Tax

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Pennsylvania, Indiana and Alabama round out the top 10.

In Nebraska, the bottom 20 percent of earners pay 10.9 percent of their income in taxes. The top 1 percent pay 5.8 percent.

In the newest edition of "Who Pays: A Distributional Analysis of the Tax Systems in All Fifty States," ITEP assesses the fairness of state and local tax systems by measuring the amounts paid by different income groups in 2013 (at 2010 income levels including the impact of tax changes enacted through Jan. 2, 2013) as shares of income.

"The main finding of this report is that virtually every state's tax system is fundamentally unfair, taking a much greater share of income from middle- and low-income families than from wealthy families," the authors of the report state. "The absence of a graduated personal income tax and the overreliance on consumption taxes exacerbate this problem in many states."

South Dakota is one of seven states that does not have a personal income tax.

"Combining all of the state and local income, property, sales and excise taxes state residents pay, the average overall effective tax rates by income group nationwide are 11.1 percent for the bottom 20 percent, 9.4 percent for the middle 20 percent and 5.6 percent for the top 1 percent," according to the report.

ITEP finds South Dakota's tax system has no progressive features, and its regressive features include having no personal income tax, a sales tax base that includes groceries, and no corporate income tax.

In Nebraska, progressive features include an income tax that uses a graduated rate structure, a refundable earned income tax credit and an income tax credit for child and dependent care expenses. Its sole regressive feature is a comparatively high reliance on property taxes.

Gov. Dave Heineman proposed getting rid of Nebraska's individual income tax this year, but the idea met a great deal of resistance and was shelved.

South Dakota once had a personal income tax, too. But the Legislature repealed it in 1943. Subsequent efforts to reinstate the tax have failed.

TAXING OPTIONS

So what are the options a state has when constructing a tax system?

States have three broad forms of taxes they can levy — income, property and consumption.

"The income tax is the only one that is typically progressive in that its rate rises with income levels," ITEP states in its report. "Property taxes are usually somewhat regressive. Sales and excise taxes are the most regressive, with poor families paying eight times more of their income in these taxes than wealthy families, and middle income families paying five times more."

At the simplest level, Nesiba contends there are four main principles of good taxation:

• Efficiency. "The actual administration of the tax-gathering process should not be high relative to the amount of revenue raised, and the tax should not cause serious disincentives for work, investment and job creation," he said.

• Fairness. "By this, economists mean that one's payment obligation should be governed by one's ability to pay," Nesiba stated. "Those with higher levels of income and wealth should pay comparatively more than those with less."

• Third, taxes should be levied on those who benefit most from the government good or service being provided.

• Finally, taxes should be simple. "Ordinary taxpayers should be able to understand and explain the basic precepts of the system," Nesiba said. "This is desirable to avoid discontent or perceptions of unfairness that come from an unnecessarily complex system."

Those four principles, Nesiba warned, can and often do conflict with one another.

"In South Dakota, our sales tax system does relatively well in terms of principles one and four," he said. "The sales tax system costs relatively little for the state to administer, and it is fairly simple. We levy 4 percent on the sale of most goods and services in the state, including food, and most cities tack on an additional 2 percent. Commercial establishments collect the tax at the time of sale and regularly turn those funds over to the state."

The South Dakota tax system fails on the equity principle, Nesiba continued.

"Lower-income people pay a higher percentage of their incomes in taxes than do wealthier people," he said. "Most would say that this is inherently unfair because it violates the ability to pay. In South Dakota, we burden those least able to pay with the highest share of income paid in taxes. This also means we protect the richest among us. The richest people in South Dakota pay the lowest percent of income in tax."

Nesiba believes it is important to talk about South Dakota's regressive tax structure in the context of growing income inequality.

A recent report by the Center on Budget and Policy Priorities and the Economic Policy Institute found that, between the late 1970s to the mid-2000s, the income of the bottom 20 percent of households in South Dakota had risen 24.3 percent. Meanwhile, the middle 20 percent saw an increase of 48.6 percent and the top 20 percent's income jumped by 91.7 percent.

By the mid-2000s, the poorest 20 percent of households had an average income of $22,000, while the richest 5 percent of households had an average an income 11 times that — $241,300. The middle 20 percent had an average income of $58,700.

The aforementioned report, called "Pulling Apart: A State-by-State Analysis of Income Trends," found that the divide in South Dakota was growing faster than in any other state but Mississippi.

"There is a tendency to blame these outcomes solely on individuals and their choices," Nesiba said. "However, we should not overlook tax structures that insidiously prey on those least able to fight back. One of the causes of inequality in South Dakota is the state's unfair tax system. It takes far more from those in the bottom half of the income spectrum then it does from those at the top. That worsens whatever income and wealth inequality existed before the tax system is even considered."

WHY NOT HAVE A PERSONAL INCOME TAX?

The reason South Dakota doesn't have an income tax is quite simple: It doesn't have support among legislators or the public.

That prevailing consensus shows no sign of changing anytime soon.

An income tax was enacted early in the 20th century but was repealed by the Legislature in 1943.

In the 1970s, former Gov. Richard Kneip said he would sign a bill reinstating an income tax. However, with fellow Democrats in control of the Legislature, the measure still faced an uphill battle. The bill passed the House, but a tie occurred in the Senate. Then-Lt. Gov. Bill Dougherty cast the deciding vote. Even though he was a Democrat selected by Kneip for the position, he voted against the tax because he had political aspirations, according to Jim Fry, director of the South Dakota Legislative Research Council.

South Dakotans last decided against implementation of a personal income tax in the 1990 general election on a 114,215 to 119,037 vote.

Charlie Gross, an assistant professor of business at Mount Marty College, acknowledges that South Dakota has a regressive tax system.

However, he said South Dakota's residents have valid reasons for opposing an income tax.

"I think it was a vote to keep state government small, because without an income tax, the state government has a tough time growing," Gross said. "Had the electorate approved a state income tax, I think the size of state government would have grown because it would have had more money to spend."

The effects of a personal income on a state's economy is disputed.

William McBride, chief economist at the Tax Foundation, a tax research group based in Washington, did a literature review on the subject in December.

"This review of empirical studies of taxes and economic growth indicates that there are not a lot of dissenting opinions coming from peer-reviewed academic journals," he states in "What is the Evidence on Taxes and Growth?" "More and more, the consensus among experts is that taxes on corporate and personal income are particularly harmful to economic growth, with consumption and property taxes less so. This is because economic growth ultimately comes from production, innovation and risk-taking."

McBride examined 26 studies dating back to 1983. He discovered that all but three of the studies, and every study in the last 15 years, found a negative effect of taxes on growth.

"Of those studies that distinguish between types of taxes, corporate income taxes are found to be most harmful, followed by personal income taxes, consumption taxes and property taxes," McBride states.

In another article — "How to Judge a Tax Plan" — McBride has harsh words for income taxes.

"The more we try to make an income tax progressive, the more we undermine the factors that contribute most to economic growth: investment, risk-taking, entrepreneurship and productivity," he wrote. "This is because high-income earners tend to do much of the saving, investing, risk-taking and high-productivity labor. In simple terms, the more you tax something, the less you get of it, so taxing high-income earners reduces all the key factors in job creation and economic growth."

ITEP contests the idea that income taxes are harmful to economies.

"In reality, the residents of the states that levy income taxes — including residents of those states with the highest top tax rates — are experiencing economic conditions at least as good, if not better, than those living in states lacking a personal income tax," the organization said in a February report titled, "States with 'High Rate' Income Taxes are Still Outperforming No-Tax States."

One of the studies it cites is "Do State Fiscal Policies Affect State Economic Growth?" by James Alm and Janet Rogers, which was published in the Public Finance Review in 2011. It was not included in McBride's literature review.

Looking at many variables in the 48 contiguous states over 50 years, they found an income tax does not have a significant impact on economic growth.

However, in a direct response to the "Who Pays?" report, Elizabeth Malm at the Tax Foundation accuses ITEP of suggesting that states move toward a tax revenue source that would harm future economic growth in favor of equalizing incomes in the short term.

"'Fairness' is a subjective concept and by ITEP's own admission, 'in the eye of the beholder,'" Malm wrote. "Ultimately, ITEP's recommendations are at odds with sound state and local tax policy."

Here is some more food for thought: With Heineman proposing to eliminate Nebraska's personal income tax, the *Omaha World-Herald* examined the differences between states with and without that form of taxation in a Feb. 24 report titled, "Texas Sets Bar High for States Axing Income Taxes."

Texas, which does not have an income tax, has been emulated by conservative governors for its rapid economic growth, which they attribute to the state having no income tax.

The *World-Herald* found that states without income taxes have grown faster than the nation as a whole, and particularly when compared with states that have the highest income taxes.

"But what is less known is how much the growth in those states has been caused by other factors, such as climate or regional economic advantages," wrote Henry J. Cordes. "The vast majority of the growth in no-income-tax states has been centered in Texas, Florida and Nevada, three Sun Belt states that are attractive for a lot of reasons."

To account for variables like climate, the *World-Herald* paired the no-income-tax states with a similar neighboring state for comparison.

The pairs were as follows: South Dakota and Nebraska; New Hampshire and Vermont; Wyoming and Montana; Tennessee and Kentucky; Nevada and Arizona; Washington and Oregon; and Texas and California.

Although Texas and California are not neighbors, the *World-Herald* felt they shared many traits. The newspaper felt there were no comparable neighbors for Alaska or Florida.

"On population growth since 2000, all seven of the no-income-tax states examined outpaced their neighbors," Cordes said. "The average was 18 percent growth compared with 12 percent for the income-tax-levying states.

"On job growth, no-tax states overall grew jobs an average of 8 percent compared with 3.5 percent for those with the tax, though two no-income-tax states — Washington and New Hampshire — trailed their neighbors.

"The results were more mixed when it came to growth in personal income, gross domestic product, unemployment and attraction of people with college degrees, with the no-income-tax states having a slight average advantage overall on each measure," Cordes wrote.

Nebraska was found to lag behind South Dakota on all the measures except unemployment.

Ultimately, Nesiba believes a more progressive tax structure would benefit South Dakotans.

"A fairer tax structure that included a state personal income tax would not only take less from the poor and more from the rich, it could also be used to provide additional assistance for those in the middle and on the bottom of the income distribution," he said. "Some states have a graduated income tax rate structure so that the rate increases as incomes rise. Others offer tax credits for child and dependent care expenses, a refund on property taxes paid through rent or a state-level refundable earned income tax credit. At a minimum, the state should eliminate the sales tax on food and utilities."

Tax revenue spent correctly can address some shortcomings in the state, Nesiba added.

"Ensuring that our state provides adequate funding for high-quality K-12 education, that there is affordable access to universities and tech schools, and access to Medicaid or other health insurance programs for all of our residents would help to reduce inequality in our state and provide opportunities for upward social mobility," he said.

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