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A Progressive Federal Tax Credit for State Tax Payments

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SOLUTIONS

A Progressive Federal Tax Credit for State Tax Payments

In one bold fell swoop, we could counteract the chronic regressivity of America's state tax systems.

RESEARCH & COMMENTARY

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by Eric Kades

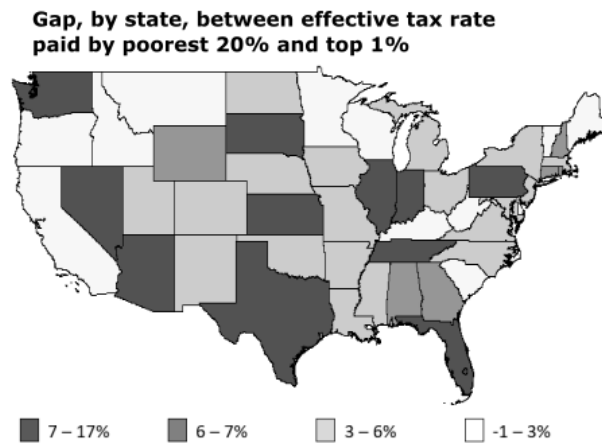


Anyone not living in a cave knows that levels of income inequality in America have, ever since about 1980, been exploding. Top incomes have soared while middle- and low-income paychecks have stagnated.

Just as income inequality has exploded, so too has the scholarly literature surrounding inequality. Researchers have proposed a number of policy measures to address our top-heavy distribution of income, everything from increasing the minimum wage and reinvigorating unions to placing a global tax on capital.

Amid all this research, one key driver of income inequality has often gone overlooked. This key driver — unfair, regressive state taxation — lies entirely within the control of our governments. Simply put, all 50 states are now operating unfair tax systems.

This map below tells the basic story. In dark-colored states like Texas and Illinois, the top 1 percent of taxpayers are paying anywhere from 7 to 17 percent *less* of their incomes in state and local taxes than the state's poorest 20 percent of taxpayers. Even in the less regressive white-colored states, the poor still bear a heavier tax burden than the wealthy. All these states have *regressive* tax systems: Their poorest citizens pay taxes at a lower rate than their richest.



Now we have in the United States today advocates for a *flat* tax rate structure, a system that taxes all levels of income at the same rate. And we have over a century of experience with *progressive* taxation, taxing people of higher income at higher rates. But hardly anyone in the United States has ever openly supported *regressive* taxation, creating situations that have lower-income people paying a *greater* proportion of their income in taxes than higher-income people.

Yet despite the almost complete absence of express support for regressive taxation, *every single state* in the United States taxes regressively.

Why? Highly regressive state sales taxes and often regressive property taxes tend to outweigh the slightly progressive income taxes that some states levy. States that lack income taxes and rely almost exclusively on sales and property taxes have even more regressive overall tax systems.

The most egregious example may be the state of Washington, where the lowest-income households must devote 16.8 percent of their income to states taxes while those at the

top pay less than 2.8 percent, an astounding level of regressivity. Many states have only modestly less regressive tax systems.

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Regressive state tax schemes gratuitously contribute to inequality. Governments can do little to counteract some of the market forces driving the divergence between the incomes of the top 1 percent and the incomes of everyone else. But taxation, an animal entirely of government creation, remains entirely under government control. That makes our current reality — with state tax codes “piling on” to inequality instead of offsetting it — even more disturbing and perverse.

To make matters worse, tax codes have always been notoriously difficult to amend. Reforms typically involve major ideological battles — rich v. poor, capital v. labor, urban v. rural — and their details attract special interest groups large and small. In this environment, the chances that more than just a few states would ever challenge regressive tax systems and effectuate serious tax reform appear vanishingly small for the foreseeable future.

Indeed, the trend has been moving in the opposite direction: State tax codes are becoming more rather than less regressive.

But an innovative *federal* tax solution could offer an end-run around state roadblocks and actually eliminate unfair taxation across every state in one fell swoop.

A PROGRESSIVE STATE TAX CREDIT

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This one step — what we can call a progressive state tax credit — would simply give poorer households a 100 percent federal tax credit for all of their estimated state tax payments, including income, sales, and property taxes.

As a household's income rises, the percent of this credit would decline. The most affluent households would pay a "negative credit" or surcharge to fund the tax relief for their lower-income counterparts.

This progressive state tax credit would be well-suited to counteract, at least partially, growing American income equality in this second decade of the 21st century.

Two important facets of the credit bear highlighting.

First, a progressive state tax credit's effects would vary from state to state. The 100 percent credit for the poorest households would operate symmetrically across states, but the rates at which the credit phases out and the surcharge increases would depend on the extent of regressivity in each state's tax system.

Second, to prevent states from exploiting the credit by raising their taxes and shifting the burden onto the federal government and, in effect, onto all Americans, a progressive state tax credit would need to be designed to raise the same amount of revenue as the current tax code *in each state*. The credit, in other words, would be "revenue neutral" at the level of each state and, by extension, nationally as well.

Structuring the progressive state tax credit in this way would ensure that the credit does not reduce federal income tax revenue and also ensure that states would not be able to use the credit to foist off their citizens' state tax burden onto out-of-staters.

Eric Kades is the Thomas Jefferson Professor of Law at William & Mary Law School. His current research focuses on inequality writ large and the role that the law plays in reinforcing and expanding inequality. He is nearing completion of a comprehensive book on law and inequality entitled *The New Feudalism*. A more detailed version of this article [appears](#) in the *Louisiana Law Review*.