciprocity agreements with other states that allow outside income to be taxed in the state of residence. For example, Maryland's reciprocity agreement with DC allows Maryland to tax income earned in the District by a Maryland resident. As of 2010, 15 states and DC had adopted reciprocity agreements with specific states. Typically, these are states with major employers close to the border and large commuter flows in both directions.

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FIGURE 2
Top State Individual Income Tax Rates
 2018



Source: Federation of Tax Administrators, "State Individual Income Taxes (Tax Rates for Tax Year 2018—as of January 1, 2018)."

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Data Sources

Federation of Tax Administrators. "[State Individual Income Taxes \(Tax Rates for Tax Year 2018—as of January 1, 2018\)](#)."

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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?

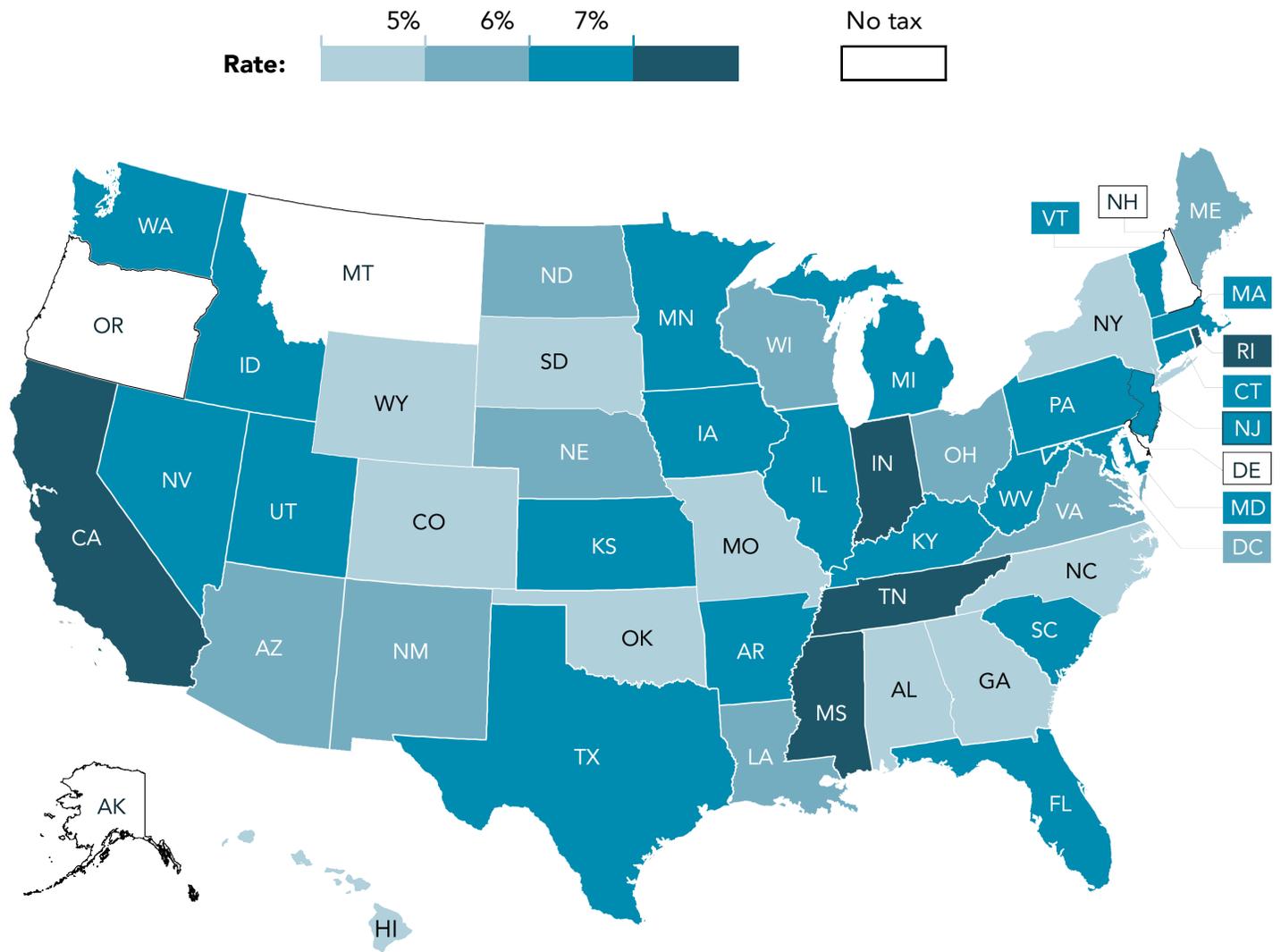
The treatment of online and other remote sales (e.g., catalog sales) is complex. In 1992, the Supreme Court ruled (*Quill Corp. v. North Dakota*) that under the commerce clause of the US Constitution, a retailer with no physical presence in the online purchaser's state of residence (technically called 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.

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Q. How do state and local property taxes work?

A. Jurisdictions in all 50 states and the District of Columbia impose property taxes. Most property tax revenue comes from local levies on land and improvements to it, but some states also tax personal property (such as machinery, equipment, and motor vehicles). The tax equals a percentage of the taxable value of the property and may be levied in some form at every level of government: state, county, municipal, township, school district, and special district.

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

While property taxes are a significant source of local government revenue, they are a very small revenue source for most states (table 1). State governments levied property taxes in 36 states in 2016, collecting \$16 billion in revenue, or 1 percent of own-source state general revenue. (Own-source revenue excludes intergovernmental transfers.) Meanwhile, local governments collected \$487 billion from property taxes in 2016, or nearly half of their own-source general revenue.

Property taxes are the largest own-source of revenue for counties, cities, townships, school districts, and special districts, which are specific-purpose units, such as water and sewer authorities. School districts rely quite heavily on property taxes, collecting \$181 billion in 2012, which was 82 percent of their own-source general revenue. Because school districts receive substantial intergovernmental transfers, own-source revenue makes up less than half (about 45 percent) of their total general revenue. (Census only releases data for these specific local jurisdictions in years that end in 2 or 7.)

TABLE 1

State and Local Property Tax Revenue 2016



	Revenue (billions)	Percentage of own source general revenue
State and local	\$503	22%
State	\$16	1%
Local	\$487	47%

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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IN WHICH STATES ARE PROPERTY TAXES MOST IMPORTANT?

New Hampshire, which has neither a broad-based income tax nor a general sales tax, was the most reliant on property taxes in 2016, with property tax revenue accounting for 47 percent of its combined state and local own-source general revenue. Property taxes also contributed more than 30 percent of state and local revenue in Connecticut, Maine, New Jersey, Rhode Island, and Vermont. Alabama was the least reliant on property tax revenue in 2016, with only 10 percent of its combined state and local own-source general revenue coming from the tax. Arkansas, Delaware, Hawaii, Kentucky, Louisiana, New Mexico, North Dakota, Oklahoma, and West Virginia also collected less than 15 percent of combined state and local revenue from property taxes (figure 1).

Looking only at local governments, property taxes provided more three-quarters of own-source general revenue in Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, and Rhode Island in 2016. Alabama's local governments received 19 percent of their own-source revenue from property taxes, the lowest percentage in any state.

At the state level, Vermont's property taxes contributed 27 percent of state own-source general revenue in 2016, far and away the highest percentage in any state. Nearly all of Vermont's education spending is financed at the state level, and the state property tax is the largest source of that funding. The next-highest percentage was in Wyoming, where property taxes were 11 percent of state own-source general revenue. Wyoming's revenue is relatively high in part because the state levies its tax on mineral production.

Property taxes were also 5 percent or more of state own-source revenue in Arizona, Arkansas, Kansas, Michigan, Montana, New Hampshire, and Washington. State property taxes are often on personal property and taxes on land that is used for utilities. Fourteen states did not levy a state-level property tax.

HOW MUCH DO PROPERTY TAX RATES DIFFER ACROSS THE COUNTRY?

Effective property tax rates differ widely across and within states, making them difficult to compare. In addition to variation in statutory tax rates, local governments use various methods to calculate their real property tax base.

The taxing jurisdiction typically assesses the real property value by estimating what the property would sell for in an arms-length transaction. However, some jurisdictions base value on the last sale price or acquisition value of the property, others consider the income that a property could generate (for example, an empty lot that could be used for a hotel), and some base the assessment solely on the size or physical attributes (e.g., design, location) of the property. There is also variation in the timing of assessments, with some jurisdictions assessing annually and others less frequently.

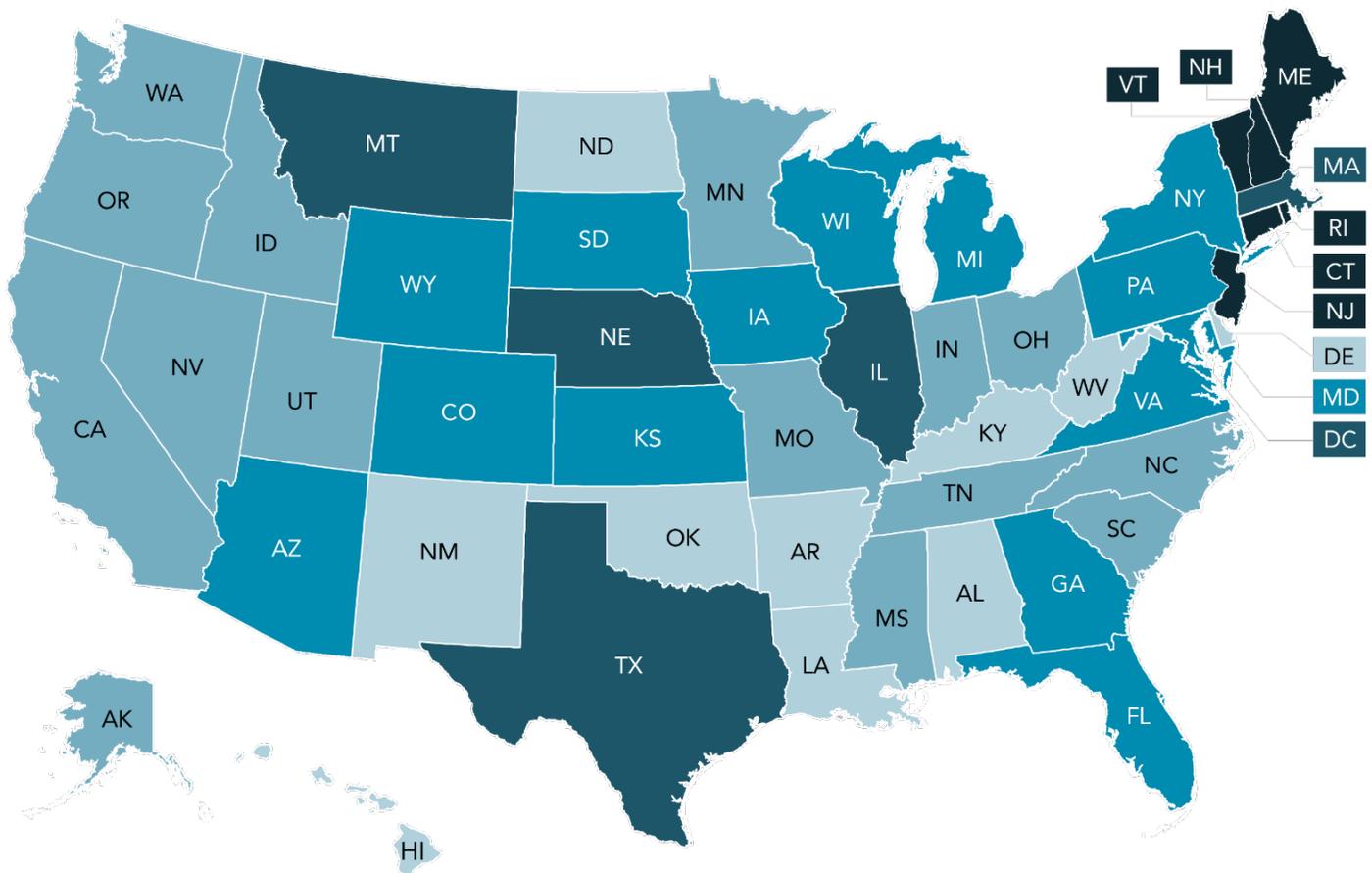
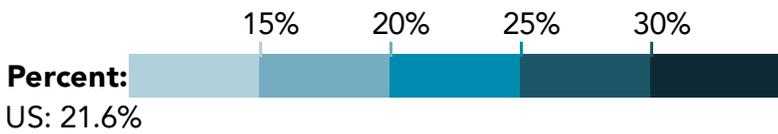
Some jurisdictions tax the entire assessed value of the property (before deductions and credits). Others tax only a fraction of the assessed value. For example, counties in South Carolina tax only 4 percent of a property's assessed value. Jurisdictions may impose different statutory tax rates ("classifications") for different types of property, most commonly distinguishing between residential and business property.

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FIGURE 1

Property Tax Revenue as a Percentage of State and Local Own-Source General Revenue
2016



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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HOW DO STATES LIMIT PROPERTY TAXES?

Many states have imposed limits on property tax rates, property tax revenue, or increases in assessed property values, reducing reliance on the property tax as a source of revenue. California, for example, limits the tax rate to 1 percent and annual assessment increases to 2 percent until a property is resold. As a result, neighbors with similar houses may have dramatically different tax liabilities depending on when their houses last changed hands.

States and local governments also often use limits, exemptions, deductions, and credits to lower tax liability. Here are some examples:

- Assessment limits prevent a property's assessed value from increasing by more than a fixed percentage between assessments. These limits can reduce a property's assessed value below its market value and prevent rapid property value increases from raising the owner's tax burden. When the property is sold, its assessed value is reset at market value.
- Homestead deductions and exemptions decrease the taxable value of real property by a fixed amount (much the same way a standard deduction decreases taxable income) for owners who occupy the property. Forty-one states and the District of Columbia have homestead exemptions that reduce the fraction of the assessed property value subject to tax.
- Circuit breaker programs provide relief for elderly and low-income residents with property tax liabilities above a specified percentage of their income. Although relief is based on property tax payments, it is typically provided via an income tax credit. In most states, the state government collects income tax while local jurisdictions collect property tax, making circuit breakers a type of subsidy from state to local governments. Unlike the other approaches described here, circuit breakers benefit renters as well as homeowners in some jurisdictions. According to the Lincoln Institute of Land Policy, 33 states and the District of Columbia offer some form of circuit breaker program. In 22 of these states and the District of Columbia, renters are eligible for a circuit breaker program (some states offer multiple programs for different types of residents).
- Property tax deferrals allow elderly and disabled homeowners to defer payment until the sale of the property or the death of the taxpayer.

Data Sources

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Q. How do state and local corporate income taxes work?

A. Forty-four states and the District of Columbia levy corporate income taxes. Ohio, Nevada, Texas, and Washington tax corporate gross receipts. South Dakota and Wyoming had no corporate income tax or gross receipts tax in 2016.

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

State and local governments raise a small share of revenue from corporate income taxes (table 1). States collected \$46 billion from corporate income taxes in 2016, or 4 percent of state own-source general revenue. (Own-source revenue excludes intergovernmental transfers.) Local governments collected \$8 billion from corporate income taxes in 2016, or 1 percent of own-source revenue. Census includes the District of Columbia's \$500 million of revenue in the local total. The local total is low partly because only seven states allowed localities to levy a corporate income tax. Among them, New York (and mostly New York City) was responsible for 86 percent of all corporate income tax revenue collected by local governments.

TABLE 1

State and Local Corporate Income Tax Revenue 2016



	Revenue (billions)	Percentage of own source general revenue
State and local	\$54	2%
State	\$46	4%
Local	\$8	1%

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

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

At the state level, New Hampshire collected 16 percent of state own-source general revenue from corporate income taxes in 2016, the highest share of any state. New Hampshire does not have a broad-based individual income tax or general sales tax. Corporate income taxes were also more than 5 percent of state own-source revenue in Delaware, Illinois, Massachusetts, and Tennessee. Among the 44 states with a corporate income tax, the lowest percentage was in Hawaii, Louisiana, and New Mexico, which all collected only 1 percent of revenue from the tax.

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WHAT INCOME IS TAXED?

Most states use the federal definition of corporate income as a starting point. However, states deviate from federal rules in some instances. For example, when the federal government enacted “bonus depreciation” in 2008, which allowed businesses to deduct a larger portion of capital investment in the year the investment is first made, many states did not enact conforming rules. Many states will again have to decide if they want to conform or decouple from several corporate income tax provisions in the recently passed Tax Cuts and Jobs Act.

While states benefit from federal tax administration and enforcement by following the federal definition of corporate income, they must take additional steps to determine what portion of multistate corporation income is taxable in their states.

States must first establish whether a company has “nexus” in the state, that is, enough physical or economic presence to owe income tax. Next, they must determine the taxable income generated by activities in the state. For example, multistate companies often have subsidiaries in no-tax or low-tax states that hold intangible assets such as patents and trademarks. The rent or royalty payments to those wholly owned subsidiaries may or may not be considered income of the parent company operating in another state. Finally, states must determine how much of a corporation’s taxable income is properly attributed to that state.

Until recently, most states used a three-factor formula based on the Uniform Division of Income for Tax Purposes Act to determine the portion of corporate income taxable in the state. That formula gave equal weight to the shares of a corporation’s payroll, property, and sales in the state. In the last 20 years, however, states have moved toward formulas that either weight more heavily or rely exclusively on sales within the state to apportion income. By using the portion of a corporation’s sales rather than employment or property to determine tax liability, states hope to encourage companies to relocate or to expand their operations within these states.

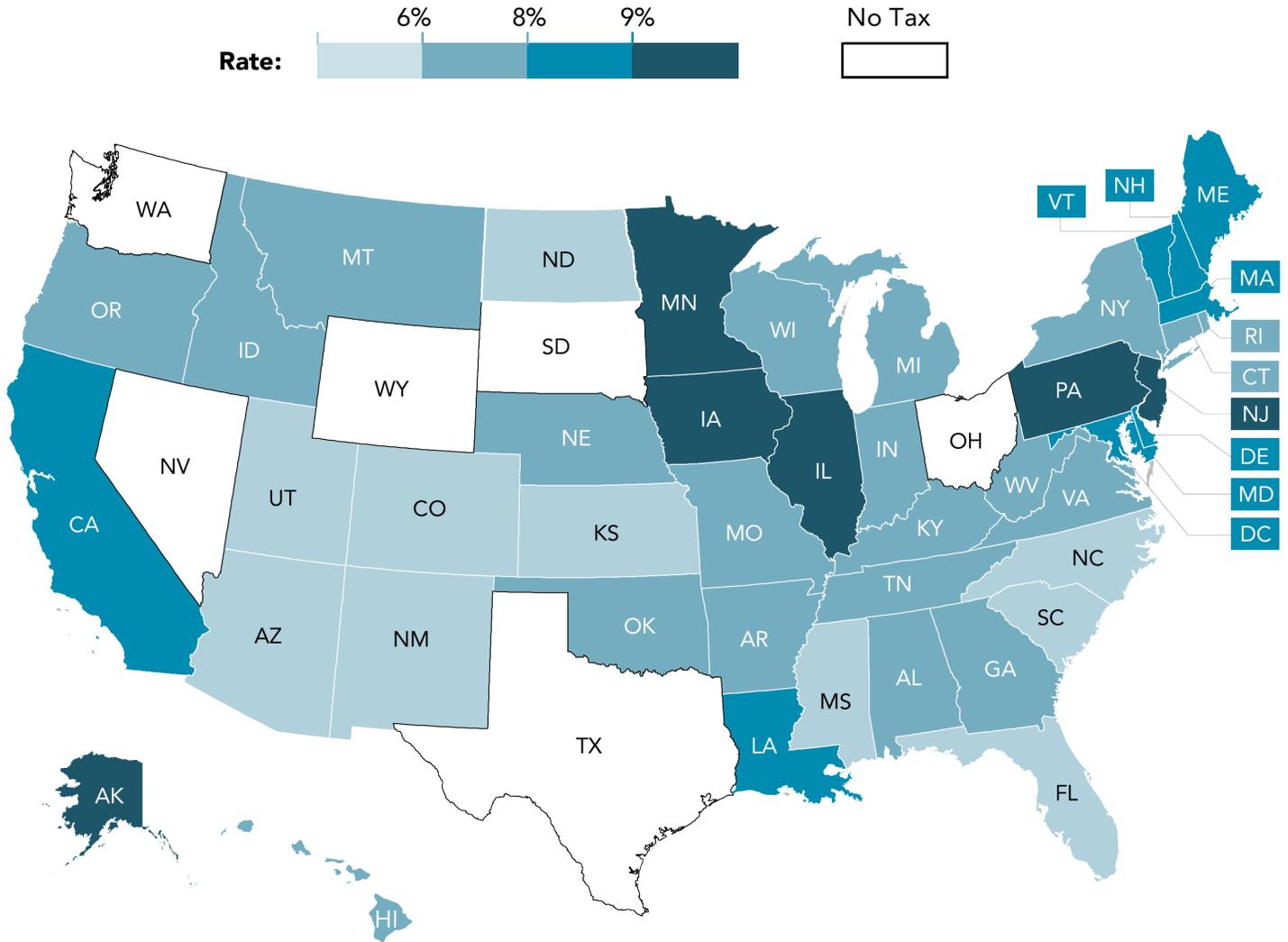
HOW MUCH DO CORPORATE INCOME TAX RATES DIFFER ACROSS STATES?

In 2018, top corporate income tax rates ranged from 3 percent in North Carolina to 12 percent in Iowa (figure 1). Six states (Alaska, Illinois, Iowa, Minnesota, New Jersey, and Pennsylvania) had top corporate income tax rates at or above 9.0 percent. Ten states (Arizona, Colorado, Florida, Kansas, Mississippi, New Mexico, North Carolina, North Dakota, South Carolina, and Utah) had top rates below 6.0 percent.

The State of State (and Local) Tax Policy

How do state and local corporate income taxes work?

FIGURE 1
Top State Corporate Income Tax Rates
 2018



Source: Federation of Tax Administrators.

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The State of State (and Local) Tax Policy

How do state estate and inheritance taxes work?

SPECIFIC STATE AND LOCAL TAXES

5/9

Q. How do state estate and inheritance taxes work?

A. Twelve states and the District of Columbia have an estate tax and six have an inheritance tax (Maryland has both). Before 2001, when a federal credit offset the cost of state taxes, all states taxed the transfer of wealth at death.

State and local governments collected \$5 billion from estate and inheritance taxes in 2016, well less than 1 percent of combined state and local own-source general revenue. In 2000, the last year all states levied an estate tax, these taxes still provided less than 1 percent of combined state and local own-source general revenue.

ESTATE TAX

An estate tax is paid by the estate itself on the transfer of property at the time of a person's death. States must allocate assets across jurisdictions if the deceased person lived or owned property in multiple jurisdictions.

Before 2001, all 50 states and the District of Columbia had an estate tax because the federal estate tax provided a state tax credit worth 16 percent of the taxable value of the estate. Thus, states could raise revenue without increasing the net tax burden on their residents by linking directly to the federal credit, and all states did this by setting their estate tax rate equal to the maximum credit. However, federal tax changes in 2001 replaced the credit with a less valuable deduction, and many states eliminated their tax.

Currently, only 12 states and the District of Columbia levy an estate tax. Delaware and New Jersey repealed their estate taxes on January 1, 2018. Kansas, North Carolina, Ohio, Oklahoma, and Tennessee also recently repealed their estate taxes.

Each state exempts a gross amount from its tax (figure 1). These exemptions range from \$1 million in Massachusetts and Oregon to \$5.6 million in the District of Columbia and Maine. Some states previously tied their exemption to the federal amount, but after the Tax Cuts and Jobs Act raised the federal exemption from \$5.49 million to \$11.2 million beginning in 2018, the District of Columbia, Hawaii, Maryland, and Maine all decoupled and established their own exemption amounts. Connecticut was planning to match the federal amount in 2020, but recent legislation pushed the conformity date to 2023. New York is still set to match the federal exemption in 2019.

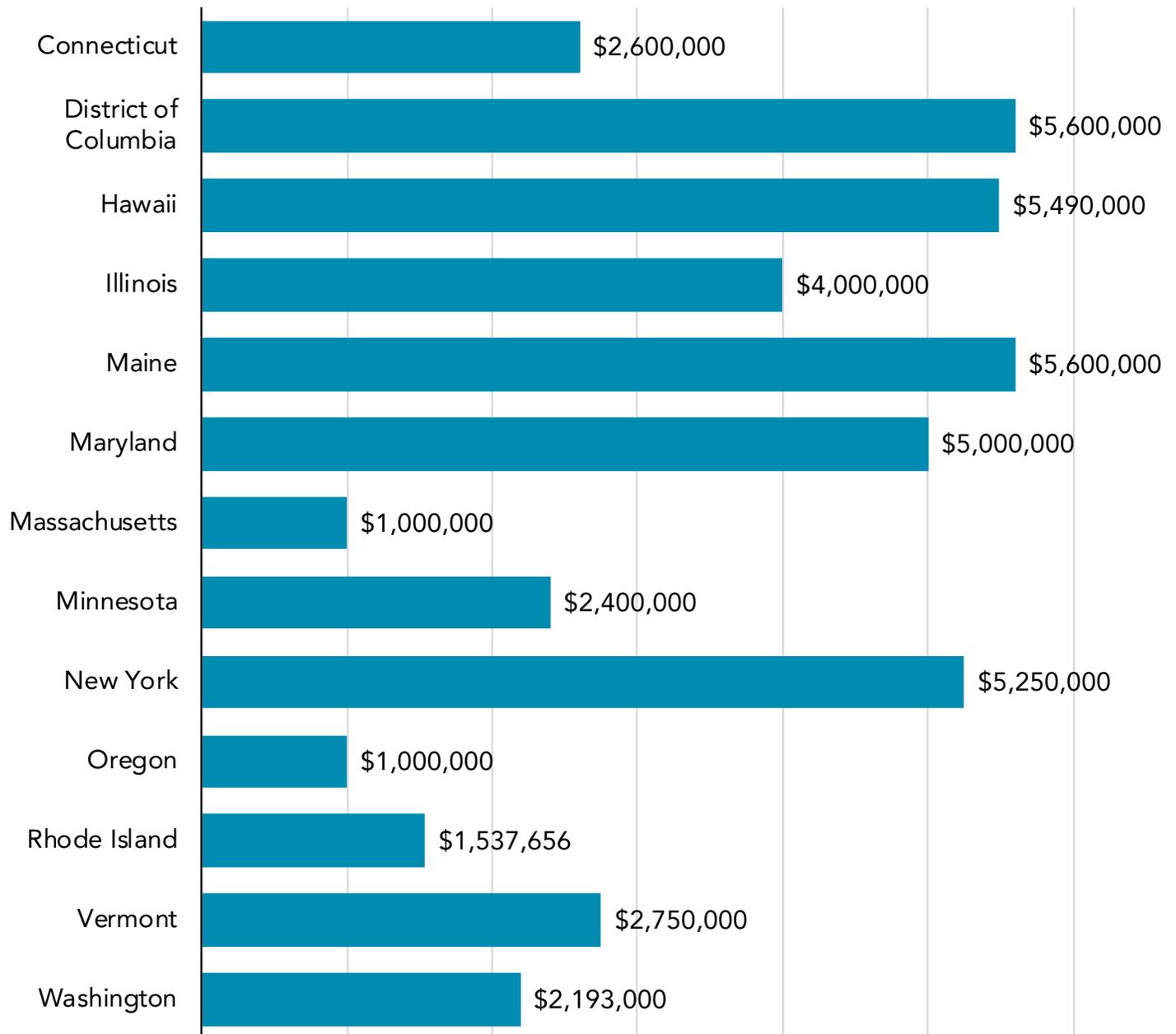
Most states have a top estate tax rate of 16 percent, a relic of the previous federal estate tax credit system (see below). However, Connecticut (12 percent), Hawaii (15.7 percent), Maine (12 percent), and Washington (20 percent) have different top rates.

The State of State (and Local) Tax Policy

How do state estate and inheritance taxes work?

FIGURE 1

Exemption Amounts for States with Estate Taxes 2018



Source: State tax codes.

Notes: The federal exemption threshold is \$11,200,000.

The State of State (and Local) Tax Policy

How do state estate and inheritance taxes work?

INHERITANCE TAX

An inheritance tax is similar to an estate tax but is paid by the heirs rather than the estate. The tax is levied on a resident's estate or a nonresident's in-state property at the time of death. The tax depends on the heir's relationship to the decedent. Surviving spouses are exempt in all states with inheritance taxes; some states also exempt direct descendants. Iowa, Kentucky, Maryland, Nebraska, New Jersey, and Pennsylvania have inheritance taxes. Indiana recently repealed its inheritance tax.

BACKGROUND

From 1924 to 2005, the federal government shared estate tax revenue with the states by allowing a credit for state estate and inheritance taxes. From 1924 to 1954, the credit was equivalent to 25 percent of the federal estate tax. After 1954, estates could claim a credit for state estate and inheritance taxes according to a progressive schedule with a top rate of 16 percent of the taxable value of the estate. As a consequence, rather than establishing unique taxes, states enacted estate taxes that equaled the maximum credit. In 2000, the last year the full credit was available, the state tax credits totaled \$6.4 billion.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) phased out the credit, replacing it with a less generous deduction. Many states directly linked the estate tax to the amount of the credit, and estate taxes would go to zero if they did not "decouple" from the federal law. In fact, 30 states let their tax go away by doing nothing. Fifteen states and DC did decouple, establishing separate estate taxes; five states explicitly repealed their taxes.

All provisions of EGTRRA were scheduled to expire in 2010 but were extended to 2012. In 2012, Congress did not address EGTRRA until the very end of the year, creating a fiscal cliff for most federal taxes and the possibility that the federal credit for state death taxes would return. In the end, Congress permanently replaced the state credit with a deduction for estate taxes paid to the states.

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The State of State (and Local) Tax Policy

How do state earned income tax credits work?

SPECIFIC STATE AND LOCAL TAXES

6/9

Q. How do state earned income tax credits work?

A. In 2018, 28 states and the District of Columbia offered their own earned income tax credit (EITC). States typically set their credits as a percentage of the federal EITC. However, unlike the federal credit, some state EITCs are not refundable, which makes them much less valuable to very low income families who rarely owe income tax.

Twenty-eight states and DC offered their own earned income tax credit (EITC) in 2018. This does not include Washington's credit which, while a part of the state's tax code, has never been implemented or funded. If Washington did fund its credit, it would be the only state without an income tax to offer an EITC.

In all but six states—Delaware, Hawaii, Ohio, Oklahoma, South Carolina, and Virginia—state EITCs, like the federal credit, are refundable. That is, if a refundable credit exceeds a taxpayer's state income tax, the taxpayer receives the excess amount as a payment from the state. A nonrefundable EITC can only offset state income taxes, so the benefit is limited for low-income families with little taxable income.

All states but one set their credits as a percentage of the federal credit, the exception being Minnesota, which calculates its credit as a percentage of income (table 1). State credits as a percentage of the federal credit ranged from 3 percent in Montana to a nonrefundable 125 percent in South Carolina. The highest refundable credit is in the District of Columbia (40 percent).

California's credit is 85 percent of the federal credit but is based on a smaller earnings range than the federal EITC. In 2018, the state will expand the income range and allow previously ineligible self-employed workers to qualify for the credit.

Wisconsin's EITC depends on the number of qualified children: 4 percent of the federal credit for filers with one child, 11 percent for filers with two children, and 34 percent for filers with three or more children. A filer in Wisconsin without children is not eligible for the state EITC.

The District of Columbia also offers 100 percent of the federal EITC to earners without qualifying children and expanded the range of eligible income beyond the federal limits. The maximum federal credit for earners without a qualifying child is far lower (\$519) than the max credit for earners with at least one child (\$3,461), and the eligible income range is also far smaller for earners without qualifying children.

In 2018, Maryland passed legislation that extends eligibility for the state's credit to workers without a qualifying child who are between 21 and 24 years old (workers without qualifying children must be between 25 and 65 years old to claim the federal credit).

The State of State (and Local) Tax Policy

How do state earned income tax credits work?

TABLE 1

Description of State Earned Income Tax Credits 2018



State	Year enacted	Refundable	Percentage of federal EITC
California	2015	Yes	85 percent (applies to a smaller range of eligible income than the federal credit)
Colorado	2015		10
Connecticut	2011	Yes	27.5
Delaware	2005	No	20
District of Columbia	2000	Yes	40 (100 for childless workers)
Hawaii	2018	No	20
Illinois	2000	Yes	10
Indiana	1999	Yes	9
Iowa	1989	Yes	15
Kansas	1998	Yes	17
Louisiana	2007	Yes	3.5
Maine	2000	Yes	5
Maryland	1987	Yes	Refundable: 27; nonrefundable: 50
Massachusetts	1997	Yes	23
Michigan	2006	Yes	6
Minnesota	1991	Yes	Calculated as a percentage of income
Montana	2020	Yes	3
Nebraska	2006	Yes	10
New Jersey	2000	Yes	30
New Mexico	2007	Yes	10
New York	1994	Yes	30
Ohio	2013	No	10, limited to 50 percent of liability for Ohio taxable income over \$20,000
Oklahoma	2002	No	5
Oregon	1997	Yes	8
Rhode Island	1986	Yes	12.5
South Carolina	2018	No	125
Vermont	1988	Yes	32
Virginia	2004	No	20
Washington	2008 (never implemented)	Yes	10 (or \$50, whichever is greater)
Wisconsin	1989	Yes	4 for families with one child; 11 for families with two children; 34 for families with three or more children

Source: Tax Credits for Workers and Their Families, "State Tax Credits."

The State of State (and Local) Tax Policy

How do state earned income tax credits work?

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The State of State (and Local) Tax Policy

How do state and local severance taxes work?

SPECIFIC STATE AND LOCAL TAXES

7/9

Q. How do state and local severance taxes work?

A. Thirty-four states levy severance taxes, which are taxes on the extraction of natural resources (including oil and natural gas). The revenue from these taxes is extremely volatile because it rises and falls with the price and production of natural resources.

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

State and local governments collected \$8 billion from severance taxes in 2016. Nearly all this revenue came from state taxes. Only 12 states allowed local severance taxes in 2016, collecting a combined \$225 million that year.

Severance taxes accounted for less than 1 percent of national state and local own-source general revenue in 2016, but provided a substantial amount of own-source revenue in a few resource-rich states, such as North Dakota (21 percent) and Wyoming (10 percent) (figure 1). "Own-source" revenue excludes intergovernmental transfers.

The states with the next-highest contributions from severance taxes were Alaska, New Mexico, and West Virginia—all collected 4 percent of state and local own-source revenue from severance taxes. Severance taxes in Texas account for 30 percent of national state and local severance tax revenue, but they provide only 1 percent of Texas's state and local own-source revenue. Sixteen states and the District of Columbia do not levy severance taxes.

Alaska typically depends on severance tax revenue more than any other state. However, the price and production of oil have fallen dramatically and so has the state's tax revenue. In 2012, Alaska's severance tax revenue was nearly \$6 billion and accounted for over 40 percent of the state's combined state and local own-source general revenue. Since then, however, revenue has fallen to \$4 billion in 2013 (33 percent), \$2 billion in 2014 (23 percent), \$636 million in 2015 (8 percent), and \$337 million in 2016 (4 percent).

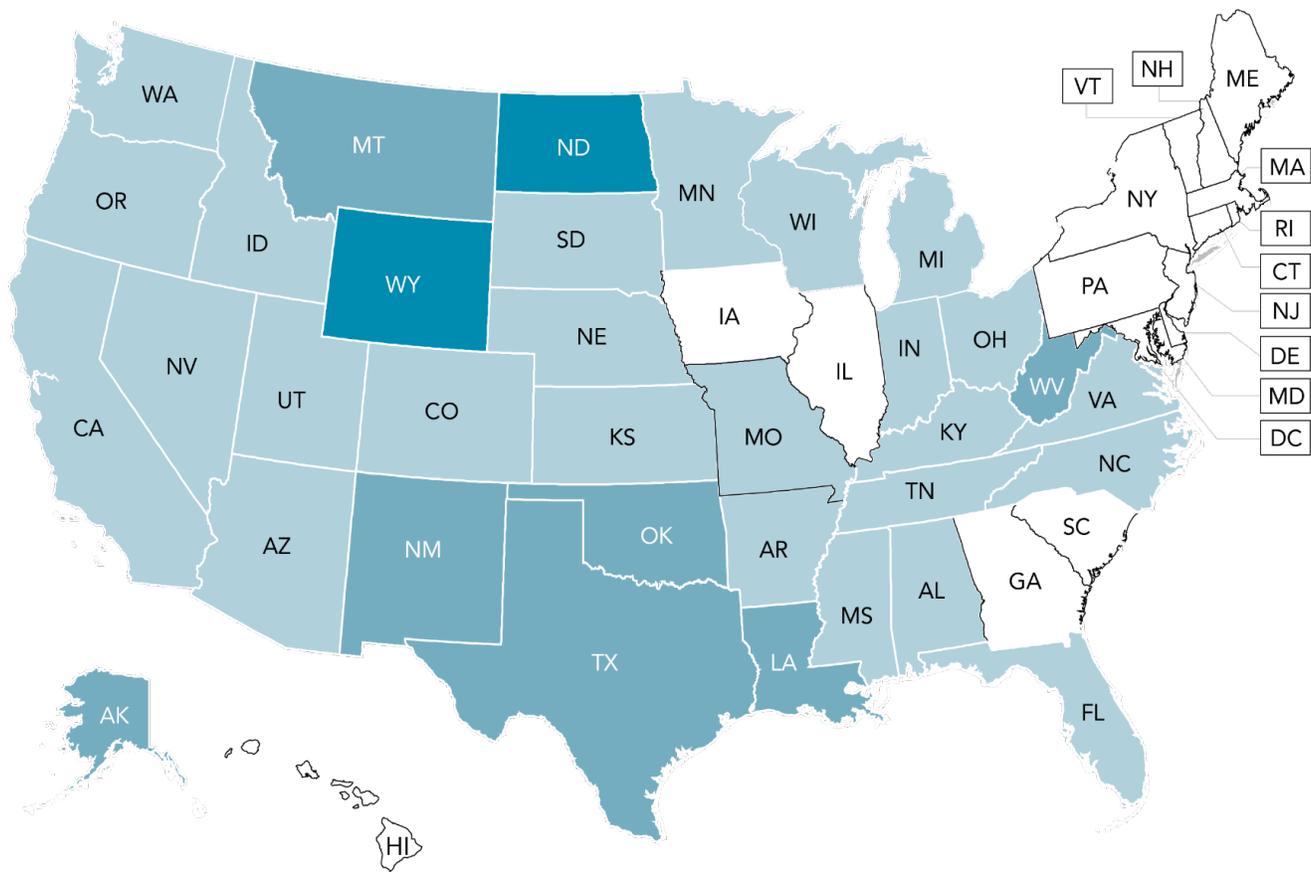
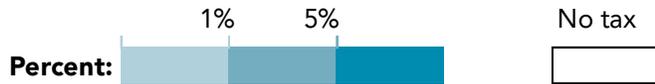
Alaska highlights the volatility of severance taxes and the challenges that poses to states that heavily rely on them. Therefore, these states must have flexible budgeting arrangements or significant rainy day funds to accommodate unforeseen changes in severance tax revenue flows.

The State of State (and Local) Tax Policy

How do state and local severance taxes work?

FIGURE 1

Severance Tax Revenue as a Percentage of State and Local Own-Source General Revenue
2016



Source: US Census Bureau, Census of Governments.

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

Data Sources

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

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The State of State (and Local) Tax Policy

How do state and local soda taxes work?

SPECIFIC STATE AND LOCAL TAXES

8/9

Q. How do state and local soda taxes work?

A. While no state currently taxes sweetened beverages, several localities levy what's commonly referred to as a soda tax. Six local governments levy a per volume excise tax on drinks sweetened with sugar and one government levies a per volume tax on all sweetened drinks.

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

No state currently has an excise tax on sugar-sweetened beverages. Instead, soda taxes are levied locally in Boulder, Colorado; Philadelphia, Pennsylvania; Seattle, Washington; and four California cities: Albany, Berkeley, Oakland, and San Francisco.

Philadelphia's tax is nearly 2 percent of its own-source revenue, but the taxes in the other jurisdictions account for 1 percent or less of own-source general revenue. (Own-source revenue excludes intergovernmental transfers.)

HOW DO SODA TAX RATES DIFFER?

All current soda taxes are based on a drink's volume. Tax rates range from 1 cent per ounce in all four California jurisdictions to 2 cents per ounce in Boulder (table 1). For concentrates (i.e., fountain soda), the tax is typically applied to the maximum volume the syrup can produce. As with state alcohol taxes, distributors or wholesalers pay the tax when they deliver products to retailers. The expectation is that much or all of the tax on soda is then passed on to customers in the form of higher retail prices. No current soda taxes are levied as a percentage of retail price.

Each jurisdiction exempts some beverages from its tax, including alcoholic beverages, milk, infant formula, and drinks for medical purposes (not including sports and energy drinks). Philadelphia's tax base is notably larger than other jurisdictions' because it includes any beverage with real or artificial sweeteners. As such, Philadelphia is the only jurisdiction that taxes diet sodas. In the other six localities, a drink is only taxed if the sweetener adds calories. Further, some jurisdictions only tax drinks if the drink surpasses a calorie minimum (e.g., 2 calories per ounce in Berkeley).

Cook County, Illinois (which includes Chicago), passed a 1 cent per ounce soda tax in November 2016. However, that tax was in effect for only a few months before the county board reversed itself and repealed it in October 2017.

Arizona and Michigan preemptively blocked local governments from enacting soda taxes. California,

The State of State (and Local) Tax Policy

How do state and local soda taxes work?

despite already having four local soda taxes, passed legislation in June 2018 banning any new locality from establishing a tax for 12 years.

Washington voters also approved a ban on local soda taxes in November 2018. The ban does not affect Seattle's soda tax, though. Oregon voters rejected a similar ballot initiative that would have preemptively blocked local soda taxes.

TABLE 1
Soda Tax Rates



City	Tax rate	Eligible drinks	Paid by
Albany, CA	1 cent per ounce	Sugar-sweetened beverages	Distributors
Berkeley, CA	1 cent per ounce	Sugar-sweetened beverages	Distributors
Boulder, CO	2 cents per ounce	Sugar-sweetened beverages	Distributors
Oakland, CA	1 cent per ounce	Sugar-sweetened beverages	Distributors
Philadelphia, PA	1.5 cents per ounce	Sweetened beverages (includes diet drinks)	Distributors
San Francisco, CA	1 cent per ounce	Sugar-sweetened beverages	Distributors
Seattle, WA	1.75 cents per ounce	Sugar-sweetened beverages	Distributors

Source: City government websites.

Notes: Every jurisdiction exempts certain drinks such as milk. Seattle's tax is on "sweetened beverages" but their definition of these drinks only includes drinks with "caloric sweetener." Manufacturers in Seattle can apply for a lower rate based on gross income.

WHAT ARE THE OBJECTIONS TO TAXING SODA?

Soda taxes tend to be regressive because lower-income consumers spend a larger share of their income on the tax than higher-income consumers. Further, families with lower incomes typically spend more of their income on groceries—specifically, on products like sugar-sweetened beverages. However, policymakers could soften the regressivity of the tax by using the revenue for targeted tax relief (e.g., the earned income tax credit) or spending it on programs aimed at lower-income communities. Further, the tax might encourage the purchases of healthier beverages and thus amplify positive public health effects for this group.

Also, while sugar is consistently identified as contributing to obesity, it is not the only factor. And the health effects and medical costs of obesity are not uniform. Some consumers with no risk of harm or medical cost will pay the tax. Meanwhile, others may substitute equally or more unhealthy options (such as alcohol) to avoid the tax.

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The State of State (and Local) Tax Policy

How do marijuana taxes work?

SPECIFIC STATE AND LOCAL TAXES

9/9

Q. How do marijuana taxes work?

A. Marijuana sales are legal and taxed in seven states. Most of these states tax the consumer purchase of marijuana (similar to a retail sales tax) but some tax the transaction between cultivators and distributors or retailers (similar to taxes on alcohol).

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

Although prohibited under federal law, marijuana sales are legal and taxed in seven states: Alaska, California, Colorado, Massachusetts, Nevada, Oregon, and Washington. Marijuana is legal in Maine and Vermont but neither state has established its tax system yet. Michigan voters approved legal and taxable marijuana in November 2018. The District of Columbia also legalized marijuana but Congress currently prevents the city from regulating and taxing sales (figure 1).

In Colorado and Washington, where marijuana has been taxed since 2014, marijuana taxes bring in hundreds of millions of dollars, or roughly 1 percent of each state's own-source general revenue. (Own-source revenue excludes intergovernmental transfers.) Nevada collected nearly \$70 million in its first year of taxable sales, which is also roughly 1 percent of its own-source general revenue. In the past year, Alaska collected \$10 million and Oregon collected \$80 million—both totals are well below 1 percent of each state's own-source general revenue. California and Massachusetts have taxed marijuana for less than a year.

Medical marijuana is legal in 32 states and some of these states levy a tax on the purchase. But these tax rates are often the same as or close to the state's general sales tax rate and do not raise much revenue.

HOW DO MARIJUANA TAX RATES DIFFER?

Most states tax marijuana as a percentage of the retail price (table 1). These rates range from 10 percent in Nevada to 37 percent in Washington. California, Colorado, Massachusetts, and Oregon also use these taxes, which are similar to a retail sales tax the consumer pays on the purchase and the retailer remits to the state. Michigan's legislature will set up its tax system, but the ballot initiative called for a 10 percent excise tax on retail sales. Localities can also levy an additional tax in some states, mostly as an excise tax on retail sales.

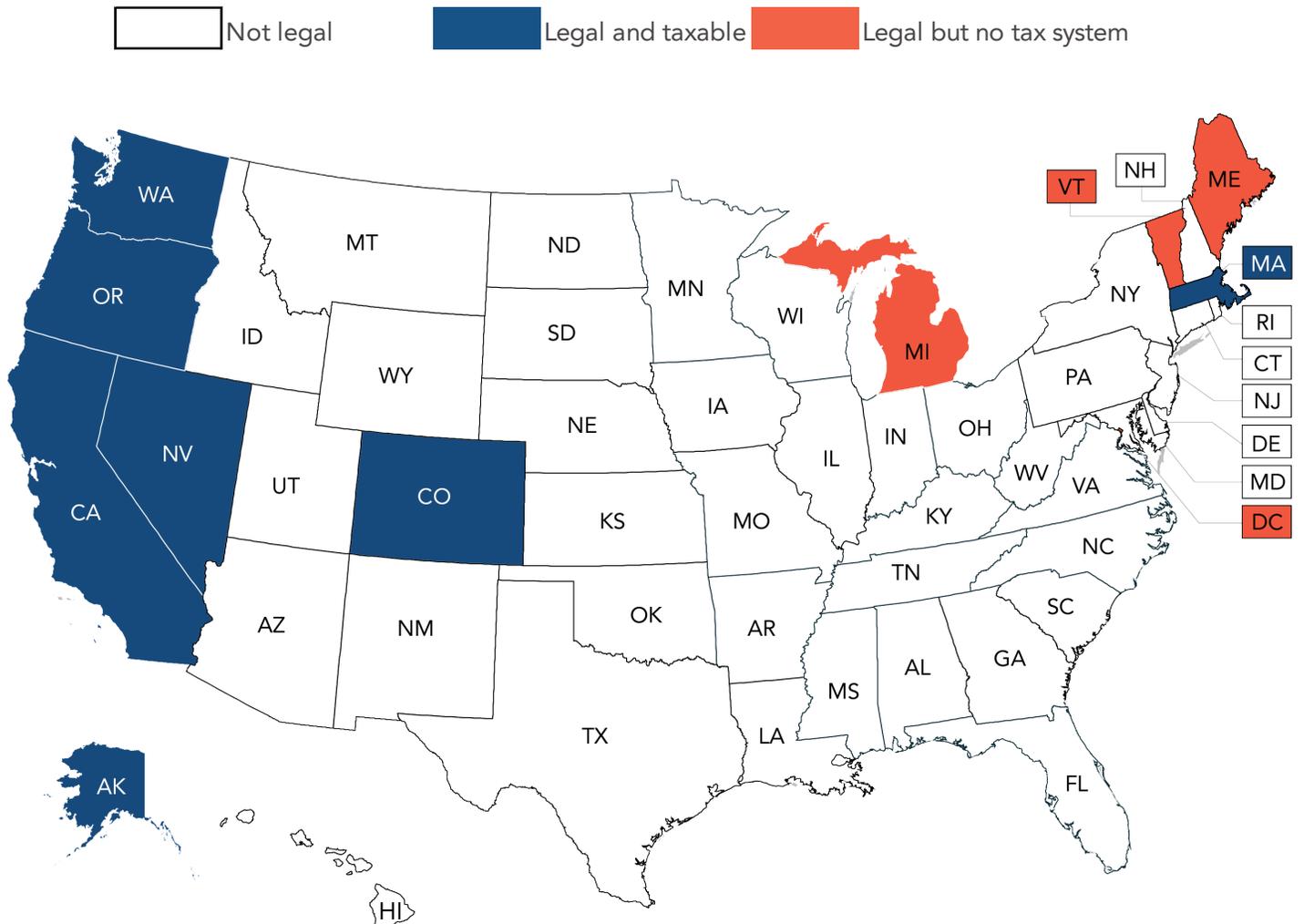
Colorado and Nevada additionally have a tax on the wholesale transaction between cultivators and distributors or retailers. The expectation is that some or all of these wholesale taxes are passed through to the consumer via higher purchase prices—similar to how alcohol taxes work. Alaska and California also levy a tax at this stage of production but tax marijuana per ounce instead of as a percentage of price (similar to a cigarette tax).

Some states also levy their general sales tax on the purchase of marijuana in addition to the excise taxes.

The State of State (and Local) Tax Policy

How do marijuana taxes work?

FIGURE 1
Where is Marijuana Legal and Taxable?
 2018



Source: State government websites.
Note: Medical marijuana is legal in 32 states. [?](#)

The State of State (and Local) Tax Policy

How do marijuana taxes work?

TABLE 1
Marijuana Tax Rates



State	Taxes	Legalization Date
Alaska	Cultivators pay \$50 per ounce for bud/flowers and \$15 per ounce for remainder of plant Localities can levy an excise tax on retail sales	2014
California	15% state excise tax on retail sale Cultivators pay \$9.25 per ounce for flowers and \$2.75 per ounce for leaves Localities can levy an excise tax on retail sales	2016
Colorado	15% state excise tax on retail sale 15% marijuana tax on contract price (cultivator) Localities can levy both a retail and/or cultivator tax	2012
District of Columbia	Prevented from taxing sales	2014
Maine	No tax system in place	2016
Massachusetts	10.75% state excise tax on retail sale Local excise taxes on retail sales capped at 3%	2016
Michigan	No tax system in place Ballot initiative proposed 10% excise tax on retail sale	2018
Nevada	15% state excise tax on wholesale sale (cultivator) 10% state excise tax on retail sale Localities can levy an excise tax on retail sales	2016
Oregon	17% state excise tax on retail sale Local excise taxes on retail sales capped at 3%	2014
Vermont	No tax system in place	2018
Washington	37% state excise tax on retail sale	2012

Source: State government websites.

Notes: Some states also levy their general sales tax on marijuana purchases. The legalization date is when the law passed and not when taxable sales began.

The State of State (and Local) Tax Policy

How do marijuana taxes work?

HOW DO STATES USE MARIJUANA REVENUE?

- Alaska sends half of its revenue to its general fund and half to programs aimed at reducing repeat criminal offences.
- California's revenue pays for administrative costs associated with marijuana legalization, and then uses excess funds for programs related to drug use, including economic development, academic studies, and youth programs.
- Colorado's revenue is dedicated to education programs.
- Massachusetts distributes its revenue to various public safety programs.
- Nevada's revenue is sent to education programs and its rainy day fund.
- Oregon dedicates its revenue to education programs, drug prevention and treatment programs, and transfers to local governments.
- Washington dedicates its revenues to health care programs.

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