Texas Public Policy Foundation

Income Tax

Legislator's Guide to the Issues 2015-16

Income Tax

The Issue

Although no one likes to pay taxes, they are an inevitable part of funding core government functions. As such, a policymaker's challenge is to develop an efficient tax system that provides necessary revenue while doing the least economic harm. A policymaker should take care, however, as not all methods of raising revenue are created equal.

While each tax affects behavior and distorts choices differently, the income tax is among the most pernicious because, as a tax on an individual's earnings, it negatively affects earnings, productivity, and wage gains. As a consequence of these adverse effects, people are generally not able to save and consume as much as they would have otherwise.

What's more, an income tax requires a particularly large bureaucratic apparatus for tax collection purposes. Much more so than, say, for the collection of sales taxes. With more bureaucracy comes more costs for taxpayers. This means higher taxes and fees.

There are other ways to raise revenue without incurring such harmful economic effects or enlarging the bureaucracy with an income tax. And to its credit, Texas is one of only nine states without an income tax.

While some argue that a broad-based personal income tax is needed to improve the state's overall outlook, this raises the question: How has Texas' economy performed without an income tax?

According to the latest Tax Foundation data, Texas' state and local tax burden ranks 45th nationally, placing it among the very best states for taxpayers. As a result of the state's comparatively friendly tax environment, Texas' private sector economy is surging forward, outperforming the nation as a whole in a number of key areas, such as:

- Texas' economy is growing faster than the national average. In 2013, Texas' real gross domestic product grew by 3.7%, more than twice as fast as the national average of just 1.9%;
- Texas' labor market is adding jobs at a faster rate than the rest of the nation. From December 2012 to December 2013, Texas' employment grew by 2.7% and U.S. employment increased by only 1.7%;
- Texas replaced all of the jobs it lost during the recession by September 2011; however, there remain 1.7 million fewer Americans employed in December 2013 than before the recession; and
- Despite a large increase in the state's labor force relative to the nation, Texas' unemployment rate, 6% in December 2013, has been at or below the national average for 84 consecutive months, or 7 years.

In How Big Government Hurts the Economy, the Foundation compares the past economic performance of the nine states without a personal income tax (including Texas) to the nine with the highest marginal income tax rates (including California) and the 50-state average. The study's results show clear differences.

In every category analyzed—including Gross State Product, Personal Income, Non-Farm Payroll Employment, Population, and State and Local Tax Revenue—the states without a personal income tax performed better than the states with the highest marginal personal income tax rates. Not only that, but the nine states without an income tax also outperformed the national average in every category, often by a wide margin (*see chart next page*).

continued on back

Based on this empirical data, Texas' economic prospects as well as its citizens are best served by its current low-tax, pro-growth approach rather than a new income tax.

9 Zero Personal Income Tax States vs. 9 Highest Personal Income Tax Rate States: 10-Year Growth
(tax rates as of 1/1/2013, growth rates 2001 to 2011 unless otherwise noted)

State	Top Marginal Personal Income Tax Rate	Gross State Product	Nonfarm Payroll Employment	Population	State and Local Tax Revenue***
Alaska	0.00%	85.2%	13.2%	14.0%	166.8%
Florida	0.00%	48.9%	12.5%	16.5%	57.0%
Nevada	0.00%	64.9%	18.1%	29.8%	74.0%
New Hampshire	0.00%	42.2%	4.2%	5.0%	53.1%
South Dakota	0.00%	59.1%	12.4%	8.7%	48.9%
Tennessee	0.00%	45.1%	5.5%	11.3%	46.8%
Texas	0.00%	71.5%	20.5%	20.4%	65.6%
Washington	0.00%	54.2%	8.9%	14.1%	42.9%
Wyoming	0.00%	100.7%	18.9%	14.9%	131.3%
9 Zero Personal Income Tax Rate States*	**0.00%**	**63.54%**	**12.68%**	**14.98%**	**76.26%**
50-State Average**	**5.69%**	**51.41%**	**7.62%**	**9.54%**	**49.79%**
9 Highest Personal Income Tax Rate States**	**10.23%**	**45.90%**	**5.30%**	**6.50%**	**47.74%**
Kentucky	8.20%	41.6%	5.0%	7.4%	35.4%
Ohio	8.43%	26.5%	-2.5%	1.4%	26.8%
Maryland	8.95%	53.9%	9.5%	8.4%	53.5%
Vermont	8.95%	37.7%	4.5%	2.3%	57.5%
New Jersey	9.97%	33.4%	5.2%	3.9%	55.6%
Oregon	10.61%	73.1%	6.5%	11.6%	39.5%
Hawaii	11.00%	57.5%	10.2%	12.1%	60.9%
New York	12.70%	43.1%	7.2%	2.0%	56.8%
California	13.30%	46.2%	2.2%	9.3%	43.8%

* equal-weighted average, NH and TN tax only "unearned" (dividend and interest) income only
** equal-weighted average, does not include D.C.
*** 2000-2010 due to data release lag
Source: Laffer Associates, Bureau of Economic Analysis, U.S. Census Bureau

The Facts

- Texas is one of nine states without an income tax.
- Income taxes damage a state's economy more than any other tax because they disincentivize savings, investment, productivity, job creation, and economic expansion.
- Short-term revenue gains from a new personal income tax are outweighed by the long-term economic damage the tax creates.
- The nine states without an income tax out-performed the nine states with the highest marginal income tax rates in nearly every key economic indicator from 2001 to 2011.
- In addition, the nine states without an income tax also outperformed the national economy.

Recommendations

- Never create a personal income tax in Texas.
- Encourage economic growth by keeping taxes low and adopting pro-growth reforms.

Resources

How Big Government Hurts the Economy by Laffer, Drinkwater, DeVore, and Moore, Texas Public Policy Foundation (Nov. 2013).

900 Congress Ave., Ste. 400, Austin, Texas 78701 | 512.472.2700 phone 512.472.2728 fax | www.TexasPolicy.com