The State of State (and Local) Tax Policy

SPECIFIC STATE AND LOCAL TAXES

How do state and local income taxes work?

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.

HOW MUCH REVENUE DO STATE AND LOCAL GOVERNMENTS COLLECT FROM INDIVIDUAL INCOME TAXES?

State governments collected $352 billion from individual income taxes in 2017, 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. (The Census Bureau includes the District of Columbia's revenue in the local total.)

TABLE 1

State and Local Individual Income Tax Revenue

2017

	Revenue (billions)	Percentage of own source general revenue
State and local	$385	16%
State	$352	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 2021.) 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 2017, with the tax accounting for 29 percent of its own-source revenue. The District of Columbia and eight other states—California, Connecticut, Kentucky, Massachusetts, Minnesota, New York, Oregon, and Virginia—

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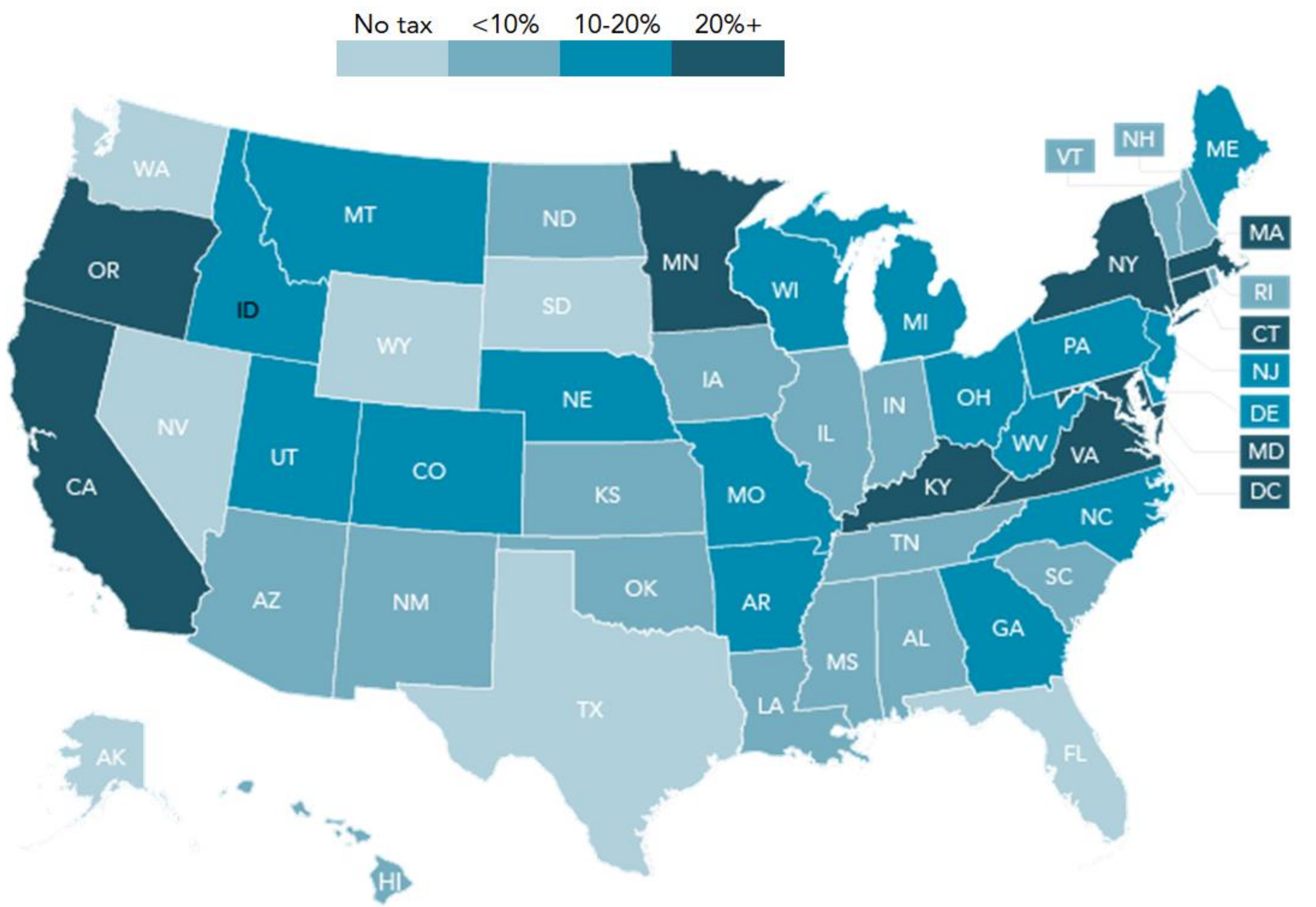
collected more than 20 percent of their own-source revenue from individual income taxes in 2017.

North Dakota's individual income tax yielded 4 percent of its own-source revenue, 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 9 percent of own-source general revenue. New Hampshire and Tennessee each collected about 1 percent of own-source revenue from their far more limited individual income tax.

FIGURE 1

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

2017



Source: Urban-Brookings Tax Policy Center, State and Local Finance Data: Exploring the Census of Governments.

Note: Own general revenue does nt include intergovernmental transfers.

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 2017, 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 2017.

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. 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. Many states allow a full or partial exemption for pension income. And most states, but not all, require taxpayers who itemize their federal tax deductions and claim deductions for state and local income taxes to add back this deduction on their state income tax return.

HOW DO INDIVIDUAL INCOME TAX RATES VARY ACROSS STATES?

Most state income taxes are fairly flat, even in those states that apply graduated rates. Nine states impose a single tax rate on all income, while Hawaii has the most with 12 tax brackets and rates. Top marginal rates for state income tax in 2020 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).

In some states with multiple tax brackets, the top tax bracket often begins at a low level of 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 2020, California, Hawaii, New Jersey, Minnesota, and Oregon had top rates above 9 percent and another six states and the District of Columbia had top income tax rates at or above 7 percent.

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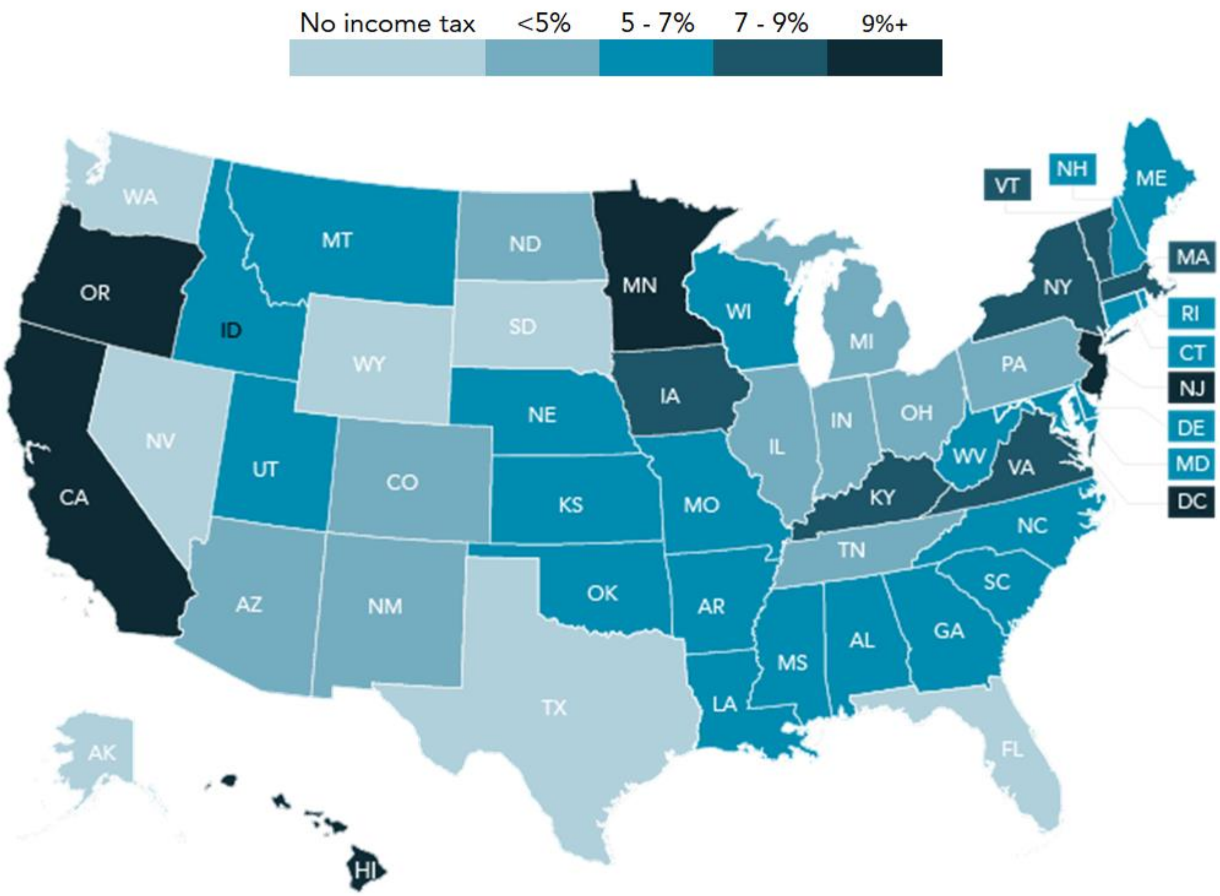
How do state and local income taxes work?

FIGURE 2
Top State Individual Income Tax Rates
2020



Source: Federation of Tax Administrators, "State Individual Income Taxes (Tax Rates for Tax Year 2020 as of January 1, 2020)."

HOW DO STATES TAX CAPITAL GAINS AND LOSSES?

Five 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.

Other states provide exemptions and deductions that go beyond the federal rules. 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 states that tax income generally follow the federal treatment of capital gains, except for various state-specific exclusions and deductions.

Most states tax capital gains at the same rate as ordinary income, while the federal government provides a preferential rate.

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 the District of Columbia allows Maryland to tax income earned in the District by a Maryland resident. As of 2010, 15 states and the District of Columbia 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.

Updated May 2020

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How do state and local sales taxes work?

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 $457 billion from sales taxes in 2017, or 35 percent of their own-source general revenue (table 1). "Own-source" revenue excludes intergovernmental transfers. Nearly two-thirds ($300 billion) of that total came from general sales taxes, while the other third ($157 billion) came from selective sales taxes (or excise taxes) on specific purchases such as motor fuel, tobacco, and alcohol. Local governments collected $124 billion from sales taxes in 2017, or 11 percent of their own-source general revenue. Of that total, $89 billion came from general sales taxes and $34 billion came from selective sales taxes. (Census includes the District of Columbia's revenue in the local total.)

TABLE 1

State and Local Sales Tax Revenue

2017

	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	389	16	191	8	581	24
State	300	23	157	12	457	35
Local	89	8	34	3	124	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.

Nevada relied on sales tax revenue more than any other state in 2017, with general sales and selective sales taxes accounting for 47 percent of combined state and local own-source general revenue. General sales and selective sales taxes also represented 30 percent or more of combined state and local revenue in Arizona,

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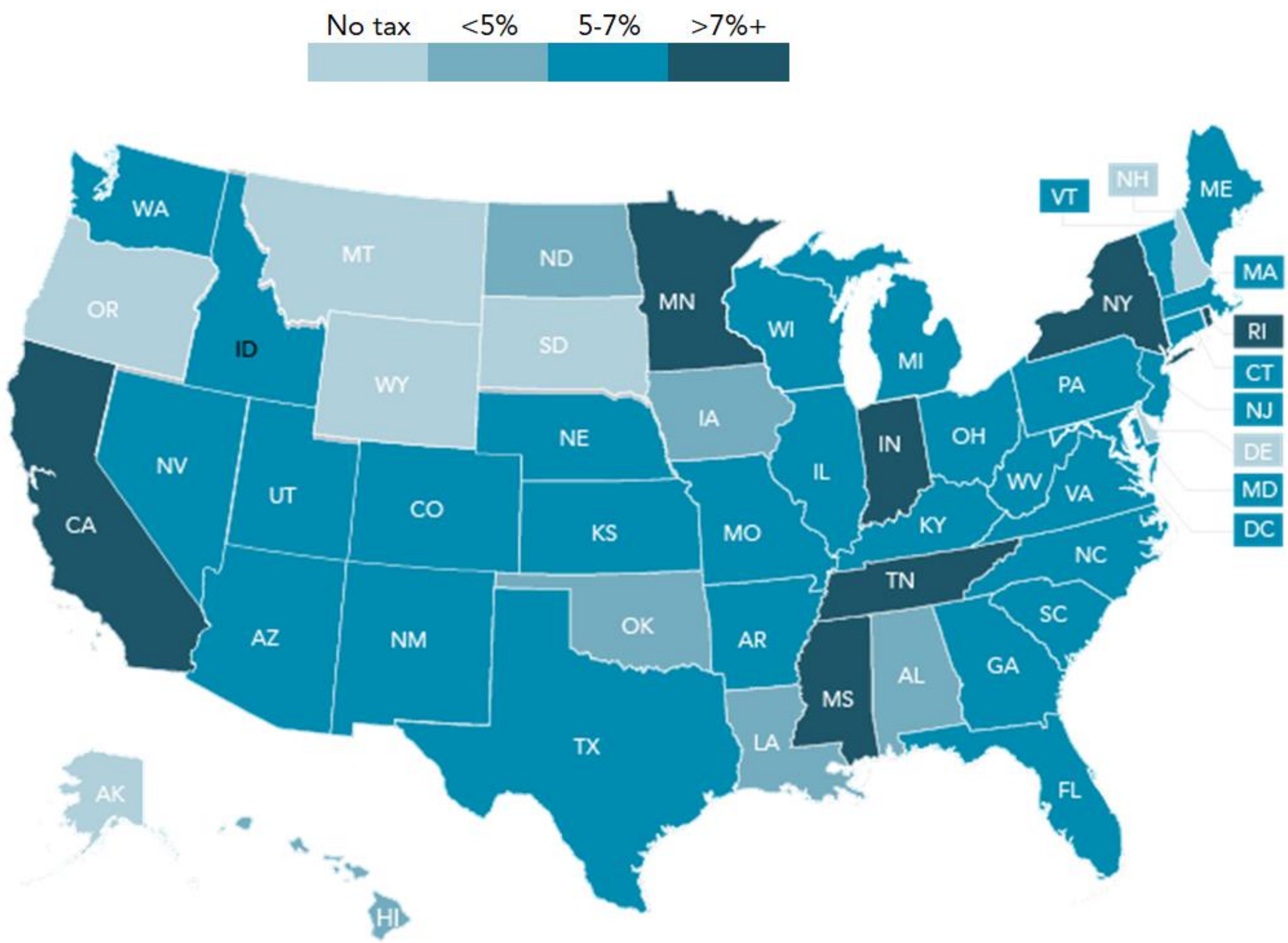
Arkansas, Florida, Hawaii, Louisiana, New Mexico, South Dakota, Tennessee, Texas, and Washington. Among the states with a general sales tax, Massachusetts and Wyoming relied least on general sales and selective sales tax revenue as a percentage of combined state and local own-source revenue (15 percent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

Every state and the District of Columbia collected revenue from selective sales taxes in 2017. The average revenue from these taxes was 8 percent of state and local own-source general revenue, but 15 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.

FIGURE 1

State General Sales Tax Rates

2020



Source: Federation of Tax Administrators (FTA), Tax Rates (as of January 1, 2020).

Note: Tax rates do not include local sales taxes.

How do state and local sales taxes work?

HOW DO GENERAL SALES TAX RATES DIFFER ACROSS STATES?

Colorado has the lowest state general sales tax rate (2.9 percent). No other state with a general sales tax has a rate below 4.0 percent, but the state general sales tax rate is below 5.0 percent in 10 other states (figure 1). In addition to California, which has the highest state general sales tax rate (7.3 percent), four states (Indiana, Mississippi, Rhode Island, and Tennessee) have rates at or above 7.0 percent. Alaska, Delaware, Montana, New Hampshire, and Oregon do not have a state general sales tax.

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 six 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.

HOW DO SALES TAXES APPLY TO ONLINE PURCHASES?

The evolving 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 remit the state's sales tax. Other states quickly enacted similar laws. As of March 2020, Florida and Missouri were the only states with a general sales tax but not a law requiring remote sellers to collect tax.

Many states are now working on legislation that would require "marketplace facilitators," organizations such as Amazon and eBay that allow third-party retailers to also sell items on their platform, to collect state sales taxes on those third-party sales as well. As of January 2020, 38 states and the District of Columbia had marketplace facilitator collection provisions.

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 and 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 tobacco, alcohol, and motor fuels. Those products are also subject to a federal tax. For tobacco 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. In 2020, Missouri had the lowest rate (17 cents per pack) and the District of Columbia had the highest ($4.50). 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).

All states also levy taxes on other tobacco products, including cigars and loose tobacco. State and local governments also increasingly—21 states and the District of Columbia in 2020—tax e-cigarettes and vaping products.

State and local governments collected $19 billion in revenue from tobacco taxes in 2017, nearly all of it from cigarette taxes.

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, 22 states collected revenue from government-owned liquor stores.

State and local governments collected $17 billion in revenue from alcohol in 2017—$7 billion from alcohol taxes and $10 billion from government-owned liquor stores.

Motor Fuels Taxes

Motor fuel taxes are typically per gallon taxes. That is, consumers pay tax based on how much gas they

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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 $47 billion in revenue from motor fuel taxes in 2017.

Local Special Sales Tax

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.

Updated May 2020

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How do state and local sales taxes work?

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How do state and local property taxes work?

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 (county, municipal, township, school district, and special district) on land and improvements to it, but some states also tax personal property (such as machinery, equipment, and motor vehicles).

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 2017, collecting $16 billion in revenue, or 1 percent of their own-source general revenue. (Own-source revenue excludes intergovernmental transfers.) Meanwhile, local governments collected $509 billion from property taxes in 2017, or nearly half of their own-source general revenue.

TABLE 1

State and Local Property Tax Revenue

2017

	Revenue (billions)	Percentage of own source general revenue
State and local	$526	22%
State	$16	1%
Local	$509	47%

Source: Urban-Brookings Tax Policy Center, State & Local Government Finance Data Query System

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

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 $212 billion in 2017, which was 83 percent of their own-source

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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.

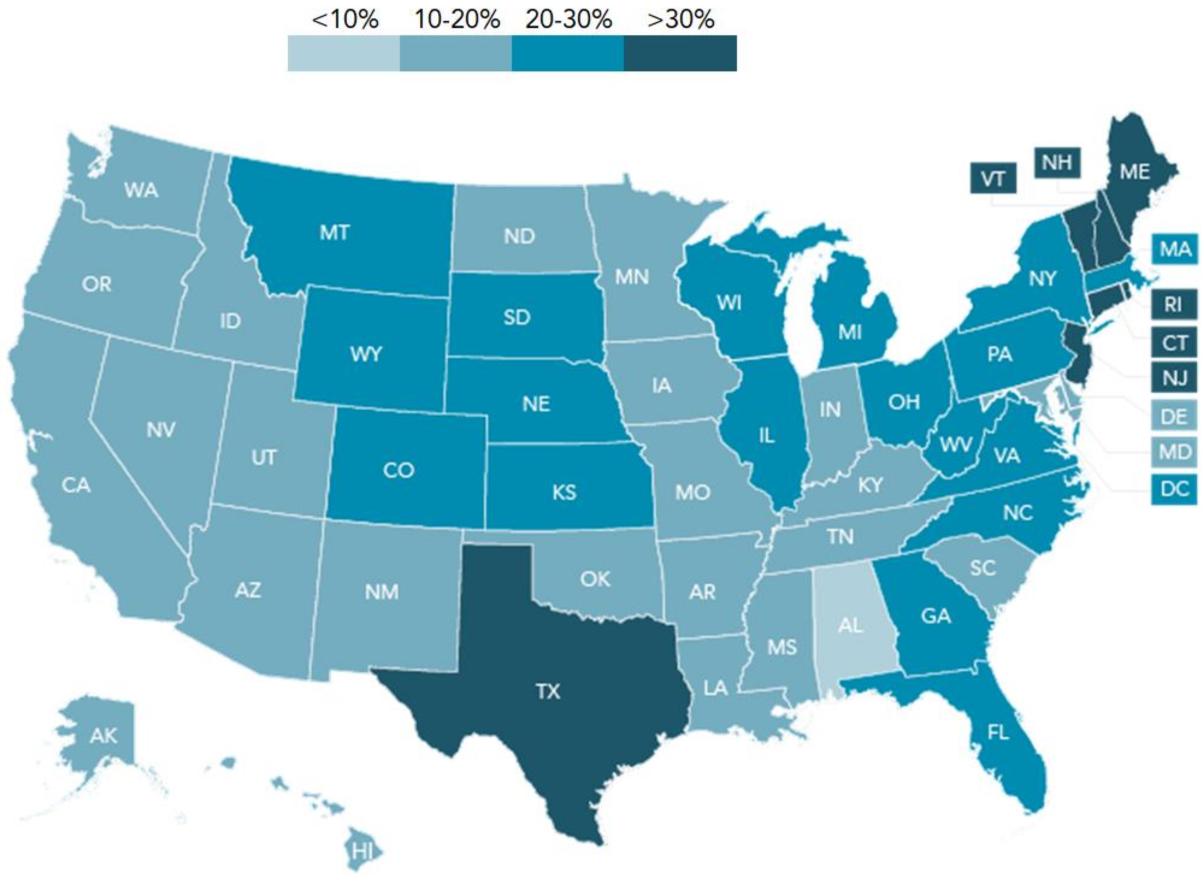
IN WHICH STATES ARE PROPERTY TAXES MOST IMPORTANT?

New Hampshire, which has neither a broad-based income tax nor a general sales tax, was the most reliant on property taxes in 2017, with property tax revenue accounting for 49 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, Texas, and Vermont. Alabama was the least reliant on property tax revenue in 2017, 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, Oklahoma, and West Virginia also collected less than 15 percent of combined state and local revenue from property taxes (figure 1).

FIGURE 1

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

2017



Source: Urban-Brookings Tax Policy Center, State & Local Government Finance Data.

Note: Own general revenue does nt include intergovernmental transfers.

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How do state and local property taxes work?

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 2017. Alabama's local governments received 20 percent of their own-source revenue from property taxes, the lowest percentage in any state.

At the state level, Vermont's property taxes contributed 26 percent of state own-source general revenue in 2017, 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 percentages were in Arkansas, New Hampshire, and Wyoming, where property taxes were approximately 9 percent of own-source general revenue in each state. Wyoming's property tax 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, Kansas, Michigan, Montana, 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.

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

How do state and local property taxes work?

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-six 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 2018. 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.

Updated May 2020

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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 2020.

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 $45 billion from corporate income taxes in 2017, or 3 percent of their own-source general revenue. (Own-source revenue excludes intergovernmental transfers.) Local governments collected $8 billion from corporate income taxes in 2017, or 1 percent of own-source revenue. The Census Bureau includes the District of Columbia's $554 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 81 percent of all corporate income tax revenue collected by local governments in 2017.

TABLE 1

State and Local Corporate Income Tax Revenue

2017

	Revenue (billions)	Percentage of own source general revenue
State and local	$53	2%
State	$45	3%
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 13 percent of state own-source general revenue from corporate income taxes in 2017, 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 California, Illinois, Massachusetts, New Jersey, and Tennessee. Among the 44 states with a corporate income tax, the lowest percentage was in, New Mexico, North Dakota, Oklahoma, and South Dakota, which each collected only 1 percent of revenue from the tax in 2017.

How do state and local corporate income taxes work?

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.

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 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 20 years ago, 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. Now, however, most states use formulas that either weight more heavily or rely exclusively on sales within the state to apportion income. In 2020, only five states used the traditional three-factor formula, while 26 states and the District of Columbia relied exclusively on sales in their formula. 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 2020, top corporate income tax rates ranged from 2.5 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. Fourteen states had top rates below 6.0 percent.

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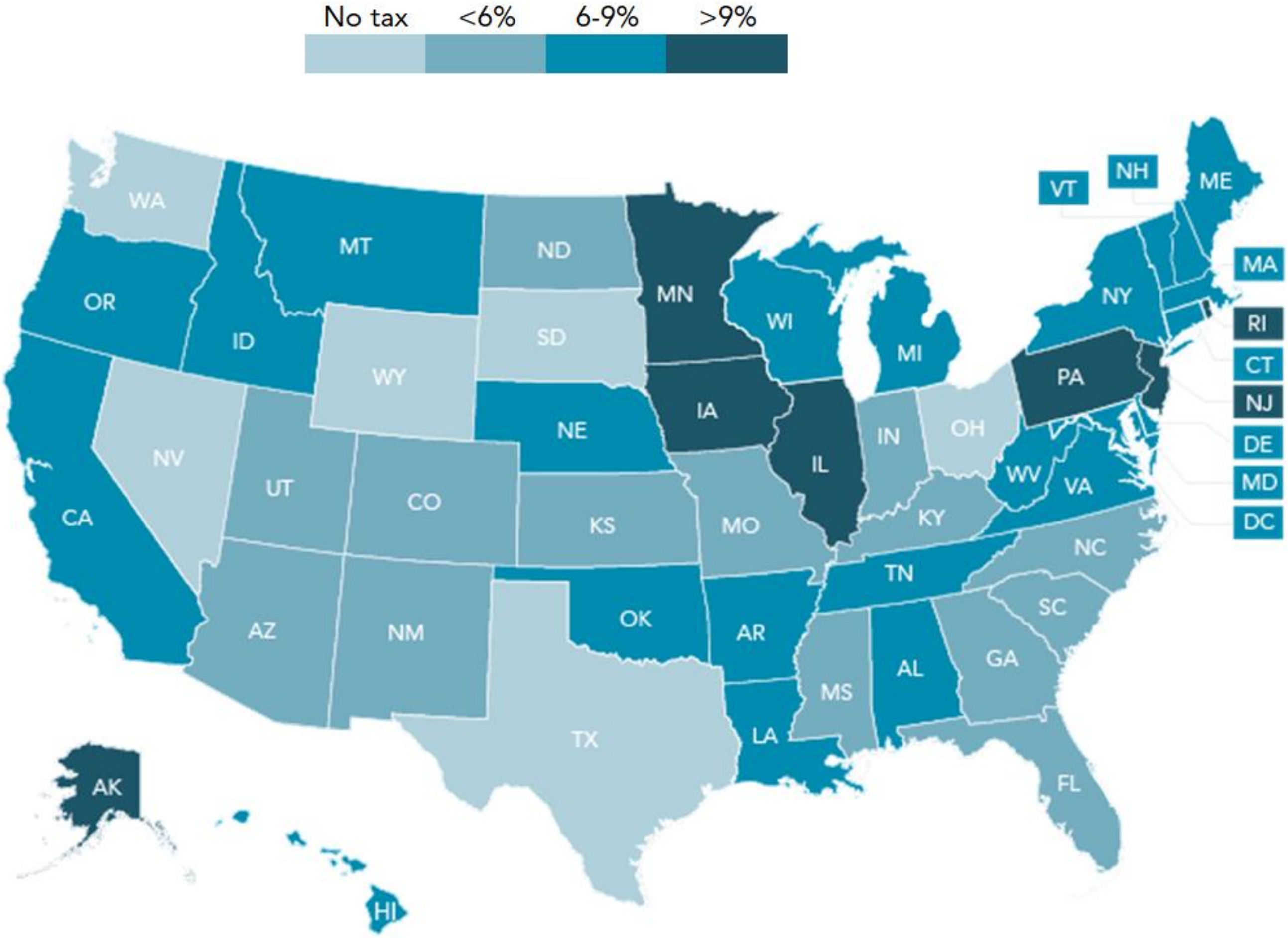
FIGURE 1

Top State Corporate Income Tax Rates

2020



Source: Federation of Tax Administrators (FTA), Tax Rates (as of January 1, 2020).
Note: Ohio and Texas have gross receipts taxes; various states apply different rates for financial institutions, including Ohio and South Dakota, which do not otherwise tax corporate income.

Updated May 2020

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The State of State (and Local) Tax Policy

How do state and local corporate income taxes work?

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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 2017, 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 $5.85 million in New York. 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.

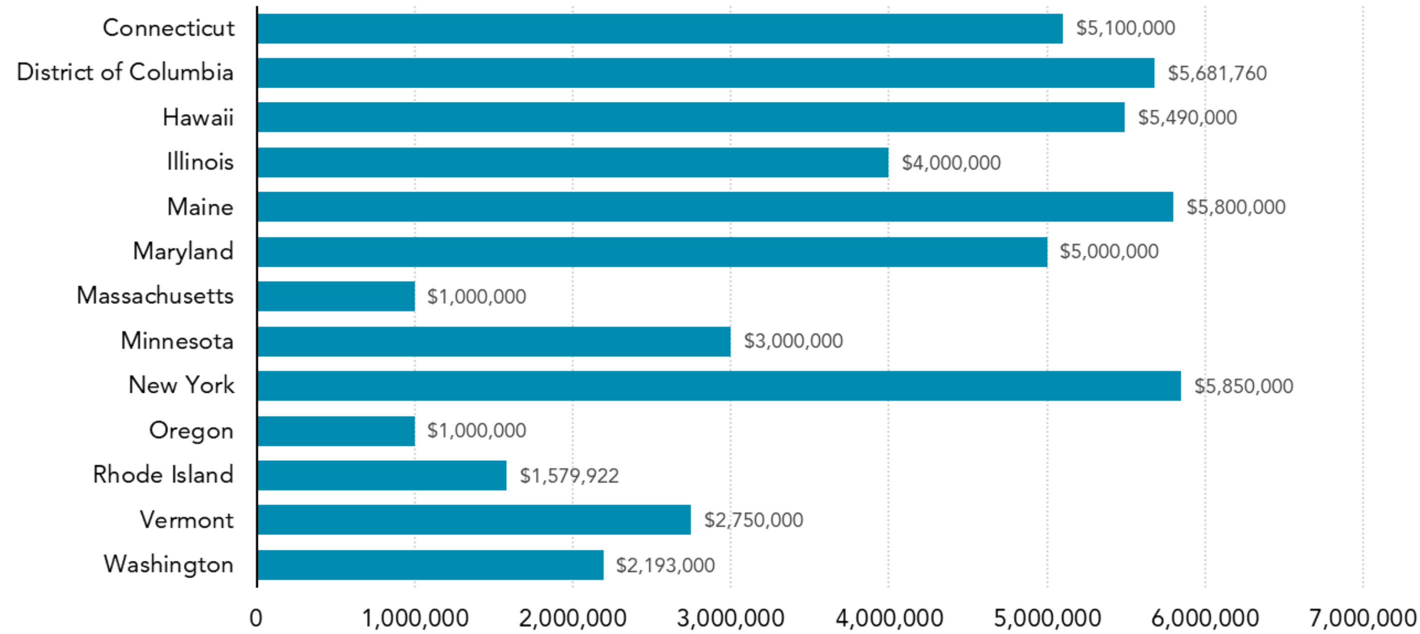
The State of State (and Local) Tax Policy

How do state estate and inheritances tax work?

FIGURE 1

Exemption Amounts for States with Estate Taxes

2020



Source: State tax codes.
Note: The federal exemption amount is $11,200,000.

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 (20 percent), Maine (12 percent), and Washington (20 percent) have different top rates.

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,

How do state estate and inheritances tax work?

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.

Updated May 2020

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How do state earned income credits work?

Q. How do state earned income tax credits work?

A. In 2020, 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 2020. 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 62.5 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 (up to $30,000 if there is one or more qualifying children) than the federal EITC (up to $56, 844 if married with three or more qualifying children).

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 ($538) than the max credit for earners with at least one child ($3,584), and the eligible income range is also far smaller for earners without qualifying children.

California, Maine, and Maryland are the first states to make residents without qualifying children ages 18 to 24 eligible for their state credit. (These filers are not eligible for the federal credit, which can only be claimed by childless workers ages 25 to 64.) Minnesota allows such filers ages 21 to 24 to claim their credit.

How do state earned income credits work?

TABLE 1

Description of State Earned Income Tax Credits

2020

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	Yes	10
Connecticut	2011	Yes	23
Delaware	2005	No	20
District of Columbia	2000	Yes	40 (100 for childless workers)
Hawaii	2018	No	20
Illinois	2000	Yes	18
Indiana	1999	Yes	9
Iowa	1989	Yes	15
Kansas	1998	Yes	17
Louisiana	2007	Yes	5
Maine	2000	Yes	12 (25 for childless workers)
Maryland	1987	Yes	Refundable: 28; nonrefundable: 50
Massachusetts	1997	Yes	30
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	37
New Mexico	2007	Yes	17
New York	1994	Yes	30
Ohio	2013	No	30, limited to 50 percent of liability for Ohio taxable income over $20,000
Oklahoma	2002	No	5
Oregon	1997	Yes	9
Rhode Island	1986	Yes	15
South Carolina	2018	No	62.5
Vermont	1988	Yes	36
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

Sources: TPC analysis of state department of revenue websites; Tax Credits for Workers and Their Families, "State Tax Credits," 2020.

The State of State (and Local) Tax Policy

How do state earned income credits work?

Updated May 2020

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How do state and local severance taxes work?

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 $9 billion from severance taxes in 2017. Nearly all this revenue came from state taxes. Only 12 states allowed local severance taxes in 2017, collecting a combined $53 million that year.

Severance taxes accounted for less than 1 percent of national state and local own-source general revenue in 2017, but provided a substantial amount of own-source revenue in a few resource-rich states, such as North Dakota (22 percent), Wyoming (8 percent), Alaska (7 percent), and New Mexico (6 percent) (figure 1). "Own-source" revenue excludes intergovernmental transfers.

The states with the next-highest contributions from severance taxes were Montana and West Virginia, each of which collected 3 percent of state and local own-source revenue from severance taxes. Severance taxes in Texas account for 37 percent of national state and local severance tax revenue, but they provide only 2 percent of Texas's state and local own-source revenue. Sixteen states and the District of Columbia do not levy severance taxes. California does not have a severance tax but levies an assessment fee on oil and gas produced in California, and Census records this as severance tax revenue.

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), $337 million in 2016 (4 percent), and $585 million in 2017 (7 percent).

Alaska highlights the volatility of severance taxes and the challenge they pose to states that heavily rely on them. 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

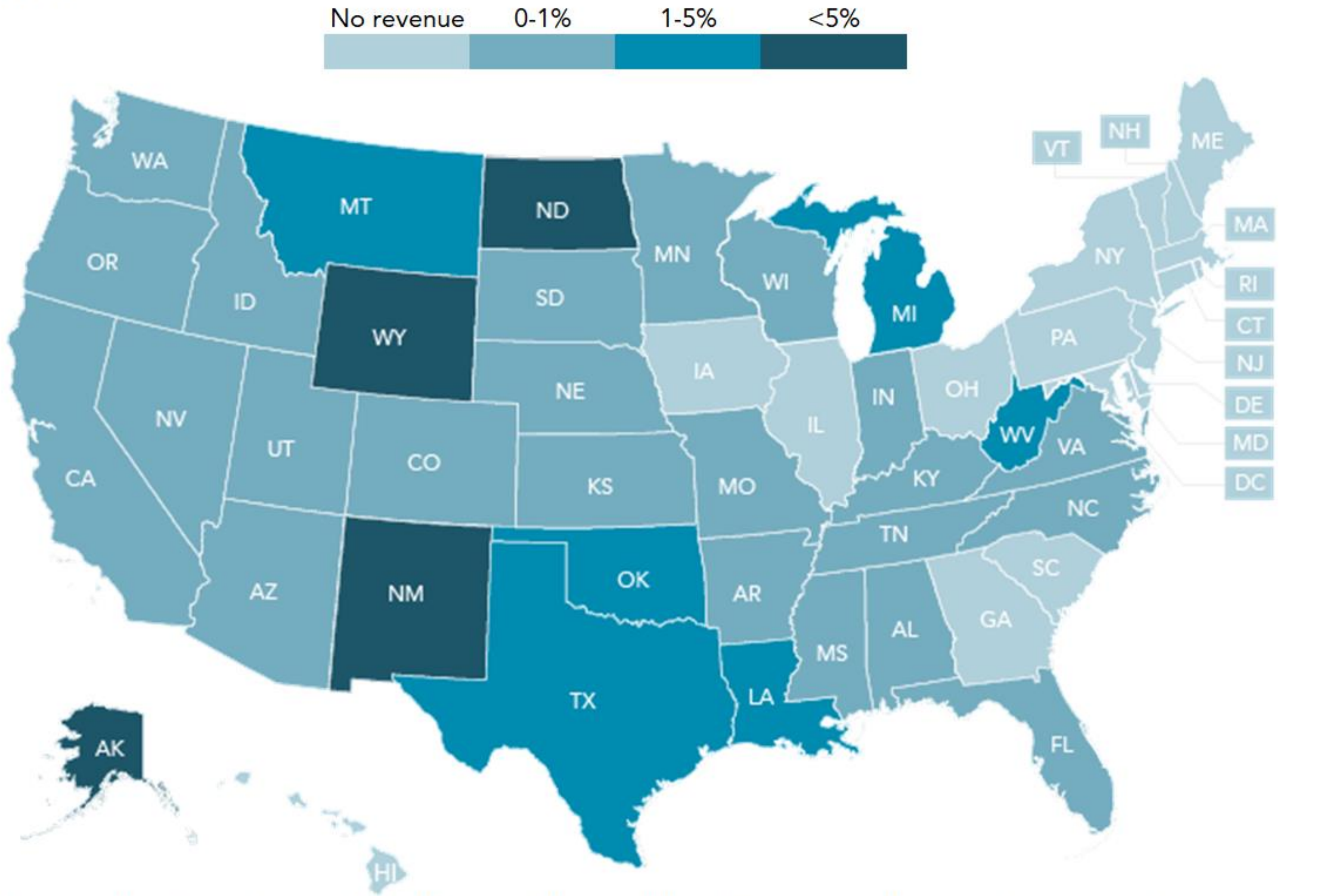
SPECIFIC STATE AND LOCAL TAXES

How do state and local severance taxes work?

FIGURE 1

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

2017



Source: U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments.
Note: Own-source general revenue does not include intergovernmental transfers.

Updated May 2020

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How do state and local soda taxes work?

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; the District of Columbia; Philadelphia, Pennsylvania; Seattle, Washington; and four California cities: Albany, Berkeley, Oakland, and San Francisco.

Annual soda tax revenue ranges from about $2 million in Berkeley to $75 million in Philadelphia, but this range is almost entirely a function of each city's population. In each locality the tax accounts for 1 percent or less of own-source revenue. (Own-source revenue excludes intergovernmental transfers.)

HOW DO SODA TAX RATES DIFFER?

Except for the District of Columbia, these local 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. The District of Columbia levies a special 8 percent sales tax on the retail purchases of soda. (The city's general sales tax rate is 6 percent.) However, the DC Council is considering changing this to a per-ounce tax.

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). The tax base in Philadelphia and the District of Columbia is notably larger than in other jurisdictions because they include any beverage with real or artificial sweeteners, and thus the tax applies to 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.

How do state and local soda taxes work?

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
Washington, DC	8 percent sales tax	Sweetened beverages (includes diet drinks)	Consumers

Source: City government websites.

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

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

WHAT ARE OTHER OPTIONS FOR TAXING SODA?

Most current soda taxes in the United States are based on an eligible drink's volume and not its sugar content. That is, an eight-ounce drink with two teaspoons of sugar (e.g., iced tea) is taxed the same rate as an eight-ounce drink with seven teaspoons of sugar (e.g., soda). This tax is simple and allows distributors to collect a set amount based on sales. It also works well if the government's primary goal is raising tax revenue. Notably, Philadelphia's tax, which taxes all sweetened beverages including diet drinks, is specifically designed to generate revenue. In fact, the tax was sold as a means for funding education programs and not primarily for improving health outcomes.

However, if the primary goal of the tax is improving public health by reducing sugar consumption, governments should consider taxing a beverage's sugar content. Taxing sugar content could encourage consumers to choose lower-sugar options and possibly encourage manufacturers, distributors, and retailers to stock and market more healthy options. The government could tax each unit of sugar or create a tiered system—similar to the different tax rates on liquor, wine, and beer. Taxes in Hungary, South Africa, and the United Kingdom are based on sugar content.

The State of State (and Local) Tax Policy

How do state and local soda taxes work?

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.

Updated May 2020

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How do state and local marijuana taxes work?

Q. How do marijuana taxes work?

A. Marijuana sales are legal and taxed in nine states. States currently levy three types of marijuana taxes: as a percentage of price (either the retail or wholesale price), based on weight (i.e., per ounce), and based on the drug's potency (i.e., THC level). Some states use a combination of these taxes.

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

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

Colorado and Washington have collected marijuana taxes since 2014. In calendar year 2018, Colorado collected $267 million and Washington collected $439 million in state marijuana taxes, or roughly 1 percent of state and local own-source revenue in each state. Four other states reported a full year's worth of state marijuana tax revenue in 2018: Alaska ($15 million), California ($354 million), Nevada ($87 million), and Oregon ($94 million). All totals were less than 1 percent of state and local own-source general revenue. (Note: None of these totals include local tax revenue.)

Medical marijuana is legal in 33 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.

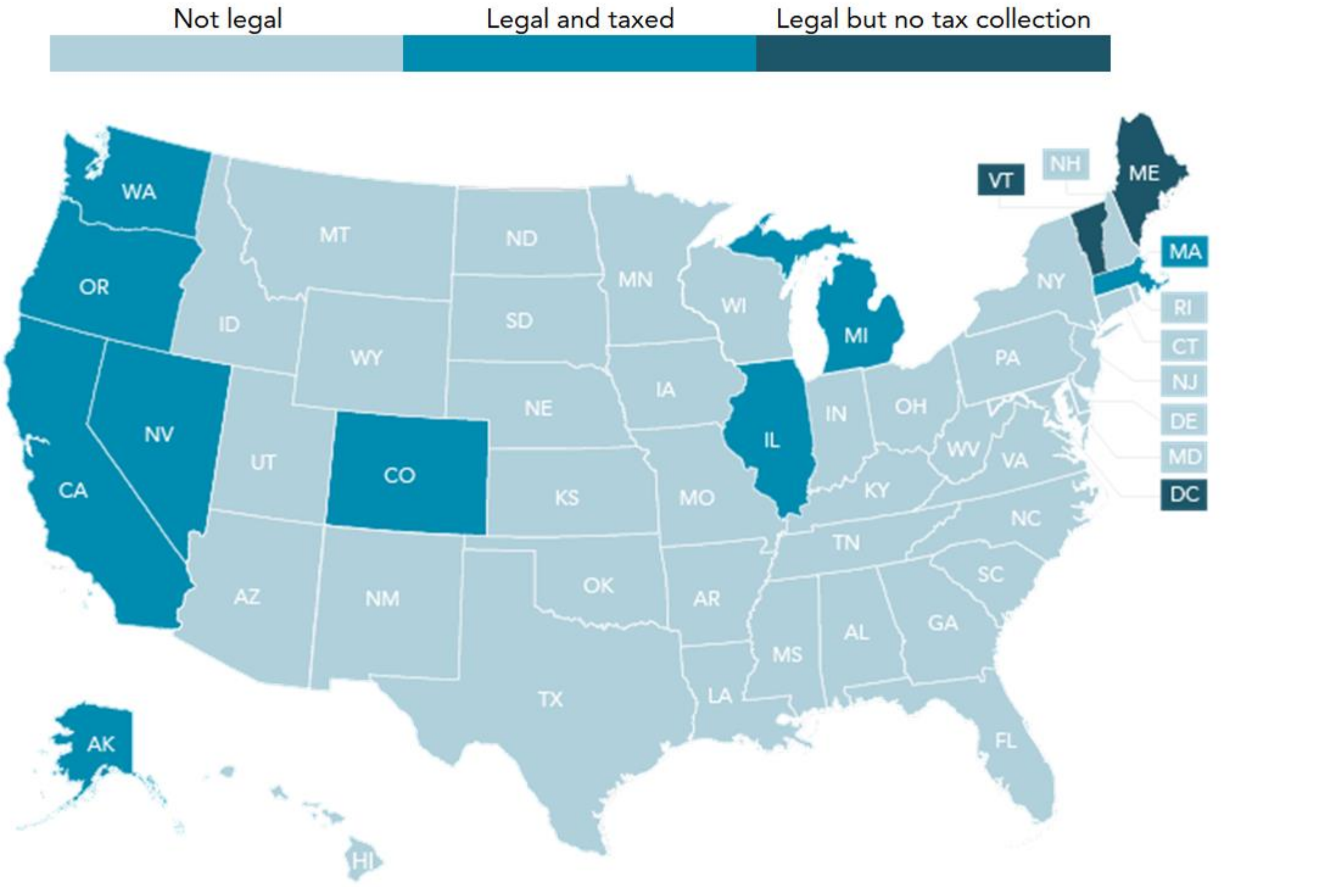
The State of State (and Local) Tax Policy

SPECIFIC STATE AND LOCAL TAXES

How do state and local marijuana taxes work?

FIGURE 1

Where is Marijunana Legal and Taxable?
2020



Source: State government websites.
Note: Medical marijuana is legal in 33 states.

HOW DO MARIJUANA TAX RATES DIFFER?

There are three ways state and local governments tax marijuana.

Percentage-of-price. These taxes are similar to a retail sales tax where the consumer pays a tax on the purchase price and the retailer remits it to the state. A few states levy their percentage of price tax on the wholesale transaction, but it is assumed this cost is then passed on to the consumer in the final purchase price. Some states also let localities levy a percentage of price tax—typically with a maximum rate.

Weight-based. These taxes are similar to cigarette taxes, except instead of taxing per pack of cigarettes the tax is based on the weight of the marijuana product. States with this type of tax also typically set different rates for different marijuana products. For example, California levies a $9.65 per ounce tax on marijuana flowers, a $2.87 per ounce tax on marijuana leaves, and a $1.35 per ounce tax on fresh plant material. As

How do state and local marijuana taxes work?

with other wholesale taxes, it is assumed most of this cost is passed on to the consumer in the final purchase price.

Potency-based. These taxes are similar to alcohol taxes, except instead of taxing drinks with a higher percentage of alcohol at higher rates (i.e., liquor is taxed at a higher rate than beer), the tax is based on the THC level of the marijuana product. Illinois is currently the only state with a THC-based tax. It taxes products with a TCH content of 35 percent or less at 10 percent of retail price and those with more than 35 percent at 25 percent of retail price. All marijuana-infused products (e.g., edibles) are taxed at 20 percent of retail price.

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

TABLE 1

Marijuana Tax Rates

State	Taxes	Legalization Date
Alaska	Cultivators pay $50 per ounce for bud/flowers, $25 per ounce for immature bud/flowers, and $15 per ounce for remainer 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
Illinois	7% state excise tax on gross receipts (cultivator). 10% state excise tax on retail sale of products with 35% or less THC. 25% state excise tax on retail sale of products with greater than 35% THC. 20% state excise tax on retail sale of cannabis-infused products (i.e. edibles).	2019
Maine	10% state excise tax on retail sale. Cultivators pay $335 per pound of flowers, $94 per pound of trim, $1.50 per pound of seedling, and $0.35 per pound of seed.	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 mariujana purchases. The legalization date is when the law passed and not when taxable sales began.

How do state and local marijuana taxes work?

HOW DO STATES USE MARIJUANA REVENUE?

So far, every state that taxes marijuana has dedicated at least a portion of the resulting revenue to specific programs:

- 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.
- Illinois's revenue first pays for administrative costs associated with marijuana legalization. Any remaining revenue is then divided among the general fund, programs that supporting criminal justice reform efforts, substance abuse programs, and local government transfers.
- When Maine begins collecting tax revenue, it will evenly split its revenue between public health and safety programs and law enforcement training programs associated with marijuana legalization.
- 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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