

# Presentation to the Revenue Interim Committee on Sales Taxes

HJ 35: STUDY OF STATE AND LOCAL TAX POLICY

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# Introduction to ITEP

## The Institute on Taxation and Economic Policy (ITEP)

- Non-profit
- Non-partisan research organization
- Federal, state, and local tax policy issues

### **Mission:**

Ensure elected officials, media, and general public have access to accurate, timely, and straightforward information that allows them to understand the effects of current and proposed tax policies with an emphasis on tax-incidence analysis.

# Overview

1. Sales Taxes in Context
2. Montana's Tax Systems vs. Other States
3. Design and Best Practices
4. Addition of a General Sales Tax in Montana
5. Summary and questions

# Sales Taxes in Context

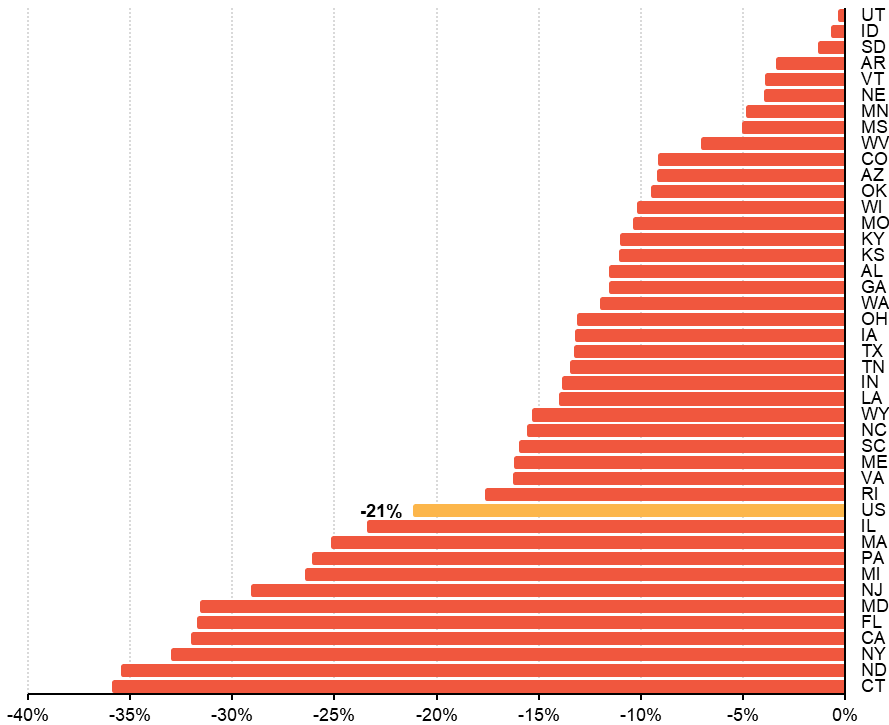
- 3 Major Sources of Revenue for State and Localities
  - Personal Income Tax
  - General Sales Tax
  - Property Tax
- Sales Taxes Are Regressive
  - Low-income taxpayers pay a greater share of their income in sales tax than the wealthy
- Income Spent on Sales-Taxable Items
  - Low-income: Three-quarters
  - Middle-income: Half
  - Upper-income: One-sixth

*“While sales taxes don’t grow with the economy as well as personal income taxes do over the long term, they also tend to decline less than income taxes when a recession hits. During recessions, income tax revenues fall as people lose their jobs or see their hours cut; sales tax revenues decline too (since people consume fewer taxable goods and services when their incomes drop), but usually not as sharply.”*

--Michael Leachman & Michael Mazerov, Center on Budget and Policy Priorities, (2013)

# Current Sales Tax Collections

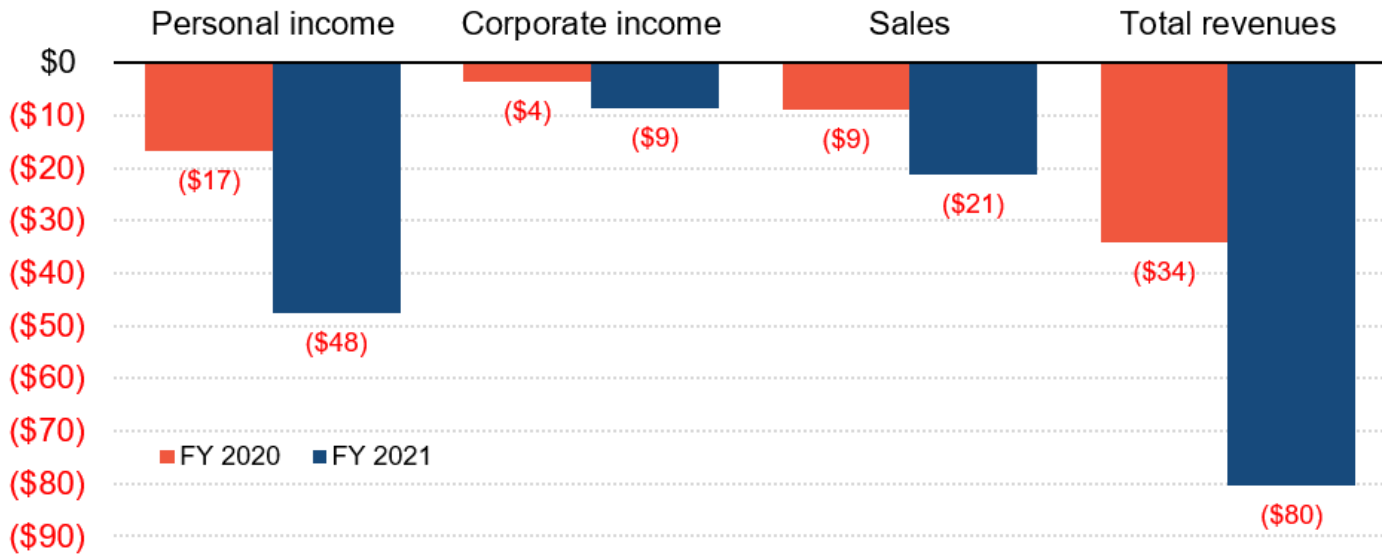
State sales tax revenues declines were widespread in May  
*Nominal year-over-year percent change, May 2020 vs May 2019*



Source: Individual state data collected by Urban Institute.

## Anticipated revenue shortfalls in 27 states

*Dollars in billions*



Note: In addition to income and sales taxes, total revenues also include all other revenue sources such as motor fuel taxes or severance taxes.

# Montana Compared to Other States





- Average State's Consumption Tax Structure is Equivalent to an Income Tax of...
  - 7.1% for the Poor
  - 4.8% for Middle Class
  - 0.9% for the Wealthy

Reference: [ITEP Who Pays? Sixth Edition](#)

## MONTANA State and Local Taxes (cont.)

### TOTAL TAX

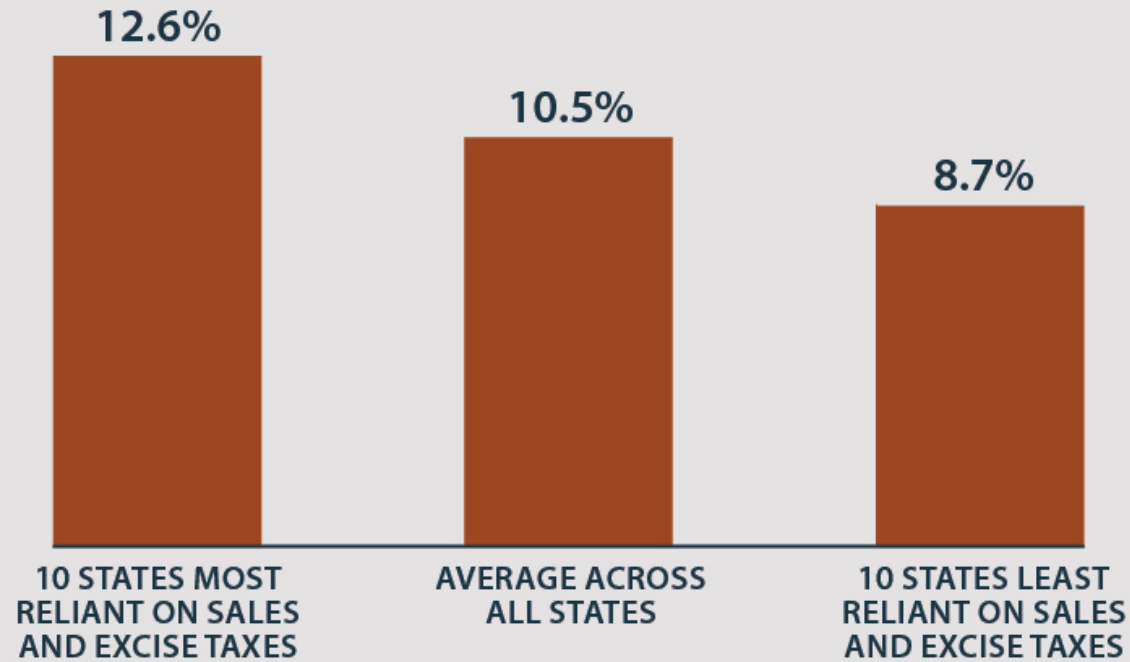
Share of Family Income

INCOME GROUP	LOWEST 20%	SECOND 20%	MIDDLE 20%	FOURTH 20%	TOP 20%		
					NEXT 15%	NEXT 4%	TOP 1%
INCOME RANGE	Less than \$18,000	\$18,000 to \$35,800	\$35,800 to \$56,500	\$56,500 to \$92,200	\$92,200 to \$185,400	\$185,400 to \$448,500	over \$448,500
AVERAGE INCOME IN GROUP	\$9,700	\$26,800	\$42,800	\$73,600	\$123,200	\$261,900	\$1,126,400
 <b>SALES &amp; EXCISE TAXES</b>	<b>2.1%</b>	<b>1.7%</b>	<b>1.2%</b>	<b>0.9%</b>	<b>0.6%</b>	<b>0.3%</b>	<b>0.1%</b>
General Sales—Individuals	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other Sales & Excise—Ind.	1.7%	1.4%	0.9%	0.7%	0.4%	0.2%	0.1%
Sales & Excise on Business	0.4%	0.3%	0.3%	0.2%	0.1%	0.1%	0.0%
 <b>PROPERTY TAXES</b>	<b>5.3%</b>	<b>3.5%</b>	<b>3.0%</b>	<b>2.6%</b>	<b>2.4%</b>	<b>2.0%</b>	<b>1.6%</b>
Home, Rent, Car—Individuals	4.6%	2.9%	2.5%	2.1%	1.9%	1.2%	0.4%
Other Property Taxes	0.7%	0.6%	0.6%	0.5%	0.5%	0.8%	1.2%
 <b>INCOME TAXES</b>	<b>0.5%</b>	<b>1.0%</b>	<b>2.8%</b>	<b>3.1%</b>	<b>3.9%</b>	<b>3.8%</b>	<b>4.8%</b>
Personal Income Tax	0.4%	1.0%	2.8%	3.1%	3.8%	3.7%	4.7%
Corporate Income Tax	0.0%	0.0%	0.1%	0.0%	0.1%	0.1%	0.1%
 <b>TOTAL TAXES</b>	<b>7.9%</b>	<b>6.3%</b>	<b>7.1%</b>	<b>6.6%</b>	<b>6.9%</b>	<b>6.1%</b>	<b>6.5%</b>

Individual figures may not sum to totals due to rounding.

## STATES RELYING HEAVILY ON SALES AND EXCISE TAXES LEVY HIGHER EFFECTIVE TAX RATES ON LOW-INCOME FAMILIES

*Total State and Local Effective Tax Rate on Lowest 20 Percent of Taxpayers*



**NOTE:** Effective tax rates in this chart are unweighted averages across each group of states.

Reference: [ITEP Who Pays? Sixth Edition](#)

# Most & Least Equitable Tax Systems

Most...

& Least

## CHARACTERISTICS OF MORE EQUITABLE STATE AND LOCAL TAX SYSTEMS

Taxes as share of family income + Tax features driving the data

RANK	STATE	POOREST 20%	MIDDLE 60%	TOP 1%	Higher Income Tax Brackets/ Rates on Upper- Income	Limits Deductions and/or Exemptions for Upper- Income	High Reliance on PIT	Use of Refundable Credits	Low Use of Sales & Excise Taxes	Levies Estate or Inheritance Tax
51	California	10.5%	8.9%	12.4%	✓	✓		✓		
50	District of Columbia	6.3%	9.6%	9.5%	✓	✓		✓	✓	Estate Tax
49	Vermont	8.7%	9.4%	10.4%	✓	✓		✓	✓	Estate Tax
48	Delaware	5.5%	5.7%	6.5%				✓	✓	
47	Minnesota	8.7%	9.7%	10.1%	✓	✓		✓		Estate Tax
46	New Jersey	8.7%	9.8%	9.8%	✓	✓		✓	✓	Inheritance Tax
45	Maine	8.7%	9.2%	8.6%		✓		✓	✓	Estate Tax
44	New York	11.4%	12.2%	11.3%	✓	✓	✓	✓	✓	Estate Tax
43	Montana	7.9%	6.7%	6.5%			✓	✓	✓	
42	Maryland	9.8%	10.3%	9.0%	✓		✓	✓		Both

**NOTE:** States are ranked by the ITEP Tax Inequality Index. The ten states in the table are those whose tax systems have the least detrimental impact on income inequality.

## ITEP'S TERRIBLE 10 MOST REGRESSIVE STATE & LOCAL TAX SYSTEMS

Taxes as share of family income + Tax features driving the data

RANK	STATE	POOREST 20%	MIDDLE 60%	TOP 1%	Little or No Income Tax	Flat-Rate Income Tax	Top Income Tax Rate Starts at Low Amount	Lack of Refundable Credits	High Reliance on Sales & Excise Taxes	High Reliance on Property Tax
1	Washington	17.8%	10.9%	3.0%	✓			✓	✓	
2	Texas	13.0%	9.7%	3.1%	✓			✓	✓	✓
3	Florida	12.7%	8.1%	2.3%	✓			✓	✓	✓
4	South Dakota	11.2%	8.7%	2.5%	✓			✓	✓	
5	Nevada	10.2%	7.4%	1.9%	✓			✓	✓	
6	Tennessee	10.5%	8.4%	2.8%	✓			✓	✓	
7	Pennsylvania	13.8%	11.0%	6.0%		✓		✓	✓	
8	Illinois	14.4%	12.3%	7.4%		✓		EITC non-refundable; small refundable low-income credit		✓
9	Oklahoma	13.2%	10.5%	6.2%			✓		✓	
10	Wyoming	9.6%	7.2%	2.6%	✓			✓		

**NOTE:** States are ranked by the ITEP Tax Inequality Index. The ten states in the table are those whose tax systems most increase income inequality. See Methodology for a full description of the Index.

Reference: [ITEP Who Pays? Sixth Edition](#)



## CHARACTERISTICS OF MORE EQUITABLE STATE AND LOCAL TAX SYSTEMS

*Taxes as share of family income + Tax features driving the data*

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46	New Jersey	8.7%	9.8%	9.8%	✓	✓		✓	✓	Inheritance Tax
45	Maine	8.7%	9.2%	8.6%		✓		✓	✓	Estate Tax
44	New York	11.4%	12.2%	11.3%	✓	✓	✓	✓	✓	Estate Tax
43	Montana	7.9%	6.7%	6.5%			✓	✓	✓	
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# Design & Best Practices

- Principles of a Good Sales Tax
  - Broad base
  - Low Rate
  - Exemption(s) for low- and middle-income taxpayers
  - Sustainable

# Design & Best Practices Cont.

- Horizontal equity

- A tax is structured to impose the same tax liability on two taxpayers in similar economic circumstances — most often, two taxpayers with the same income

&

- Vertical equity

- The distribution of tax liabilities among people with different incomes

# Services Taxed by Category & State

- Montana taxes 17 services out of more than 176
- States need to ensure their taxable base remains up-to-date

Number of Services Taxed by Category and State - January 2017

	Utilities	Personal Services	Business Services	Computer Services	Online Services	Admission Amusement	Professional Services	Fabrication, Repair & Installation	Other Services	Total
AL	12	1	6	3	6	10	0	1	3	42
AK	0	0	0	0	0	0	0	0	1	1
AR	16	7	12	1	0	12	0	11	14	73
AZ*	12	2	7	0	5	9	0	2	23	60
CA	2	2	7	1	0	1	0	3	5	21
CO*	4	1	2	1	5	2	0	3	3	21
CT	10	9	21	6	8	10	0	10	25	99
DE	9	20	34	6	8	10	9	19	37	152
DC	14	9	17	6	4	10	0	14	17	91
FL	9	4	11	0	2	13	0	15	15	69
GA	10	4	5	2	0	8	0	1	6	36
HI	16	20	34	8	6	14	9	18	42	167
ID	0	3	4	0	4	9	0	6	4	30
IL	12	2	1	1	1	9	0	1	2	29
IN	12	4	3	1	5	3	0	1	7	36
IA	10	15	17	0	1	13	0	13	20	89
KS	10	10	9	1	1	13	0	15	15	74
KY	11	2	4	1	6	8	0	4	4	40
LA*	10	8	5	3	5	9	0	13	7	60
ME	10	1	6	0	5	3	0	4	4	33
MD*	5	3	13	1	0	11	0	4	3	40
MA*	9	1	4	0	1	1	0	2	1	19
MI	12	2	7	1	1	1	0	1	2	27
MN	15	8	11	0	6	12	0	6	9	67
MS	10	5	8	3	7	11	0	13	22	79
MO	8	1	2	1	0	10	0	0	2	24
MT	12	0	0	0	0	1	0	0	4	17
NE	14	10	14	3	6	12	0	12	10	81
NV	0	1	4	0	0	7	0	2	7	21
NH	6	1	0	0	0	0	0	0	2	9
NJ	12	6	17	1	4	7	0	15	22	84
NM*	16	20	32	8	6	14	9	18	41	164
NY	5	5	13	1	1	6	0	14	19	64
NC	12	7	8	0	6	9	0	14	6	62
ND	4	1	4	2	1	8	0	0	2	22
OH	8	11	14	5	8	13	0	11	16	86
OK*	9	3	5	1	0	10	0	0	5	33
OR	0	0	0	0	0	0	0	0	1	1
PA	9	5	16	4	8	2	0	14	9	67
RI*	10	1	6	3	0	4	0	3	2	29
SC	4	6	7	4	2	10	0	1	5	39
SD	14	19	28	8	8	13	5	18	39	152
TN	11	10	7	3	6	12	0	14	13	76
TX	12	10	14	8	8	12	1	10	15	90
UT	7	8	6	0	5	11	0	15	12	64
VT	9	2	5	1	6	11	0	2	1	37
VA	1	3	4	0	0	1	0	4	4	17
WA	16	20	33	8	8	13	9	16	44	167
WV	8	18	27	4	5	13	1	13	26	115
WI	11	10	8	3	7	14	0	13	16	82
WY	10	7	5	4	5	6	0	16	13	66
Total	16	20	34	8	8	15	9	19	47	176

\* State Did not Respond, 2007 data reported  
Source: FTA Survey.

Reference: [FTA Survey of Services Taxation - Update, July-August 2017](#)

# *Wayfair* and Online Sales Tax Collections

- *South Dakota v. Wayfair, Inc.* (2018)
  - SCOTUS overruled the “physical presence” requirement for out-of-state sellers
  - Opened the door for states to collect sales tax from remote sellers
  - States have begun enacting similar laws exempting sellers below a specific amount of income in sales and/or a sales threshold

# Options for Reducing Regressivity

- Exemptions

- Eliminate sales tax on specific item

## Credits Designed to Offset Sales Tax/Taxes on Food

State	Description of the credit
AZ	Refundable "Increased Excise Tax Credit" for low-income taxpayers of all ages.
HI	"Refundable Food/Excise Tax Credit" for single taxpayers with FAGI below \$50,000. In 2016, eligibility changed for single taxpayers to \$30,000 FAGI.
ID	Refundable "Grocery Credit" to all families regardless of income. The credit is \$100 per family member. Elderly taxpayers receive an extra \$10 per filer.

- Sales Tax Holiday

- Temporary break on sales tax liability

- Sales Tax Credit

- An amount taxpayers may subtract from taxes owed

KS	Targeted, nonrefundable food sales tax credit to families with income below \$30,615 with at least one dependent or who are over 55 years of age; the maximum credit is \$125 per exemption.
ME	Targeted, refundable Sales Tax Fairness Credit to low- and middle-income families dependent on family size and income; the maximum credit is \$225.
NM	Refundable "Low Income Comprehensive Tax Rebate" for all low-income taxpayers.
OK	Refundable "Credit/Refund of Sales Tax" for low-income taxpayers of all ages.

Reference: [Options for a Less Regressive Sales Tax in 2019](#)

# Sales Tax Holidays 2019



Source: Institute on Taxation and Economic Policy, July 2019.

Reference: [Sales Tax Holidays: An Ineffective Alternative to Real Sales Tax Reform](#)

# Sales Tax Credits & Maine

- **Advantages:**
  - Refundability
  - Targeted
  - Do not affect sales tax base
  - Less expensive alternative
- **Disadvantages:**
  - Administration

## The Maine Sales Tax Fairness Credit

Filing Status	Reduction Of	For Every	Exceeding This Income Level
Single	\$10	\$500	\$20,000
Head of Household	\$15	\$750	\$30,000
Joint	\$20	\$1,000	\$40,000

## Credit Amount

Per Personal Exemption	TY 2018
1	\$125
2	\$175
3	\$200
4	\$225

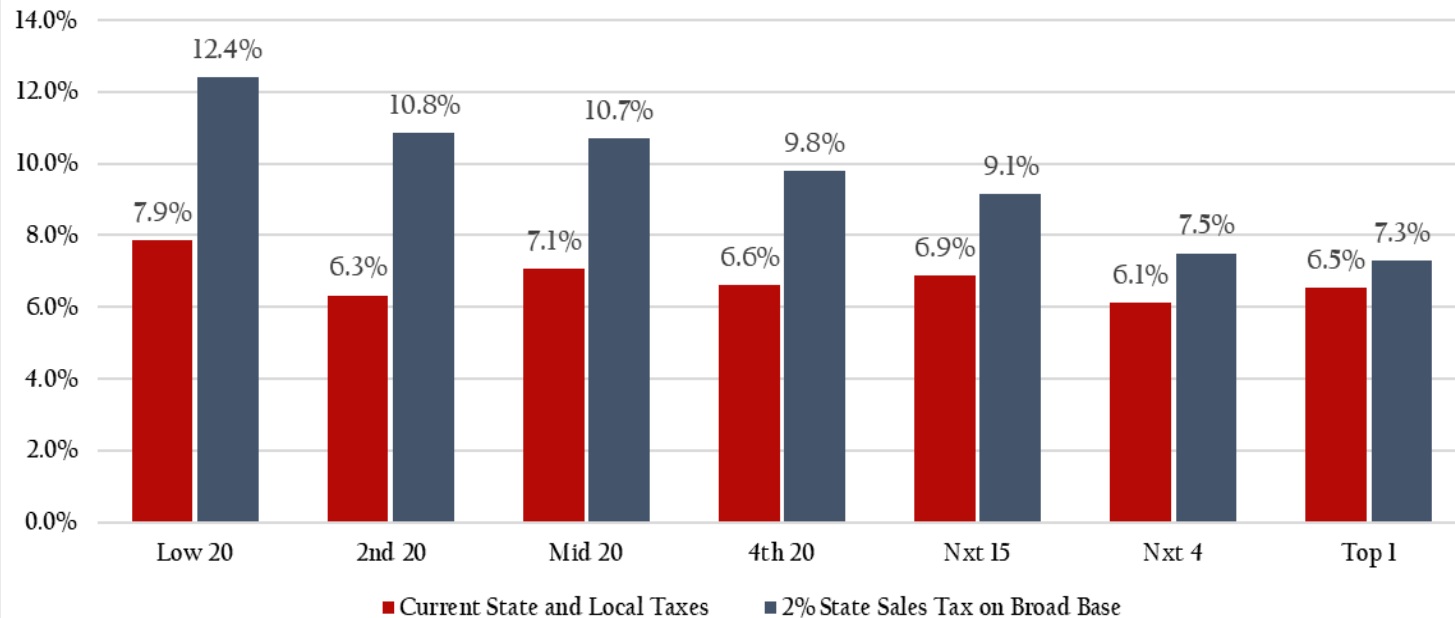
Source: <http://legislature.maine.gov/legis/statutes/36/title36sec5213-A.html>

Reference: [Options for a Less Regressive Sales Tax in 2019](#)

# A Sales Tax in Montana?

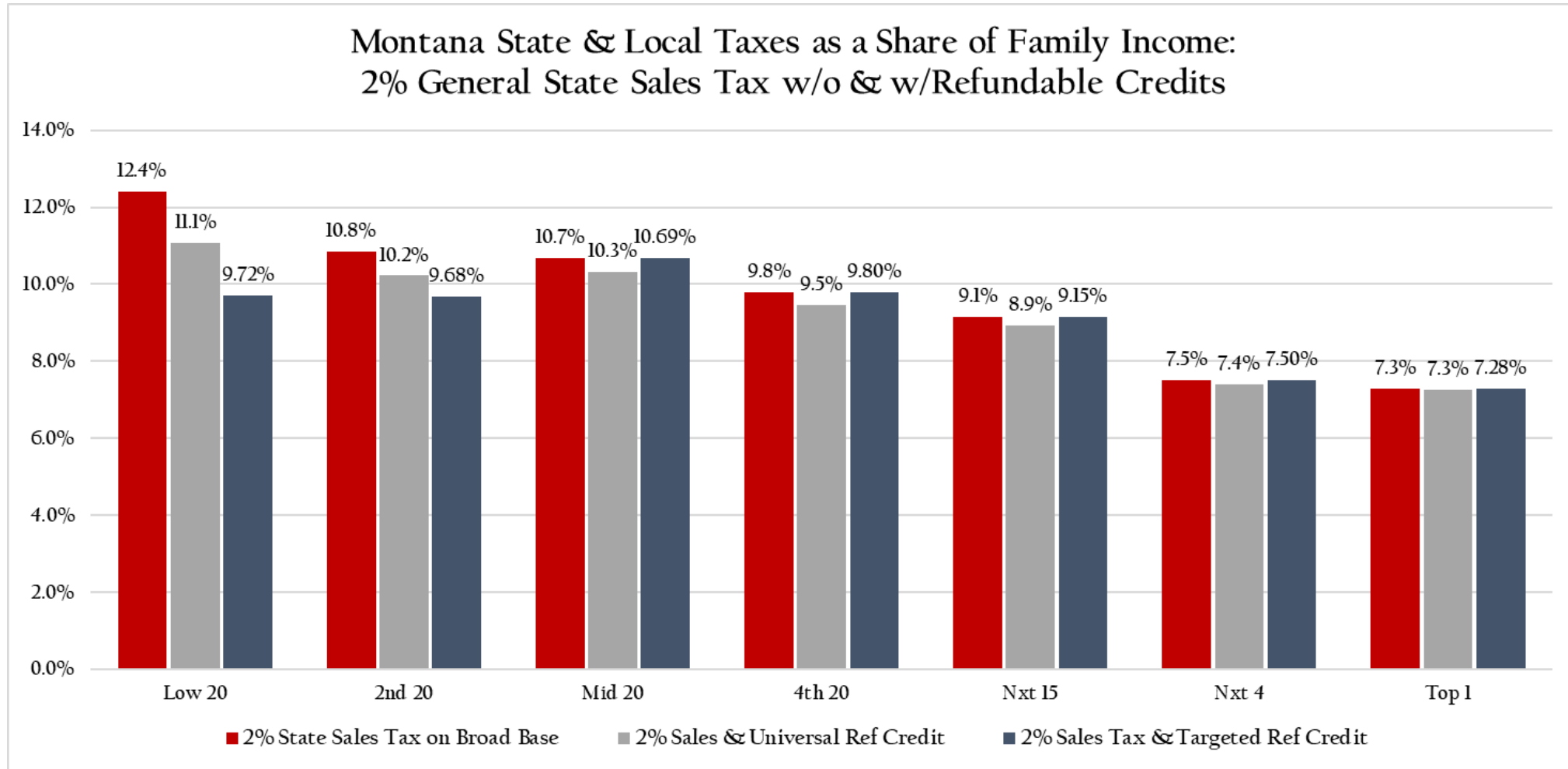
- 2% broad based sales tax based on HB 300 & HB 620

Montana State & Local Taxes as a Share of Family Income:  
Current vs. with a 2% General State Sales Tax



- Raise \$1.4 Billion in 2019 \$
- New ITEP Tax  
Inequality Index Rank:  
39<sup>th</sup>

# Sales Tax & Credits



# Sales Tax & Credits Notes

- First bar:

- Universal credit
- \$100 per person
- Fully refundable
- Cost: \$102 million in 2019 \$
- New Tax Inequality Index Rank: 36<sup>th</sup>

- Second bar:

- Targeted credit to taxpayers making >\$35,000
- \$200 per person
- Cost: \$53 million in 2019 \$
- New Tax Inequality Index Rank: 43<sup>rd</sup>

# Summary

- Sales taxes can be an important part of state tax systems despite being regressive
- Avoid relying too heavily on sales tax
- Implement a sales tax to diversify tax system and not to replace other taxes
- Utilize policy to offset regressive nature of sales tax

