



Zero.Zero Sales Tax

How Do Other States Do It?

September 30, 2013

Highlights

- Non-sales-tax states have higher revenue per capita than Rhode Island in certain key areas, without necessarily taxing at a higher rate.
- The overall tax structures of non-sales-tax states do not rely on high rates in multiple categories.
- Despite Rhode Island's high taxation in all available categories, revenue in non-sales-tax states proved more resilient than in RI during the economic crisis, falling less and recovering more quickly, at and above the national average.
- Non-sales-tax states manage to spend *more* per capita on critical government activities than RI, such as infrastructure and education.
- The exception, where non-sales-tax states reduce their spending relative to Rhode Island, is in social welfare/wealth redistribution.
- Non-sales-tax states have all seen net taxpayer migration *from* other states *to* them; Rhode Island has gone the other way.
- The employment situation is healthier in non-sales-tax states than in Rhode Island.
- Studies show residents *will* cross borders to shop in states without sales taxes.

- The high population density across Rhode Island's borders is likely to amplify the benefit to the state.

RI & Non-Sales-Tax States

Rates

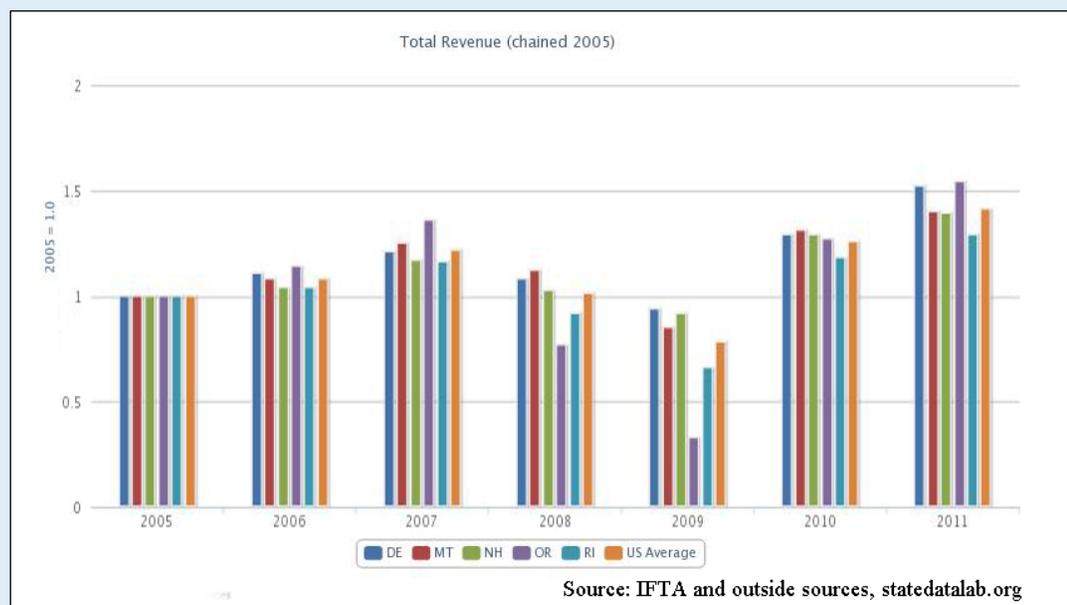
Tax Rates in Select Categories: Rhode Island and Non-Sales-Tax States ¹					
	DE	MT	NH	OR	RI
Top corporate income (%)	8.70	6.75	8.50	7.60	9.00
Top individual income (%)	6.75	6.90	5.00	9.90	5.99
Fuel (¢/gallon)	23.0	27.8	19.6	31.0	33.0
Cigarette (\$/gallon)	1.60	1.70	1.68	1.18	3.46
Long-term capital gains (%)	6.80	4.90	0.00	9.90	5.99

Note: In 2010, Rhode Island lowered its top income tax rate from 9.9%, but adjusted deductions so that the overall income tax burden would not be reduced.

Source: Tax Foundation

Revenue Trends for RI and Non-Sales-Tax States

Non-sales-tax states have recovered at the national average or better, while Rhode Island has lagged.



Revenue

In 2011, **Delaware** collected \$975 more per capita in taxes than Rhode Island and had \$1,377 more in total revenue.² Apart from the sales tax, RI collects more in excise taxes, utility revenue, insurance trust revenue, and intergovernmental revenue than DE, which makes up the difference as follows:

- License taxes:³ \$1,211
- Individual income taxes (top rate = 6.75%; RI = 5.99%): \$332
- Corporate income taxes (top rate = 8.7%; RI = 9.0%): \$236
- Other taxes: \$46
- Current charges: \$495
- Miscellaneous revenue: \$562

Montana collects \$313 less in taxes per capita than Rhode Island and has \$965 less in total revenue. Rhode Island collects more in taxes in most other categories, with the exception of the following:

- License taxes: \$217
- Other taxes: \$498
- Liquor store revenue: \$74
- Insurance trust: \$20

New Hampshire collects \$844 less in taxes, per capita, than Rhode Island and has \$2,450 less in total revenue. If Rhode Island completely removed its sales tax revenue, with no increases elsewhere, New Hampshire would still have \$60 less in taxes and \$1,666 less in total revenue. It does, however, collect more revenue in some categories:

- Excise taxes: \$77
- License taxes: \$161
- Corporate income taxes (top rate = 8.5%; RI = 5.99%): \$302
- Other taxes: \$334
- Liquor stores: \$410

Oregon collects \$523 less in taxes than Rhode Island but has \$57 more in total revenue. The following areas account for the difference:

- License taxes: \$153
- Individual income taxes (top rate = 9.9%; RI = 5.99%): \$452
- Other taxes: \$1
- Current charges: \$112
- Liquor store revenue: \$113
- Insurance trust: \$1,403

Per Capita Revenue by Source, 2011: Rhode Island and Non-Sales-Tax States (\$)

	DE	MT	NH	OR	RI
Total revenue	10,307	7,965	6,480	8,987	8,930
Intergovernmental	2,085	2,419	1,637	1,965	2,598
Taxes	3,595	2,308	1,776	2,097	2,620
General sales	0	0	0	0	784
Selective sales (excise)	544	534	686	283	609
License taxes	1,302	308	222	244	91
Individual income	1,298	814	63	1,419	967
Corporate income	377	124	442	121	141
Other taxes	74	527	363	29	28
Current charges	1,250	607	748	867	755
Misc. general revenue	1,396	446	598	449	835
Utility revenue	18	0	0	0	30
Liquor stores revenue	0	74	410	113	0
Insurance trust revenue	1,962	2,112	1,312	3,496	2,092

Source: <http://www.census.gov/govs/state/>

Spending

With the exception of Delaware, all of the non-sales-tax states simply spend less per resident than does Rhode Island. It is almost the case that the lower spending in all three states equals or surpasses Rhode Island’s sales tax revenue, per capita. All four non-sales-tax states spend significantly *less* per capital than Rhode Island on:

- Public welfare, which is by far the greatest difference
- Interest on general debt
- Utility expenditures

At the same time, all four states spend *more* per capita than Rhode Island on:

- Highways
- Natural resources
- Parks and recreation

All but New Hampshire also spend more, per capita, on Education and Corrections. (See sidebar.)

Per Capita Spending by Source, 2011: Rhode Island and Non-Sales-Tax States (\$)

	DE	MT	NH	OR	RI
Education	2,804	1,844	1,529	1,834	1,727
Public welfare	1,943	1,393	1,475	1,557	2,286
Hospitals	57	48	38	421	56
Health	436	170	67	128	162
Highways	508	711	419	432	242
Police	126	48	42	41	68
Correction	294	189	85	184	173
Natural res.	110	260	51	116	42
Parks and rec.	42	31	26	25	5
Admin.	485	421	194	203	305
Interest	294	156	298	117	407
Other	682	822	610	394	622

Source: <http://www.census.gov/govs/state/>

RI Sales Tax Rationale

§ 44-18-2 Declaration of necessity.

“The recognition of the state of its obligation to grant pay increases for teachers in the manner provided in chapter 7 of title 16, to assure the maintenance of proper educational standards in the public schools, coupled with the compelling necessity for additional state aid to the several cities and towns now confronted with financial crisis, have created an increased burden on the finances of the state. To the end that adequate funds are available to the state government to enable it to meet these newly adopted obligations, without impairing the ability of the state to fulfill its existing obligations, a revision of the tax structure is unavoidable. The enactment of the provisions of chapters 18 and 19 of this title is declared to be necessary to enable the state to carry out the provisions of chapter 7 of title 16.”

If the rationale for implementing the sales tax was to bolster education spending while not neglecting more fundamental responsibilities of state government, comparison with states that never implemented a sales tax suggests that the experiment was not a success.

State in Need

Migration

Last year, the RI Center for Freedom & Prosperity published a report analyzing IRS data related to taxpayer migration,⁴ which found that Rhode Islanders are leaving the Ocean State and taking their incomes with them. Moreover, a large portion of them are simply moving across nearby state borders, thus remaining within driving distance of their Rhode Island neighborhoods.

According to the same IRS data, all non-sales-tax states, excluding Alaska, have experienced net migration *from* other states *to* their own since the beginning of records in 1993, in contrast with RI.

State-to-State Net Taxpayer Migration, 1993-2010: Rhode Island and Non-Sales-Tax States

	Exemptions (People)	Adjusted Gross Income
Delaware	60,317	\$1.2 billion
Montana	47,258	\$2.7 billion
New Hampshire	66,941	\$3.9 billion
Oregon	240,645	\$7.6 billion
Rhode Island	-69,408	-\$2.0 billion

Note: Income data is inflation-adjusted, 2010 dollars.

Source: <http://interactive.taxfoundation.org/migration>

Employment

Local news media regularly report on the dire employment situation in Rhode Island. In prior research, the Center has found that perspective to be true no matter the metric or angle at which one looks at the numbers.

As of August 2013, Rhode Island continued to lag all of the non-sales-tax states, as well as the nation in employment.

Unemployment Rate and Distance from Peak Employment: Rhode Island and Non-Sales-Tax States

	Unemployment Rate (%)	% of Peak Employment
Delaware	7.3	95.3
Montana	5.3	98.2
New Hampshire	5.0	98.4
Oregon	8.1	96.1
Rhode Island	9.1	91.5
All-state ave.	7.0	98.0

Note: The unemployment rate is the percentage of all residents employed or looking for work within the most-recent month who say they are not currently employed.

Source: <http://www.bls.gov/lau/>

Cross-Border Shopping

Studies consistently find that shoppers who live in counties along a border with a non-sales-tax state will cross the line to shop. The Center’s February 2013 report about the possibility of eliminating Rhode Island’s sales tax cites findings along both sides of New Hampshire’s longer borders:⁵

- In Maine, retail sales could be as much as \$2.2 billion higher per year along the border if its retail sales had kept pace with New Hampshire.
- In Vermont, retail sales could be as much as \$540 million higher, annually.

Just as the total for Vermont is lower than for Maine, Rhode Island could benefit even more than New Hampshire, given the higher population

density in nearby Massachusetts and Connecticut. In his May 15, 2013, testimony before the Rhode Island House of Representatives Finance Committee, Beacon Hill Institute economist Paul Bachmann stated:

... unlike large states without sales taxes such as Oregon, Montana, Alaska and somewhat New Hampshire, Rhode Island is a small state that borders Connecticut and Massachusetts, states that have the fourth and fifth highest household incomes respectfully. Moreover, all three states are connected by the heavily travelled Interstate 95, which runs through the heart of Rhode Island. This route not only provides a great conduit to transport shoppers from Connecticut and Massachusetts to Rhode Island, but also tourists from other states that travel to Cape Cod and other New England destinations in the summer months. Rhode Island also has a higher population density on its borders than New Hampshire. The counties in Maine, Massachusetts and Vermont that border New Hampshire have an

average population density of 400 persons per square mile. The Massachusetts and Connecticut counties that border Rhode Island have a population density of over 1,500 persons per square mile. Rhode Island has many more potential shoppers on its borders than New Hampshire.

Outside of New England, a 2002 study of tax policy conducted by the Washington State Revenue Department found that “sales and revenues in the 14 counties bordering Oregon and Idaho would increase by an estimated 22 percent if the sales tax differential were eliminated.”⁶ Although anecdotal evidence suggests that the lack of an income tax in Washington leads people to live and work there, while shopping across the border in Oregon,⁷ a comparison of county unemployment rates shows Oregon to have the advantage over Washington in the more populated areas along the border.⁸

¹ For the purposes of this document, we have removed Alaska from the analysis. Although Alaska has no sales tax, the state’s oil reserves, large size, and small population make its financial circumstances incomparable.

² The Center applied U.S. Census population estimates for 2011 to the U.S. Census state budget analysis for that year, which is the latest available: <http://www.census.gov/govs/state/>

³ For definitions of the tax categories cited here, see: <http://www.census.gov/govs/state/definitions.html>

⁴ Moody, Scott J., and Justin Katz. Rhode Island Center for Freedom and Prosperity. “Keeping Rhode Islanders Home.” July 2012. <http://www.rifreedom.org/2012/07/county-out-migration-should-be-alarm-to-municipalities/>

⁵ Rhode Island Center for Freedom and Prosperity. “Zero.Zero Sales Tax.” February 2013. Pg. 3. <http://www.rifreedom.org/wp-content/uploads/Zero-point-Zero-2013-final-wattachment.pdf>

⁶ Washington State Tax Structure Study Committee. “Tax Alternatives for Washington State: A Report to the Legislature.” November 2002. http://dor.wa.gov/Content/AboutUs/StatisticsAndReports/WAtaxstudy/Final_Report.htm

⁷ Vekshin, Alison. *BloombergBusinessweek*. “Washington and Oregon, Taxing Neighbors.” April 7, 2011. http://www.businessweek.com/magazine/content/11_16/b4224B16629236.htm

⁸ U.S. Dept. of Labor Bureau of Labor Statistics, Local Area Unemployment Statistics. See results graphically rendered here: <http://www.bls.gov/lau/maps/twmcort.pdf>