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Pennsylvania among 'Terrible 10' most regressive tax states

STAFF REPORT
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Working families in Pennsylvania pay a far higher share of their income in state and local taxes than their wealthiest counterparts, according to a new study by the Institute on Taxation & Economic Policy (ITEP).

In 2007, middle-class earners paid nearly double the share of their income in taxes than the very wealthiest Pennsylvanians. For minimum-wage earners, the share of family income spent on taxes was even larger.

The study, which examined state and local taxes in all 50 states, ranked Pennsylvania's tax system as the ninth most regressive in the nation, meaning taxes fall disproportionately on middle-class, working and poor families to the advantage of the richest taxpayers.

"Middle-income and working families get shortchanged by Pennsylvania's tax system, and wealthy Pennsylvanians reap major benefits," said Sharon Ward, director of the Pennsylvania Budget and Policy Center (PBPC). "Pennsylvania should reform its tax system to shift more of the costs of vital services to those who can better afford to pay."

The ITEP study, ***Who Pays? A Distributional Analysis of the Tax Systems in All 50 States***, examined state and local tax rates on taxpayers under age 65. It found that middle- and lower-income families end up paying larger shares of their income in taxes:

Pennsylvania families earning less than $19,000 - the poorest fifth of Pennsylvania taxpayers - pay 11.3 percent of their income in Pennsylvania state and local taxes.
Middle-income Pennsylvania taxpayers - those earning between $35,000 and $56,000 - pay 9.6 percent of their income in Pennsylvania state and local taxes.
The richest Pennsylvania taxpayers - with average incomes of $1,369,600 - pay only 5 percent of their income in Pennsylvania state and local taxes.
After accounting for federal deduction offsets, the discrepancy is even starker: the poorest fifth pay 11.2 percent of their income in state and local taxes, middle-income families pay 9.1 percent, and the richest Pennsylvanians pay 3.9 percent.
Washington, Florida, South Dakota, Tennessee, Texas, Illinois, Arizona, Nevada, Pennsylvania, and Alabama were named as the 10 Most Regressive Tax States.
Pennsylvania ranked ninth.

"No one would ever design an income tax with lower tax rates for the best-off taxpayers," said Matthew Gardner, ITEP's executive director and lead author of the study. "But that is exactly what Pennsylvania's tax system overall does: it allows the very wealthiest individuals to contribute less of their income, on average, than middle- and lower-income families must pay."

This study debunks the myth that the poorest families don't pay taxes. While some low-income families qualify for state personal income tax forgiveness, these families are still paying large shares of their earnings in local income, sales and property taxes.

The state's flat income tax contributes to Pennsylvania's highly regressive tax ranking. Without a graduated tax rate, which increases for more affluent earners, Pennsylvania's income tax does little to offset more regressive sales and property taxes.

Pennsylvania could make the tax system more fair by amending the state Constitution to create a graduated personal income tax and closing corporate tax loopholes that allow multi-state businesses to avoid paying state taxes. Companies use those loopholes to shift income out of Pennsylvania to mailbox subsidiaries in no-tax states like Delaware.

"Pennsylvania has a rickety tax structure that allows some corporations to game the system and gain a tax advantage," said state Rep. David Levdansky, chair of the Pennsylvania House Finance Committee and a supporter of closing those loopholes. "We lose $600 million a year from these loopholes, which leave the rest of us paying more."

Of the 41 states and the District of Columbia that have personal income taxes, Pennsylvania has the second lowest top rate. The commonwealth could increase the effective tax rate on the wealthiest with little impact. Between 2001 and 2007, the top 1 percent of Pennsylvania earners captured 56 percent of all growth in personal income. Additionally, studies in New Jersey and California, states with higher income tax rates than Pennsylvania, found that tax rates have not driven residents out of those states.

Wealthy taxpayers also benefit greatly from tax laws that allow them to write off property and income taxes from their federal income taxes. This is, at best, a modest benefit for middle-class families and no benefit to very low-income earners.

The Pennsylvania Budget and Policy Center is a non-partisan policy research project that provides independent, credible analysis on state tax, budget and related policy matters, with attention to the impact of current or proposed policies on working families. To learn more, go to www.pennbpc.org.