

Briefings

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Reinstatement of the Federal Income Tax Deduction for State and Local Sales Taxes Would Restore Equity Across the States

There is a lot of talk currently in Washington D.C. about tax cuts and tax reform. Part of that debate, while not getting much publicity, centers on a proposed tax reform measure that should be of great interest to the taxpayers of Florida. It is the reinstatement of the federal personal income tax deduction for state and local sales taxes paid.

Under current law, individuals who itemize their deductions for federal tax purposes are only permitted to deduct state and local income taxes and property taxes paid. State and local sales taxes are not deductible. Bills have been introduced in both the United State Senate and House of Representatives to allow a sales tax deduction. In Florida, the Legislature is considering a proposed memorial to Congress supporting the reinstatement of the deduction. At the request of House Fiscal Policy and Resource Chairman Rob Wallace, Florida TaxWatch drafted the memorial, which he filed (see memorial at the end of this report.)

Prior to 1986, taxpayers were permitted to deduct all of their state and local taxes paid (along with some other taxes) when computing their federal tax liability. Since the creation of the Federal income tax in 1861 until 1986, the sales tax deduction had been accepted as a necessary feature of federalism. This has promoted the idea that states should have the right to decide for themselves how they want to collect their revenues without interference from the federal government. The ability to deduct all state and local taxes was also based on the principle that levying a tax on a tax is unfair.

However, the Tax Reform Act of 1986 made dramatic changes to the tax code. Congress significantly reduced federal tax rates on individuals. In exchange for these lower rates, Congress broadened the base of income by eliminating many of the deductions and credits that previously existed in the code, including the deduction for state and local sales taxes.

This has resulted in a growing inequity between taxpayers in different states regarding the amounts they pay in federal taxes. Taxpayers in 43 states may deduct state income tax payments from their federal returns, but more than 50 million Americans living in nine states have no comparable relief. Seven states -- Florida, Texas, Alaska, Wyoming, Washington, South Dakota and Nebraska -- have no state income tax. Two states -- Tennessee and New Hampshire -- only impose an income tax on interest and dividends, but not wages. Most of these states have a heavy reliance on sales taxes, and their

taxpayers have large sales tax burdens (Alaska and New Hampshire have no state sales tax). Clearly, Florida is one of those states.

Federal tax laws should be neutral with respect to state and local taxes. However, the current tax code is biased in favor of states that raise revenue through an income tax. As a result, residents of states without state income taxes generally pay a greater percentage of taxes to the federal government than residents of states with state income taxes. This means that two taxpayers with identical income and financial circumstances can have differing federal tax liabilities because they live in different states.

The proposed federal legislation would allow taxpayers to deduct *either* their state income tax *or* state sales taxes paid in a given year. By giving the choice of deducting either sales or income taxes, the fiscal impact is lessened, but equity and fairness are restored across states. All taxpayers would be able to determine which deduction would work best for them.

To promote simplicity, the Internal Revenue Service would be directed to develop standard tables for taxpayers to use in determining their average sales tax deduction. Such tables, similar to those used prior to 1986, would provide the deduction amount, based upon income and household size, for a taxpayer in a given state. The bill does not allow for the itemized deduction of individual purchases, so there is no need to save sales receipts or other similar paperwork.

As the Florida Legislature enters the last week of its regular session, it needs to send a message to Congress. Rep. Wallace's memorial can do that. Taxpayers in states such as Florida are discriminated against under federal tax laws simply because their states have no income tax. The federal government must strive to avoid tax policies that favor residents of some states over others.

**A memorial to the Congress of the United States,
Urging Congress to reinstate the federal income tax deduction for sales
taxes paid.**

WHEREAS, prior to 1986, American taxpayers were allowed to deduct state and local sales taxes paid from their federal income tax liabilities, and

WHEREAS, the Tax Reform Act of 1986 repealed this deduction and this has resulted in a growing inequity between taxpayers in different states regarding the amounts they pay in federal taxes, and

WHEREAS, citizens of 43 states may deduct state income tax payments from their federal returns, but more than 50 million Americans living in nine states have no comparable relief. Seven states -- Florida, Texas, Alaska, Wyoming, Washington, South Dakota and Nebraska -- have no state income tax. Two states -- Tennessee and New Hampshire -- only impose an income tax on

interest and dividends, but not wages, and

WHEREAS, taxpayers in these states are discriminated against under federal tax laws simply because their states have no income tax and the federal government must strive to avoid tax policies that favor residents of some states over others, and

WHEREAS, the ability to deduct state and local taxes is based on the principle that levying a tax on a tax is unfair and federal law currently permits taxpayers to include itemized deductions for state and local income taxes and foreign income taxes; personal property taxes; real estate taxes; self-employment taxes; certain business expenses and occupational taxes, and taxes paid on rental property or royalty income - but not state sales taxes, and

WHEREAS, residents of states without state income taxes pay a greater percentage of taxes to the federal government than residents of states with state income taxes and this system means that two taxpayers with identical income and financial circumstances can have differing federal tax liabilities if they live in different states, and

WHEREAS, since the creation of the Federal income tax in 1861 until 1986, the sales tax deduction had been accepted as a necessary feature of federalism and states should have the right to decide for themselves how they want to collect their revenues without interference from the federal government, and

WHEREAS, allowing taxpayers to deduct either their state and local income tax or state and local sales taxes paid in a given year would restore equity and fairness across the states,

NOW, THEREFORE,

Be It Resolved by the Legislature of the State of Florida:

That the Congress of the United States is respectfully requested to
reinststate the federal income tax deduction for sales taxes paid.

BE IT FURTHER RESOLVED that copies of this memorial be sent to the President of the United States, to the President of the United States Senate, to the Speaker of the United States House of Representatives, and to each member of the Florida delegation to the United States Congress.

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