

No More Tax Heroin

Federal Action Could Restore Sales Tax Deductibility

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Finally the folks in Washington are doing something to help Texas. For those who believe in limited government and personal liberty, the most horrifying development of the May special session on school finance was talk of instituting some type of income tax.

This makes all the more welcome the news that our federal representatives are a big step closer to once again making state and local sales taxes deductible on the federal income tax.

State income taxes and their close cousins, various so-called “business” taxes such as the gross receipts tax, payroll tax, and business activity tax, can be deducted from the federal income tax. Texas’ biggest state tax, the sales tax, is not currently federally deductible.

The only tax a large number of Texans can deduct is the property tax. However, this is the tax that everyone agrees is too high. The problem with reducing property taxes, though, is some other tax will have to be created or raised.

Most economists agree consumption taxes – like the sales tax – least harm an economy. Taxing goods and services purchased by the final consumer avoids taxing the same thing repeatedly, it does not discourage work, and actually encourages saving.

A big impediment for the last 18 years to shifting from property to sales taxes has been the lack of federal tax deductibility for sales taxes.

HR 4520, currently in conference negotiations, could once again make sales tax deductibility a reality. However, since sales tax deductibility is not in the Senate version, House conferees must stand firm in order to send this long-overdue reform to the president for his signature.

President Bush has signaled his strong support for such a move.

It was estimated by Texas' Comptroller's office that for every dollar shifted from the property tax to the sales tax, Texans would lose 14 cents in federal income tax deduction. A \$2 billion shift from the property tax to the sales tax would have directly cost Texas taxpayers \$280 million dollars – more in economic terms.

In 2003, over \$14 billion of all state tax revenues were collected through the state sales tax. That means Texans lost almost \$2 billion in federal income tax deductions that ought to be ours since, along with only eight other states, we have no income tax. For this reason, some in the Texas legislature felt compelled to recommend some type of deductible income-type tax to replace property taxes.

Current federal tax policy forces states to adopt an income tax. Income taxes admittedly have some great characteristics. The personal income tax, gross receipts tax, business activity tax, and payroll tax all tax broadly and can raise a lot of money at a very low rate.

But heroin has a lot of desirable characteristics, too. So many wonderful uses did heroin have when it was discovered, it was considered “heroic” and thus its name: “hero-in.” Only later was its dangerous addictive quality realized.

Similarly, income taxes are addictive and dangerous.

Ohio was once like Texas. Three decades ago it had a thriving economy with the nation's third lowest tax burden. Then, Ohio's politicians imposed an income tax, with the federal tax code giving them cover. That cover may have shielded the politicians, but it left the economy very cold.

Today, Ohio has the third highest tax burden. It leads the nation in the number of individuals in their prime earning years leaving for work in other states.

It has only been since 1986 that the state and local sales tax has not been deductible. That mistake has long needed correcting.

It is time the federal government stopped encouraging states to dig their own economic graves. It's up to the U.S. Senate to help states put away their shovels.

