EXECUTIVE SUMMARY

The 2013 Who Pays: A Distributional Analysis of the Tax Systems in All Fifty States (the fourth edition of the report) assesses the fairness of state and local tax systems. The report measures the state and local taxes paid by different income groups in 2013 (at 2010 income levels including the impact of tax changes enacted through January 2, 2013) as shares of income for every state and the District of Columbia. It discusses state tax policy features and includes detailed state-by-state profiles providing essential baseline data for lawmakers seeking to understand the effect tax reform proposals will have on constituents at all income levels.

- The main finding of this report is that virtually every state’s tax system is fundamentally unfair, taking a much greater share of income from middle- and low-income families than from wealthy families. The absence of a graduated personal income tax and the over reliance on consumption taxes exacerbate this problem in many states.

- Combining all of the state and local income, property, sales and excise taxes state residents pay, the average overall effective tax rates by income group nationwide are 11.1 percent for the bottom 20 percent, 9.4 percent for the middle 20 percent and 5.6 percent for the top 1 percent.

- Ten states rank as having the most regressive overall tax systems. In these “Terrible Ten” states, the bottom 20 percent pay up to six times as much of their income in taxes as their wealthy counterparts. Washington State is the most regressive, followed by Florida, South Dakota, Illinois, Texas, Tennessee, Arizona, Pennsylvania, Indiana, and Alabama.

- Five of the ten most regressive states derive roughly half to two thirds of their tax revenue from sales and excise taxes, compared to a national average of roughly one third. Five of these ten most regressive states do not levy a broad-based personal income tax (four do not have any taxes on personal income and one state only applies its personal income tax to interest and dividends) while the other five have a personal income tax rate that is flat or virtually flat.

- Of the three broad kinds of taxes states levy (income, property, consumption), the income tax is the only one that is typically progressive in that its rate rises with income levels. Property taxes are usually somewhat regressive. Sales and excise taxes are the most regressive, with poor families paying eight times more of their income in these taxes than wealthy families, and middle income families paying five times more.

- Personal income taxes vary in their fairness not only because of rates but because of deductions and exemptions. For example, the Earned Income Tax Credit improves progressivity in 24 states and the District of Columbia, while nine states undermine progressivity by allowing taxpayers a reduced rate on capital gains income.
• States’ consumption tax structures are highly regressive with an average 7 percent rate for the poor, a 4.6 percent rate for middle incomes, and a 0.9 percent rate for the wealthiest taxpayers. Because food is one of the largest expenses for a low-income family, taxing food is a particularly regressive tax policy; five of the ten most regressive states tax food at the state or local level. Excise taxes on things like gasoline, cigarettes or beer take about 1.6 percent of the income of the poorest families, 0.8 percent from middle income families and 0.1 percent of income from the most well-off.

• Taxes on personal and business property are a significant revenue source for both states and localities and are generally regressive in their overall effect, particularly for middle income households. A homestead exemption (exempting a flat dollar or percentage amount of property value from a property tax) improves progressivity. A property tax circuit breaker that caps the amount a property owner pays in property taxes can also improve progressivity; none of the ten most regressive states offer this tax break for low-income families regardless of age.

• States commended as “low tax” are often high tax states for low- and middle-income families. The ten states with the highest taxes on the poor are Arizona, Arkansas, Florida, Hawaii, Illinois, Indiana, Pennsylvania, Rhode Island, Texas, and Washington. Seven of them are also among the “terrible ten” because they are not only high tax for the poorest, but low tax for the wealthiest.