



Taxes in Texas
Understanding the Policy & Political Arena

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An analysis of the Texas Tax System and what reforms are needed to make sure we have a balanced budget for the future. The report analyzes various state tax systems across the United States and uses Texas' demographics to figure out which system, if any, will benefit Texas.

Community Scholars acknowledges and thanks the following organizations for their support in 2010

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The Robert E. & Evelyn McKee Foundation
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Amidst the United States recession, Texas is one of many states facing a financial burden. As lawmakers strive to alleviate the problem through budget cuts and constricted spending, the Lone Star state is currently confronting one of its largest budget deficits since 2003. Reforming Texas's tax structure, including the implementation of a state income tax, has been brought up by some lawmakers, yet the issue remains controversial to both Democrats and Republicans. Texas depends greatly on the general sales tax as its main source of revenue. With such dependency, the fluctuations of the U.S. economy have proved negative to the economy of Texas.

The goal of Community Scholars is to analyze the Texas tax system and compare it with the systems of four other states: Washington, California, New York and Montana. Having collected information on the current economy and structure of these states, Community Scholars will create a hybrid tax model for the state of Texas. The tax model will then be used to calculate the possible tax revenue and individual tax burden that Texas can incur if such a model is used. From these results, Community Scholars will be able to suggest changes to the Texas tax system if deciding that the current tax structure of Texas needs to be reformed.

Introduction to Taxes

A tax system, in its simplest definition, is used to raise revenue for a unit of government or a system of governments. Depending on economic conditions, any given tax in a tax system may be raised or lowered to maintain the budget and to keep up with population growth. A tax system can be regressive, progressive or proportionate.¹

Types of Tax Systems

A regressive tax system is where one's tax burden increases as one's income decreases. Sales taxes are regressive because the proportion of household income spent on taxable consumption is usually higher for low-income households than high-income households. Contrary to a regressive tax system, a progressive tax system is based on the ability to pay, thus the tax burden, the portion of one's income used to pay one's tax bill, decreases as one's income decreases. To determine the tax burden for a particular tax, the tax bill is divided by the annual income. In a proportionate tax system, the tax burden is the same for everyone regardless of their income. Reaching a completely proportionate tax system is not realistically possible.²

- **Regressive Taxes:** taxes on essentials (food, clothing, et cetera), "sin" taxes (on cigarettes, alcohol), social security, and fixed/flat fees (entrance fees, hunting/fishing licenses, and so forth)³
- **Progressive Taxes:** income tax, federal estate tax⁴

Adam Smith and Tax Equity

The ultimate effect of a mix of regressive and progressive taxes is known as tax system equity. If no progressive taxes are in place to balance the effect of sales taxes and other

¹ (Momayezi, et al. 2005)

² (Momayezi, et al. 2005)

³ (Internal Revenue Service 2010)

⁴ (Houghton Mifflin Company 2003)

regressive taxes, then the system as a whole will be regressive and those with low incomes will pay more. Adam Smith, an eighteenth century economist, defined tax equity as the subjects of every state having to contribute towards the support of the government as nearly as possible, in proportion to their respective abilities; that is in proportion to their respective revenue. This implies that each individual should contribute to the government as best as they can. Evidently, Adam Smith strongly advocated a tax system based on the ability to pay. Along with his ideals, Smith introduced the concept of subsistence and of surplus to support his definition of tax equity.⁵

Subsistence is the income necessary to live at the level of bare existence. In Smith's opinion, if one's income allows one only to live at a modest level, one should pay very low, if any taxes. Surplus is the opposite of subsistence, meaning there is more than just enough income for the bare necessities. From surplus one can buy higher quality necessary items, enjoy luxuries, and have money left over for saving and investment. According to Smith, those living in surplus should pay for government by paying higher taxes. In all, Adam Smith supported a progressive tax system which places a higher tax burden on individuals with higher income and a lower tax burden on low-income individuals.⁶

The economist Adam Smith embraced the notion of equity within the tax system through his four maxims.

- **First Maxim:** High-income individuals, who benefit the most from the government, ought to pay the most taxes, though that is not to say that the other citizens are exempted from taxes. People who earn income and can afford the services of the government should pay taxes
- **Second Maxim:** Tax codes must be written in a manner that is comprehensible to tax payers in order to not lose trust in their government.
- **Third Maxim:** Taxes should be levied "at a time, or in a manner" that is most convenient to tax payers. Smith called this "tax simplification."
- **Fourth Maxim:** Creation of an efficient tax that is paid by the people, but still leaves money in the pockets of the people. An efficient tax would leave "the annual [product] of the land and labor of society, the real wealth and revenue [of a nation] the same as before."

Smith believed that citizens have the duty to pay taxes to receive and maintain government services just as the government itself has the duty to keep administration expenses and other expenditures to a minimum.⁷

State Tax Model Methodology

In the following section, six different tax systems are discussed:

- Texas
- Federal

⁵ (Momayezi, et al. 2005)

⁶ (Momayezi, et al. 2005)

⁷ (Walton 2003)

- Washington
- California
- New York
- Montana

Community Scholars begins by covering the federal tax system, for this tax system works cohesively with the tax systems of all the states. Subsequently, the Texas tax system, seventh most regressive tax system in the U.S., is introduced and thoroughly explained.⁸ The remaining tax systems discussed in this section were chosen based on the progressivity of their tax systems. Washington is ranked the most regressive tax system in the nation, California is ranked second most progressive tax system and New York is considered to be a moderate tax system being ranked 26th in the nation for progressivity. Community Scholars chose these ranked states with the purpose of showing extremes to both types of tax systems, progressive and regressive, and a moderate tax system. Montana’s tax system was chosen because amidst the national recession and every state facing a budget shortfall, Montana currently has one of the smallest budget gaps to fill. Montana is ranked the third most progressive tax system.⁹

Community Scholars researched five tax systems in order to develop an appropriate comparison and analysis of the Texas tax system. Through these findings, Community Scholars hopes to identify the strengths and weaknesses of the tax system of Texas and the other four states. The aspects of a tax system, whether identified by Community Scholars as a weakness or strength to the state’s budget, serve as the foundation of the hybrid tax model Community Scholars created for Texas. The analysis of the states and the hybrid tax model assists Community Scholars on the decision of possible reformation to the Texas tax system.

Texas Tax System

The Texas tax system is said to be regressive since the tax burden falls more heavily on lower-income families. Texas is one of seven states that do not have a state income tax, thus the state depends on other taxes for its revenue. In addition, Texas is also one of only thirteen states that do not collect a state-wide property tax; however, it greatly depends on the revenue generated from the property taxes collected by each of its localities. Texas’ General Fund relies heavily on the revenue generated from three major taxes: sales, property and the Texas Marginal Tax.¹⁰

Texas Sales Tax

The Texas tax system is said to be “too regressive.” It relies heavily on the sales and use tax for more than 55 percent of state tax revenue and 24 percent of overall revenue.¹¹ The Texas sales tax rate is 6.25 percent, which is higher than the national average of 5.85 percent.¹² Although the sales and use tax exempts most groceries, medicines and residential utilities, the tax

⁸ (Wychen 2010)

⁹ (Wychen 2010)

¹⁰ (The Tax Foundation 2010)

¹¹ (Champagne, et al. 2006)

¹² (The Tax Foundation 2010)

is still considered regressive because basic necessities such as food, clothing and shelter, make up a high portion of the budget of low-income individuals.¹³

The Institute on Taxation and Economic Policy performed an analysis of the different spending patterns of the wealthy and the low-income individuals in each of the fifty states. The analysis shows that a Texas family with an income in the lowest 20 percent bears a sales tax burden of 8.5 percent. Simultaneously, a Texas family with an income in the highest one percent bears a sales tax burden of 1.2 percent.¹⁴ Put into perspective, if a person has \$10 and buys a bag of chips for \$1, that person has 90 percent of their money left to spend and bears a burden of only 10 percent. Just the same, if a person who has \$5 buys the same bag of chips, they will have only 80 percent of their money left and bear a burden of 20 percent.

History of Sales Tax in Texas

The Limited Sales and Use Tax, Texas House Bill 20, was initially enacted in Texas, during the 57th Texas Legislative Session in 1961.¹⁵ Before 1961, there had only been a sales tax on certain items such as gasoline, cigarettes, motor vehicles, etc. The Limited Sales and Use Tax was the first tax that was broad-based in the state, only exempting groceries, medicines, agricultural implements and services.¹⁶

Table 1: Texas Sales Tax Rates

Year	Sales Tax Rate
1961	2%
1968	3%
1969	3.25%
1971	4%
1984	4.125%
1986	5.25%
1987	6%
1990-present	6.25%

Source: Calvert 1999

By 1992, the general sales tax had become Texas main source of revenue, accounting for 60 percent of all state tax revenue. With the institution of the sales tax, revenue in Texas increased from \$149 million in 1961 to \$7.59 billion in 1990.¹⁷

Texas has a municipal sales tax along with the state sales tax. The municipal sales tax was implemented in 1967 by the 60th Texas Legislature, after the authorization for cities to have the option to levy a one percent sales tax. Most cities approved such tax and it significantly increased municipal revenues and became a main source of revenue. In some cities, the municipal sales tax became the city's second largest source of revenue. The municipal sales tax and the state's sales tax are both collected by the State Comptroller of Public Accounts and then

¹³ (Lavine and McCown 2006)

¹⁴ (Momayezi, et al. 2005)

¹⁵ (Texas State Legislature 1961)

¹⁶ (Calvert 1999)

¹⁷ (Calvert 1999)

paid back to the municipalities after a collection fee is deducted. As of 1992, local governments were given the option to impose a sales tax between 0.5 percent and two percent. Accordingly, the maximum sales tax rate that can be implemented by a local government is two percent, thus many areas have seen their sales tax rate increase to 8.25 percent.¹⁸

Texas Property Taxes

Texas depends on property taxes for the funding of schools, roads, jails and hospitals.¹⁹ School districts and local governments can raise property taxes up to a certain amount without the voting consent of local residents. The burden falls on property owners to compensate for funds that the state fails to generate. The Texas Constitution provided five rules to the property tax:

- **Equal and Uniform Taxation:** Owners of residential and commercial properties should never pay more than their fair share of taxes.
- **Taxation on Current Market Value:** With the exceptions of agricultural land and timberland, tangible properties must be taxed on its current market value.
- **All Property is Taxable:** A property is taxable unless a state or federal law, authorizing Texas legislature, exempts the property from taxation
- **Proper Notification of Increases:** Property owners are allowed to receive appropriate notification of increases in the appraised value of their property
- **Appraised Value of Property:** Each property in a county may only have a single appraised value.²⁰

In 2005, a lawsuit was filed against the education system. In *Neeley v. West Orange-Grove Consolidated Independent School District*, the Texas Supreme Court ruled the property tax system unconstitutional. As the state had begun to shift the burden of funding public education to localities, school districts were forced to begin to raise and ultimately max out their property tax rates. Due to the fact that most school districts found themselves taxing at the maximum constitutionally-allowed rate, the Court ruled that the State had inadvertently levied a state *ad valorem* tax, which is unconstitutional. The Court required that schools revise their tax system to move away from this, however, little has been done to reverse this taxation practice.²¹

Texas Marginal Tax of 2006

The Court set a deadline for the Texas Legislature to correct the constitutional deficiencies by June 1, 2006. By Monday May 15, 2006, the Legislature was able to adjourn after passing five bills, ultimately becoming law.²²

Under the revised franchise tax proposed in 2006, Texas House Bill 3 established a new way to calculate a modified franchise tax, officially referred to as the “Marginal Texas Tax”. The “margin tax” applies only to for-profit corporations and taxable entities. In addition, this bill

¹⁸ (Calvert 1999)

¹⁹ (Lavine and McCown 2006)

²⁰ (Texas State Comptroller No Date)

²¹ (The Supreme Court of Texas 2005)

²² (Novakov and Kirsner 2006)

extended the taxpayer base to include all Texas businesses. Sole proprietorship, general partnerships owned directly by natural persons, certain incorporated passive entities receiving limited amounts of active trade or business income and entities, such as non-profit organizations, remained exempt from the tax along with businesses with no more than \$300,000 in revenue and those that owe less than \$1000 in tax. This bill took effect in January 1, 2008.²³

To compute the revised franchise tax, a taxable entity's total revenue is determined, and from this amount, the entity has the option to deduct either its cost of goods sold or total compensation, up to \$300,000 per employee, adjusted for inflation. If the entity's margin exceeds 70 percent of its total calculated revenue, the business is only taxed 70 percent of its total revenue. The margin tax applies a tax rate of one percent to a taxable entity's total revenue and a 0.5 percent for retailers' and wholesalers' total revenue.²⁴

Texas Constitutional Constraints to a State Income Tax

Supporters of the income tax believe that adding an income tax will greatly decrease Texas's dependency on sales taxes. In doing so, they believe that more revenue can be generated to add to the state's general fund.²⁵ The income tax is considered by some to be an equitable way of taxing citizens, for despite how much a person earns, he or she is still taxed: the tax rate increases with income.²⁶ In the opinion of Texas State Representative Marisa Marquez (D-77) the state may be ready to start a conversation about the implementation of a state income tax during the next legislative session. A state income tax will allow the state more flexibility in allocating funds to state agencies and programs.²⁷ Opposing the state income tax is Texas State Representative Joseph C. Pickett (D-79), who believes the income tax will have a minimal effect on Texas as a whole. He stated that the tax would only benefit some individuals on the local level, while not positively impacting the state as a whole. He added that policy needs to benefit the majority and not the minority.²⁸

However, the Texas Constitution restricts passage of a personal income tax. The proposal for adding a personal income tax to Texas law, before it is enacted by legislators, must go through several processes. As stated by Article 8, Section 24 of the Texas Constitution, Texas may impose a personal income tax that is in compliance with federal law. The majority of registered voters in a statewide referendum must first approve the income tax. The legislature can then either repeal or amend the tax. If the income tax, which is submitted by voters, is repealed, the legislature may still reenact the law without submitting the repeal or amendment back to the voters.²⁹

²³ (Novakov and Kirsner 2006)

²⁴ (Novakov and Kirsner 2006)

²⁵ (Lavine and McCown 2006)

²⁶ (Momayezi, et al. 2005)

²⁷ (Marquez 2010)

²⁸ (Pickett 2010)

²⁹ (State of Texas 2010)

Texas 2003 Budget Shortfall

In 2003, Texas faced a \$10B budget shortfall.³⁰ To remediate the deficit without raising taxes, the state government made deep budget cuts.³¹ The government also turned to alternative ways to generate more revenue.³² Thousands of children were dropped from state-sponsored health insurance programs such as the Children's Health Insurance Program (CHIP), and nursing home residents' monthly allowance for personal expenses was decreased from \$60 to \$45 as a result of the \$6B cut to healthcare.³³ Education was affected by a \$1B budget cut: tuition was deregulated at public universities, and staff and faculty members were laid off.³⁴ Besides the \$2.7B that was generated by higher fees, the appearance of new revenue was created by cost-shifting. Cost-shifting is transferring the burden of paying government service to those who benefit from them. People enrolled under state-subsidized health insurance dealt with higher costs as well as \$790M in new co-pays, premiums, and other expenses.³⁵

Texas 2008 Budget Surplus

Texas began the 2008 biennium with a budget surplus of \$10.7B as estimated by Comptroller Susan Combs (R-Texas).³⁶ Representative Dan Branch (R-Dallas) attributed the surplus primarily to the oil and gas sector, but property tax cuts and fiscal regulation, helped bring in extra revenue.³⁷

Texas Predicted 2011 Budget Shortfall

As the 82nd Texas Legislature approaches, there has been much speculation about the budget shortfall that Texas will be facing for the next biennial budget. Lawmakers initially expected a shortfall of about \$11B; however, despite the negations that the budget shortfall is far from reaching \$20B, the Texas House Speaker Joe Straus (R-Texas) and Lt. Governor David Dewhurst (R-Texas) predict the shortfall will reach \$18B.³⁸ Other elected officials have predicated amounts ranging from \$10.8B to \$20B.³⁹

The budget shortfall can in part be attributed to the economic recession of 2008-2009, where Texas experienced a significant decrease in state revenues for 14 months straight. This decrease in state revenues resulted from a dramatic drop of sales tax revenue, which provides 60 percent of all state revenue.⁴⁰ According to Texas State Representative Joseph Moody (D-78)

³⁰ (Mann 2010)

³¹ (Mann 2010)

³² (Eye on Williamson County 2010)

³³ (Mann 2010)

³⁴ (Mann 2010)

³⁵ (Eye on Williamson County 2010)

³⁶ (Robinson 2008)

³⁷ (Higgins 2009)

³⁸ (Ficak 2010)

³⁹ (Garrett 2010)

⁴⁰ (Hu 2010)

Texas' great dependency on the sales tax can be hurtful considering that the state's economy fluctuates with national and state decreases in sales due to periods of economic recession.⁴¹

In addition, the franchise tax currently in place generates billions less each year than the property tax it replaced. This means that with every new budget, lawmakers need to find additional money to make up the difference. The current structure of the revenue system creates deficits each year.⁴²

Though the exact amount of the budget deficit cannot be calculated yet, Governor Rick Perry (R-Texas) and Lt. Governor Dewhurst have already asked state agencies to cut their current budget by five percent in response to the growing budget shortfall. An additional five percent cut to state agencies is expected in the next budget, but even with these cuts, the billions saved are small in proportion to the total budget shortfall, considering that only some of these suggested cuts will be approved.⁴³ State Representatives Joe Pickett, Marisa Marquez and Joseph Moody agree in Texas legislature prioritizing budget cuts when considering essential state programs, such as CHIP, and the negative effects such cuts will have on Texas residents who depend on these services.⁴⁴ In addition to budget cuts in state agencies, Texas legislators have begun considering using the state's Rainy Day Fund, which is currently between \$8.2B and \$8.5B. Lt. Gov. Dewhurst adds that the state will have to start "dipping" into the fund to try and keep the state budget balanced.⁴⁵ Although Texas historically has usually opposed tax increases in general, given its current economic status, state representatives Pickett, Marquez and Moody all foresee increases on "sin" taxes, if any, to raise more revenue for Texas.⁴⁶

Federal Tax System

The United States tax system is considered to be progressive, meaning that the income one pays in taxes increases as income increases. The federal system does include a mixture of progressive and regressive taxes, but the system in general incorporates the concept that those with a higher income should pay more in total taxes as seen with the income tax, which is a main source of revenue for the federal government.⁴⁷

The five main federal taxes of the national tax system are personal income taxes, federal corporate taxes, social insurance taxes, federal excise taxes and federal estate taxes.⁴⁸

Federal Income Tax

The income tax makes up a great portion of the total revenue for states with an income tax. By income, it is meant that wages, salaries, and other sources of revenue (dividends, capital gains, interest, alimony, self-employment income and prizes) are considered for taxation. Not all income is taxable though. Total income is first obtained to calculate taxable income. Total

⁴¹ (Moody 2010)

⁴² (Hu 2010)

⁴³ (Talbert 2010)

⁴⁴ (Moody 2010)

⁴⁵ (Talbert 2010)

⁴⁶ (Moody 2010)

⁴⁷ (Roach 2006)

⁴⁸ (Roach 2006)

income is the sum of one’s income from all sources. Certain contributions and expenses, such as retirement account contributions, student loan interests or tuition, are subtracted from total income to get the adjusted gross income. Taxable income is expressed as the following:

$$\text{Taxable income} = \text{Adjusted Gross Income} - (\text{Deductions} + \text{Exemptions})$$

Deductions are expenses or items that are subtracted from the adjusted gross income, and can either be standard or itemized. A standard deduction would be a fixed amount that is subtracted from the adjusted gross income. Itemized deductions are certain expenses (medical expenses, real estate taxes) made during the year that a tax-filer may add to this. When itemized deductions exceed standard deductions, only the total for itemized items is deducted from the adjusted gross income. Exemptions, which are based on the number of tax filers and their dependents, reduce the income amount to be taxed. Those who are over the age of 65 and/or are blind are allowed additional exemptions. Exemptions should not be confused with a tax credit, which reduces the amount of tax that is owed.

A marginal tax rate is then applied to the taxable income but different tax rates are applied to different portions of one’s taxable income. The rate for investment income varies from income from labor, and so forth.⁴⁹ The progressivity of the federal personal income tax is conveyed by the following table:

Table 2: 2010 Federal Income Tax Table

Single Filing Status		Joint Filing Status	
Tax Bracket	Rate	Tax Bracket	Rate
\$0-\$8,375	10%	\$0-\$16,750	10%
\$8,376-\$34,000	15%	\$16,751-\$68,000	15%
\$34,001-\$82,400	25%	\$68,001-\$137,300	25%
\$82,401-\$171,850	28%	\$137,301-\$209,250	28%
\$171,851-\$373,650	33%	\$209,251-\$373,650	33%
\$373,651 >	35%	\$373,651 >	35%

Source: Securities Industry and Financial Markets Association

Income tax is a type of progressive tax as previously mentioned: the amount of taxes increase as one’s income increases. Tax payers meeting certain income brackets may be eligible for the federal Earned Income Tax Credit (EITC), a tax credit that reduces the amount of income taxes owed.⁵⁰

Federal Corporate Tax

Like individual tax payers, corporations must file income tax forms. The process is similar to the process for non-corporate tax-filers. The difference is that taxable corporate income is “defined as total revenues minus cost of goods sold, wages and salaries, depreciation [expense], repairs, interest paid and other deductions.” Taxable corporate income is expressed in the formula:

⁴⁹ (Roach 2006)

⁵⁰ (Internal Revenue Service 2010)

$$\text{Taxable Corporate Income} = \text{Total Revenues} - (\text{Cost of goods sold} + \text{Wages and Salaries} + \text{Depreciation} + \text{Expenses} + \text{Repairs} + \text{Interest paid} + \text{Deductions})$$

A corporation can have many deductions, to the point of having little to no corporate taxes to pay, or that the corporation received a rebate check from the federal government. Corporate taxes are progressive as well, and their marginal rates differ with each corporate income bracket.⁵¹

Social Insurance Taxes

Social insurance taxes, which fund Social Security, Medicaid and Medicare, are levied on wages, salaries and income from self-employment. These taxes are sometimes referred as Federal Income Contribution Act (FICA) taxes. Employers directly deduct FICA taxes from their workers' paychecks and are required to pay when filing their federal income tax return.

FICA taxes are however paid as two taxes, one for Social Security and the other for Medicare. The tax for Social Security is 12.4 percent of wages, half the tax being deducted from the employee's paycheck while the employer is responsible for paying the remaining amount. The second tax is 2.9 percent of wages. Once again employee and employer each pay for half the tax.⁵²

The Social Security tax has a taxing limit. For 2010, Social Security taxes only the first \$106,800 of one's income.⁵³ For income that goes over \$106,800, no additional Social Security tax is imposed. The maximum Social Security contribution one can pay is then \$6,621.60 (\$106,800 x 6.2 percent). The 6.2 percent used in the formula, is half of the rate for Social Security, which is 12.4 percent. The Medicare tax has a flat tax rate, and is thus paid on all wages. For example, one who earns an income of \$200,000 a year is taxed at 1.45 percent (half of the Medicare rate) just as someone earning a lower income of \$30,000 is taxed at the same rate.⁵⁴

Federal Excise Taxes

Excise taxes are levied on the sale, production and use of an item or service. The federal government collects the tax from the manufacturers, retailers, and producers of such taxable items, which include fossil fuels, telephone services, tobacco, alcohol, firearms, air travel and tires. Excise taxes should not be confused with a sales tax. Sales taxes are added to the total bill of a consumer. Excise taxes are usually incorporated to the selling price of a service or product. Unlike income taxes, federal excise taxes are considered to be regressive. Low-income residents are more likely to spend a great portion of their income on excise taxed products and services than people with a higher income.⁵⁵

⁵¹ (Roach 2006)

⁵² (Roach 2006)

⁵³ (Money-Zine 2010)

⁵⁴ (Roach 2006)

⁵⁵ (Roach 2006)

Federal Estate and Gift Taxes

Federal estate and gift taxes apply only to the wealthiest income group so a majority of tax payers will never be subjected to such taxes. The estate tax is levied on large estates that are transferred from their owners to beneficiaries, but the tax burden is reduced when small farms or businesses are transferred. The transfer of large gifts is also taxed. Gift taxes then influence people to not give away their estate to beneficiaries while they are still alive. Federal estate and gift taxes are then the most progressive taxes in the U.S. tax system. Estate rates can be as high as 55 percent, but are paid by a minority group of taxpayers.⁵⁶

Washington Tax System

The basic tax structure of Washington was established in the 1930's, thus it is regarded as in need of reform since the needs of the state have significantly shifted since that time. Washington's General Fund relies heavily on three major sources of revenue: sales, business and operations (B&O) and property taxes. Washington's tax system is regarded as on with a regressive tax system, meaning that most of the tax burden falls on the low- and moderate-income families. Washington is one of the seven states that have no personal income tax, thus it generates its revenue from other sources and other taxes.⁵⁷ The state of Washington has one of the highest state sales taxes, which is 6.5 percent and can go up to 9.5 percent depending on the different local sales tax rates.⁵⁸ The retail sale and use tax generates over half of the General Fund.⁵⁹ The property taxes account for up to 30 percent of the state's total state and local revenue.⁶⁰ The state portion of the property tax is used to support public schools and accounts for 25 percent of the total property taxes Washington residents pay.⁶¹ Along with this tax, Washington offers a property tax exemption for all those whose household income is below or at \$35, 000.⁶²

Destination-based Sales Tax

On July 1, 2008, the state of Washington changed from an origin-based system for local retail sales tax to a destination-based system. Prior to this date, retailers in Washington collected local sales tax based on where a product was shipped from. Since July 1, 2008, retailers collect taxes based on the destination of the shipment or delivery of the sale instead. This tax only affects shipments and deliveries to locations within the state of Washington, thus this specific tax only applies to businesses that ship or deliver the goods they sell to places within Washington.⁶³

This tax was implemented in order for local "brick-and-mortar" stores to become more competitive against "remote sellers" who aren't collecting or paying taxes. The destination-based tax will encourage "remote sellers", which are those selling by internet and mail, to collect tax on

⁵⁶ (Roach 2006)

⁵⁷ (Watkins 2008)

⁵⁸ (Retirement Living 2010)

⁵⁹ (Watkins 2008)

⁶⁰ (Retirement Living 2010)

⁶¹ (Watkins 2008)

⁶² (Retirement Living 2010)

⁶³ (Department of Revenue Washington State 2007)

sales to customers from Washington and make local stores and remote sellers operate by the same rules and same competitive environment. With this tax, even if customers buy something out of state online, once shipped to Washington, they will be required to pay the local and state tax rate of where it was shipped. This way, Washington will receive additional sales and retail tax revenue and their petition to join the Streamlined Sales and Use Tax Agreement (SSUTA) will be granted. The SSUTA is a cooperative effort of 44 states and the District of Columbia to simplify and make more uniform sales and use tax collection and administration by retailers and states.⁶⁴

Business and Occupation Tax

The business and occupation (B&O) tax is a gross receipts tax measured on the values of products, gross proceeds of sale or gross income of the business and from activities, meaning that there are no deductions from the B&O tax for labor materials taxes or other costs of doing business. The B&O tax rate varies by the classification of a business. The B&O tax is paid on the excise tax return or by electronic filing.⁶⁵ Along with the B&O tax, businesses that engage in transportation, communications, and the supply of energy, natural gas, and water must pay the public utility tax at different rates depending on the specific utility activity. Beginning June 1, 2010, the state of Washington will implement an “economic nexus” standard. This standard calls for businesses earning apportionable income, which is income earned from various service activities and royalty income, from Washington customers to pay taxes whether or not their business is physically present in the state of Washington.⁶⁶

Real Estate Excise Tax

The real estate excise tax (REET) is a tax on the sale, not total property value, of real estate that is customarily paid by the seller of the property. The state tax rate is .0128 plus each county’s or city’s additional rate. If the seller of the property does not pay the REET, the buyer is liable for the tax even though the tax is meant to apply to the seller. In addition, the tax also applies to the transfers of controlling interests in entities that own property in the state. The funds collected from this tax go into the account set up to help fund maintenance of local government public works facilities, the city/county assistance account, some of it is retained to pay for administration costs and the remainder is kept by the state general fund.⁶⁷

Sales Tax Exemption

The state of Washington provides an exemption from the retail sales tax to certain nonresidents of Washington for purchases of tangible personal property that will be taken or used outside of the state. The purchasers wishing to take advantage of this tax exemption must be able to prove their nonresidential status. This exemption will only apply to residents of certain states starting July 1, 2010.⁶⁸

⁶⁴ (Department of Revenue Washington State 2007)

⁶⁵ (Department of Revenue Washington State 2007, Department of Revenue Washington State 2007)

⁶⁶ (Department of Revenue Washington State 2010)

⁶⁷ (Department of Revenue Washington State 2007)

⁶⁸ (Department of Revenue Washington State 2007)

This exemption is available to the residents of these states when the jurisdiction does not impose a retail sales tax of three percent or more; however, sellers are not required to make any tax-exempt sales to nonresidents. If sellers choose to make tax-exempt sales, they must meet specific requirements including checking one piece of identification that proves the purchaser is from out of state and maintaining record of the type of documentation presented.⁶⁹

Washington's Current State

Ever since the nation entered the recession in December 2007, every state has found itself struggling to balance its respective budget. Washington State is no exception. Since the recession, the state has seen its economy greatly affected with its unemployment rate growing up to 9.5 percent and its state revenues declining as a result of the dramatic fall of taxable economic activity. Consequently, the need for state assistance programs has significantly increased. In conjunction, increased need and falling resources led Washington to have an imbalance in their budget totaling a shortfall of \$11.8 B in fiscal years 2009 through 2011. Policymakers focused on making four primary adjustments in the 2009-2010 legislative sessions as a way to address the shortfall.

- Deep budget cuts in education, communities, health and economic security. These budget cuts represented 37 percent of total solution.
- Nearly one-third of the solution came from replacing some state funding with federal funding.
- Transfers and changes, such as using the rainy day fund, accounted for 24 percent of the solution.
- Only eight percent of the solution consisted of revenue increases in areas such as taxes and improving compliance.

In an attempt to shorten the budget gap, the legislators also turned to additional transfers and changes and federal recovery funds. In addition, the state of Washington joined 20 other states in the United States in raising taxes by more than one percent; ten states even went as far as increasing taxes by five percent. Washington State had tax increases of about 3.6 percent of total state revenues, which is below the national average of 3.8 percent of total revenues. The state of Washington adopted both, permanent and temporary changes in their tax system in response to their budget shortfall and current recession. Temporary tax increases accounted for forty percent of the revenue measures taken and will generate a total of \$369M. These taxes are set to expire after three years. The temporary increases include:

- An additional 0.3 percentage-point B&O tax on business services (\$242M)
- Implementation of a sales tax to certain bottled water purchases (\$33M)
- Higher taxes on large-scale production of beer by multistate breweries (\$59M)
- A two-cents per 12 ounces excise tax on carbonated drinks (\$34M)
- Eliminating a sales tax exemption on particular equipment bought by dairy companies (\$1M)

⁶⁹ (Department of Revenue Washington State 2007)

Twenty-five percent of the revenue measures consist of permanent tax increases and they not only generated much needed additional revenue, they improved Washington’s overall tax structure. Permanent tax changes include:

- Implementation of “economic nexus” which was put into effect on June 1, 2010. The economic nexus cut back about \$32M in deductions, tax avoidance strategies and “wasteful” business tax exemptions.
- Termination of three renowned tax loopholes which will save taxpayers about \$8.5M that had previously been lost through lost sales, B&O, and real estate excise tax (REET) revenues.
- Five cents per cigarette tax increase (i.e. \$1 on a 20-pack of cigarettes) made effective as of May 1, 2010.
- The extension of the sales tax on candy and gum, which is expected to generate approximately \$30.3M.

Lastly, lawmakers will increase state revenues by about \$9.2M by extending the authority to open certain liquor stores on Sundays and holidays to the State Liquor Control Board. These revenue measures along with compliance and clarification account for about 35 percent of the revenue increases in 2009 and 2010 and total about \$328M. Even with revenue measures and budget cuts totaling \$755 M, the state of Washington was unable to completely fill the gaps in the budget.⁷⁰

California Tax System

At the state level, California depends on personal income tax, sales tax and the corporate income tax for revenue. The revenue generated by those three main taxes account for more than 90 percent of California’s General Fund.⁷¹ California is very regressive on state and sales taxes (the tax burden falls heavily on the shoulders of families and individuals of the lower part of the income scale).⁷² The California tax system, however, is more progressive than other states.⁷³ The following table displays the highest income tax rates in the nation. The tax rates displayed below are ones levied on the highest-income individuals in a particular state. For example, while Hawaii has an 11 percent income tax rate, not everyone in the state pays income taxes at this rate, only individuals who make over \$200,000.

Table 3: Five Highest Individual Income Tax Rates

State	National Rank	Top Rate	Income (Single Tax Payer)
Hawaii	1	11 %	\$200,001 >
Oregon	2	11%	\$250,000 >
California	3	10.55%	\$1,000,001 >
Rhode Island	4	9.90%	\$373,651 >
Iowa	5	8.98%	\$63,316 >

Source: Tax Foundation

⁷⁰ (Washington State Budget & Policy Center 2010)

⁷¹ (Public Policy Institute of California 2010)

⁷² (Macías and Ross 2010)

⁷³ (Cohen 2009)

The California's tax system is considered progressive because of its personal and corporate income tax rates.⁷⁴ Its personal income tax rate is the third highest in the nation and the corporate income tax is the highest in the western part of the United States.⁷⁵

The funding of California's services has changed within the past two decades. The burden of these costs have shifted from corporate tax payers to personal income tax payers, the burden being weighed heavily on tax payers of the low-income range. The shift is obvious when comparing corporate and personal income tax receipts for the periods 2009-2010 and 1980-1981. From 1980-1981, the personal income tax provided 35.4 percent of the General Fund revenues while the corporate income tax provided 14.6 percent. For the 2009-2010 period, the California Department of Finance estimated that personal income tax will provide 53.2 percent of the revenue and that corporate income tax will provide 10.7 percent. The corporate income tax has generated less revenue due to increased tax breaks and lower corporate tax rates. Corporate tax cuts made in 2008 and 2009 were estimated to have caused a \$2M loss per year.⁷⁶

Recently, California's lawmakers enacted another corporate tax cut, a cut that is predicted to cost California \$900M for the 2011 fiscal year.⁷⁷ California's families belonging to the lowest income bracket pay the most taxes, when considering total income v. taxes paid. The poorest fifth of families, which does not include families with elderly members, had an average income of \$13,200 and spent 11.11 percent of their income on state taxes. Those earning a greater income spent less on taxes. Families of the wealthiest one percentile had an average income of \$2.2M and spent 7.8 percent of their income on state taxes.⁷⁸

Low-income people were then impacted by the February 2009 budget agreement. The budget, which was created to close California's \$41B gap, consisted of \$14.8B in spending cuts, \$12.5B in tax increases, \$5.4B in borrowing and \$1B to the creation of a Federal Reserve Fund.⁷⁹ Part of the agreement was revision to California's personal income level and tax credit eligibility. The income level at which families and individuals begin to pay income taxes was lowered, broadening the group of low-income citizens who need to pay personal income taxes. The tax credit claimed by families with children and/or other dependents was cut, also lowering the income level at which families begin to pay income taxes.⁸⁰

California's Current State

As of 2010, California has an estimated budget deficit of \$19.9B.⁸¹ California's condition is attributed to the national recession of 2009, overall inflation and population growth in California and Proposition 13.⁸² Proposition 13 was enacted by Californian voters in June 1978, a mandate that cut tax rates by 57 percent and restricts legislators and assessors from raising

⁷⁴ (Auerbach 2010)

⁷⁵ (The Tax Foundation No Date)

⁷⁶ (Macías and Ross 2010)

⁷⁷ (Citizens for Tax Justice 2010)

⁷⁸ (Macías and Ross 2010)

⁷⁹ (Steinhauer 2009)

⁸⁰ (Macías and Ross 2010)(Macias, Raule and Jean Ross, 2010)

⁸¹ (Office of the California Governor 2009)

⁸² (Kloberdanz 2009)

property taxes. The proposition then forced California to depend greatly on income taxes as a source of revenue.⁸³

Not wanting to raise taxes, Governor Arnold Schwarzenegger (R-California) and legislature sought other means to close the budget gap. They agreed on \$12.4B in spending cuts when the state's unemployment rate did not decrease and personal income taxes generated \$3B less than the amount lawmakers anticipated.⁸⁴ Fund shifts, alternative funding streams and additional federal funds are also part of the governor's 2010-2011 budget proposal.⁸⁵ The budget proposal includes, among others, the following objectives:

- Reduce Medi-Cal eligibility and coverage
- Limit eligibility and increase premiums for the Healthy Families program
- Cut state workers' salaries and benefits
- Increase tuition at state Colleges, Universities, and Community Colleges
- Reduce Public Transit Account funded programs by \$1.7B

In addition to the mentioned proposals, if California fails to meet federal funding levels, seven programs will be eliminated. These cuts cannot be implemented by Schwarzenegger unilaterally. Most of California's legislators are Democrats, a challenge the governor must confront in obtaining the support of two-thirds of lawmakers. Some Democrats in the California State Assembly want to borrow \$9B and have a new tax on oil production. Opposing this plan are lawmakers in the Senate who want to temporarily increase income-tax, vehicle-license fees and taxes on alcohol.⁸⁶

The federal government owes California \$6.9B in unfunded and underfunded federal mandates. To Schwarzenegger, the federal government is part of the state's budget problem for the \$6.9B will cover about 35 percent of the \$19.9B deficit. It is not guaranteed that the federal government will pay the debt, but doing so would make certain cuts and the elimination of programs unnecessary.⁸⁷

New York Tax System

The State of New York relies on three major taxes for revenue, individual income taxes, property taxes and general sales tax. New York is regarded as a state with a moderate tax system meaning that it is not too regressive or too progressive. Since 1977, New York has consistently ranked among the states with the highest state/local tax burden. The tax burden is calculated by dividing the total amount of taxes residents pay by the residents' total income. As of 2008, the state's tax burden was ranked second highest in the nation at about 11.7 percent with New York citizens paying \$6,419 per capita in state and local taxes. Moreover, according to the Tax Foundation's State Business Tax Climate Index, New York ranks forty-ninth compared to all other states in the U.S. The Index compares five areas of taxation that most significantly impact

⁸³ (Suddath 2009)

⁸⁴ (Wingert 2010)

⁸⁵ (Office of the California Governor 2009)

⁸⁶ (Marois 2010)

⁸⁷ (Office of the California Governor 2009)

businesses: individual income taxes, property taxes, sales taxes and unemployment insurance taxes.⁸⁸

Individual Income Tax

In the State of New York, 31.8 percent of the generated revenue comes from the collected individual income taxes.⁸⁹ The State of New York collects state income taxes based on a five-bracket progressive system. For single taxpayers⁹⁰:

- 4 percent on the first \$8,000 of taxable income
- 4.5 percent on taxable income \$8,001-\$11,000
- 5.25 percent on taxable income \$11,001-\$13,000
- 5.9 percent on taxable income \$13,001-\$20,000
- 6.85 percent on taxable income \$20,001 and above.⁹¹

For taxpayers filing joint returns, such as married couples, the rates are similar but the income brackets are doubled. These tax rates apply for the whole state except New York City, which has its own tax rates and brackets.⁹²

As of 2010, the State of New York ratified two new temporary tax rates directed at the highest-income taxpayers. The temporary tax rates are 1 and 2.12 percent higher than the former tax rate.⁹³

- Regardless of filing status, taxpayers with income greater than \$500,000 will pay 8.97 percent in income taxes.
- Single taxpayers with a taxable income greater than \$200,000 but less than \$500,000 will pay 7.85 percent.
- Heads of households with a taxable income greater than \$250,000 but less than \$500,000 will pay 7.85 percent.
- Married couples earning above \$300,000 but below \$500,000 filing joint returns will pay 7.85 percent.⁹⁴

New York has the eighth highest personal income tax rate in the nation of 8.97 percent. In 2008, New York's individual tax collections were of \$1,880 per person, which ranked the state third highest in the U.S.⁹⁵

Sales and Excise Tax

The sales tax was initially adopted in New York in 1951.⁹⁶ New York has a state sales tax of four percent and allows other local taxing entities to levy an additional tax rate of up to five

⁸⁸ (The Tax Foundation 2010)

⁸⁹ (Prante 2009)

⁹⁰ (Bankrate 2009)

⁹¹ (Bankrate 2009)

⁹² (Bankrate 2009)

⁹³ (Retirement Living Information Center 2010)

⁹⁴ (Retirement Living Information Center 2010)

⁹⁵ (The Tax Foundation 2010)

percent exempting food, prescription and non-prescription drugs.⁹⁷ Though the state-wide sales tax is lower than the national median of 5.85 percent, New York allows for a significantly higher additional sales tax rate from its localities.⁹⁸ Of the state's total tax revenue, 24.2 percent comes from the general and selective sales tax generated revenue.⁹⁹ Combined state and local general sales and excise tax collections totaled \$1,677 per person in 2007 and ranked the state eleventh highest in the nation. Compared to the rest of the country, New York has the highest gas tax which stands at 44.6 cents per gallon and the fourth highest cigarette tax standing at \$2.75 per pack of twenty.¹⁰⁰

Corporate Income Tax

The corporate income tax was enacted by the State of New York in 1917.¹⁰¹ This tax is a tax imposed on domestic and foreign corporations who do business, employ capital, own property or lease property in New York. The State taxes all corporate income at a flat rate of 7.1 percent. The corporate income tax is measured by net income and by the value of subsidiary capital allocated to New York. Compared to the other states in the nation that levy a corporate income tax, New York's rate ranks twenty-fourth highest. In 2008, New York collected \$259 per capita in state-level corporate taxes ranking the state eighth with highest per capita collections.¹⁰² Only about 9.3 percent of the state's total tax revenue is generated from the corporate income tax.¹⁰³

New York's Current State

With the economic recession that the nation currently faces, New York has found itself with a \$8.2B deficit. Governor Paterson says this budget gap can be accounted in part to the national recession and the smaller bonuses on Wall Street in the financial services sector generating less revenue than expected. In addition, the decrease in income tax revenues and the increase of \$400M in Medicaid expenses raised the budget shortfall by \$750M.¹⁰⁴ As a result of the recession, the state now faces its highest unemployment rate since 1992 after a significant increase from 5.3 percent unemployment in 2008 to 8.4 percent in 2009.¹⁰⁵ Despite this increase, New York remains well below the national unemployment rate of 9.3 percent.¹⁰⁶

In order to alleviate the budget gap that the state currently faces, New York legislators opted to make budget cuts in different state programs. New York was among the number of states who enacted cuts in Medicaid; these cuts included reduced or frozen reimbursements to health care providers. The State of New York also turned to higher education funding to help reduce the budget shortfall, thus it increased its state university system undergraduate tuition by

⁹⁶ (The Tax Foundation 2010)

⁹⁷ (Retirement Living Information Center 2010)

⁹⁸ (The Tax Foundation 2010)

⁹⁹ (Prante 2009)

¹⁰⁰ (The Tax Foundation 2010)

¹⁰¹ (The Tax Foundation 2005)

¹⁰² (The Tax Foundation 2010)

¹⁰³ (Prante 2009)

¹⁰⁴ (Associated Press 2010)

¹⁰⁵ (David A. Paterson 2010)

¹⁰⁶ (U.S. Bureau of Labor Statistics 2010)

14 percent beginning in the 2009 spring semester. Even the state's workforce was affected and saw hiring freezes in order to save much needed money in the state. New York has implemented additional cuts to various localities, which in turn increased local concerns about the reduced funding for crucial local services. Despite these cuts, New York's federal funds have protected in part or whole prescription drugs for seniors and tuition assistance.¹⁰⁷

Montana Tax System

The Minnesota 2020, a policy research organization, conducted research regarding the progressivity of states' tax system. A scale of 1 through 50 was used, one being the most progressive state and 50 being the most regressive. Montana was ranked as the third most progressive state in the nation.¹⁰⁸

The tax system of Montana includes both individual and corporate income taxes. Individual income rates range from 1-6.9 percent.¹⁰⁹ Its corporate income tax rate is a single rate of 6.25 percent. Although these rates are ranked high nationally, Montana's tax burden is well below the national average. Its property taxation at both state and local levels is also considered to be low or modest in comparison to other states.¹¹⁰

Montana is one of five states (Delaware, Alaska, New Hampshire and Oregon) without a general statewide sales tax.¹¹¹ It also does not impose a tax on gross receipts, occupational licenses, use or consumption of tangible personal property that is within Montana. Montana levies taxes on lodging facilities, a sales and use tax on accommodations and campgrounds, a rental vehicle sales tax and vehicle sales tax.¹¹²

Lodging Facilities

Two taxes are imposed on users of overnight lodging facilities: the lodging facility use tax and the lodging facility sales tax.¹¹³ While many municipalities, including the City of El Paso, levy such a tax, this particular revenue stream is dedicated to the state.

People using an overnight lodging facility (motels, hotels, campgrounds) for less than 30 days are charged a 4 percent lodging facility use tax which is collected by the owners or operators of the facility.¹¹⁴ Proceeds of the tax are then deposited in the state special revenue fund of the Department of Revenue. From this fund, administrative costs are paid for, certain state funds are reimbursed for taxes paid by state agencies and \$400,000 is given to the Montana Heritage Preservation fund each year. The lodging facility sales tax, also known as the accommodation and campgrounds sales and use tax, is a 3 percent tax imposed on

¹⁰⁷ (Nicholas Johnson 2010)

¹⁰⁸ (Wychen 2010)

¹⁰⁹ (The Tax Foundation 2010)

¹¹⁰ (The Tax Foundation 2010)

¹¹¹ (Johnson No Date)

¹¹² (Business Owner's Toolkit 2010)

¹¹³ (Department of Revenue Montana State No Date)

¹¹⁴ (Business Owner's Toolkit 2010)

accommodation and campground fees. The tax is an addition to the 4 percent lodging facility use tax. Proceeds of the lodging facility sales tax are deposited in Montana's general fund.¹¹⁵

Rental Vehicle Sales Tax

The sales tax is a 4 percent tax on the base rental charge of a rental vehicle. Base rental charges include charges for the time of use of the rental, mileage, personal accident insurance, additional drivers or underage drivers and accessory equipment such as luggage racks or child safety seats. Automobiles, motorcycles, sail boats, off-road recreational vehicles and trucks with a gross weight of 22,000 pounds are subject to the tax.¹¹⁶

Montana's Current State

Entering 2010, Montana and North Dakota were two of fifty states that reported no budget deficit.¹¹⁷ As of June, Montana now faces a shortfall. The Legislative Budget Office (LBO) predicts a \$350M budget shortfall by the end of the biennium and foresees a \$450M shortfall for the next biennium session. Montana's two largest tax sources are individual and corporate income taxes. These sources suffered a decrease in revenue. LBO projected \$735M in individual income taxes to be collected by the end of May, but only \$595M was collected. Revenue from the corporate income tax was also overestimated. Corporate taxes were expected to generate \$96M but only \$65.5M was brought in. From both income taxes there was a total shortfall of \$170M, \$139M from individual income taxes and \$31M from corporate taxes.¹¹⁸

Governor Brian Schweitzer (D) proposed to cut five percent in spending to prepare Montana for the next fiscal year, the current budget period ending in the middle of 2011. Schweitzer's budget director, David Ewer, approves of a \$40M cut to the state. Ewer considers public safety, public education and public health to be "core services" or priorities of Montana when considering budget cuts. However, the consequence of the \$40M cut will be a reduction of programs. Increases to doctors and health care providers for the care of their patients, will be reduced, for example. Health care and almost all other areas of the state government may then experience budget cuts. Tax increases are not part of Montana's budget plan and two-thirds majority vote from legislature would be needed to override David Ewer's proposal to not have tax increases. There will be only one small increase in Montana; \$2M is going to be cut from local school districts' block grants. As a result, property taxes are expected to rise to compensate for the cut.¹¹⁹

¹¹⁵ (Department of Revenue Montana State No Date)

¹¹⁶ (Department of Revenue Montana State No Date)

¹¹⁷ (Johnson, McNichol and Oliff 2010)

¹¹⁸ (Banks 2010)

¹¹⁹ (Gouras 2010)

Percent of Income Paid in Taxes

Community Scholars developed the tables in this section to display the percentage of individual income that is paid in the different types of taxes in each state. The percentages vary by income bracket for each tax and state. The dollar amount paid in taxes shown in the tables is based on the income amounts shown in the parenthesis in each income group bracket. The figures shown correspond to the year 2007. Following each table, Community Scholars provides an analysis of what each table displays and its relevance to the state tax systems that have been previously discussed.

Table 4: Total Taxes Paid in 2007

State	Income Group	Lowest 20% (\$15,000)	Second 20% (\$30,000)	Middle 20% (\$50,000)	Fourth 20% (\$85,000)	Top 20%		
						Next 15% (\$175,000)	Next 4% (\$450,000)	Top 1% (\$750,000)
Texas	Percent of Income	12.2%	10.3%	8.5%	7.7%	6.7%	5.3%	3.3%
	Amount Paid	\$1,830	\$3,090	\$4,250	\$6,545	\$11,725	\$23,850	\$22,500
California	Percent of Income	10.2%	8.7%	8.3%	8.3%	8.8%	9.2%	9.8%
	Amount Paid	\$1,530	\$2,610	\$4,150	\$7,055	\$15,400	\$41,400	\$73,500
Montana	Percent of Income	6.1%	6.2%	6.2%	6.1%	6.4%	5.7%	5.5%
	Amount Paid	\$915	\$1,860	\$3,100	\$5,185	\$11,200	\$25,650	\$41,250
New York	Percent of Income	9.6%	10.1%	12.0%	12.2%	12.7%	11.8%	9.4%
	Amount Paid	\$1,440	\$3,030	\$6,000	\$10,370	\$22,225	\$53,100	\$70,500
Washington	Percent of Income	17.3%	12.7%	11.2%	9.5%	7.6%	5.5%	2.9%
	Amount Paid	\$2,595	\$3,810	\$5,600	\$8,075	\$13,300	\$24,750	\$21,750

Source: Institute on Taxation & Economic Policy 2009

The table above clearly depicts Washington's regressive tax system, having the largest tax burden on their lowest income groups and the lowest tax burden on the top one percent income group. California and Texas also place the highest of their tax burdens on their lowest income groups, thus reflecting their regressive tax systems. Montana, considered one of the most progressive tax systems, has

the lowest tax burden of the five states being compared on the lowest 20 percent and second 20 percent income groups. New York, considered to have a moderate tax system, places the highest tax burden on their middle class.

Table 5: 2007 Income Taxes (Individual and Corporate) Paid in Percentage to Income

State	Income Group	Lowest 20% (\$15,000)	Second 20% (\$30,000)	Middle 20% (\$50,000)	Fourth 20% (\$85,000)	Top 20%		
						Next 15% (\$175,000)	Next 4% (\$450,000)	Top 1% (\$750,000)
California	Percent of Income	0.1%	0.5%	1.2%	2%	3.4%	5.3%	7.5%
	Amount Paid	\$15	\$150	\$600	\$1,700	\$5,950	\$23,850	\$56,250
Montana	Percent of Income	0.6%	1.5%	2.4%	2.9%	3.5%	3.6%	4.0%
	Amount Paid	\$90	\$450	\$1,200	\$2,465	\$6,125	\$16,200	\$30,000
New York	Percent of Income	-3.5%	0.3%	3.4%	4.7%	5.8%	6.8%	7.0%
	Amount Paid	-\$525	\$90	\$1,700	\$3,995	\$10,150	\$30,600	\$52,500

Source: Institute of Taxation and Economic Policy

The table above shows that of the states with a personal and corporate income tax, the citizens of the state of New York pay the highest percentage of their income in income taxes. The negative percentage in the lowest 20 percent income group in New York is due to the state Earned Income Tax Credit. The negative percentage represents a supplement on the tax refund; people falling under this income bracket end up getting a full tax exemption as well as additional money. As mentioned earlier, this particular tax is naturally progressive, as individuals/corporations make more money; they pay higher percentages in taxes. Texas and Washington are not displayed in the table above because both states do not levy personal/corporate income taxes on their citizenry.

Table 6: Sales and Excise Taxes Paid in 2007

State	Income Group	Lowest 20% (\$15,000)	Second 20% (\$30,000)	Middle 20% (\$50,000)	Fourth 20% (\$85,000)	Top 20%		
						Next 15% (\$175,000)	Next 4% (\$450,000)	Top 1% (\$750,000)
Texas	Percent of Income	8.2%	7.2%	5.8%	4.5%	3.2%	2.0%	1.0%
	Amount Paid	\$1,230	\$2,160	\$2,900	\$3,825	\$5,600	\$9,000	\$7,500
California	Percent of Income	6.5%	5.4%	4.1%	3.2%	2.3%	1.5%	0.8%
	Amount Paid	\$975	\$1,620	\$2,050	\$2,720	\$4,025	\$6,750	\$6,000
Montana	Percent of Income	2.2%	1.9%	1.3%	1.0%	0.6%	0.4%	0.1%
	Amount Paid	\$330	\$570	\$650	\$850	\$1,050	\$1,800	\$750
New York	Percent of Income	7.3%	6.0%	4.7%	3.7%	2.8%	1.7%	0.9%
	Amount Paid	\$1,095	\$1,800	\$2,350	\$3,145	\$4,900	\$7,650	\$6,750
Washington	Percent of Income	13.1%	10.0%	8.3%	6.7%	5.1%	3.3%	1.8%
	Amount Paid	\$1,965	\$3,000	\$4,150	\$5,695	\$8,925	\$14,850	\$13,500

Source: Institute on Taxation & Economic Policy 2009

According to the table above, Washington has the highest overall sales tax burden in every income group compared to that of the other states displayed. Considering that Montana has no statewide sales tax, it places the lowest sales tax burden on its citizens. In Texas, the range between the tax burden of the lowest income group and highest income group is 7.2 percent, making it the second most regressive of the five states being compared, Washington being the first. All states' sales tax burdens fall heavier on the lowest income groups, as is the nature of the sales and use tax, regressive.

Table 7: Property Taxes Paid in 2007

State	Income Group	Lowest 20% (\$15,000)	Second 20% (\$30,000)	Middle 20% (\$50,000)	Fourth 20% (\$85,000)	Top 20%		
						Next 15% (\$175,000)	Next 4% (\$450,000)	Top 1% (\$750,000)
Texas	Percent of Income	3.9%	3.0%	2.7%	3.1%	3.4%	3.1%	2.1%
	Amount Paid	\$585	\$900	\$1,350	\$2,635	\$5,950	\$13,950	\$15,750
California	Percent of Income	3.6%	2.8%	3.0%	3.1%	3.0%	2.4%	1.4%
	Amount Paid	\$540	\$840	\$1,500	\$2,635	\$5,250	\$10,800	\$10,500
Montana	Percent of Income	3.3%	2.8%	2.6%	2.2%	2.2%	1.7%	1.4%
	Amount Paid	\$495	\$840	\$1,300	\$1,870	\$3,850	\$7,650	\$10,500
New York	Percent of Income	5.8%	3.8%	3.9%	3.8%	4.1%	3.3%	1.5%
	Amount Paid	\$870	\$1,140	\$1,950	\$3,230	\$7,175	\$14,850	\$11,250
Washington	Percent of Income	4.2%	2.7%	2.9%	2.8%	2.5%	2.3%	1.1%
	Amount Paid	\$630	\$810	\$1,450	\$2,380	\$4,375	\$10,350	\$8,250

Source: Institute on Taxation & Economic Policy 2009

First off, it should be noted that most states do not levy statewide property taxes directly. These figures are calculations based on what the average citizen in each of the states pays in property taxes to localities and special districts located on the municipal, not state, level. Overall New York citizens carry the highest property tax burden in every income group except the top one percent; this income group has the highest tax burden in Texas. Montana, however, has the lowest tax burden in every income tax group, with the exception of the second 20 percent income group: Washington has the lowest tax burden for this income group. As previously discussed, the property tax seems to have facets that are both regressive and progressive in nature.

Hypothetical Tax Models

The tables in this section display the tax burden individual Texas citizens may hypothetically incur if Texas were to adopt the tax systems of Washington, California, New York or Montana. The median incomes were determined based on Texas numbers according to the U.S. Census Bureau data on income and property values. The quartiles are based on the incomes of Texas citizens; quartile one representing citizen with incomes in the lowest 25 percent, while quartile 4 represents citizens with income in the highest 25 percent. The three main taxes were compared in this section: personal income, sales and property. Other state taxes and exemptions were excluded from calculating the hypothetical tax burdens, thus the actual tax burden could be either lower or higher.

To calculate total tax burden, the current tax rates of each state were used. Specifically, to calculate the personal income tax burden, Community Scholars created income brackets that would not only fit the statistical economic data of Texas, but also the already established income brackets of each state regarding the personal income tax rates. In order to calculate the sales tax burden of the individual Texan, Community Scholars gathered the average dollar amount of consumption of the American citizen according to their respective incomes. Consumption was then multiplied by each individual sales tax rate and then the product of these two numbers was divided by the median incomes determined in the quartiles then yielding to total sales tax burden.

To calculate property tax burden, Community Scholars first calculated hypothetical property values by multiplying median income by two for each bracket. Community Scholars learned that individuals generally own homes that are valued at twice their annual income. It should be further stated that this is only an estimate to further explore taxation principles and practices. After the value was calculated, the value was divided by \$100 and then multiplied by the property tax rate. This first table displays the State of Texas' tax system and its associated burdens.

Table 8: Texas Tax Burden

Quartile	Median Income	Type of Tax			Total Tax Burden
		Income	Sales	Property	
1	\$12,500	0%	5.00%	0%	5.00%
2	\$37,500	0%	5.68%	0%	5.68%
3	\$75,000	0%	4.83%	0%	4.83%
4	\$100,000	0%	4.86%	0%	4.86%

Source: Community Scholars, Inc.

As previously discussed, the State of Texas only implements a statewide sales tax, as the above table displays. The second quartile, thought of as lower-middle class, has the highest tax burden at near six percent. The following table will now display the tax burdens Texas citizens would experience if the State implemented the tax rates of the State of Washington.

Table 9: Washington Tax Burden

Quartile	Median Income	Type of Tax			Total Tax Burden
		Income	Sales	Property	
1	\$12,500	0%	5.20%	0.81%	6.01%
2	\$37,500	0%	5.91%	0.81%	6.72%
3	\$75,000	0%	5.03%	0.81%	5.84%
4	\$100,000	0%	5.06%	0.81%	5.87%

Source: Community Scholars, Inc.

Washington, like Texas, does not have a state personal income tax. The tax burden pattern follows that of Texas, where the second quartile pays the most in taxes. While the range of burden is lower than that of Texas, the burden placed on Texans would still be regressive in nature. This next table displays California’s information.

Table 10: California Tax Burden

Quartile	Median Income	Type of Tax			Total Tax Burden
		Income	Sales	Property	
1	\$12,500	2.25%	6.60%	0%	8.85%
2	\$37,500	8.25%	7.50%	0%	15.75%
3	\$75,000	9.55%	6.38%	0%	15.93%
4	\$100,000	9.55%	6.42%	0%	15.97%

Source: Community Scholars, Inc.

California does not have a statewide property tax, and thus relies on the personal income and sales taxes. The largest total tax burden, which is 15.97 percent, falls on the highest income group, and is far greater than the total tax burden of the lowest-income group. There is a large jump between the first and second quartiles however, where the lower-middle class is paying nearly identical rates as the highest quartile. While the introduction of an income tax does help make the overall system more progressive, the rates are relatively the same, introducing the possible idea of fairness or equal distribution of burden. This next table displays New York’s system.

Table 11: New York Tax Burden

Quartile	Median Income	Type of Tax			Total Tax Burden
		Income	Sales	Property	
1	\$12,500	5.25%	3.20%	0%	8.45%
2	\$37,500	6.38%	3.64%	0%	10.02%
3	\$75,000	7.85%	3.09%	0%	10.94%
4	\$100,000	7.85%	3.11%	0%	10.96%

Source: Community Scholars, Inc.

Like California, New York does not have a statewide property tax. It places its highest total tax burden on the highest income group, and places the lowest total tax burden on the lowest income group. In general, the table shows New York as having a progressive tax system, but since the state has a lower difference between its largest and lowest tax burden than that of California, New York is moderate in comparison to the other states. The New York model displays the more

equitable distribution of burden, as California does, as compared to Washington and Texas. The last state model, Montana, is displayed in the table below.

Table 12: Montana Tax Burden

Quartile	Median Income	Type of Tax			Total Tax Burden
		Income	Sales	Property	
1	\$12,500	5.96%	0%	0.31%	6.27%
2	\$37,500	6.20%	0%	0.31%	7.21%
3	\$75,000	6.20%	0%	0.31%	7.21%
4	\$100,000	6.20%	0%	0.31%	7.21%

Source: Community Scholars, Inc.

Montana does not have a statewide general sales tax. The total tax burden for each quartile is then due to the personal income tax and the statewide property tax. Montana places its lowest tax burden, 6.27 percent, on the lowest income group, and the highest tax burden for the remaining quartiles. Since these are hypothetical figures, the repeated tax burdens for the last three quartiles are due to the actual income tax brackets of Montana, which are very moderate in comparison to the other states in the nation. As with the previous two state models, introduction of the income tax, when mixed with a flat-rate regressive style tax, helps to distribute burden evenly across the income-quartiles presented in the tables above.

Taking it one step further, Community Scholars calculated how much revenue the State of Texas could generate if it implemented a taxing system of the previously compared models. The following table displays the amount of revenue each tax system would yield the State of Texas.

Table 13: Total Tax Revenue

State	Type of Tax			Total Tax Revenue
	Income	Sales	Property	
Texas	\$0	\$23.6B	\$0	\$23.6B
Washington	\$0	\$24.5B	\$3.1B	\$27.6B
California	\$53.8B	\$31.2B	\$0	\$84.9B
New York	\$51.2B	\$15.1B	\$0	\$66.3B
Montana	\$45.9B	\$0	\$1.2B	\$47.1B

Source: Community Scholars, Inc.

Based on taxes alone, and not user fees, the state of Texas currently generates approximately \$24B annually. This figure could be tripled if the State followed the model that California currently uses. In fact, the introduction of any of the comparison models would yield an increase in tax revenue, regardless of whether a statewide-income tax was introduced or not. However, it should be noted that the systems, all of which would yield increased revenue, have at least two taxes to rely on to produce revenue.

Discussion

Taxation is a very complex and challenging issue to discuss, especially during a period of economic recession. The role that taxes should play in governing date back to the days of the

Second Continental Congress as individuals argued whether or not the then proposed-federal government would even need to levy taxes on the citizenry. As services provided by government have expanded, the need for larger budgets has also developed. While critics of “big government” argue that the easiest way to avoid or alleviate a budget shortfall is to cut programs, many programs are legally, either by law or constitutional authority, required of the states, and as such, simply making cuts will not work. It requires thoughtful discussion from individuals on both sides of the political aisle to engage in a healthy balance of fiscal responsibility and moderate, equal and fair taxation practices. The following section presents the conclusions and recommendations put forth by Community Scholars.

Conclusions

The Texas Constitution makes it very difficult for a statewide income tax to ever be implemented. Not only is it constitutionally banned, but the funding stipulations tied to the tax make it near impossible to implement legally. Through the research, it became apparent that switching Texas over to a more moderate to progressive taxing system would require a new amendment to the state constitution to either nullify the existing ban or modify the requirements associated with introducing an income tax.

Another issue with the state taxing system is the overreliance on the sales and use tax. While the state has gone without a mixture of taxes for many years, great dependency on the sales tax makes the state susceptible to market fluctuations, as we currently see. Other states generally employ a mixture of taxes, both regressive and progressive, in order to maintain a more stable tax base to avoid overwhelming shortfalls. Of the five states analyzed throughout the report, Montana is facing the “smallest” shortfall while California is the most grave.

While most budget “fixes,” including cuts and increased taxing rates, are negative on tax payers, it is evident that a combination of both must be done in order to help balance state budgets. Texas is in a serious financial crisis, just as most states and localities, and an appropriate plan of action must be developed that prioritizes services that are mandated of the state as well as the introduction of tax increases or new taxes entirely, to ward off the budget concerns.

In fact, Texas could possibly generate more revenue if implementing another state’s tax system or simply reforming its own tax system by shifting the dependence of revenue from only one type of tax to several. Though the implementation of an additional statewide tax would not necessarily lower the total tax burden on Texas citizens, the additional revenue generated by such a tax would be helpful in meeting more of the state’s needs, as well as possibly balance the burden of taxation further.

Recommendations

A portion of the Rain Day Fund should be used towards funding needed programs/services throughout the current budget shortfall. The fund exists for situations where the State is unable to generate or dedicate funds to programs that may not necessarily be mandated by law but are generally expected by the average citizenry. Many individuals are

dependent on certain social service programs and as such, the state arguably has a moral obligation to continue to assist these individuals.

In addition, the Texas Marginal Tax may need to be reformed or replaced with a more effective form of taxation to help fund schools. For the last decade, the State has continued to shift its financial responsibility to fund public education to local school boards which has negatively impacted local property owners. This trend of devolution cannot continue because most school districts are currently at their tax rate maximums and are still left wanting. A new funding stream that is reliable needs to be committed to public education.

The Texas tax system should be reformed by adding an additional statewide tax i.e. a state income tax, in order to better balance the tax burden on its citizens and increase tax revenue generated in the state. With another statewide tax, the local property taxes could be lower because the dependency on such would be lowered as well. The implementation of a statewide progressive tax would help alleviate tax burden on low- and moderate- income families and would allow Texas to have a more moderate tax system. The following describes a tax model proposed by Community Scholars. The model, which was with the priorities of saving most tax payers money and making the system more moderate, introduces a statewide income tax as a secondary state revenue generator.

Community Scholars' Tax Model

Community Scholar developed a hybrid tax model for the state of Texas, in which a state income tax has been implemented and in which the statewide sales tax, currently 6.25 percent, has been lowered to 5.85 percent. The income brackets shown in the first column are the brackets for the state personal income tax, which ranges from 1 percent to 5.65 percent. The personal income tax is estimated to \$17B. The sales tax revenue, calculated using the Community Scholars rate of 5.85 percent and estimated amounts of consumption appropriate to each income bracket, is estimated to bring in \$22.1B. With the hybrid tax model, the state personal income tax and the sales tax alone will generate an estimated \$39.1B, close to the total tax amount Texas collected for the year 2009: \$40.78B. The 2009 revenue was due to sales and gross receipts, licenses and other sources of revenue.

Furthermore, the total tax burden under the Community Scholars model, which adds the tax burden for both the personal income and sales tax, is moderate: the lowest burden is 5.68 percent on the lowest income group while the remaining burdens ranges from the 7.02 percent to 7.93 percent for the other four income brackets. The highest tax burden, 7.93 percent, is then placed on the highest income group, those with incomes over \$150,000. This is due to the high income tax rate, 5.65 percent, that is placed on this income group.

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Table 14: Taxes Paid by an Individual El Pasoan

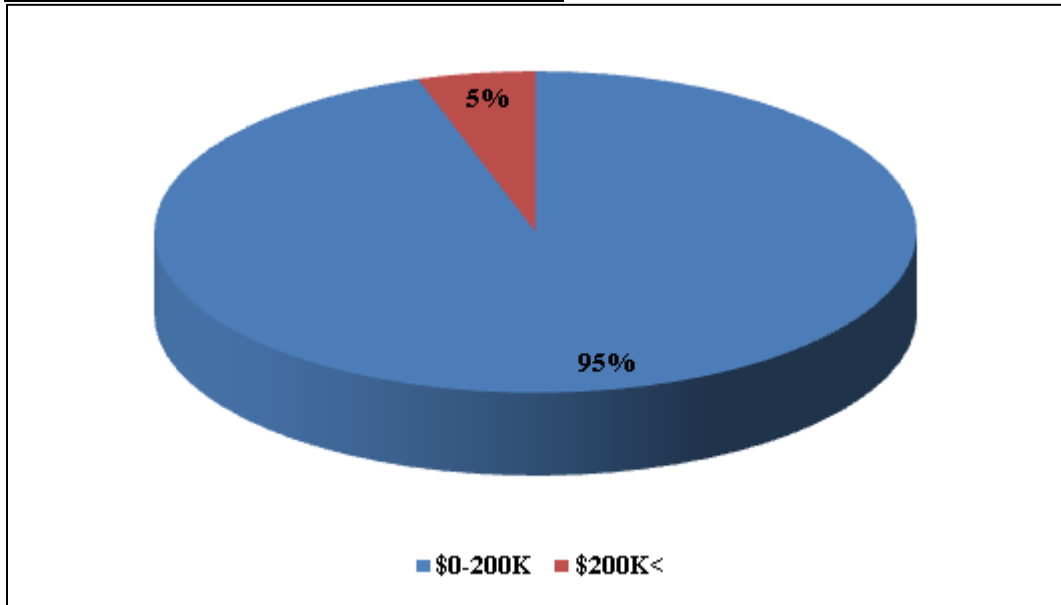
Income	Type of Tax	Taxes Paid		Difference
		Current Tax System	C.S. Hybrid Tax System	
\$50,000	Property	\$2,505	\$1,256	-
	Sales	\$2,763	\$2,694	-
	Income	\$0	\$1,250	-
	Total	\$5,268	\$5,200	\$68
\$100,000	Property	\$5,009	\$2,512	-
	Sales	\$4,670	\$4,553	-
	Income	\$0	\$2,500	-
	Total	\$9,679	\$9,565	\$114
\$150,000	Property	\$7,513	\$3,768	-
	Sales	\$4,670	\$4,553	-
	Income	\$0	\$3,750	-
	Total	\$12,184	\$12,072	\$111
\$200,000	Property	\$10,018	\$5,025	-
	Sales	\$4,670	\$4,553	-
	Income	\$0	\$11,300	-
	Total	\$14,688	\$20,878	\$-6,190

Source: Community Scholars, Inc.

The table above shows amount of taxes (property, sales and income taxes) an individual El Pasoan may pay with either tax system, (the current Texas tax system and the Community Scholars hybrid model) and how much tax money a tax payer can save with the hybrid model. The amount of taxes shown and the differences for this table only applies to tax payers in El Paso, for El Paso local and county rates were used in calculating the property tax portion. An El Pasoan taxpayer in the first income group, \$50,000, pays \$5,268 under the current system, which does not include a state personal income tax for Texas has not implemented one. Paying a state personal income tax, as with the Community Scholars tax system, the tax payer will pay \$5,200. Despite the addition of a personal income tax, the amount of property and sales taxes are lower than with the current tax system.

The taxpayer of this income group will then save \$68 with the Community Scholars hybrid model. Tax payers within the next two income groups (\$100,000 and \$150,000) also save money for property and sales taxes greatly decrease with a state personal income group. El Paso taxpayers of the \$100,000 income group will save \$114 and those of the \$150,000 income group save \$111. As shown by the negative difference of \$6,190, those with an income of \$200,000 will not save money with the Community Scholars hybrid model, which increases the amount of taxes to be paid, \$20,878 as opposed to \$14,688 with the current Texas tax system. Even though the amount of property and sales taxes are lower for the \$200,000 income group, as previously mentioned, personal income taxes are progressive. The income tax then falls heavier on higher income groups than on groups of the lowest income brackets, but the majority of taxpayers benefitting from the hybrid model is of importance and is further discussed with the following figure.

Figure 1: Percentage of Texas Taxpayers



Source: U.S. Census Bureau

As shown, Texans with incomes of less than \$200,000, compose 95% of Texas' taxpayers while the remaining 5% are taxpayers with incomes over \$200,000. The majority of taxpayers then benefit from the Community Scholars hybrid model, which saves money and lowers the tax burden for individuals with incomes that fall within the sampled income amounts, shown in the previous table. Although the tax burden is raised for those with an income over \$200,000, the tax burden of the majority of Texas taxpayers is initially considered in lowering the burden while implementing an additional tax such as the state personal income tax.

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