Miscellaneous Reports

TAXES REPEALED
(SINCE STATEHOOD)

1. Alaska Net Income Tax Act (Individual) - AS 43.20
   (repealed SLA 1980, ch. 1, second special session)

2. Alaska Net Income Tax Act (Fiduciary) - AS 43.20
   (repealed SLA 1980, ch. 1, second special session)

3. Oil and Gas Corporate Income Tax (separate accounting) - AS 43.21
   (repealed SLA 1981, ch. 19)

4. Inheritance and Transfer Taxes - AS 43.30
   (repealed SLA 1970, ch. 24)

5. School Tax - AS 43.35
   (repealed SLA 1980, ch. 113)

6. Disaster Taxes (Disaster Relief tax) - AS 43.43
   (repealed SLA 1969, ch. 48)

7. Disaster Severance Tax - AS 43.43
   (repealed SLA 1970, ch. 247)

8. Oil & Gas Reserves Ad Valorem Tax - AS 43.58
   (repealed SLA 1984, ch. 6)

9. Alaska Business License Act (Bus. Gross Receipts) - AS 43.70
   (repealed SLA 1978, ch. 144)

10. Alaska Business License Act (Financial Institutions) - AS 43.70
    (repealed SLA 1984, ch. 98)

MATERIAL FROM
Committee Notebooks
1ST MEETING

TERRITORIAL TAX STRUCTURE

TITLE 4 LEGISLATIVE DEPARTMENT

4-2-1 General Power and Limitations

TITLE 35 BUSINESS AND PROFESSIONS

Article 2
35-1-11 Territorial License Taxes

Article 3
35-1-31 Mining License Tax

Article 6
35-1-71 Alaska Business License Act

Article 7
35-1-91 Salmon Canneries: certain fish processors

Article 8
35-1-111 Cold Storage and other fish processors

Article 8a
35-121 Taking of fisheries products which are sold outside taxing jurisdiction

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35-1-131 Punchboards

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36-6-1 Fees and taxes
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TITLE 42 INSURANCE

42-3-9 Annual statement of business by agent or broker: Premium Tax

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44-2-13 Creation of Fund

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48-10	Income Taxes (Individual, fiduciaries, corporations and banks)
48-11	Tobacco Tax
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TITLE 50 — VEHICLES

50-3-11	Annual Tax: Plates

Dave R[illegible] -
[illegible] -
Dick [illegible] [illegible]
Barbra Hermann AG
Gordon Harrison

Alaska State Legislature

Speaker of the House of Representatives

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Official Business

July 14, 1986

To: Rep. Ben Grussendorf
From: Mary Halloran

BRIEFING PAPER ON TAX POLICY

This briefing paper is based on a review of documents made available through House Research, Dept. of Revenue, OMB, and NCSL.

1. COMMITTEE PROCESS/METHODOLOGY:

The work of other states in tax policy review indicates that certain procedures are more productive than others. In general, the following recommendations should be considered by the committee:

1. That the committee's first meeting include a discussion of the policies or goals of the work;

2. That advice or counsel be actively sought from the following entities: big business, small business, labor, legal and accounting professions, the university, state agencies (OMB, Revenue, Law), public interest groups, and the public at large;

3. That a computer model be constructed of any proposed tax changes to provide an adequate analysis of the impacts;

4. That technical workshops be held with tax experts, such as CPAs and tax attorneys;

5. That staff work should include information on the proposed administration of each tax, including collection and auditing;

6. That staff be directed to issue a staff report with options which can then be discussed by the committee and serve as the basis for public review.

ALASKA STATE TAX POLICY REVIEW

Staff work outline:

1. **Identification of Existing Taxes, Tax Credits, Licenses, User Fees, Program Receipts. For each, identify the following:**
   - A. Tax/Tax Credit/User Fee/Program Receipt
   - B. Statutory Authority
   - C. Effective Tax Rate
   - D. Tax Incidence
   - E. FY 85 and FY 86 Revenue Generated (Both Amount & Percentage of Total State GF Revenues)
   - F. FY 87 and FY 88 Revenue Estimated (Amount & Percentage of Total State GF Revenues)
   - G. Date Tax/etc. Was Begun
   - H. Associated Administrative Costs (Collection, Processing, etc.)

2. Identification of Taxes Deleted Since 1975 or Earlier

3. Identification of Tax Modifications Since 1975

4. Outstanding Litigation Regarding Alaska State Tax Statutes

5. Implications of Recent/Pending Federal Tax Code Revisions on State Tax Statutes - Impact on Ability to Raise Revenues And Ability to Bond

6. Review of Taxes Currently Collected by Other Natural Resource-Based States Not Authorized in Alaska

7. Identify Economic Components of Alaska; Which of Those Components Are Taxed and How; Relationship of Each Tax to Economic Growth

8. Relationship of Tax Statutes to Royalty Statutes, i.e. Will Any Proposed Changes in Tax Statutes Affect Royalties?

9. Relationship of Tax Revenues to Permanent Fund Income From 1990 On, Assuming Stable Budgetary Levels of X Amount

10. Impacts of Inflation Upon Previously Enacted Taxes With No Inflation Adjustment Formula

11. **Areas of Review:**

A. Which Approach:
   i. Separate Accounting
   ii. "Water's Edge"
   iii. Worldwide Unitary Tax
B. ELF
C. Sales
D. Personal Income
E. Corporate Income
F. Gross Receipts
G. Alcohol Excise Tax
H. Cigarette Tax
I. Major Fuel Taxes: Highway, Aviation, Marine
J. Fisheries Business Tax
K. Gambling Tax (tour boat casinos)
L. Banking & Financial Institutions
M. Existing tax credits
N. Licenses, permits, user fees

ITEMS OF INTEREST:

1. Alaska is one of only two states which does not have either a general sales tax or personal income tax (New Hampshire is the other). Thus, Alaska "has not been in the main stream of the movement toward more progressive and broadly based forms of taxation." Thirty-seven states levy both, 11 others have one or the other. Nationwide, property tax has been de-emphasized and personal income tax increasingly relied upon for a stable tax base.

2. Current Alaska statutes provide several tax incentives for industry. But the research concensus overwhelmingly labels tax incentives the "least effective means of encouraging economic development." More important to most development are labor force quality, adequate transportation, public infrastructure, land availability and reduction in red tape. Hence, an appropriate analysis would be of the efficiency of current tax incentive credits.

3. A recent cost analysis of state permits and licenses showed that it costs more to administer permit and licenses for some departments than is collected. The difference is $3 million annually -- a sufficient amount to warrant the review of the permits and licenses: are the permits such that the state should absorb the loss, i.e. the public purpose of the permit is more important than the revenue loss? Or are the permits/licenses not set at the proper fee level? Or are the permits/licenses merely nuisances which should be eliminated rather than revised?
(DCED, Fisheries Entry Commission, Public Safety, Revenue and the judicial system show positive net revenues. Labor breaks even. DEC, DHSS, DNR, and DOT-PF show negative net revenues.)

4. Tax "troubles" in most states are common. New Mexico, finding itself in a situation similar to Alaska this year, passed $150 million in tax increases to address revenue shortfalls related to oil price declines. That legislation, as well as that of other states, should be reviewed.

5. There is general agreement that 50 to 80 percent of new jobs are created by small businesses. Therefore, in most states, an increase in tax revenues is linked to small business growth.

6. The Permanent Fund earnings are projected to outstrip oil revenues in FY 92, based on the March revenue estimates. Given the current situation, the Permanent Fund earnings will probably provide the major source of Alaska's revenues before FY 92, perhaps as early as FY 89.

7. Alaska's taxing approach is not philosphically consistent. Water's edge vs. worldwide vs. separate accounting are the three main thrusts of taxation -- one of the first tasks of the committee should be to review and understand the differences among these three approaches.

MARY HALLORAN

April 18, 1986

POTENTIAL "ELF" PROBLEM

Alaska's petroleum severance tax is a major source of the state's revenues, an estimated $770.5 million of the $2077.6 million projected for FY 87. North Slope producers currently pay the full 15 percent nominal severance tax rate, with a downward adjustment scheduled to begin in 1987 on the Prudhoe Bay field.

The formula for the adjustment of the nominal severance tax rate is called the economic limit factor, fondly known as the ELF. Under the ELF, actual severance tax paid equals [ELF X statutory tax rate]. The severance tax features an 80¢/barrel minimum tax, supposedly an insulating barrier from low oil prices. <u>But, the 80¢/barrel minimum tax is also subject to the ELF under AS 43.55.011(a).</u> The ELF is not operative until its calculated value is .7 or less, or until a field begins its eleventh year of production.

The ELF formula is:

$$ELF = (1 - PEL/TP)^{[(460 \times WD)/PEL]}$$

This unwieldy formula can be simplied to the following:

$$\text{Current ELF} = (1 - 300/\text{well production})^{1.533}$$

The controlling factor of the ELF formula is the PEL. Put simply, PEL is the amount of production needed to cover direct operating costs. Under current statute, that amount is specified to be 300 barrels per day. But, as wellhead values decrease, PEL increases since it takes more barrels to cover actual operating costs. The producers can request a change in the official PEL, based on one month's market prices and four consecutive months' of operating costs. Given the predictions that prices will stay low, on average, for the next 18 months, then operating costs will be proportionately larger as a percentage of the total production than in the past. As the PEL increases, the value of ELF decreases, eventually becoming zero. A zero ELF means, of course, zero severance taxes.

Low wellhead prices make it conceivable that producers will request the necessary administrative hearing(s) to increase the PEL which will, in turn, decrease the ELF, which will, in turn, decrease the amount of severance tax received by the State. The Dept. of Revenue calculates that at today's prices the PEL is greater than 300 barrels/day at three North Slope fields - Kuparuk, Milne Point and Lisburne.

The ELF for Prudhoe Bay production becomes sensitive to price after wellhead prices go below $2/barrel, or $11/barrel on the West Coast and $13.50 on the Gulf. The Prudhoe Bay wellhead value becomes zero at a West Coast market price of $6.50 and a Gulf Coast price of $9.00. Thus, it may be to the producers' economic advantage to ask for a new Prudhoe Bay PEL/ELF calculation if the price falls to $11 West Coast and $13.50 Gulf. Prudhoe Bay will provide between 83.7 and 86 percent of the expected FY87 production.

The ELFs for the Kuparuk, Milne Point and Lisburne fields are considerably more sensitive to probable oil prices than is Prudhoe Bay. The ELF for Kuparuk becomes sensitive to prices when the wellhead price falls below $3/bbl. The Kuparuk ELF reaches .7 at approximately $12.50 West Coast and $15.00 Gulf, and drops to zero at $8.10 West Coast and $10.60 Gulf. Kuparuk will provide between 11.8 and 12 percent of the expected FY87 production.

The ELF for Milne Point becomes sensitive to prices when the wellhead falls below $5.00/bbl. The Milne Point ELF reaches .7 at approximately $13.70 West Coast and $16.20 Gulf, and drops to zero at $10.30 West Coast and $12.80 Gulf. Milne Point will provide between 1.6 and 2 percent of the expected FY87 production.

Production at Lisburne is still scheduled to begin in December 1986 or early 1987. The Lisburne ELF also becomes sensitive to prices when the wellhead drops below $5.00/bbl. The Lisburne ELF reaches .7 at approximately $10.60 West Coast and $13.10 Gulf, and drops to zero at $7.20 West Coast and $9.50 Gulf. If Lisburne goes on line on schedule, it will provide about 2.7 percent of the expected FY87 production.

To trigger the re-evaluation of the value of the PEL/ELF, the producers must request an administrative hearing, either by February 15 of the affected year or within the first six months after commencement of a field's production. Once set, the ELF cannot be changed during that calendar year [AS 43.55.013(d)].

For Prudhoe Bay, the ELF kicks in automatically under current statute on June 17, 1987, although a change could take place as early as the beginning of 1987. A changed PEL/ELF could be established for Kuparuk, effective January 1, 1987, while different PEL/ELFs for both Milne Point and Lisburne fields could be established retroactive to the beginning of production as both fields are or will be in their respective first six months of production. Once the PEL/ELF is changed, its new valuation is set for the calendar year. Whether a change takes place depends on market prices and the producers' willingness to request the necessary administrative hearing this fall. Under the provisions of AS 43, the hearing would be confidential and action would proceed without any notification to the legislature.

Also, the statute does not provide the Dept. of Revenue with discretionary powers. The direct operating costs are tightly and narrowly defined in statute [AS 43.55.013(e)]. Thus, the request would be evaluated on mathematics -- does it now take more than 300 barrels per day to pay direct operating costs? At this time it appears that the actual PEL is more than 300 barrels/day in the Kuparuk, Milne Point, and Lisburne fields.

At risk is some portion of about $38.5 million in FY 87 severance taxes from Milne Point, Lisburne, and Kuparuk production. The Dept. of Revenue and OMB expect the loss of at least $12 to 14 million. The $38.5 million equals about 5% of total severance taxes expected, or about 2% of total state revenues. Also at risk is some portion of about $28.2 million in FY 88 severance taxes, or about 2% of total state revenues.

These calculations are based on the March 1986 revenue projections, including TAPS. For FY87, Milne Point and Lisburne are each expected to bring in $7.7 million, while Kuparuk would bring in $23.1 million for the period January 1, 1987 through June 30, 1987. For FY88, Milne Point, Lisburne, and Kuparuk should generate $56.4 million in severance taxes. Half this amount, or $28.2 million would be at risk because the new ELFs would remain in effect through the calendar year 1987.

A simple statutory change can provide a fundamental protection for the State's severance tax income so that it is never calculated on less than the 80¢/bbl floor set out in AS 43.55.011(c).

The necessary language would be as follows:

* Section 1. AS 43.55.011(a) is amended to read:

Sec. 43.55.011. OIL PRODUCTION TAX. (a) There is levied upon the producer of oil a tax for all oil produced from each lease or property in the state, less any oil the ownership or right to which is exempt from taxation. The tax is equal to either the percentage-of-value amount calculated under (b) of this section, multiplied by the economic limit factor determined for the oil production of the lease or property under AS 43.55.013, or the cents-per-barrel amount calculated under (c) of this section, whichever is greater[, MULTIPLIED BY THE ECONOMIC LIMIT FACTOR DETERMINED FOR THE OIL PRODUCTION OF THE LEASE OR PROPERTY UNDER AS 43.55.013]. If the amounts calculated under (b) and (c) of this section are equal, the amount calculated under (c) [(b)] shall be treated as if it were the greater for purposes of this section.

* Section 2. Section 1 of this Act takes effect immediately in accordance with AS 01.10.070(c).

This language does not attempt to solve another identified issue - inflation-proofing the cents-per-barrel floor. The 80c/bbl floor was originally established in 1977, and has not been revised since that time, despite the considerable effects of inflation during the past nine years. In today's dollars, the 80¢ of 1977 would be about $1.25.

There also exist potential problems with royalty revenue. At zero wellhead value, the State receives no royalty revenue except from those sales contracts which specify a premium over "in value" price. Those contracts affect only about 25% of the royalty share, providing 30c to 35¢/barrel premium. (The following royalty contracts currently provide premiums above the "in value" price: Tesoro- second contract, 13.876% of Prudhoe Bay royalty production; Chevron, 9.6% of Prudhoe Bay royalty production; GVEA, 2.667% of Prudhoe Bay royalty production; and Petrostar, 19.198% of Kuparuk royalty production).

Unfortunately, the economic interests of the producers and the State are not the same because of the TAPS tariff, shipping costs, and the producers' federal taxes. It is apparently in the producers' economic interests to maintain the flow of Prudhoe Bay oil until the market price drops to approximately $3 on the West Coast and $5.50 on the Gulf. Thus, the State could conceivably find itself in the situation where its royalty oil has little or no value in terms of state revenues yet the oil is pumped daily into TAPS. In fact, there is even the remote possibility of a 70¢/bbl cleaning and dehydration charge on all royalty barrels being levied against the State by the producers even when the wellhead value is zero.

The possible actions necessary to protect the State's royalty revenue seem to be administrative in nature, and would involve cooperative negotiations with the producers. In contrast, the severance tax floor can be fixed only through legislative action.

This paper was prepared by Mary Halloran, Special Assistant to the Speaker of the House of Representatives.

NORTH SLOPE PRODUCTION AND THE ELF

FIELD	PRUDHOE BAY	KUPARUK	MILNE POINT	LISBURNE
Wellhead price at which field becomes sensitive to ELF	$2.00 or less/bbl	$3.61 or less/bbl PEL > 300 at 3.61 WH	$5.00 or less/bbl PEL > 300 at $4.85 WH	$5.00 or less/bbl PEL> 300 at $4.90 WH
Sales price/value at which ELF reaches .7 West Coast Gulf	Now above .7 7.15 WC 9.65 Gulf	Now below .7 Approx 12.50 WC 15.00 Gulf	Now below .7 Approx 13.70 WC 16.20 Gulf	Now below .7 Approx 10.60 WC 13.10 Gulf
Sales price/value at which ELF reaches 0 West Coast Gulf	6.50 WC 9.00 Gulf	> $1.20 Wellhead 8.10 WC 10.60 Gulf	> $1.50 Wellhead 10.30 WC 12.80 Gulf	> $1.50 Wellhead 7.20 WC 9.50 Gulf
Time period for confidential hearing request	By Feb. 15, 1987	By Feb. 15, 1987	(1) Within first 6 months of production (by May 15,1986) or (2) By Feb. 15, 1987	(1) Within first 6 months of production(Scheduled to begin Dec. 1986 or Jan 1987), or (2) Feb 15,1987, whichever is latest
Time period when new ELF would apply	1987	1987	(1) Retroactive to beginning of production or (2) 1987, depending on timing of request	(1) Retroactive to beginning of production or (2) 1987
Basis for calculation of current direct operating costs (PEL)	300 bbls/day	300 bbls/day	300 bbls/day	300 bbls/day
Percentage of North Slope production: w/o Lisburne with Lisburne	85% 83.7%	12% 11.8%	2% 1.6%	N/A 2.7%
Percentage of expected severance tax for FY 87 (based on March forecast) and dollar value	92% $708.9 million	6% $46.2 million	1% $7.7 million	1% $7.7 million
Percentage of expected severance tax for FY 88 (based on March forecast) and dollar value	89.4% $476.5 million	7.1% $37.8 million	1.3% $6.9 million	2.2% $11.7 million

Report of the

FIRST TAX REVIEW COMMISSION

to the

THIRTEENTH LEGISLATURE

STATE OF HAWAII

December 17, 1984

Report of the

FIRST TAX REVIEW COMMISSION

to the

THIRTEENTH LEGISLATURE

STATE OF HAWAII

December 17, 1984

GEORGE R. ARIYOSHI
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December 17, 1984

To the Honorable Members of the Thirteenth Legislature:

The Tax Review Commission is pleased to present this report containing its recommendations regarding the adequacy, fairness, and economic impact of Hawaii's tax structure.

Article VII, Section 3 of the Hawaii Constitution as amended in 1978, provides that "there shall be a tax review commission which shall be appointed by law on or before July 1, 1980, and every five years thereafter." Act 218, State Laws of Hawaii 1979, established a seven-member Hawaii Tax Review Commission to be appointed by the Governor with the advice and consent of the Senate.

The first Commission, sworn in on May 28, 1980, observed that Hawaii's tax system had not been subject to comprehensive study since the mid-1950's, and it agreed to focus on the larger issues of taxation: fairness of the State's taxes, adequacy and responsiveness of the tax structure, degree to which taxes are exported and further exportable to nonresidents, and effects of taxation on business and economic efficiency. A lack of funding to support its research agenda caused the Commission members to resign.

Act 212, State Laws of Hawaii 1983, authorized the appointment of replacement members to the Commission, and the new Commission held its first meeting in August of the year. The present Commission endorsed the focal points of study established by the earlier Commission with emphasis on the general excise and the net income taxes. Other sources of revenue were evaluated within the context of the broader policy issues noted above under the assumption that more narrow issues can be addressed by subsequent commissions.

The Commission would like to take this opportunity to thank the many individuals and organizations providing information and assistance to the Commission in carrying out its tasks. The Hawaii Department of Taxation, under its former director George Freitas and present director Herbert Dias, contributed administrative support, data necessary to carry out analytical studies, and comments on the administrative implications of the Commission's recommendations. The state Department of Budget and Finance made available its resources for the Commission's expenditure estimates and the Department of Social Services and Housing provided data on the relationship between taxes and welfare benefits. Data on the Hawaiian economy and the Hawaii input-output model was supplied by the Department of Planning and Economic Development. A volunteer panel of national and local tax policy experts also provided guidance and input on the Commission's technical research agenda (see Appendix C). Finally, the Commission benefited from the suggestions and critiques of local tax practitioners and members of the general public.

Respectfully submitted,
HAWAII TAX REVIEW COMMISSION

Hideto Kono, Chairman

Christopher G. Pablo, Vice Chairman

Thomas M. Foley

Albert S. Nishimura

Carole Ann Gibbs

Russell K. Okata

Richard Pollock

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INTRODUCTION

In developing its findings and recommendations the Tax Review Commission established a comprehensive research agenda and secured input of the general public. The research was carried out by the Commission's staff and consultants. The results of this research are presented in ten consultant's reports and thirteen staff working papers (see Appendixes D and E). The Commission's "Background Report" provides a synthesis of these research efforts. The technical work of the Commission was scrutinized by a volunteer panel of national and local tax policy experts. Public input was solicited at hearings held in each county in both May and November of 1984. In addition, the commissioners and staff met with tax practitioners and interested public groups to obtain their suggestions and advice. While the Commission's agenda was comprehensive, time and resource constraints prevented the Commission from addressing all structural inconsistencies in the tax system.

The Commission's recommendations reflect an attempt to strike a balance among often conflicting goals in tax policy. These goals include the fairness of taxes (equal treatment of equal taxpayers), simplicity of the tax system, efficiency of the tax structure in generating revenue with a minimum of economic dislocation, and the ability of revenues to meet future expenditure needs. Not all of these criteria can be satisfied simultaneously. For example, a tax that is simple, as is the present gross receipts tax, may create some inefficiencies since inter-business transactions are subject to taxation. As a second example, a progressive income tax that provides tax adjustments to reflect ability to pay may not be simple to comply with or administer. Since not all goals of tax policy can be achieved at the same time, the Commission was forced to accept compromises of one goal versus another.

The findings and recommendations of the Commission also reflect the Commission's assumption that the current level of State spending in Hawaii is consistent with that desired by Hawaii's people. Thus, recommendations that result in reduced taxes to the State are accompanied by others that offset these losses. (See Appendix A for a tally of revenue effects of the recommendations.) The recommendations are thus a package that is "revenue neutral," and the failure to adopt recommendations that increase revenues or shifting of those revenues out of the state general fund will require a pull-back from the tax reductions proposed by the Commission.

The report is divided in two sections. The first presents the general findings and conclusions of the Commission as they relate to the overall tax structure of the state. These conclusions form a philosophical framework for the specific recommendations presented in the second part of the report. Each recommendation is accompanied by a statement of rationale and justification and an estimate of the revenue implications of the recommendation.

GENERAL FINDINGS AND CONCLUSIONS

Adequacy of Revenues

The Tax Review Commission concludes that the present tax structure will provide adequate revenues to meet state spending needs over the next five years at current levels of service. This conclusion is based on the assumption that there will be neither a severe recession nor major cutbacks in Federal aid during the period and the understanding that the present state tax system is responsive to economic growth. This responsiveness (or "elasticity") should permit very modest expansion of state services consistent with the growth of population and real incomes. In any given year, however, the probability is that there will be a revenue overage or shortage.

To offset possible revenue losses from cyclical declines in the economy or fluctuations in the flow of Federal aid the Commission considers it desirable that a formal general fund stabilization fund ("rainy day" fund) be established. Since Hawaii's tax structure is "elastic," revenue growth will exceed long-term expenditure needs during periods of prosperity making it possible to expand programs and/or reduce tax rates. Conversely, revenues can be expected to fall below requirements during down-turns in the economy. Thus while the present elasticity is consistent with long-term revenue needs, there will be year-to-year imbalances between revenues and base-line spending levels. Instead of having to adjust spending up or down to match available revenues for a given year, the State should divert revenues to a rainy day fund when excess revenues occur and draw on this fund during periods of revenue shortfalls (see Recommendation #3).

Equity and Efficiency Adjustments to the Tax System

The Commission finds that the legislative intent to have a progressive ability-to-pay tax structure has been substantially undermined by inflation and by an increasingly complex tax code that provides opportunities to avoid taxation. To counteract these effects there will have to be changes in the structure of some of the State's taxes.

The Legislature has historically supported the concepts of a progressive tax system wherein individual tax liabilities are reflective of ability to pay taxes. For this reason the state individual income tax was formulated to exempt very low incomes from taxation and to tax higher incomes at progressively increasing rates. Likewise, the State has provided income tax credits for excise taxes paid and structured these credits to provide the greatest relief to the lowest income taxpayers. However, legislative intent and actual outcomes do not always coincide.

With respect to the individual income tax, inflation has eroded the value of exemptions and deductions. In addition, because income tax brackets have remained unchanged since 1966, taxpayers with inflated incomes have been pushed into higher tax brackets. This effect has been most adverse for those with the lowest incomes. To a lesser degree, the value of income tax credits available to low income households for excise taxes paid has not kept pace with inflation in spite of periodic adjustments by the Legislature.

The Commission finds that simplifying the tax system is necessary to achieve a more efficient taxing structure. This includes a more uniform treatment of taxpayers for both excise and income tax purposes. Concurrent with inflation, the income and excise tax codes have become proliferated with special interest exclusions, exemptions, deductions, and credits. The effect of these is to narrow the tax base and reduce collections compared to what they would have been otherwise. Thus tax rates are higher than might otherwise be the case. In addition, these special provisions create confusion and compliance problems among taxpayers. They create incentives to minimize tax liabilities by undertaking economic activity that is otherwise not productive. Simplifying the tax codes and treating taxpayers more uniformly will reduce the incentives to avoid taxes.

County Revenue Structure

The Commission finds that conditions such as increased population (including tourists), urbanization, and general societal attitudes of the time have resulted in considerable financial pressure on county administration. In addition, there is concern among the counties that the degree of fiscal centralization in Hawaii does not permit sufficient flexibility to meet the perceived needs of each individual county.

However, it was not demonstrated to the Commission's satisfaction that the revenue raising powers held by county authorities are not adequate to finance the expenditure needs of the respective counties at this time.

Compared with other local governments in the United States, Hawaii's counties have only limited functional responsibilities. Inasmuch as the State directly administers general education, social welfare, health care and hospitals, the financing requirement on the counties' major tax source, the property tax, is relatively low. Thus, even with very high property values, Hawaii's property tax is low compared to virtually all other states. Even with stable, or even declining, state aid to the counties, the property tax should remain an adequate source of revenue. Table 1 shows that rising property values since 1975 have made it possible for the counties to steadily lower the tax rate per $1000 net assessed value. Had the rate remained unchanged between 1983 and 1984, the counties would have had an additional $16.5 million in revenue. Additional revenues can also be obtained through expanded and more realistic county user charges.

TABLE 1: COUNTY PROPERTY TAX RATES*, 1975-84

FISCAL YEAR	Honolulu	Maui	Hawaii	Kauai	Average
1984	7.60	4.50	9.19	8.05	7.34
1983	8.06	4.50	10.01	8.70	7.76
1982	9.14	4.50	10.74	8.70	8.53
1981	9.14	3.88	10.74	8.70	8.57
1980	9.14	5.45	10.74	8.70	8.55
1979	9.14	7.18	10.74	8.70	8.87
1978	9.22	7.50	10.74	8.70	9.15
1977	9.22	7.50	10.74	8.70	9.19
1976	10.76	9.80	12.53	10.15	10.72
1975	12.40	10.50	12.53	10.15	10.72

*All rates computed at dollars per $1000 of 100% of net assessed value.

Source: Tax Foundation of Hawaii, **Government in Hawaii, 1984**, p. 30.

In public testimony, it was not established to the Commission's satisfaction that the unmet needs of the counties are any more pressing than those of the State. To shift the tax burden from real property to the excise and income tax would further throw out of balance the state-local revenue structure which already intensively taxes consumption and income. However, the Commission does suggest that as part of a reform of the Public Service Company Tax counties tax the property of public service companies (see Recommendation #24).

The Commission did receive input indicating dissatisfaction with the high degree of fiscal and functional centralization in Hawaii state-local government. This degree of centralization may have been appropriate for conditions 15 or 20 years ago, but since then the counties have evolved into more populous jurisdictions with greater political sophistication. The degree of dominance held by the State is thus called into question. However, the Commission concludes that the appropriate forum to address these concerns is the State Legislature and the Constitutional Convention.

The Business Tax Burden

The Commission finds that Hawaii's business tax structure is, on average, not disproportionately burdensome when compared with other States and should not be altered significantly in uncertain expectation of stimulating new business investment. However, there are several areas in the tax system that require adjustment to remove inequities and inefficiencies, and possibly to help improve Hawaii's business climate or the perception thereof.

Among the many factors that businesses consider in making investment decisions are costs of land, labor, transportation, energy and taxes. In the light of adverse national publicity and some local dissatisfaction with Hawaii's business environment, the impact of the State's taxes on business is of urgent concern to the Commission. In response, the Commission has made an extensive study of the issues and has obtained a broad spectrum of input from the public.

Hawaii's tax structure is unique in its reliance on the broad-based general excise and use tax and its low property taxes. To compare Hawaii with other states (notably California, Massachusetts and Texas, several development "success stories") requires that all state and local taxes be compared and that the interaction of the Federal and state taxes be taken into account. When this is done it is found that Federal taxes are far more significant than state taxes in affecting returns on business investment. Nevertheless, differences exist among states, and when compared, Hawaii's business taxes are moderate; they are lower than those of California and Massachusetts but higher than in Texas. In no case can the differences be considered large. Thus, while taxes are one of many factors that may contribute to the perception by some that Hawaii is a difficult place to do business, the State's aggregate tax structure should not be considered as contributing significantly to any adverse business climate which may exist in the state.

Nevertheless, there are several specific aspects of the tax system that, when adjusted, may improve people's perceptions. These relate to the excise tax levied on inter-affiliate transactions and exports from Hawaii. The Commission has made specific recommendations regarding these issues (see Recommendations #11 and #12).

The Commission did not address non-tax sources of business frustration. These include unemployment and workers compensation insurance which have been evaluated in separate State studies. In addition, regulatory and land use policies also contribute to perceptions of an adverse business climate, but these issues were deemed not to be within the scope of the Commission's mandate.

New Revenue Sources

To replace lost revenues associated with some of the recommended specific equity and efficiency adjustments, the Commission concludes that the following new sources should be adopted: a transient accommodations tax, or variant thereof, and a state lottery (see Recommendations #15, 16, and 29).

In view of its findings that the present tax structure will generate revenues sufficient to meet the State spending needs for the next five years, the Commission sought a package of proposals that is "revenue neutral," i.e., that will produce neither higher nor lower levels of revenues than those projected under the present system.

Several Commission recommendations intent on improving the equity and efficiency of the tax system will result in considerable losses of revenue. These losses must be made up by rate increases, further broadening of the present tax base, and or adding new sources of revenue. The recommendation to utilize the revenue sources above is based on the Commission's need to make up losses of revenue from priority given to equity and efficiency adjustments of the present system.

RECOMMENDATIONS RELATED TO THE OVERALL TAX STRUCTURE

In this section of the report the Commission presents its recommendations related to the overall tax structure of the State. Each recommendation is accompanied by a brief statement of rationale and justification as well as an estimate of the revenue effects, if any. Details of the justification for the Commission's actions can be found in the Commission's background report, consulting reports, and staff working papers.

Overall Equity Considerations

Recommendation #1:

The Commission recommends continued adherence to the policies that State taxes used to support the general fund should be levied in a manner that reflects, in aggregate, the ability of residents to pay these taxes. The incidence pattern of these taxes should reflect no taxation of income up to a threshold level with progressive marginal rates thereafter leveling off to a flat rate.

Rationale and Justification: The Legislature has long held that Hawaii's general fund taxes should reflect ability to pay and should not be levied on subsistence incomes. Thus, income exclusions, standard deductions, and progressive tax credits have been provided. In addition, tax rates have been progressively formulated with a leveling-off to a flat rate. This rate structure and exemption of subsistence income creates what is known as a "digressive" incidence pattern. The intent of this digressive incidence pattern is to exclude low incomes from taxation, i.e., households should not be required to pay tax on subsistence income. In the ideal, it provides for fair progressive taxation of higher incomes at marginal rates which level off and never become sufficiently high to create incentives for undesirable tax avoidance or evasion.

However, real growth coupled with significant inflation since the late 1960's has altered the actual distribution pattern of Hawaii's taxes. In aggregate, the State's taxes are regressive. Even the income tax, with its statutory progressive structure, effectively has a proportional distribution pattern. This violates the basic principles established by the State. Specific recommendations by the Commission are aimed at returning some of the intended equity features to the tax structure (see Recommendations #8, 17, and 21).

Revenue Implications: While this recommendation results in no change in aggregate tax revenues, some change in revenue mix is suggested.

Recommendation #2:

To broaden the tax bases and to keep tax rates low, the Commission recommends that many narrow tax preferences in the existing state tax code should be eliminated. Since it is difficult to consider the large number of such tax provisions involved in any one legislative session, all provisions should be "sunsetted" to expire by 1987 unless explicitly retained by the Legislature. The specific preferences recommended for review are discussed under their respective tax in this report (see Recommendations #14 and #20).

Rationale and Justification: The public acceptance and understanding of the state tax system is called into serious question when the code is proliferated with selective special interest tax preferences. Frequently these preferences do not stand close examination when viewed individually, and there is serious question if the complex of exemptions and preferences makes much sense from an equity or efficiency perspective when viewed together.

There is growing evidence that narrow tax preferences for specific industries or individuals have very little impact on economic behavior. Thus, whatever positive goals may be intended by these preferences the effect is to reduce revenues while doing little to achieve these goals.

Indeed, selective tax preferences can have detrimental effects. They can be challenged on constitutional grounds as being discriminatory, thus subjecting the entire tax structure to the uncertainties of legal battles. Further, some tax preferences serve as precedents to other or larger preferences thus adding to tax revenue erosion and complexity.

To avoid these problems, the narrow preferences should be eliminated.

Revenue Implications: Increased revenues are anticipated reflecting the Commission's specific recommendations.

Overall Revenue Adequacy Considerations

Recommendation #3:

The State should establish a formal general fund stabilization ("rainy-day") fund to stabilize the year-to-year expenditure changes. Contributions to this fund should be made during times of budget surpluses and draw-downs should occur in times of fiscal stress. The fund balance should be allowed to grow to a level which can provide adequate reserves in the event of revenue shortfalls.

Rationale and Justification: The year-to-year growth of expenditures and tax revenues do not necessarily coincide. In some periods the growth of receipts exceeds that of expenditures while in others the reverse occurs. Given the ongoing program needs of the state, it is better to have a level trend in spending rather than to accelerate spending in good fiscal times and have spending cutbacks when fiscal stress occurs. Too rapid expansion raises costs of government while severe contractions create dislocations in public services that could readily be avoided.

The stabilization of expenditures can be accomplished through the use of a rainy day fund which can be built up during the periods when receipts exceed expenditures and drawn down when the reverse is the case. This sort of system already exists implicitly. State budget data indicate that during times of stress unreserved balances are drawn down (but expenditure growth is also slowed). The Constitution requires that excess revenues be returned to taxpayers, thereby establishing an implicit 5% rainy day fund. Formalizing this procedure could further reduce unnecessary fluctuations in expenditures.

The Commission estimates that during periods of above-average growth the annual contributions to the stabilization fund should range from 5 to 6% of current general fund expenditures after other needs are met. Balances should be allowed to accumulate to about 12% of expenditures. The failure of voters to repeal the Constitutional requirement for a mandated tax rebate when general fund surpluses exceed 5% of general fund receipts need not prevent establishing a rainy day fund. A transfer of cash balances to a special fund will reduce the general fund surplus in which case only the Constitutional spending limit must be considered. Since expenditures have been consistently below the spending ceiling, funding the rainy day fund should be possible without exceeding the ceiling.

In 12 of 20 states that use a formal rainy day fund, expenditures from the fund are automatic when revenue shortfalls occur. In the remaining states, expenditures require explicit appropriations by the Legislature.

Revenue Implications: Since the built-in responsiveness of the tax structure is adequate to meet expenditure needs with some cushion, financing of a "rainy-day" fund can over time be accomplished without having to increase taxes.

Recommendation #4:

The following state special funds should be self-supporting and should not be subsidized by infusion from the general fund on a permanent basis: highways, airports, harbors, parking, unemployment compensation, and disability compensation.

The financing requirements should reflect realistic costing of services provided by the funds, including overhead charges to the general fund, sinking funds adequate to replace depreciating capital, and balances to offset revenue declines during periods of fiscal stress.

In addition to the special funds mentioned above, the state should evaluate its other user charges and fees to determine if they are consistent with the value of services exchanged and the true cost of providing those services. This includes regulatory activities, recreation, licensing, inspection services, and water supply.

Rationale and Justification: Special fund financing is justified in those areas of government activity where the users or beneficiaries can be readily identified and charged for the use of the service or activity. In view of this, it is equitable and efficient that the users of such services do pay their own way. This is particularly true in an inflationary period when the costs based on accounting data do not reflect the full economic or replacement costs of the service or facility. Levying of user charges or benefit taxes related to the current real economic replacement costs will generate a more adequate flow of funds to the activity.

Revenue Implications: Adequate charges will reduce the need to make transfers from the General Fund to special funds. In 1984 this amounted to $15 million. More realistic user charges will add to non-tax revenues and will reduce the pressure on tax revenues.

Tax Exporting

Recommendation #5:

Hawaii's taxes should be structured in such a way as to maximize the "exporting" of taxes consistent with constitutional criteria and other goals of the state.

Rationale and Justification: Most states attempt to "export" their taxes to nonresident taxpayers. This is done in three ways: exported commodities are taxed at high rates (e.g., oil and coal in energy-rich states), services provided to nonresidents are taxed (e.g., hotel rooms, car rentals, gambling), and state taxes are "exported" to the Federal treasury through taxes on Federal construction. Under the present tax structure about 30% of Hawaii's taxes are exported. Two-thirds of this amount (20%) is exported to visitors through their purchases of goods and services. In spite of the significant tax exporting that occurs in Hawaii, other states, such as Alaska, Nevada, Texas, and Wyoming, export their taxes to a comparable or even greater extent.

Through judicious structuring of the tax system, Hawaii can increase its tax exporting.

Revenue Implications: Depending on how this recommendation is implemented some revenue increase is possible.

Business Impact of Hawaii's Taxes

Recommendation #6:

The Commission recommends that there should be no large-scale reduction or increase in direct business taxes.

Rationale and Justification: Hawaii has a high per-capita tax burden when compared to other states, but this does not translate into a burdensome tax pattern on businesses. The higher per capita taxes are the result of high costs of living in Hawaii, the degree of urbanization in the state and the relatively low reliance on user charges. Further, it may be overstated by the degree to which taxes are exported out-of-state.

The Commission has found that the total state and local tax burden on businesses for Hawaii is not out of line with other states. Hawaii compares favorably to numerous states including California, Massachusetts, and Oregon. Thus, while Hawaii levies a 4% excise tax on capital purchases, its corporate income tax is comparatively low and property taxes are extremely low.

Given these results, neither a broad-based business tax reduction nor tax increase is called for.

Revenue Implications: No changes in revenues are specifically related to this recommendation.

Recommendation #7:

The Commission recommends that if the Legislature perceives the need to provide specific reliefs or incentives to business that this be done via case-by-case expenditure assistance.

Rationale and Justification: The Commission is guided by the principle that business taxes should be uniform and structured in such a manner as to minimize differences in effective tax rates across similar firms and across industries. This applies to both the overall design of major business taxes (for example, the corporate income tax) as well as the question of special tax preferences. Further, the Commission has found that special tax preferences have very little impact on the economic behavior of businesses. Thus, tax preferences cannot be generally justified on the basis that they will stimulate new investment.

The recent experience with the state liquor tax indicates the dangers of providing narrow, highly selective tax preferences or tax expenditures to specific firms or industries. The portion of the business community that does not benefit from the tax breaks will have incentives to legally challenge the state, as occurred in the liquor tax case.

Even in the absence of court challenges and accompanying financial disruptions, serious equity and efficiency questions are raised by the use of selective tax preferences. If the breaks are provided to only "new" firms or industries, existing firms can claim unfair advantage. However, if the tax break is provided to an industry inclusive of both the old and new firms, the revenue loss is likely to be significant. The less-favored industries or firms are likely to pay higher taxes than would be the case if the tax revenues were raised in a more even-handed, broad-based manner. Moreover, the granting of significant tax preference to any large group of firms would establish a precedent that could be used as a wedge to elicit less justifiable tax distortions.

The prospect of receiving preferential tax treatment gives rise to proposals that distract legislative attention from more important features of tax policy refining.

As an alternative to narrowly targeted tax preferences the Legislature can opt to provide direct expenditure assistance to worthy businesses. This can be done through direct loans (as is done in 21 states including Hawaii), loan guarantees (used in 11 states), state-funded interest subsidies, state-funded or -chartered equity venture capital corporations (established in 5 states), or privately sponsored development credit corporations.

Revenue Implications: To the extent that this recommendation forms the basis for other recommendations to reduce tax preferences, revenues will be increased.

RECOMMENDATIONS RELATED TO THE GENERAL EXCISE TAX

Equity Considerations

Recommendation #8:

Income tax credits are the appropriate vehicles to offset the regressive effects of excise taxes on food and drugs. While past inflation and equity considerations require some adjustment of the value of these credits, the Commission recommends that the credit approach is advantageous compared to across-the-board exemption of food and drugs from excise taxes.

Rationale and Justification: As a general principle of good tax policy, any tax should be applied to as wide and uneroded a base as possible. Given the tax revenue to be raised, this permits a lower marginal tax rate to be used, thus facilitating tax efficiency. Broader tax bases are also consistent with efficiency in that fewer administrative costs have to be incurred in making and monitoring distinctions among the many firms and products subject to the tax. Moreover, any exemption, however meritorious, provides a precedent for other exemptions, the cumulative effect of which narrows the tax base further and gives rise to differential treatment among taxpayers that may lead to legal action challenging the preferences granted.

Any adverse effect of such a broad-based tax policy can be mitigated by a system of tax credits applied against the state individual income tax. In general the tax credit approach is more equitable and efficient than exemptions as a means of mitigating adverse tax effects on low income households. Based on data compiled by the U.S. Bureau of Labor Statistics, exempting food from the excise tax in 1984 would have reduced a low-budget family's excise tax paid by $269, and intermediate-budget family's tax $337, and a high-budget family's tax by $430. A tax credit, on the other hand, can be targeted specifically at those with the greatest need: low-income wage earners and low-income senior citizens.

Income tax credits are extensively used by low-income people. In 1982, 208,644 tax returns (50% of the total) had taken an excise tax credit. Among these were 55,300 returns with adjusted gross income below $1,000.

There is evidence that tax credits are reaching proverty level taxpayers. In 1979, 204,000 returns had claimed an excise tax credit while there were 17,771 families and 24,775 individuals below the poverty line. In 1979 the poverty threshold for income was $4,080 for a single person and $8,300 for a family of four.

Revenue Implications: No change in revenues is anticipated due to this general recommendation.

Recommendation #9:

The amount of the excise tax credits and the income brackets that determine the levels of the credit should be adjusted for inflation. The accompanying table makes the suggested changes.

It is further recommended that adjusted gross income be modified for determining the amount of the credit. This modification should add back to income the following exclusions: 60% of capital gains, excluded dividends and interest, payments to IRA and Keogh plans, unemployment and worker's compensation payments, public assistance benefits, and payments to individual housing accounts.

Proposed Excise Tax Credit Schedule

Modified Adjusted Gross Income	Tax Credit Per Exemption
under 9,700	$58
9,700 - 11,600	54
11,600 - 13,500	50
13,500 - 15,500	46
15,500 - 17,400	43
17,400 - 19,300	39
19,300 - 21,300	33
21,300 - 23,200	27
23,200 - 25,100	21
25,100 - 27,000	15
27,000 - 29,000	12
29,000 and over	0

Rationale and Justification: The excise tax credit is designed to counteract the regressive nature of the general excise tax. Inflation is a two-edged sword which reduces the effectiveness of the credit in achieving this goal. First, inflation reduces the real value of the credit to individuals. Second, it simultaneously pushes individuals into higher income brackets where the amount of the credit is reduced. Inflation adjustments of both the levels of the credits and the qualifying income brackets counteracts these effects keeping constant the credit's ability to offset the regressive nature of the excise tax, as designed.

To qualify for the credit, all sources of income regardless of taxability should be included. That is to say, the need for the credit is the same for a low-income wage earner as a low-income person who receives tax free interest income.

Revenue Implications: Adjusting both the levels and the income brackets of the credit for inflation would increase the value of credits taken for 1984. However, this is in part offset by expanding the definition of income. The net effect of this recommendation in the context of other proposals is to reduce taxes by $7 million.

Recommendation #10:

The Commission recommends that no substantial changes be made in the present general excise tax with the exception of minor adjustments which will remove some of the more inequitable aspects of the tax (see Recommendations #11, 12, and 13).

Rationale and Justification: The present general excise tax is actually two taxes in one. While it is technically a privilege of business tax on all those doing business in Hawaii, the differential rate structure creates the image of a business privilege tax plus a broad-based sales tax.

Beyond the confusion it creates, the present general excise tax is perceived to have certain detrimental effects. There are cases of tax pyramiding due to the fact that many intermediate business transactions are taxed at 4%. In addition, the general excise tax is levied on gross receipts from inter-affiliate transactions thus creating some incentives for integration of business. Finally, the existence of a preferential rate for certain gross receipts creates inequities among essentially equal taxpayers. For example, receipts from some intermediate business services are taxed at 1/2% while others are taxed at 4%. Still other gross receipts, because of exemption, are not taxed at all.

Leaving the general excise tax structure essentially as is does not eliminate pyramiding of the tax. The Commission has found that the degree of pyramiding is not as large as some have suspected. That is to say, the 4% retail rate is actually about a 5.0% rate, on average, when the pre-retail general excise tax imbedded in the price is considered. Even though the degree of pyramiding is small, the present structure of the general excise tax causes pyramiding to have different effects for different types of transactions, e.g., services are more highly taxed than goods.

To eliminate pyramiding of the general excise tax while still retaining the productiveness of the tax necessarily complicates the tax structure. There are several ways in which this can be done: a retail sales tax, a non-pyramiding gross receipts tax, and a net excise tax.

Retail Sales Tax. Most states levy a retail sales tax. The base of this tax usually includes sales of only tangible personal property (and not services) and frequently excludes food consumed at home and drugs. This base is much smaller than that of the present Hawaii general excise tax, and the Commission estimates that such a base would require nearly a 20% tax rate to equal the revenue generated by the present general excise tax.

Non-Pyramiding Gross Receipts Tax. A non-pyramiding gross receipts tax would exempt inter-business transactions from the tax. However, this is easier said than done. In New Mexico, which also has a broad-based gross receipts tax, sales of tangible personal property that becomes a **physical ingredient** of another product are not taxed. Services sold to businesses are taxed. The so-called "physical ingredient" rule provides a narrow exemption and may not significantly alter the degree of pyramiding in Hawaii because much of the pyramiding arises out of taxation of service transactions and goods that do not satisfy this rule.

Ohio, by contrast, employs a "direct use rule" whereby any product that is used or consumed in the production of another product or used to produce a product used in the production of another product (use on use) is exempt from

their sales tax. A system like this was proposed by A. D. Little in their 1968 report on the Hawaii general excise tax. Since Ohio does not tax services, the issue of intermediate services does not arise. Defining direct use is not straightforward especially for new production processes. After years of experience and litigation, the system in Ohio is well understood except for new industries and production processes. Ohio has 43 volumes of court cases since 1935 of which 60% relate to the direct use rule applied to manufacturing. Thus, while a direct use rule appears attractive to taxpayers because it requires fewer accounting records, it will create administrative problems for the Tax Department.

Administering either the direct use rule or the physical ingredient rule is not easy. It requires that a certificate of exemption be attached to or be part of each invoice of an exempt transaction. This places a compliance burden on the taxpayer as well as an administrative cost on the Tax Department.

Net Excise Tax. In its preliminary recommendations report, the Commission proposed to eliminate pyramiding by taxing the net receipts of a business. There are two ways in which this can be done: a tax on net receipts (the net approach) or a tax on gross receipts plus a credit for taxes paid on intermediate services (the credit approach).

Net Approach: This would levy a tax on the difference between a firm's gross receipts and the costs of goods sold. Effectively this taxes value added. When combined with the 1/2% gross receipts tax proposed by the Commission, this would increase the tax on all transactions now only subject to the 1/2% general excise tax (manufacturers, producers, wholesalers, intermediate services) but reduce it on most transactions now taxed at 4% of gross receipts. This approach requires that the taxpayer keep track of legitimate deductions from gross receipts. This is done presently in Hawaii for certain types of inter-business transactions: cash discounts, sales returns, bad debts, trade-ins, reimbursements for cost advances, payments by contractors to licensed sub-contractors if the sub-contractor is subject to the tax. If this net approach were to be used, it could be expected that confusion would arise about what is deductible and that litigation and refining legislation will be needed to settle some disagreements. However, administration of the net approach might be made less difficult by the fact that aggregate accounting data is required to compute net receipts; data that already must be calculated for net income tax purposes.

Credit Approach: The credit approach would levy a 4% tax on the gross receipts of a firm but provide a credit for taxes paid on intermediate business purchases. Defining these purchases raises the same issues as defining deductible transactions. Mississippi uses this approach for its wholesale tax. Prior to 1984, the state levied a 5/8% wholesale tax and retailers took a credit for taxes paid to wholesalers. Effective in 1984, the wholesale tax was repealed. However, some wholesale transactions are still taxed and credits are still provided. The credit system appears to be working well and auditors can use wholesalers' records to confirm the credits claimed by retailers. While the credit approach is clearly workable, it will require firms to keep records that they may not currently keep, i.e., the sum of all excise taxes paid on intermediate purchases.

In Sum. Removing pyramiding would complicate the present tax system for both taxpayer and Tax Department. A non-pyramiding gross receipts tax is probably easier for businesses than for the Tax Department. The credit approach is probably easiest for the Tax Department but would require firms to keep additional records.

While the present general excise tax has problems, any attempt to resolve them along the lines suggested above may create new and more significant problems. The Commission found considerable opposition to the complexities created by its net excise tax proposal especially from small businesses. The present general excise tax is familiar to all, easy to comply with and its economic effects have been integrated into prices, land costs, rents, etc. Thus no large-scale change is recommended.

Revenue Implications: No specific revenue effects are implied by this recommendation.

Recommendation #11:

To remove the inequitable taxation of certain inter-affiliate business transactions, the Commission recommends that receipts from the sale of goods or services by a parent company doing business in Hawaii to its wholly-owned subsidiaries not be taxable if the parent to whom the receipts accrue is not in the business of providing those goods and services to anyone but its subsidiary firms.

Rationale and Justification: One of the more frequently cited equity problems of the general excise tax is its treatment of payments received by one firm from affiliated firms for what are essentially in-house transactions, e.g., accounting, payroll, computing services, legal services. The Commission is convinced that taxing such transactions discriminates against those firms that choose to organize their internal operations into separate companies versus those that are entirely integrated. If the firm in question sells the goods or services to other persons as well as its affiliated firms, then the sale to the affiliate should be treated as any other sale and be taxable.

Revenue Implications: Some reduction in revenue is anticipated though the amount is likely to be small since firms are presently minimizing their general excise tax liability by organizing in a manner to avoid the tax on inter-affiliate transactions.

Recommendation #12:

The Commission recommends that the price paid by the purchaser for a good or service should be the measure of gross receipts. In the event that such a price is not directly observable because the good or service is sold through an agent, the actual receipts should be "grossed up" by a reasonably assumed or demonstrable sales commission. This commission should not automatically be assumed equal to the difference between actual receipts and receipts based on the list or "rack" price.

Rationale and Justification: The general excise tax defines taxable income as the gross receipts of a business without any deductions, including selling commissions. Thus a firm that has a sale staff cannot deduct from gross receipts the

commissions paid to these sales personnel. Some businesses, including many in the visitor industry, sell their products through outside sales agents. The sales agents resell the products at prices frequently unknown to the original provider. If these products are sold by the agent as part of a package, the resale price of any component of that package is frequently indeterminable. The difference between the sales agent's receipts and the price paid to the provider is the agent's implicit sales commission and is taxable at 4% under the general excise tax.

To treat businesses equally, the firm that sells its product via outside sales agents rather than having its own sales staff is subject to having its receipts "grossed up" to reflect the implicit commissions paid to the outside sales agents. The suggested retail price stated by the firm is often used by the Department of Taxation to calculate the appropriate gross-up amount.

While use of the suggested retail price is generally a reasonable guide to constructing gross receipts, it can, in some cases, be unrealistic. For example, a hotel that posts a $65 "rack rate" on standard rooms may actually be selling these rooms at an average price of $45. If the hotel received $30 from a tour packager, the grossed-up receipts of the hotel should reflect the $45 price actually paid on average rather than the $65 rack rate.

The Commission recognizes that there can be reasonable differences in interpretation of appropriate gross-up amounts between taxpayers and the Department of Taxation. The burden of proof should be on the taxpayer to show that the suggested retail price, or rack rate, is not the appropriate measure of gross receipts.

This recommendation does not suggest that the practice of constructing prices for intra-firm transactions be changed. It is recognized that there are situations where list prices are the appropriate measure of the gross receipts that should be attributable to a specific transaction. However, when goods or services are sold for prices below their list price, the actual price should serve as the indicator of gross receipts.

Revenue Implications: A small decrease in general excise tax revenues is anticipated. However, the thrust of this recommendation is to prevent additional taxation of gross income not realized.

Recommendation #13:

The receipts from goods shipped outside the state should be exempt from the 4% general excise tax. Includes in the definition of goods are services with tangible by-products such as computer software and mailing lists.

Rationale and Justification: If tangible goods change title outside the state (i.e., they are shipped CIF destination), they are subject to at most a 1/2% general excise tax. On the other hand, goods shipped FOB Honolulu so that title changes in the state are taxed at 4%. This puts those who choose to export in the latter manner at a disadvantage. Reducing the tax for all exported goods provides an incentive, albeit small, for export activities. The Commission does not intend that purchases made by individuals and subsequently transported out of state be exempt from the 4% general excise tax.

Under the present general excise tax, the gross receipts from exported services are taxed at 4% since the service is performed in Hawaii regardless of who pays for the service. However, services rendered to out-of-state clients are "exported" as much as tangible goods. Removing this inequity for services with tangible by-products is consistent with state goals to enhance exports. Restricting the preference to services with tangible by-products establishes safeguards that these services are not "sent back" and consumed in Hawaii after making a trip out-of-state to avoid the excise tax.

Revenue Implications: This is a tax reduction on exported goods and services and thus revenues will decline. The estimate for 1984 is $14 million.

Recommendation #14:

To reduce the complexity of the general excise tax, certain narrow tax preferences should be reviewed for possible sunsetting by no later than 1987. These include, but are not limited to, the following exempt organizations:

- **—fraternal, charitable, religious, scientific organizations**
- **—Hansen's disease patients**
- **—state-supported radio promoting tourism**
- **—local development companies approved by the Small Business Administration**
- **—prepaid legal services**
- **—nonprofit cemeteries**
- **—nonprofit shippers association**
- **—nonprofit hospitals**

Further, exempt transactions including, but not limited to the following, should also be granted renewed specific legislative exemption or be required to sunset by 1987:

- **—first $2000 of gross receipts of blind, deaf, disabled**
- **—foster home receipts**
- **—brooms manufactured by the blind**
- **—certain petroleum products to be further refined**
- **—bagasse by-products**
- **—scientific contracts with the U.S. government**
- **—low-income housing**
- **—air pollution devices**
- **—repairs of Federally owned ships or ships in international or interstate business**
- **—gasohol**

In addition, the following classes of activities should be reviewed for the low rates at which they are currently taxed:

- **—insurance commissions (.15% versus 4% on other commissions) (see also Recommendation #27)**
- **—alternate energy receipts (1/2% versus 4%)**
- **—receipts by blind, deaf, and disabled person (1/2% versus 4%)**

Rationale and Justification: As noted in Recommendation #2, special tax preferences create complexities which undermine public understanding of and confidence in the tax system. Since the economic benefits of these preferences are often not significant enough to alter behavior, they cannot be justified on the grounds that they will stimulate new or expanding businesses or retain existing ones. If the Legislature is guided by cases of compassion or severe economic distress, the present exemptions should be explicitly reaffirmed through the legislative process.

In considering the extension of special preferences, the Legislature should weigh the relative merits of using tax preferences versus other, more direct approaches. Using the tax system as a vehicle for promoting economic or social change may provide preferences for those who are not necessarily the target of such policies. As noted previously, preferences beget attempts to create more preferences and/or litigation challenging the equity of the tax breaks. The state

may be better served by a less complex tax system and more direct assistance to businesses or organizations that merit special treatment (see also Recommendation #20).

Revenue Implications: Only the revenue impact of insurance commissions can be estimated. In 1984 these commissions taxed at 4% would have yielded $8.6 million instead of $323,000 at the present .15%. However, since the Commission only recommends legislative review of the noted excise tax preferences, no revenue gain is presumed.

Excise Tax Revenue Adequacy

Recommendation #15:

Consistent with the Commission's intent to increase the degree of tax exporting, a differential tax on short-term (less than 30 days) transient accommodations is recommended without earmarking the resulting revenues.

Rationale and Justification: A Commission survey of a large number of localities indicates that transient accommodations are virtually always taxed and at rates in excess of 6%, and that tourist as well as business destinations levy hotel room taxes (see Table 2). Hawaii, by contrast, levies only the 4% excise tax on room rentals.

TABLE 2: TOTAL TAXES APPLIED TO HOTEL ROOM BILLS IN SURVEYED LOCALITIES

Percent Total Tax on Hotel Room Bills*	Number of Cities
0.00 - 2.00	5
2.01 - 4.00	6
4.01 - 6.00	6
6.01 - 8.00	12
8.01 - 10.00	12**
10.01 - 12.00	2
over 12.00	1
Total localities surveyed	44

* Includes applicable sales and separate room taxes.

**Washington, D.C., included in this bracket, also adds a flat payment of $1/day room tax.

Increasing the tax on short-term rentals will generate significant revenues to the state. Two-thirds of these revenues will be exported to out-of-state taxpayers. Calculations made by the Commission indicate that for each additional one percent tax on gross receipts of hotel and condominium rentals, the number of visitors coming to Hawaii will decrease by .35% (or 15,750 visitors, assuming 4.5 million total visitors per year). Since visitor arrivals are forecast to grow over the next few years, even an additional 3% room tax will slow the rate of tourism growth but not reduce visitor arrivals. Revenues from a transient accommodations tax will be offset somewhat by reduced visitor spending on other goods and services. The net revenue effect to the state will still be approximately $7 million per 1% additional tax.

The Commission acknowledges that a differential tax on transient accommodations may appear to discriminate against the hotel industry. However, since the demand for hotel and condominium rooms is less responsive to price changes than that for many other goods and services in Hawaii, a tax on rooms serves to export a greater proportion of Hawaii's taxes without creating economic distortions or inefficiencies.

The Commission strongly recommends that revenues from a room tax not be earmarked to specific spending programs. Doing so will reduce the extent to which such a tax could be used to support the tax cuts advocated in the Commission's other recommendations.

Revenue Implications: An additional 3% excise tax on hotel and condominium rentals would have yielded $21 million in 1984. Earmarking any of this revenue to new expenditures would reduce the extent to which the new revenues could be used to make equity and efficiency adjustments in the present tax system.

Recommendation #16:

As an alternative to the hotel room tax, the Legislature should consider raising the general excise tax and to refund the proportion not exported to resident taxpayers through enlarged excise tax credits. Again, the net new revenues should not be earmarked.

Rationale and Justification: A hotel room tax in excess of the general tax levied on gross receipts of all business may be regarded by some as discriminatory and "anti-visitor." A uniform higher general excise tax, or its successor, would not be subject to this criticism.

Since approximately 32% of the general excise tax is exported (paid by nonresidents), increased tax exporting occurs when this tax is increased across the board. By using the revenues to provide tax relief to residents there is a shift of taxes from residents to visitors. Care must be taken to increase the resident tax relief as revenues grow otherwise the intent of the policy is undermined. While this approach is not as direct as taxing rooms at higher rates, it does avoid the perception that the state is singling-out the tourist industry for higher taxes.

Again, the Commission strongly recommends that the net new revenues generated by this proposal not be earmarked for spending on specific programs.

Revenue Implications: For example, increasing the present 4% general excise tax to 4.5% would have generated an additional $75 million in 1984. Approximately 32% of this would have been exported. Thus, the rebate to Hawaii residents would have to be $51 million and net new revenue to the State would be $24 million. If any part of this revenue is earmarked to increased expenditures, the amount available for equity and efficiency adjustments of other taxes is reduced.

RECOMMENDATIONS RELATED TO THE INDIVIDUAL INCOME TAX

Equity Considerations

Recommendation #17:

The Hawaii State individual income tax should be adjusted to take into account the effects of inflation since the income tax was last adjusted. The rate brackets and standard deduction should be enlarged. However, formula or automatic tax indexation should be avoided. The state standard deduction should be made equal to that provided by the Federal government: $2300 for a single taxpayer or a single head of household, $3400 for those married filing a joint return, and $1700 for married filing separately. The tax brackets in effect since 1966 should be doubled. It is further recommended that these income tax reductions should be phased in over a four-year period.

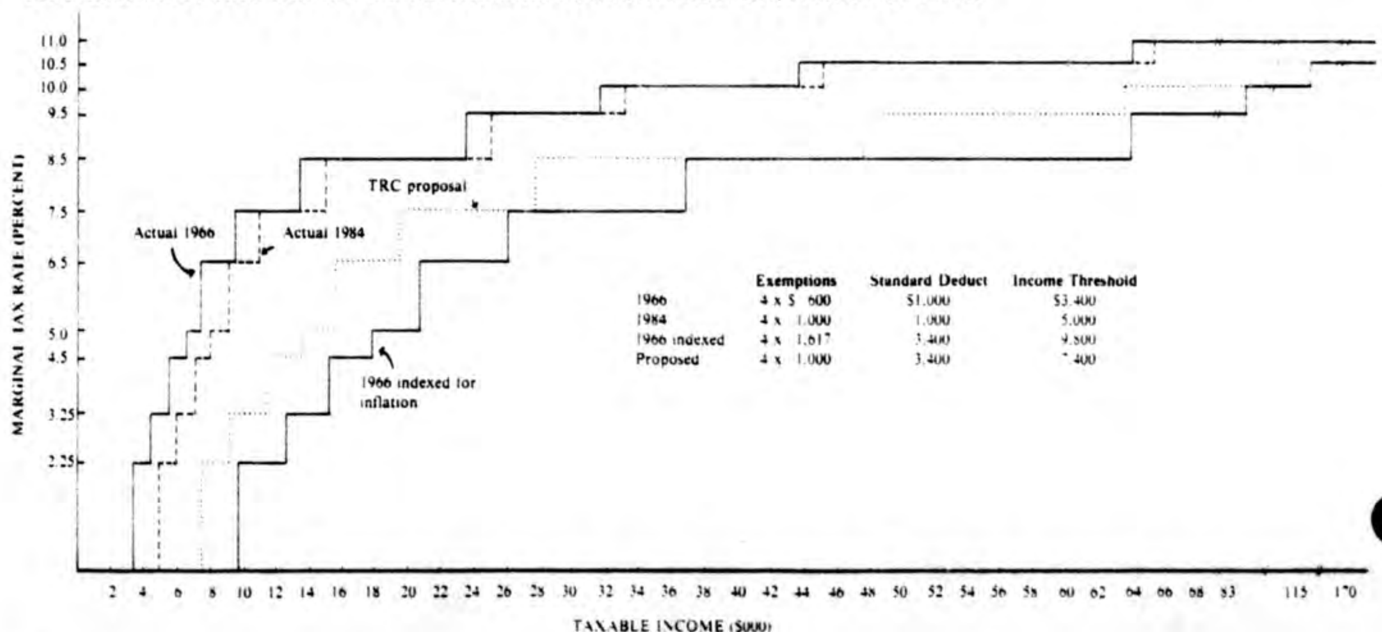
Rationale and Justification: Some countries and states have adjusted or responded to income tax distortions introduced by inflation by indexing their income tax to one degree or another. This indexing has occurred in either an ad hoc or automatic manner. Automatic indexing such as is achieved by writing formulas into the statutes should be avoided in view of the difficulties of other states in selecting the right form and extent of indexing.

Since Hawaii has not utilized either form of indexing it is appropriate that the Hawaii income tax be indexed in an ad hoc manner. Moreover, in view of the other changes in the Hawaii tax system being recommended, excessive and or unpredictable changes in tax system elasticity should be avoided.

Since inflation has changed and distorted the nature and effects of the Hawaii income tax as it was last enacted, it is necessary to restore some of the progressivity, elasticity, and equity features afforded by the system when prices were lower. This can be done by a one-time increase in the dollar amount of the brackets and the standard deduction, or zero bracket amounts. No change is recommended in the level of the personal exemption since this matches the present Federal level and has been periodically adjusted to keep up with inflation.

Figure 1 shows that tax rate structure for joint returns that existed in 1966 and 1984 and what the rates would have been had the 1966 income tax been fully adjusted for inflation. Clearly, legislated changes did not keep up with inflation, and, as a result, larger proportions of Hawaii's income tax filers were pushed into the higher marginal tax brackets. Table 3 shows that in 1966, 90.3% of taxable income accrued to people with adjusted gross income below $30,000. By 1982 this had dropped to 48.1%.

FIGURE 1: MARGINAL TAX RATE COMPARISONS FOR JOINT RETURN, FAMILY OF FOUR



	Exemptions	Standard Deduct	Income Threshold
1966	4 x $ 600	$1,000	$3,400
1984	4 x 1,000	1,000	5,000
1966 indexed	4 x 1,617	3,400	9,800
Proposed	4 x 1,000	3,400	7,400

TABLE 3: DISTRIBUTION OF HAWAII TAXABLE INCOME, 1966 and 1982

Adjusted Gross Income Class	Percent of Net Taxable Income 1966	1982
$ 0 - 9,999	40.5%	7.7%
10,000 - 29,999	49.8	40.4
30,000 - 49,999	5.0	31.9
50,000 - 99,999	2.9	15.0
over 99,999	1.8	5.0
	100.0%	100.0%

Source: Hawaii Department of Taxation, **Hawaii Income Tax Patterns, Individuals**, 1966 and 1982.

The Commission's recommendation to adjust the standard deduction and widen the tax brackets will, to a large extent, offset the adverse effects of inflation. As an example, the proposed rate structure for a joint return is illustrated in Figure 1 and the brackets are presented in Table 4, exclusive of the "zero-bracket amount."

TABLE 4: TAX RATE SCHEDULE - MARRIED TAXPAYERS FILING JOINT RETURNS, PROPOSED COMPARED TO 1966

1966 Brackets	Marginal Rate	Proposed Brackets
0 - 1,000	2.25	0 - 2,000
1,000 - 2,000	3.25	2,000 - 4,000
2,000 - 3,000	4.50	4,000 - 6,000
3,000 - 4,000	5.00	6,000 - 8,000
4,000 - 6,000	6.50	8,000 - 12,000
6,000 - 10,000	7.50	12,000 - 20,000
10,000 - 20,000	8.50	20,000 - 40,000
20,000 - 28,000	9.50	40,000 - 56,000
28,000 - 40,000	10.00	56,000 - 80,000
40,000 - 60,000	10.50	80,000 - 120,000
over 60,000	11.00	over 120,000

Since the standard deduction is used most extensively by low-income taxpayers, increasing its value provides the largest benefit to those people. In addition, the bracket widening will also have the largest impact on low- and middle-income filers. Table 5 shows that the income tax relief is largest for lower income taxpayers and smallest for high-income filers.

TABLE 5: TAX LIABILITY FOR FAMILY OF FOUR UNDER PRESENT AND PROPOSED INCOME TAX STRUCTURES, 1984

	Present	Proposed	% Change
LOW-INCOME FAMILY:			
Adjusted Gross Income	$ 7,438	$ 7,438	
Personal Exemption	4,000	4,000	
Standard or Itemized Deduction	1,228	3,400*	176.9
Taxable Income	2,210	38	-98.3
Income Tax	64	1	-98.4
MIDDLE-INCOME FAMILY:			
Adjusted Gross Income	44,429	44,429	
Personal Exemption	4,000	4,000	
Standard or Itemized Deduction	11,436	11,436	
Taxable Income	28,993	28,993	
Income Tax	2,288	1,924	-15.9
HIGH-INCOME FAMILY:			
Adjusted Gross Income	178,004	178,004	
Personal Exemption	4,000	4,000	
Standard or Itemized Deduction	48,393	48,393	
Taxable Income	125,611	125,611	
Income Tax	12,707	11,597	-8.7

*Standard deduction.

Source: Tax Review Commission calculations based on Hawaii Department of Taxation profiles of taxpayers.

Revenue Implications: If both the suggested standard deduction increases and the bracket widening had been enacted in entirety in 1984, the revenue loss would have been $73 million. Phasing-in the proposed changes reduces the immediate revenue loss. A $50 million reduction of income tax revenues can be achieved by partially adjusting the standard deduction and/or tax brackets. This maintains the revenue neutrality of the Commission's recommendations.

Recommendation #18:

To enhance the equity of the state individual income tax, the base of the state income tax should be brought into closer conformity with that of the Federal individual income tax. This would help to narrow the growing gap between taxable income and actual economic income received by individuals, thus reversing base erosion.

At a minimum the following types of personal income should be restored to the state individual income tax base consistent with Federal tax treatment: portions of pension income and part of social security benefits of high-income taxpayers. To protect elderly taxpayers from taxes on subsistence income, a double standard deduction should be provided when a single filer reaches age 65 or when either filer reaches 65 for a joint return.

Rationale and Justification: Erosion of the individual income tax base leads to various horizontal and vertical equity problems. Households with the same real or economic income may have widely disparate state income tax liabilities if a larger portion of household economic income is recognized in one case than in the other. Moreover, it is difficult to achieve progressivity if higher income groups are able to shelter or divert economic income into nontaxable forms. Any erosion of the individual tax base means that a higher tax rate has to be applied to the taxable income of all those households that are actually subject to the state individual income tax in order to raise the same amount of revenue. The higher marginal tax rates required by the base erosion may have adverse effects on work effort.

While it is not obvious that the Federal individual income tax base is as broad and free of questionable tax preferences, tax expenditures, and "loopholes" as it should be, the state should aim for the same degree of broadness of tax base achieved by the Federal government as a **minimum** tax policy goal.

The Federal income tax treatment of social security benefits is to tax one-half of the benefits if the filer has achieved a specific income threshold. That threshold is $32,000 for those filing a joint return and $25,000 for those filing a single return. Under federal statutes, pension and annuity benefits are taxable if this income was not previously taxed. Thus pensions paid from accumulated interest and the employers' contribution are taxable. National averages indicate that approximately 88% of pension income is taxable under the federal standard.

The Commission's recommendation reflects its philosophy that income is the appropriate measure of ability to pay taxes, regardless of the source of such income, while at the same time offering protection of subsistence income from taxation. It is inequitable that an elderly taxpayer who relies on interest and property income should be subject to the income tax while another with equal pension income should escape income taxes entirely.

In addition, by providing an across-the-board exemption for all pension income, benefit is extended to not only the low-income elderly but also high-income retirees. As is demonstrated in Table 6, 62.5% of pension and annuity income accrues to taxpayers who have Federal adjusted gross income of over $20,000.

TABLE 6: PENSION AND ANNUITY INCOME DISTRIBUTION, U.S. 1982

Size of Adjusted Gross Income	Amount ($ million)	% of Total Amount	Cumulative %
All returns, total	76,677	100.0	-
under 5,000	2,222	2.9	2.9
5,000 - 10,000	7,379	9.6	12.5
10,000 - 15,000	9,463	12.4	24.9
15,000 - 20,000	9,637	12.6	37.5
20,000 - 75,000	43,866	57.2	94.7
75,000 or over	4,110	5.3	100.0
Mean amount	$ 7,396		

Source: Internal Revenue Service, Statistics of Income 1982, October 1984, p. 48.

The combined effect of this recommendation and Recommendation #17 lowering tax rates will be to provide substantial income tax relief to many low-to-middle income elderly. The present double exemptions provided by the state combined with the larger and proposed double standard deductions will insure that for a couple who are both at least 65 years old the first $10,800 of income is not taxed (two standard deductions of $3,400 each and four exemptions of $1,000 each). For a single taxpayer 65 years old this threshold is $6,600 (two standard deductions of $2,300 each and two exemptions of $1,000).

Table 7 shows that with these provisions a middle-income retiree who relies on interest and property earnings will not be taxed on social security benefits and will experience a tax reduction on other income. The retiree with only pension income will not be subject to tax on social security income but will be taxed on pension benefits. This tax increase is not large and brings equity to the tax structure in that pension recipients are treated similarly to all other taxpayers.

Revenue Implications: At the proposed new tax rates, if all pension income had been taxed in conformity with Federal treatment, income tax revenues would have increased by $17 million in 1984. Taxing Social Security benefits consistent with Federal taxability standards would have yielded an additional $3 million in 1984.

TABLE 7: EFFECTS OF PROPOSED INCOME TAX CHANGES ON HYPOTHETICAL ELDERLY COUPLES

Elderly retired couple earning average social security benefits, interest, and other income:

	Present Law	Proposed Law
Income		
Pension	$ 0	$ 0
Social Security	10,776	10,776*
Interest and other inc	15,000	15,000
Adjusted Gross Income	15,000	15,000
Standard Deduction	1,000	6,800
Exemptions	4,000	4,000
Taxable Income	10,000	4,200
Income Tax	582	119

Elderly retired couple earning average social security benefits and pension income:

	Present Law	Proposed Law
Income		
Pension	15,000	15,000
Social Security	10,776	10,776*
Interest and other inc	0	0
Adjusted Gross Income	0	15,000
Standard Deduction	1,000	6,800
Exemptions	4,000	4,000
Taxable Income	0	4,200
Income Tax	0	119

*Not included in adjusted gross income since joint return gross income is less than $32,000.

Recommendation #19:

To provide equity in the State's income tax the conformity between the Hawaii individual income tax and the Federal individual income tax should be further enhanced by the adoption of the Alternative Minimum Income Tax for state purposes. The state minimum tax should be modeled after the Federal Alternative Minimum Tax.

Rationale and Justification: The Federal government has determined that the fair application of the Federal individual income tax to higher income groups requires the use of the Alternative Minimum Tax. This alternative tax becomes applicable to any high income individual taxpayer who would otherwise pay only a small income tax, if any at all, as the result of the combined or cumulative effects of several tax shelters or other tax minimization provisions in the Federal individual income tax code. Given the policy of generally conforming the state individual income tax code to the Federal code, these minimization provisions are available to higher income taxpayers in Hawaii without the state government having the same safeguard against perceived excessive use available to the Federal government, i.e., the Alternative Minimum Tax.

Adoption or adaptation of the Alternative Minimum Tax by Hawaii is consistent with present state tax policy since it would bring about a closer conformity of Hawaii state and federal income tax structures and/or policies. If this logical extension of the state income tax was not utilized, equity considerations would require that each of the tax expenditures or tax preferences in the state income tax code would have to be reexamined provision by provision at the state level. This would not be as urgent once the Alternative Minimum Tax is used to mitigate or limit abuses or excessive use.

The Commission suggests that the Legislature review for possible adoption a state corporate minimum income tax modelled after that of the Federal government. However, given the uncertain status of Federal corporate income taxation, a state corporate minimum tax should await the resolution of the Federal debate.

Revenue Implications: Increased income tax revenues of $2 million in 1984 are estimated had rates proportional to that of the Federal Alternative Minimum Tax been used.

Recommendation #20:

To reduce the complexity of the individual income tax the following special interest credits should be allowed to sunset as scheduled or be amended to sunset by 1987 unless specifically extended by the Legislature:

- **—credit to discourage sales of dangerous items**
- **—credit for regulated investment companies**
- **—solar energy device tax credit (scheduled to sunset Dec. 1985)**
- **—heat pump tax credit (scheduled to sunset Dec. 1985)**
- **—heater insulation tax credit (scheduled to sunset Dec. 1985)**
- **—credit for child care expenses**
- **—child passenger restraint system tax credit**
- **—tax credit for fuel taxes paid by commercial fishers**

In addition, the Commission recommends that no further "check-offs", such as that for the Hawaii Election Campaign Fund, be added to the current income tax.

Rationale and Justification: As noted in Recommendation #2, special tax preferences increase the complexity of the tax structure and place added administrative burdens on the Tax Department.

Alternate energy and energy conservation devices are economically justifiable without the state tax credits. The credit merely reduces the payback period on these investments. Since child passenger restraint devices are currently required by law, the credit has no impact on use of these devices other than to lower the cost of obeying the law. The rationale of Recommendations #2 and #14 is applicable here as well. The Legislature should evaluate these preferences taking into consideration that the primary purpose of a tax system is to equitably collect revenues to run the State. Attempting to promote economic and social goals may be better achieved through direct expenditure programs rather than tax preferences.

Revenue Implications: The following revenue losses are estimated for 1984:

—child care = $2,400,000
—solar energy devices = $2,200,000
—heat pump = $228,000
—heater insulation = $20,000
—child passenger restraint = $70,000

The other credits listed have negligible revenue implications due to lack of use.

Since the Commission is recommending only legislative review of these credits, no specific revenue gain is presumed from this recommendation.

RECOMMENDATIONS RELATED TO THE CORPORATE NET INCOME TAX

Equity Considerations

Recommendation #21:

The Hawaii corporate income tax brackets should be adjusted to add a greater degree of progressivity to this tax and to offset the effects of inflation on the bracket structure. The table shows the recommended rates and brackets.

PROPOSED CORPORATE NET INCOME TAX RATES

Taxable Income	Marginal Tax Rate
under $25,000	2.0%
$ 25,000 - 100,000	5.0
$100,000 and over	7.0

Rationale and Justification: The present Hawaii corporate income tax rates are 5.85% on taxable income less than or equal to $25,000 and 6.435% on amounts above that. This $25,000 cut-off has been in effect since 1958. The same real value (after inflation) would require the threshold be set at $85,000.

On the other hand, accelerated depreciation, safe-harbor provisions, and carry-back and forward losses have all contributed to more than offsetting the "bracket creep."

The table above shows how the rate structure can be adjusted to increase the progressivity of the tax while maintaining revenues. This requires higher rates at the upper levels of net income to afford lower rates at the smaller income levels. It should be noted that the Federal income tax offset reduces the effective tax rate increase of the higher income corporations just as it reduces the tax relief felt by lower income corporations.

Revenue Implications: There will be no change in current revenues; however the system is made more elastic by the greater progressivity of the structure.

Revenue Adequacy of the Corporate Income Tax

Recommendation #22:

Hawaii should partially "de-couple" from the federal accelerated depreciation rules (ACRS) by substituting pre-ACRS provisions for real property but not for personal property for purposes of determining both individual as well as corporate taxable income.

Rationale and Justification: The purpose of depreciation is to allow investors to deduct the cost of using capital. Accelerated depreciation rules (sum of the years digits, double declining balance) were adopted by the Federal government to provide an incentive for economic growth through higher profitability of investments. The recently enacted accelerated cost recovery system (ACRS) went even further in part because inflation had increased the replacement cost of capital.

While it is a Federal goal to stimulate economic activity with broadly targeted tax preferences, the primary goal of state taxation is to generate revenues to fund state services. State conformity to Federal ACRS has contributed to the long-term decline of Hawaii corporate income tax revenues. Partial de-coupling would mitigate that decline and will not have significant adverse effects on rates of return for Hawaii investments.

Eighteen of 45 states that tax corporate income have already de-coupled in full or in part from ACRS.

Complete "de-coupling" from Federal rules would present an undue bookkeeping hardship to taxpayers especially small businesses. Further, accelerated depreciation for personal property changes the timing of taxes but not the eventual total tax liability since the deductions are eventually "recaptured" if the property is sold for more than its depreciated value. On the other hand, real property is allowed an 18 year useful life under ACRS. This is unrealistically low, and since income from such property is taxed at preferential capital gains rates, ACRS provides opportunities to substantially reduce taxes. For these reasons the Commission recommends returning to pre-ACRS depreciation rules for real property only.

Revenue Implications: Over an extended period of time the loss due to ACRS increases as a larger proportion of the capital base is subject to the accelerated depreciation rules. The Commission estimates that this loss will rise to $20 million per year by 1986 for both individual and corporate taxes combined. Partial de-coupling would offset at least $2 million of this loss.

Corporate Income Tax Administration

Recommendation #23:

Given the uncertainty regarding the Federal position on worldwide unitary taxation, the State should not adopt such a policy with regard to taxation of multi-state companies operating within several states, including Hawaii. The present policy of allowing either domestic apportionment policy or separate accounting is appropriate. The separate accounting approach for corporations operating in different countries will have to be continued with regard to their foreign operations.

Rationale and Justification: The use of domestic ("waters edge") apportionment taxation is accepted and widely used by other states on the mainland. Given the highly politicized and unsettled nature of the current worldwide unitary taxation controversy, it would be premature to shift state corporate taxation policy in that direction. The appropriate solution would appear to be a strengthening of the present option to allow separate accounting or domestic apportionment by devoting considerably more audit resources to it.

Revenue Implications: Since this recommendation makes no changes, no revenue effect is anticipated.

RECOMMENDATIONS RELATED TO THE PUBLIC SERVICE COMPANY TAX

Revenue Adequacy

Recommendation #24:

Public service companies should be subject to the general excise tax rather than to the in-lieu public service company tax.

The State Constitution should be amended to allow county governments to assess and tax at appropriate property tax rates the real property of public service companies in their jurisdiction.

Rationale and Justification: This change follows from the general Commission recommendation to reduce the complexity of the tax structure and to accordingly rationalize the General Excise Tax. Whatever rationale the public service in-lieu tax might have once had has been lost over the years. No one was able to provide the Commission with a defense of the present exemption of utility property from county property taxes. By applying a uniform general excise tax rate to the gross revenue of the public service companies these firms will be treated as other taxpayers and the administration of the Hawaii gross revenue taxes will be made more uniform.

Another basis for the recommendation is that counties should be permitted to extend and rationalize the property tax which is correctly the primary source of tax revenue at the local level of government in Hawaii. The property tax is still relatively underutilized by local governments in Hawaii as evidenced by various tax effort ratios. However, it is still good public policy to expand the property tax base available to all the counties so that further revenue needs can be satisfied with minimal increases in property tax rates.

For those counties that choose to tax the property of public service companies, this recommendation implies the property tax should displace the Public Utility Franchise Tax (Chapter 240, SLH). However, no change is suggested in the Public Utility Fee (Chapter 269, SLH).

Revenue Implications: In 1984, a 4% excise tax instead of the variable rate public service company tax would have reduced revenues by roughly $4 million.

In addition, some intermediate purchases by public service companies now taxed at 4% under the present excise tax would qualify for taxation at the lower rate of 1/2% if these companies are taxed under the general excise tax. The resulting revenue loss would be $2 million in 1984.

Some of the receipts of public service companies with interstate activities may be excluded from the tax base by virtue of the interstate commerce clause of the U.S. Constitution. The estimated lost revenue collections from this could have been $5 million in 1984.

The total revenue loss associated with this recommendation is thus $11 million. Some of this revenue would be recovered through the county property tax (which would not accrue to the state).

Recommendation #25:

The State should establish a mechanism (e.g., franchise tax) to insure that commercial airlines (interisland, domestic, and international) pay directly for the privilege of doing business in Hawaii and contribute to the general fund.

Rationale and Justification: As is the case for all businesses, airlines pay taxes indirectly through imbedded taxes on their purchases as well as through the payrolls and expenditures of their employees. However, a recent U.S. Supreme Court decision precludes Hawaii from directly taxing the gross receipts of airlines. This means that unlike all other businesses operating in the state, airlines presently pay no direct tax for the privilege of doing business and thus do not directly contribute to the general fund. The U.S. law which does not allow taxation of gross receipts does, however, permit other forms of taxation, including property taxes and franchise taxes not based on gross receipts.

Revenue Implications: Unknown increase in revenues.

RECOMMENDATIONS RELATED TO OTHER REVENUE SOURCES

Fuel and Liquor Taxes

Recommendation #26:

The Commission recommends that all excise taxes be imposed on an ad valorem basis rather than on a specific amount per unit. This pertains specifically to the wholesale liquor tax but it is also applicable to the fuel tax.

Rationale and Justification: The present difficulties of the Highway Special Fund are at root traceable to the use of a constant, specific amount per gallon tax in a period of inflation. While inflation pushed up the expenditure requirements of the Highway Special Fund, income was relatively static since the tax revenue did not rise with inflation. Aside from the obvious financial problems, this tax feature has also given rise to serious equity and efficiency problems. Contrary to original tax policy, since the users of the highways are not paying their own way, general fund resources must be diverted from other programs that do not lend themselves to self-finance through user charges or benefit related taxes.

These same equity and efficiency problems arise even when the tax goes into the general fund, as in the case of the liquor wholesale tax. If a fixed, per unit tax rate were used, the users of that product and or the industry itself would make ever smaller relative contributions to the state treasury as inflation proceeded, even at recent reduced rates. Such a revenue source would not keep up with inflation, and other state taxes would have to be raised to replace the revenue shortfall. These tax policy considerations argue against shifting any present ad valorem tax to a specific per unit basis and in favor of replacing the per unit fuel tax with an ad valorem levy.

Revenue Implications: No change in current revenues. However, future revenue shortfalls would be avoided by increased use of ad valorem taxes.

Taxation of Insurance Companies and Financial Institutions

Recommendation #27:

Firms presently taxed under the insurance premium tax should be required to pay the general excise tax on rentals and other business receipts.

Rationale and Justification: At the present time, insurance companies pay no excise tax on income other than that received from insurance premiums paid in Hawaii. Thus, an insurance company that owns a building, leases space and collects lease rents, pays no tax on the rental income. Any other firm in the same position would pay the 4% general excise tax on rental income. Requiring insurance companies to pay the tax on rental and other income would remove the inequity.

Revenue Implications: The revenue effect cannot be estimated because there is little data available on the receipts of insurance companies, specifically non-domestic (non-Hawaii) firms.

Recommendation #28:

The Commission feels it is appropriate to integrate financial institutions and insurance companies with other business in Hawaii under a single tax code instead of the current in-lieu taxes. However, the complexities of such a change suggest that it should be evaluated in detail, perhaps by a subsequent Commission, before action is taken.

Rationale and Justification: The reason for having separate in-lieu taxes may have lapsed. Insurance companies and financial institutions are participating in activities that go beyond their original activities.

The ramifications of the change suggested above are of such magnitude that careful study is required before changes are made, thus the need for more analysis.

Revenue Implications: This recommendation has no revenue effects.

State Lottery

Recommendation #29:

The State should adopt a lottery to replace revenues lost due to recommended equity and efficiency adjustment.

Rationale and Justification: Currently, 18 states have established lotteries which generate from 0.2% to 4.9% of general revenues. The gross receipts a lottery can generate depend on numerous factors including the population base, the variety of games offered, and the extent to which the games are marketed. Net receipts (the revenues to the state) depend on state law and or practice. For example, Washington State requires that at least 40% of gross receipts be allocated to the state and at least 45% be awarded in prizes. National trends indicate that the larger the gross receipts, the higher the proportion that can be retained by the state.

There are three types of games under the general heading of "lotteries." One is the so-called "numbers" games whereby a participant selects a number which is entered into a computer. The winning number is selected daily (or weekly). A second class of games comes under the title of "lotteries" wherein a participant purchases a ticket. The winnings can be determined instantaneously (by rubbing off a covering substance to reveal the prize) or by drawings held weekly, monthly or at a time specified at the end of the game. The third form of state lottery is a "lotto." Here a person selects a number which is entered in a computer. The winning number is randomly generated periodically and the game continues until the random number matches one selected by a participant.

Prizes from a lottery usually cost the state less than what is advertised for a game since they are paid out over time. Thus a $1 million prize may be paid out over 20 years at $50,000 per year. At a 10% interest rate this could be financed by a $470,000 annuity.

Those who favor a lottery in Hawaii assert that it is a painless way to generate new revenues and that it can be exported to tourists. Since participants act voluntarily to purchase lottery tickets there is no forced payment to the government (as would be the case for taxes) and thus "no pain." Further, since tourists form a large part of the economic base, their participation increases the extent to which they underwrite the state treasury.

Opponents of the lottery claim that the adverse aspects of a lottery outweigh the revenue gains. In spite of voluntary participation, all studies indicate poorer people are more likely to purchase lottery tickets. Thus the revenue incidence is quite regressive. Tourists make up only 10% of the de facto population. Since tourists already pay 20% of Hawaii's taxes they would have to participate at twice the rate of local residents if the lottery is to be exported in the same porportion as Hawaii's taxes.

Revenue Implications: A Hawaii lottery could have added about $20 million in 1984 based on national patterns.

MISCELLANEOUS RECOMMENDATIONS

Recommendation #30:

The State tax structure should be carefully monitored to detect any long-term declines in its responsiveness to real or inflationary economic growth.

Rationale and Justification: The empirical studies conducted by the Commission indicate that the long-run elasticity of the tax structure is lower now than was calculated in earlier years. At the present time, the elasticity coefficient at the aggregate tax system is approximately 1.1. That is to say, a 10% increase in state personal income will, in the long-run, result in an 11% increase in tax revenues. This elasticity value is lower than was measured in previous studies but is adequate for the long-term spending needs of the state. However, a decline in the elasticity and the resulting loss in revenue responsiveness could place the state in fiscal stress. While some of the income tax recommendations made by the Commission increase the elasticity of that tax, the responsiveness of the aggregate revenue structure should be monitored to make certain that its long-run revenue adequacy can be maintained.

Revenue Implications: No impact on current revenues is anticipated.

Recommendation #31:

In addition to its current statistical studies of the individual and corporate income taxes, the Tax Department should conduct annual statistical analyses of general excise tax data.

Rationale and Justification: At present the Tax Department conducts annual statistical studies of the individual income tax and biennial analyses of the corporate income tax. Both of these are extremely useful for monitoring the respective tax structures as well as making policy judgments.

Prior to work done at the request of the Tax Review Commission there was little data available about the general excise tax other than aggregate information. It would be helpful if the Tax Department could, on a periodic basis, provide analysis as to the size distribution of general excise taxpayers, the number of separate activities general excise taxpayers report, the relationship between type of general excise tax activity and levels of taxes, etc.

It is difficult to make informed policy judgments without adequate data. Given its importance to the state, the general excise tax, or its successors, should be subject to at least as much ongoing scrutiny as the income tax.

Revenue Implications: This recommendation results in no change in revenues.

APPENDIX

A. Recommendations Scorecard

Key: + => better ; - => worse ; 0 => no change

Recom. #	Thrust	Equity	Revenue Effect	Tax Exporting	Tax Pyramiding	Business Impact
Overall						
1	Digressive incidence	+	-			
2	Limit specific preferences	+	+			
3	Rainy day fund		0			
4	Special funds self supporting		15			
5	Exporting taxes		+	+		
6	Business taxes		0			
7	Uniform preferences		0			+/-
General Excise Tax						
8	Credits to reduce regress	+				
9	Adjust credits for inflation	+	- 7			
10	No change in GET					
11	Exempt some inter-affiliate	+	-	-	+	+
12	Gross up some receipts	+	0	-	+	+
13	Exempt certain exports		-14	-		+
14	Review preferences	+	+			+/-
15	Transient accommodations tax	+	21*	+		-
16	Alternative to room tax	+	**	+		
Individual Income Tax						
17	Adjust for inflation	+	-50			
18	Base broadening	+	20			
19	State minimum tax	+	2			
20	Review credits	+	+			
Corporate Income Tax						
21	Adjust brackets	+	0	-		+
22	Partially decouple from ACRS	+	2	+		-
23	Domestic apportionment	+	0	-		
Public Service Tax						
24	Move PSC under excise tax		-11	-		+
25	Tax airlines		+	+		-
Fuel and Liquor Tax						
26	Ad valorem taxation		0			
Insurance and Financial Inst Tax						
27	Tax other incomes		+			-
28	Study combining with excise tax		+			
Lottery						
29	Adopt	-	20			
Miscellaneous						
30	Monitor elasticity of tax system					
31	Study excise tax regularly					
TOTAL REVENUE EFFECT			- 2			

Notes:
* Assumes no earmarking to new spending
** The tax rate and resident refund can be structured to yield net revenues equal to the room tax

B. Tax Review Commission

The present Commission was appointed by Governor George Ariyoshi in the summer of 1983 and confirmed by the Senate in April 1984. The Commission is chaired by Hideto Kono, former Director of the Department of Planning and Economic Development, and consists of Christopher G. Pablo (Vice Chairman), tax attorney and certified public accountant, Thomas M. Foley, attorney specializing in tax matters, Carole Ann Gibbs, Vice President, Hawaiian Trust Company, Albert S. Nishimura, Senior Vice President of First Hawaiian Bank, Russell K. Okata, Executive Director of the Hawaii Government Employees Association, and Richard Pollock, professor of economics, University of Hawaii.

The Commission's staff is directed by Dr. Jack P. Suyderhoud, professor in the College of Business Administration, University of Hawaii. Drs. Thomas A. Loudat and Prahlad Kasturi are research analysts. Amber A. L. Ling is the word processor operator and Laurie S. Matsuda is the secretary.

C. Technical Advisory Board

To obtain a broad spectrum of technical input the Commission solicited the advice of a group of local and national state-local tax experts. The individuals listed below volunteered their services. They reacted to and critiqued the Commission's research agenda, staff working papers, and/or consultants' reports. The members of the Advisory Board are:

George Freitas, Retired Director of Taxation, State of Hawaii.
Steven D. Gold, Director, State-Local Finance Project, National Conference of State Legislatures, Denver.
Thomas K. Hitch, Retired Senior Vice President and Economist, First Hawaiian Bank.
Robert M. Kamins, Attorney and Emeritus Professor of Economics, University of Hawaii.
Will S. Myers, Director of Economic Analysis, National Education Association, Washington, D.C.
James R. Nunns, Director of Tax Research and Statistics, Department of Revenue, State of New Mexico.
F. John Shannon, Assistant Director, U.S. Advisory Commission on Intergovernmental Relations, Washington, D.C.
Jon David Vasche, Senior Economist, Legislative Analyst's Office, State of California.

D. Consultants' Reports

"Impact of Hawaii's Taxes: A Look at Taxpayer Burden and Equity," Donald Phares, University of Missouri, St. Louis.
"The Hawaii Income Tax: A Case Study of Issues of Tax Base Conformity," William R. Singleton and Janet J. Singleton, Western Washington University.
"An Examination of Horizontal Inequities and Possible Structural Anomalies of the Hawaii General Excise Tax," John L. Mikesell and C. Kurt Zorn, Indiana University.
"Evaluation of Tax Pyramiding and Exporting Through Means of an Input-Output Model," Richard L. Bowen and PingSun Leung, University of Hawaii.
"Detailed Analysis of Tax Exporting," R. Bruce Billings, University of Arizona.
"Detailed Analysis of Tax Pyramiding," R. Bruce Billings, University of Arizona.
"Study Report on the Elasticity of General Fund Taxes," D. Ward Mardfin, Hawaii Loa College.
"Fiscal Projections for the State of Hawaii," Roy Bahl and Dana Weist, Syracuse University.
"Business Taxation in Hawaii: A Comparative Analysis with Policy Simulations," James A. Papke, Purdue University.
"The Incidence and Exportability of Hotel Occupancy and Other Tourist Taxes in Hawaii," Edwin Fujii, Mohammed Khaled, James Mak, University of Hawaii.

A copy of each consulting report is on file at the Hawaii Document Center of the State Library, Honolulu, and at the Hawaiian/Pacific Collection of Hamilton Library, University of Hawaii, Manoa.

E. Staff Working Papers

Working Paper #	Title
1	"Hawaii's Changing Economy: 1960-1980"
2	"A Comparative Review of Hawaii's Fiscal System: 1965-1981"
3	"Hawaii Government Revenue Trends"
4	"Hawaii Government Expenditure Trends"
5	"Inflation and Hawaii Income Taxes"
6	"Judgmental Issues Related to Tax Equity: Tax Incidence and Funding Methods"
7	"A Primer on Pyramiding"
8	"Revenue Diversification: User Charges, Gambling Taxes, and Local Non-Property Taxes"
9	"State Tax Preferences to Stimulate Investment"
10	"Ad Valorem Versus Per Unit Tax on Liquor"
11	"Special Issues of the Hawaii Income Tax"
12	"Results of the Transient Accommodations Tax Survey"
13	"Results of a Survey of Non-Profit Organizations on Oahu"

A copy of each working paper is on file at the Hawaii Document Center of the State Library, Honolulu, and at the Hawaiian/Pacific Collection of Hamilton Library, University of Hawaii, Manoa.

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STATE AND LOCAL TAX SYSTEMS IN THE MID-1980s

Legislative Finance Paper #52

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Executive Summary

This report describes the level and composition of state and local tax revenue in fiscal years 1984 and 1985 and discusses state sales and income tax changes legislated in calendar year 1985. It focuses particularly on recent reductions in personal income taxes and discusses some of the policy issues raised by these tax cuts.

1. State-local taxes per $100 of personal income in FY1984 are compared for each state. Tax levels vary considerably, with the highest state having more than three times as much revenue as the lowest state. Trade-offs exist between state and local taxes, and states that have high taxes at one level often have low taxes at the other level.

2. State tax revenue in FY1985 is estimated using Census Bureau data and compared on the basis of its relation to personal income. To obtain an estimate of state-local tax levels, it is assumed that local revenue grew in proportion to personal income. For six major state taxes, the 10 highest and 10 lowest states are noted. State taxes per $100 of personal income fell in 32 states between 1984 and 1985. On the average, local taxes also fell relative to personal income, but data for individual states are not available.

3. Fourteen states lowered their personal income taxes in calendar year 1985 and one lowered its sales tax. One state raised its income tax and one its sales tax.

4. State-local tax structures changed considerably during the period between 1970 and 1985. The personal income tax increased significantly, and the property tax was de-emphasized. State taxes rose as a proportion of personal income while local taxes decreased as a proportion of personal income. In total, state-local tax revenue per $100 of personal income fluctuated considerably but ended the period close to where it began.

5. Most of the calendar year 1985 income tax cuts represented rollbacks of increases enacted in 1982 and 1983 when states were battling fiscal problems. Concern about economic development also motivated some income tax reductions, particularly in states with high marginal and effective tax rates. The effect of these tax cuts was to make state-local tax systems more regressive. Particular attention is focused on the states with high marginal income tax rates.

State tax systems have been volatile over the past several years. Most states raised taxes in 1982 or 1983 in response to severely depressed fiscal conditions, but many of those tax increases expired or were repealed in 1984 and 1985.[1] Due to these changes, the relative tax levels of some states have changed considerably. The role of the personal income tax has been reduced as a result of tax cuts during the past two years.

This report draws upon the latest available data to describe state and local tax systems. This material is of interest to legislators and others concerned about state tax policy because comparisons with other states are frequently a consideration when new tax policy initiatives are under consideration. It consists of five sections:

- o State and local tax revenue in fiscal year 1984 as reported by the U.S. Census Bureau.
- o State and local tax revenue in fiscal year 1985 as estimated by the National Conference of State Legislatures, including detailed data on state tax revenue.
- o A review of tax changes not reflected in the statistics yet, primarily because they were passed during calendar year 1985.
- o Changes in state and local tax revenue from fiscal years 1970 to 1985.
- o Changes in state personal income taxes during calendar years 1984 and 1985, focusing particularly on reductions in marginal tax rates on high income taxpayers.

The first four sections are primarily descriptive, but the fifth section, on the personal income tax, includes not only a description of recently enacted changes, but also a discussion of policy issues.

I. STATE AND LOCAL TAX REVENUE IN FISCAL YEAR 1984

State and local government taxes amounted to 11.7 percent of personal income in fiscal year 1984, but wide differences existed from state to state in both the level and structure of the tax system. Table 1 shows tax collections for each state in total and for state and local governments separately.

Great care is needed if these data are not to be misinterpreted. For example, Alaska has the highest tax collections--equal to more than 28 percent of personal income--because of the taxes paid by oil companies, which contribute close to 90 percent of tax revenue. The taxes actually paid by Alaska residents are lower than those in any other state. Another fallacy is to assume that the lower the tax burden, the better. Low-tax states often have low levels of services. States differ greatly in how their citizens assess the trade-off between tax and service levels.

A third source of misunderstanding arises because of the passage of time. Fiscal year 1984 ended nearly 18 months ago in most states. The following section contains estimates of more up-to-date data on tax levels.

Comparisons of state tax levels sometimes ignore local taxes because data on state taxes are more readily accessible, but Table 1 shows that this can cause a serious misreading of the tax situation. For example, Delaware had the eighth highest level of state taxes (9.29 percent of income) but the lowest local taxes, so its combined state-local taxes were moderate, ranking 26th. New Hampshire had the lowest state taxes but the fifth highest local

Table 1

STATE-LOCAL TAX REVENUE PER $100 OF PERSONAL INCOME, FY1984
(Rank In Parentheses: 1 is highest, 50 is lowest)

State	Combined	State	Local
NEW ENGLAND			
Connecticut	$11.17 (27)	$6.60 (38)	$4.57 (18)
Maine	12.59 (12)	8.16 (15)	4.43 (20)
Massachusetts	11.75 (19)	7.63 (23)	4.12 (25)
New Hampshire	9.26 (49)	3.67 (50)	5.59 (5)
Rhode Island	12.10 (14)	7.26 (28)	4.84 (12)
Vermont	12.86 (10)	7.88 (19)	4.98 (10)
MID-ATLANTIC			
Delaware	11.18 (26)	9.29 (8)	1.89 (50)
Maryland	11.69 (20)	7.06 (31)	4.63 (16)
New Jersey	11.67 (21)	6.77 (35)	4.90 (11)
New York	16.46 (3)	8.20 (14)	8.26 (1)
Pennsylvania	11.44 (24)	7.05 (32)	4.39 (21)
GREAT LAKES			
Illinois	11.35 (25)	6.11 (40)	5.24 (8)
Indiana	10.47 (38)	7.04 (33)	3.43 (35)
Michigan	13.75 (5)	8.24 (12)	5.51 (6)
Ohio	11.12 (28)	6.63 (37)	4.49 (19)
Wisconsin	13.75 (6)	9.49 (7)	4.26 (24)
PLAINS			
Iowa	11.91 (17)	7.21 (29)	4.70 (14)
Kansas	10.34 (39)	6.03 (42)	4.31 (23)
Minnesota	14.39 (4)	10.28 (3)	4.11 (26)
Missouri	9.30 (48)	5.60 (46)	3.70 (32)
Nebraska	11.05 (30)	5.97 (43)	5.08 (9)
North Dakota	11.53 (23)	8.62 (10)	2.91 (39)
South Dakota	10.02 (43)	5.21 (49)	4.81 (13)
SOUTHEAST			
Alabama	9.99 (44)	7.39 (24)	2.60 (44)
Arkansas	9.74 (45)	7.38 (25)	2.36 (48)
Florida	9.51 (47)	5.92 (44)	3.59 (34)
Georgia	10.53 (37)	6.65 (36)	3.88 (30)
Kentucky	10.18 (40)	8.02 (16)	2.16 (49)
Louisiana	10.91 (31)	6.87 (34)	4.04 (29)
Mississippi	10.80 (32)	8.31 (11)	2.49 (46)
North Carolina	10.64 (34)	7.79 (20)	2.85 (41)
South Carolina	10.79 (33)	7.95 (18)	2.84 (42)
Tennessee	9.26 (50)	5.61 (45)	3.65 (33)
Virginia	10.14 (41)	6.05 (41)	4.09 (27)
West Virginia	12.07 (15)	9.52 (6)	2.55 (45)
SOUTHWEST			
Arizona	12.05 (16)	8.00 (17)	4.05 (28)
New Mexico	12.60 (11)	10.21 (4)	2.39 (47)
Oklahoma	10.57 (36)	7.36 (26)	3.21 (37)
Texas	9.71 (46)	5.35 (47)	4.36 (22)
ROCKY MOUNTAIN			
Colorado	10.62 (35)	5.32 (48)	5.30 (7)
Idaho	10.10 (42)	7.27 (27)	2.83 (43)
Montana	12.93 (8)	7.18 (30)	5.75 (4)
Utah	12.86 (9)	8.22 (13)	4.64 (15)
Wyoming	20.89 (2)	13.08 (2)	7.81 (2)
FAR WEST			
Alaska	28.56 (1)	23.95 (1)	4.61 (17)
California	11.54 (22)	7.68 (22)	3.86 (31)
Hawaii	12.93 (7)	10.07 (5)	2.86 (40)
Nevada	11.11 (29)	7.76 (21)	3.35 (36)
Oregon	12.35 (13)	6.47 (39)	5.88 (3)
Washington	11.76 (18)	8.67 (9)	3.09 (38)
TOTAL	$11.71	$7.22	$4.49

Source: U.S. Census Bureau, Government Finances in 1983-84 (Washington, DC: U.S. Government Printing Office, 1985).

taxes. (It and Alaska are the only states with neither a personal income nor a general sales tax.) While its state taxes were half of the national average, its state-local taxes were only 21 percent below average.

A trade-off frequently exists between state and local taxes--if one is particularly high, the other tends to be relatively low, and vice versa. Thirteen states have rankings for state taxes at least 20 places higher than for local taxes. In the following list, the state rank is given first and the local rank second:

	State	Local
Minnesota	3	26
New Mexico	4	47
Hawaii	5	40
West Virginia	6	45
Delaware	8	50
Washington	9	38
North Dakota	10	39
Mississippi	11	46
Kentucky	16	49
South Carolina	18	42
North Carolina	20	41
Alabama	24	44
Arkansas	25	48

Ten states have much higher local than state taxes:

	State	Local
New Hampshire	50	5
South Dakota	49	13
Colorado	48	7
Texas	47	22
Nebraska	43	9
Illinois	40	8
Oregon	39	3
Connecticut	38	18
New Jersey	35	11
Montana	30	4

Not many states manage to have consistently low or high rankings for both state and local taxes. Only four states are among the 20 lowest at both levels of government--Florida, Indiana, Missouri, and Tennessee. Seven

are among the 20 highest at both levels--Alaska, Maine, Michigan, New York (with the highest local taxes because of New York City), Utah, Vermont, and Wyoming.

The ten states with the highest levels of taxes as a proportion of personal income were Alaska, Wyoming, New York, Minnesota, Michigan, Wisconsin, Hawaii, Montana, Utah, and Vermont. The ten states with the lowest tax levels were Tennessee, New Hampshire, Missouri, Florida, Texas, Arkansas, Alabama, South Dakota, Idaho, and Virginia.

A few regional patterns exist. New England and Far West states tend to have above-average tax levels. Southeast taxes are all below average except for West Virginia.

This analysis has focused on tax revenue per $100 of personal income as an indicator of tax levels. Two alternatives which are sometimes used are discussed in appendices to this report. Appendix A compares per capita tax revenue measures with measures based on personal income. As it indicates, high-income states rank higher on per capita measures than income measures, while low-income states rank lower. Appendix B compares general revenue measures with tax measures. General revenue measures include fees, charges, and miscellaneous revenue as well as tax revenue. While some non-tax revenue burdens citizens in the same way as taxes and serves as a substitute for taxes, other non-tax revenue such as interest received is not burdensome to citizens in the same sense. Levels of non-tax revenue are often strongly influenced by the nature of activities undertaken, such as the magnitude of higher education and hospital programs.

II. STATE AND LOCAL TAX REVENUE IN FISCAL YEAR 1985

Table 2 presents NCSL estimates of state and local tax levels in 1985. These figures were derived from Census Bureau and other federal statistical sources. They provide a good indication of the tax levels that the Census Bureau will report in approximately November 1986. It should be understood, however, that these estimates are not as accurate as the Census Bureau's ultimate reports will be. They are presented here because of their timeliness--approximate 1985 data are more significant than precise 1984 data.2

The second column of Table 2 shows state tax revenue per $100 of personal income for the year ending in June 1985. For 46 states that period coincides with fiscal year 1985. Texas (August 31), Michigan (September 30), and Alabama (September 30) have fiscal years ending later, while New York ends its fiscal year earlier (March 31).

The third column of Table 2 shows local tax revenue per $100 of personal income for fiscal year 1984 (that is, the same number as in Table 1), the latest period for which state-by-state local data are available. If local tax revenue rose in proportion to personal income during fiscal year 1985, then local revenue per $100 of personal income would be the same for fiscal year 1984 and fiscal year 1985. Unfortunately, no reliable data are available yet on local tax revenue by state in fiscal year 1985. In the aggregate, local taxes rose 6.6 percent during the year ending in June 1985, somewhat slower than the state tax increase during the relevant period (8.8 percent), and considerably less than personal income rose (10.4 percent).

The estimates in Table 2 rely on the assumption that the relative levels of local tax revenue per $100 of personal income did not change much between

Table 2

STATE AND LOCAL TAX REVENUE PER $100 OF PERSONAL INCOME
FISCAL YEAR 1985 ESTIMATES
(Rank in parentheses: 1 is highest, 50 is lowest)

State	Combined	State	Local	Percentage Change, State, 1984-1985
NEW ENGLAND				
Connecticut	$11.33 (23)	$ 6.76 (33)	$ 4.57 (18)	2.42
Maine	12.48 (10)	8.05 (14)	4.43 (20)	-1.35
Massachusetts	11.83 (17)	7.71 (22)	4.12 (25)	1.05
New Hampshire	9.08 (50)	3.49 (50)	5.59 (5)	-4.90
Rhode Island	11.92 (16)	7.08 (30)	4.84 (12)	-2.48
Vermont	13.00 (7)	8.02 (15)	4.98 (10)	1.78
MID ATLANTIC				
Delaware	11.14 (26)	9.25 (7)	1.89 (50)	-.43
Maryland	11.50 (21)	6.87 (32)	4.63 (16)	-2.69
New Jersey	11.54 (20)	6.64 (36)	4.90 (11)	-1.92
New York	16.72 (3)	8.46 (9)	8.26 (1)	3.17
Pennsylvania	11.32 (24)	6.93 (31)	4.39 (21)	-1.70
GREAT LAKES				
Illinois	11.02 (28)	5.78 (43)	5.24 (8)	-5.40
Indiana	10.17 (39)	6.74 (34)	3.43 (35)	-4.26
Michigan	12.61 (9)	7.10 (29)	5.51 (6)	-13.83
Ohio	10.76 (31)	6.27 (39)	4.49 (19)	-5.43
Wisconsin	12.25 (14)	7.99 (16)	4.26 (24)	-15.81
PLAINS				
Iowa	11.21 (25)	6.51 (37)	4.70 (14)	-9.71
Kansas	10.24 (37)	5.93 (42)	4.31 (23)	-1.66
Minnesota	13.60 (4)	9.49 (6)	4.11 (26)	-7.68
Missouri	9.24 (48)	5.54 (46)	3.70 (32)	-1.07
Nebraska	10.23 (38)	5.15 (48)	5.08 (9)	-13.74
North Dakota	11.11 (27)	8.20 (12)	2.91 (39)	-4.87
South Dakota	10.13 (40)	5.32 (47)	4.81 (13)	2.11
SOUTHEAST				
Alabama	9.84 (46)	7.24 (28)	2.60 (44)	-2.03
Arkansas	9.89 (45)	7.53 (24)	2.36 (48)	2.03
Florida	9.24 (48)	5.65 (44)	3.59 (34)	-4.56
Georgia	10.58 (33)	6.70 (35)	3.88 (30)	.75
Kentucky	10.04 (43)	7.88 (17)	2.16 (49)	-1.75
Louisiana	11.80 (18)	7.76 (19)	4.04 (29)	12.95
Mississippi	10.57 (34)	8.08 (13)	2.49 (46)	-2 77
North Carolina	10.61 (32)	7.76 (18)	2.85 (41)	-.39
South Carolina	10.40 (36)	7.56 (23)	2.84 (42)	-4.91
Tennessee	9.82 (47)	6.17 (40)	3.65 (33)	9.98
Virginia	10.07 (42)	5.98 (41)	4.09 (27)	-1.16
West Virginia	12.38 (11)	9.83 (4)	2.55 (45)	3.26
SOUTHWEST				
Arizona	12.38 (11)	8.33 (10)	4.05 (28)	4.13
New Mexico	12.19 (15)	9.80 (5)	2.39 (47)	-4.02
Oklahoma	10.94 (29)	7.73 (21)	3.21 (37)	5.03
Texas	9.94 (44)	5.58 (45)	4.36 (22)	4.30
ROCKY MOUNTAIN				
Colorado	10.42 (35)	5.12 (49)	5.30 (7)	-3.76
Idaho	10.10 (41)	7.27 (27)	2.83 (43)	.00
Montana	13.11 (6)	7.36 (26)	5.75 (4)	2.51
Utah	13.46 (5)	8.82 (8)	4.64 (15)	7.30
Wyoming	20.92 (2)	13.11 (2)	7.81 (2)	.23
FAR WEST				
California	11.61 (19)	7.75 (20)	3.86 (31)	.91
Nevada	10.86 (30)	7.51 (25)	3.35 (36)	-3.22
Oregon	12.29 (13)	6.41 (38)	5.88 (3)	-.93
Washington	11.37 (22)	8.28 (11)	3.09 (38)	-4.50
Alaska	26.19 (1)	21.58 (1)	4.61 (17)	-9.90
Hawaii	12.92 (8)	10.06 (3)	2.86 (40)	-.10
U.S. TOTAL	11.57	7.08	4.49	-1.94

Note: State taxes for year ending June 1985. Local taxes per $100 assumed to be the same in 1985 as in 1984.

Sources:

U.S. Census Bureau, Quarterly Summary of Federal, State, and Local Tax Revenue: April-June, 1985 (Washington, D.C.: Government Printing Office, 1985), p. 10.

U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business 65, No. 8 (August 1985): 18.

U.S. Census Bureau, Governmental Finances in 1983-84 (Washington, D.C.: U.S. Government Printing Office, October 1985), p. 81.

U.S. Census Bureau, State Government Finances in 1984 (Washington, D.C.: U.S. Government Printing Office, September 1985), p. 49.

1984 and 1985. The assumption appears reasonable for most states, although some states may have changed their relative position considerably between the two years. Since local tax revenue in total rose at a slower rate than personal income, the table overstates actual tax revenue per $100 of personal income. If local taxes in a particular state are known to have risen significantly more or less than 6.6 percent in fiscal year 1985, that should be taken into account in using these estimates.

The first column of Table 2 shows the estimated total tax level in fiscal year 1985, which was computed by adding together the next two columns. The 1985 total tax level is considerably different from the 1984 tax level in a number of states. Since any change from 1984 to 1985 results from fluctuations of state taxes, the fourth column of the table shows the percentage change in state taxes between the two years.

Tax level decreases predominate, with 32 states having lower taxes per $100 of personal income in 1985 than in 1984. The largest decreases were in Wisconsin (15.8 percent), Michigan (13.8 percent), Nebraska (13.7 percent), Alaska (9.9 percent), and Iowa (9.7 percent). The first two states lowered tax rates, while the latter two had weak economies (Alaska due to oil price decreases and Iowa due to agriculture). In Nebraska, both factors contributed to the decrease. Regionally, the Middle Atlantic, Great Lakes, Plains, and Far West states tended to have decreases. Only three of the 23 states in these regions did not have a lower tax level (California, New York, and South Dakota.

The largest increases were primarily in states that increased tax rates in 1984. Louisiana (13 percent), South Carolina (10 percent), Utah (7.3 percent), and Oklahoma (5 percent) had the biggest percentage increases.

The Southwest and Rocky Mountain regions both had majorities of states with higher tax levels.

Tables 3 and 4 provide additional details about how state tax systems differed during the year ending in June 1985, disaggregating state (but not local) tax revenue into eight categories. Table 3 shows the percentage composition of state tax revenue, and Table 4 indicates revenue per $100 of personal income. The general sales and personal income taxes are clearly the mainstays of most state tax systems, accounting for 61.9 percent of total state tax revenue. But the energy-producing states are exceptions to the general pattern. Eight states obtain at least one-fifth of their revenue from severance taxes (Alaska, Louisiana, Montana, New Mexico, North Dakota, Oklahoma, Texas, and Wyoming). This is indicated by the high proportion of revenue from "other" taxes in the last column of Table 3. What this implies is that one cannot simply assume that data on tax levels such as those presented here are related to tax burdens on citizens. States differ in terms of their ability to export taxes to nonresidents. In particular, although Alaska and Wyoming have the highest levels of tax collections per $100 of personal income, they actually have the lowest average tax burdens on their own citizens.

According to Table 4, the sales tax (including gross receipts taxes) produced more revenue than the personal income tax in 26 states, while the personal income tax generated more revenue in 22 states. Alaska and New Hampshire have neither a sales nor a broad-based income tax.3

Following is a description of which states have the highest and lowest tax levels for each tax. Numerous qualifications should be considered in reviewing this information. 1) The data are only for state taxes, although

Table 3

COMPOSITION OF STATE TAX REVENUE
FISCAL YEAR 1985
(Percent of total)

State	Sales	Motor Fuel	Tobacco	Alcohol	Personal Income	Corp. Income	Motor Vehicle Regis.	Other
NEW ENGLAND								
Connecticut	43.6	6.0	2.6	.9	8.6	14.8	3.1	20.4
Maine	35.2	8.8	2.9	3.1	29.5	5.3	4.7	10.4
Massachusetts	21.8	4.2	2.7	1.3	47.8	13.2	2.2	6.8
New Hampshire	.0	14.2	7.4	2.4	5.4	22.9	9.4	38.4
Rhode Island	31.6	5.3	3.3	.9	32.8	8.8	2.7	14.7
Vermont	19.2	8.1	2.8	3.1	31.6	7.4	6.5	21.3
MID ATLANTIC								
Delaware	.0	4.7	1.6	.7	45.9	9.9	4.4	32.8
Maryland	25.4	6.9	1.5	.7	40.9	5.7	2.3	16.6
New Jersey	29.4	4.1	2.8	.8	25.1	11.9	3.9	22.0
New York	20.3	1.9	2.0	.8	50.8	8.8	2.4	13.0
Pennsylvania	29.7	6.1	2.4	1.3	25.5	9.3	4.1	21.7
GREAT LAKES								
Illinois	34.6	6.6	1.8	.8	28.3	7.7	6.3	13.8
Indiana	48.7	7.7	1.8	1.0	29.7	4.1	2.7	4.4
Michigan	29.4	7.5	1.6	1.1	34.7	15.3	3.8	6.6
Ohio	30.7	7.5	2.2	.8	33.4	5.2	4.0	16.1
Wisconsin	27.7	7.1	2.9	.9	38.9	8.7	2.8	10.9
PLAINS								
Iowa	32.9	7.9	2.6	.6	35.8	6.7	5.6	8.0
Kansas	28.6	7.8	[illegible].3	2.3	31.5	8.3	4.2	15.1
Minnesota	25.7	6.7	1.6	1.0	42.7	7.3	4.8	10.2
Missouri	42.2	6.2	2.4	.7	31.5	4.8	5.2	7.0
Nebraska	32.1	12.4	2.8	1.3	31.0	4.8	5.2	10.4
North Dakota	27.0	6.1	1.8	.9	11.0	12.1	4.9	34.4
South Dakota	52.6	17.3	2.5	2.2	.0	3.7	7.0	14.7
SOUTHEAST								
Alabama	27.9	8.8	2.5	3.2	24.1	7.2	1.6	24.8
Arkansas	39.8	8.6	3.6	1.4	27.2	7.5	4.3	7.6
Florida	54.2	7.8	3.6	5.3	.0	5.8	4.4	18.9
Georgia	34.0	8.5	2.0	2.4	38.0	9.3	1.6	4.1
Kentucky	27.1	6.5	.6	1.6	25.7	7.0	3.2	28.2
Louisiana	31.6	9.4	2.3	1.9	13.8	7.5	1.5	31.9
Mississippi	51.9	8.1	2.0	1.8	13.6	6.9	2.9	12.7
North Carolina	22.3	7.8	.3	2.4	39.0	9.4	4.2	14.6
South Carolina	32.5	9.8	1.2	4.0	33.7	7.9	2.2	8.7
Tennessee	57.6	9.5	2.6	2.0	2.0	8.6	4.6	13.0
Virginia	20.8	7.3	.4	2.1	43.5	6.4	4.5	14.9
West Virginia	42.9	8.5	1.9	.5	27.1	5.4	3.4	10.4
SOUTHWEST								
Arizona	46.8	7.5	2.0	1.3	20.2	6.7	5.1	10.4
New Mexico	42.1	7.3	1.0	1.1	5.9	4.5	3.0	35.1
Oklahoma	21.2	6.4	2.6	1.4	24.5	3.5	6.5	33.9
Texas	36.9	8.1	3.3	2.9	.0	.0	4.9	44.0
ROCKY MOUNTAIN								
Colorado	33.6	8.3	1.6	1.1	40.4	4.3	3.2	7.6
Idaho	32.5	10.8	1.4	1.3	35.2	5.8	4.5	8.6
Montana	.0	12.7	2.1	2.2	28.3	9.8	4.5	40.4
Utah	45.2	7.9	.9	1.0	30.8	3.7	2.4	8.0
Wyoming	22.3	4.9	.6	.2	.0	.0	4.0	68.1
FAR WEST								
California	33.7	4.0	.9	.5	37.4	12.7	2.1	8.7
Nevada	50.3	8.2	2.2	1.4	.0	.0	4.8	33.1
Oregon	.0	6.0	2.9	.5	65.9	7.7	7.6	9.4
Washington	57.7	8.1	2.1	2.2	.0	.0	3.0	26.8
Alaska	.0	1.9	.3	.7	.1	10.8	.8	85.3
Hawaii	50.1	2.6	1.4	1.6	31.5	3.6	.7	8.5
Dist. Columbia	22.5	1.7	.6	.5	27.2	7.1	1.1	39.4
U.S. TOTAL	32.1	6.2	2.0	1.4	29.8	8.2	3.5	16.7

Note: Figures for Alabama, Michigan, New York, and Texas are approximations because their fiscal years do not end on June 30, and these figures are for the 12 months ending on that date.

Sources:

U.S. Census Bureau, Quarterly Summary of Federal, State and Local Tax Revenue, April-June 1985 (Washington, D.C.: U.S. Government Printing Office, 1985), pp. 10-13.

U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business 65, No. 8 (August 1985): 18.

Table 4

STATE TAX REVENUE PER $100 OF PERSONAL INCOME
FISCAL YEAR 1985

STATE	Total	Sales	Motor Fuel	Tobacco	Alcohol	Personal Income	Corp. Income	Motor Vehicle Regis.	Other
NEW ENGLAND									
Connecticut	6.76	2.95	.41	.17	.06	.58	1.00	.21	1.38
Maine	8.05	2.83	.71	.23	.25	2.38	.43	.38	.84
Massachusetts	7.71	1.68	.33	.21	.10	3.69	1.02	.17	.53
New Hampshire	3.49	.00	.50	.26	.08	.19	.80	.33	1.34
Rhode Island	7.08	2.24	.37	.24	.06	2.32	.62	.19	1.04
Vermont	8.02	1.54	.65	.23	.25	2.54	.59	.52	1.71
MID ATLANTIC									
Delaware	9.25	.00	.43	.15	.06	4.25	.92	.41	3.03
Maryland	6.87	1.75	.47	.11	.05	2.81	.39	.16	1.14
New Jersey	6.64	1.95	.27	.19	.05	1.67	.79	.26	1.46
New York	8.46	1.71	.16	.17	.07	4.30	.74	.20	1.10
Pennsylvania	6.93	2.06	.42	.16	.09	1.77	.64	.29	1.50
GREAT LAKES									
Illinois	5.78	2.00	.38	.10	.04	1.64	.44	.36	.80
Indiana	6.74	3.28	.52	.12	.07	2.00	.28	.18	.30
Michigan	7.10	2.09	.53	.11	.08	2.46	1.09	.27	.47
Ohio	6.27	1.92	.47	.14	.05	2.09	.33	.25	1.01
Wisconsin	7.99	2.22	.57	.23	.07	3.11	.70	.23	.87
PLAINS									
Iowa	6.51	2.14	.52	.17	.04	2.33	.44	.36	.52
Kansas	5.93	1.69	.46	.14	.13	1.87	.49	.25	.89
Minnesota	9.49	2.44	.63	.15	.09	4.05	.70	.45	.97
Missouri	5.54	2.34	.34	.14	.04	1.74	.26	.29	.39
Nebraska	5.15	1.65	.64	.14	.07	1.60	.25	.27	.54
North Dakota	8.20	2.21	.66	.15	.07	.90	1.00	.40	2.82
South Dakota	5.32	2.80	.92	.13	.12	.00	.20	.27	.78
SOUTHEAST									
Alabama	7.24	2.02	.64	.18	.23	1.75	.52	.11	1.80
Arkansas	7.53	3.00	.65	.27	.11	2.05	.57	.32	.57
Florida	5.65	3.06	.44	.20	.30	.00	.33	.25	1.07
Georgia	6.70	2.28	.57	.13	.16	2.55	.62	.11	.27
Kentucky	7.88	2.14	.51	.05	.13	2.03	.55	.25	2.23
Louisiana	7.76	2.45	.73	.18	.15	1.07	.58	.12	2.47
Mississippi	8.08	4.20	.66	.16	.14	1.10	.56	.24	1.02
North Carolina	7.76	1.73	.61	.02	.18	3.03	.73	.32	1.13
South Carolina	7.56	2.46	.74	.09	.31	2.55	.60	.17	.66
Tennessee	6.17	3.55	.59	.16	.12	.13	.53	.28	.80
Virginia	5.98	1.24	.44	.02	.12	2.60	.39	.27	.89
West Virginia	9.83	4.22	.83	.19	.05	2.67	.53	.34	1.02
SOUTHWEST									
Arizona	8.33	3.89	.62	.17	.10	1.68	.56	.43	.87
New Mexico	9.80	4.13	.71	.10	.11	.58	.44	.29	3.44
Oklahoma	7.73	1.64	.50	.20	.11	1.89	.27	.50	2.62
Texas	5.58	2.06	.45	.18	.16	.00	.00	.27	2.45
ROCKY MOUNTAIN									
Colorado	5.12	1.72	.42	.08	.06	2.07	.22	.16	.39
Idaho	7.27	2.36	.79	.10	.09	2.56	.42	.33	.62
Montana	7.36	.00	.94	.16	.16	2.08	.72	.33	2.98
Utah	8.82	3.99	.70	.08	.09	2.72	.32	.22	.71
Wyoming	13.11	2.92	.64	.08	.02	.00	.00	.53	8.92
FAR WEST									
California	7.75	2.61	.31	.07	.04	2.90	.99	.17	.67
Nevada	7.51	3.78	.61	.17	.11	.00	.00	.36	2.49
Oregon	6.41	.00	.38	.19	.04	4.22	.50	.48	.60
Washington	8.28	4.78	.67	.17	.19	.00	.00	.25	2.22
Alaska	21.58	.00	.41	.06	.16	.01	2.34	.18	18.42
Hawaii	10.06	5.05	.26	.15	.16	3.17	.36	.07	.85
Dist. Columbia	14.22	3.19	.24	.09	.07	3.87	1.00	.16	5.60
U.S. TOTAL	7.08	2.27	.44	.14	.10	2.11	.58	.25	1.18

Note: Figures for Alabama, Michigan, New York, and Texas are approximations because their fiscal years do not end on June 30, and these figures are for the 12 months ending on that date.

Sources:
U.S. Census Bureau, Quarterly Summary of Federal, State, and Local Tax Revenue: April-June 1985 (Washington, D.C.: U.S. Government Printing Office, 1985), pp. 10-13.
U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business 65, No. 8 (August 1985): 18.

in some cases local taxes are also levied. 2) Revenues obtained depend not only on tax rates but also on consumption patterns, i.e., low revenue could indicate low purchases of the taxed products. 3) Not all taxes are paid by residents, with some taxes exported to tourists and to nonresidents through higher prices or decreased earnings.

General sales

Highest: Hawaii, Washington, West Virginia, Mississippi, New Mexico, Utah, Arizona, Nevada, Tennessee, and Indiana.

Lowest: Virginia, Vermont, Oklahoma, Nebraska, Massachusetts, Kansas, New York, Colorado, North Carolina, and Maryland. In addition, five states have no general sales tax.

Comments: These tabulations do not reflect local sales taxes, which are significant in several of the states with low state sales taxes (Virginia, Oklahoma, New York, Colorado, and North Carolina in particular). The rankings reflect the narrowness of the sales tax base as well as the sales tax rate. Although Connecticut has the highest tax rate, it is not among the states with the highest revenue because it allows so many exemptions; for the same reason Massachusetts has one of the lowest levels of revenue although its rate is not low.

Personal income

Highest: New York, Delaware, Oregon, Minnesota, Massachusetts, Hawaii, Wisconsin, North Carolina, California, and Maryland.

Lowest: New Mexico, North Dakota, Louisiana, Mississippi, Nebraska, Illinois, New Jersey, Arizona, Missouri, and Alabama. In addition,

10 states do not have a broad-based income tax (although three of these 10--Connecticut, New Hampshire, and Tennessee--do tax certain categories of property income).

Comments: As discussed in the following section of this report, seven of the eight states with the highest income tax levels enacted tax reductions in 1985 legislative sessions which are not reflected here because they were not yet in effect. Some trade-offs are apparent in comparing the general sales and personal income tax rankings. New York, Massachusetts, Maryland, and North Carolina have high income taxes and low sales taxes, while Delaware and Oregon have high income taxes and no sales tax at all. New Mexico and Mississippi have low income taxes and high sales taxes. (New Mexico's data are distorted by its generous income tax credits that reduce income tax revenue as an offset to its high sales taxes.) Nebraska is the only state on both lists for low taxes, while Hawaii is the only state on both lists for high taxes.

Motor fuel

Highest: Montana, South Dakota, West Virginia, Idaho, Louisiana, South Carolina, New Mexico, Maine, Utah, and Washington.

Lowest: New York, Hawaii, New Jersey, California, Massachusetts, Missouri, Rhode Island, Oregon, Illinois, and Connecticut.

Comments: Urbanization is an important factor in explaining variations in motor fuel taxes because rural states tend to have much higher per capita spending for roads and highways than do urban states.

Tobacco

Highest: Arkansas, New Hampshire, Rhode Island, Maine, Vermont, Wisconsin, Massachusetts, Florida, Oklahoma, New Jersey, West Virginia, and Oregon.

Lowest: North Carolina, Virginia, Kentucky, Alaska, California, Colorado, Utah, Wyoming, Illinois, and New Mexico.

Comments: The New England states tend to have particularly high revenue from tobacco taxes, while the major tobacco-growing states tax tobacco more lightly than other states. Revenue reflects not only tax rates but also differences among states in consumption of cigarettes.

Alcoholic beverages

Highest: South Carolina, Florida, Maine, Vermont, Alabama, Washington, North Carolina, Georgia, Montana, Alaska, and Hawaii.

Lowest: Wyoming, Illinois, Iowa, Missouri, California, Oregon, Maryland, New Jersey, Ohio, West Virginia, California, Oregon.

Comments: Revenue from alcoholic beverage taxes is strongly influenced by the existence of state liquor stores; those states that operate such stores often receive profits from them as a partial substitute for alcoholic beverage taxes. Consumption patterns also affect revenue levels.

Corporation income

Highest: Alaska, Michigan, Massachusetts, Connecticut, North Dakota, California, Delaware, New Hampshire, New Jersey, and North Carolina.

Lowest: South Dakota, Colorado, Nebraska, Missouri, Oklahoma, Indiana, Utah, Ohio, Florida, and Hawaii. Four other states have no general corporation income tax.

Comments: Alaska's corporate revenue is the highest because of the taxes paid by oil companies. Michigan is listed as the second highest state by the Census Bureau although it does not really have a corporation income tax. Its Single Business Tax is a form of value added tax, but it is included in this category. South Dakota's corporate tax is only on certain financial companies.

Motor vehicle registration fees

Highest: Wyoming, Vermont, Oklahoma, Oregon, Minnesota, Arizona, Delaware, North Dakota, Maine, and South Dakota.

Lowest: Hawaii, Alabama, Georgia, Louisiana, Maryland, Colorado, Massachusetts, South Carolina, California, Indiana, and Alaska.

Comments: No consistent relationship appears to exist between these fees and motor fuel taxes. Maine and South Dakota are among the highest for both, but California, Hawaii, and Massachusetts are among the lowest for both. Louisiana and South Carolina have high taxes and low fees, while Oregon has the opposite situation. Both fees and fuel taxes are means of financing highways, so they are substitutes in a sense. On the other hand, the relative need for highways may influence them both as well. Local fees may also be significant.

III. TAX CHANGES NOT REFLECTED YET IN STATISTICS REPORTED

Although the 1985 legislative sessions were moderately active ones in terms of state tax policy, the tax changes enacted by them are generally not reflected in the statistics reported in the previous section because it considers only taxes collected through June 1985. In addition, tax changes that took effect after July 1984 are also not fully reflected because they were not in force for an entire year. This section notes the most important of those changes, which will affect relative state tax levels in fiscal year 1986.

Twenty-four states raised taxes, and 20 states lowered them during calendar year 1985. The tax reductions tended to be larger than the increases, so the net effect was a decrease of somewhat more than $1 billion. (This is not a large amount compared to total state tax revenue of $214 billion.) The actions taken during regular legislative sessions were described in detail in NCSL's report State Budget Actions in 1985. Following publication of that reports three states passed additional tax cuts (Delaware, Massachusetts, and New Jersey) and Nebraska raised taxes.

These were the states with the major tax changes enacted in 1985:

- Connecticut exempted clothing worth $75 or less from the sales tax and passed numerous smaller tax reductions.
- Delaware increased its personal exemption and lowered income tax rates.
- Indiana increased the personal income tax exemption.
- Kansas removed a temporary limit on the amount of federal income taxes that were deductible on the state income tax.

- Massachusetts removed a 7.5 percent income tax surtax that had been in effect for nearly a decade and made other tax reductions.
- Minnesota reduced its income tax an estimated 16 percent.
- Nebraska raised its income tax from 19 percent to 20 percent of federal income tax liability.
- New Jersey lowered its income tax by allowing a deduction for property tax payments.
- New York reduced its income tax over a three year period, lowering rates and making other adjustments.
- North Carolina provided a new personal income tax credit and made other small reductions.
- Ohio reduced personal income taxes 15 percent over a three year period, with an additional contingent 5 percent reduction.
- Oklahoma raised its general sales tax rate 1/4 percent and passed other tax increases.
- Oregon allowed a temporary 8 percent income tax surcharge to expire.
- Pennsylvania reduced its personal income tax rate from 2.35 percent to 2.2 percent.
- Rhode Island reduced income tax rates twice.
- West Virginia allowed a temporary income tax increase to expire.
- Wisconsin reformed its income tax and reduced tax rates.

Of the 17 significant tax actions listed here, 15 were decreases and only two were increases (Nebraska and Oklahoma). All of the decreases except that in Connecticut involved the personal income tax. This tabulation ignores many small changes, particularly in excise taxes and corporation income taxes, because their revenue effects were not major. Continuations of temporary tax increases are not counted as tax changes, nor are changes that do not take effect for more than one year.

In addition to the changes listed above, some 1984 tax increases in Texas and a 1984 personal income tax reduction in Michigan were not in effect for all of the year ending in June 1985, so their full impact is not reflected in the statistics.

IV. CHANGES IN TAX LEVELS DURING THE PAST 15 YEARS

Table 5 shows how state and local taxes have fluctuated as a proportion of personal income since 1970. Despite large fluctuations and a considerable change in the composition of tax revenue, the aggregate tax level was not far in 1985 from where it began the period. Here are the highlights of what the table shows:

- Taxes rose faster than personal income in the early 1970s, stayed on a plateau for several years, fell sharply during the Tax Revolt after 1978, and then rebounded in fiscal year 1984.

- State taxes traced the same ups and downs as total taxes, but they wound up in fiscal year 1985 at a higher level than they started in fiscal year 1970.

Table 5

STATE AND LOCAL TAX REVENUE PER $100 OF PERSONAL INCOME, 1970 to 1985

Fiscal Year	Total	State	Local	Property[b]	State General Sales	State Personal Income
1985[a]	$11.45	$7.08	$4.37	$3.43	$2.27	$2.11
1984	11.71	7.22	4.49	3.53	2.30	2.16
1983	11.07	6.69	4.38	3.47	2.09	1.94
1982	11.07	6.79	4.28	3.41	2.10	1.91
1981	11.31	6.95	4.36	3.47	2.15	1.90
1980	11.57	7.13	4.45	3.55	2.24	1.93
1979	12.03	7.34	4.69	3.80	2.32	1.92
1978	12.75	7.49	5.26	4.37	2.33	1.93
1977	12.81	7.39	5.42	4.55	2.26	1.86
1976	12.47	7.13	5.34	4.53	2.18	1.71
1975	12.28	6.99	5.29	4.47	2.16	1.64
1974	12.36	7.05	5.31	4.51	2.15	1.62
1973	12.95	7.31	5.63	4.84	2.13	1.68
1972	12.69	7.02	5.67	4.92	2.07	1.52
1971	11.89	6.48	5.40	4.74	1.95	1.28
1970	11.66	6.47	5.19	4.57	1.91	1.24

Notes: Revenue for each fiscal year is divided by personal income in the preceeding calendar year.

a. The figures for 1985 are preliminary estimates based on tax collections in the year ending June 1985.

b. At least 95 percent of property tax revenue is raised by local governments, but some state governments also levy a property tax, usually on specific classes of property.

Source: U.S. Census Bureau, Governmental Finances, (Washington, DC: U.S. Government Printing Office, various years);
U.S. Census Bureau, State Government Finances, (Washington, DC: U.S. Government Printing Office, various years).

- Local taxes, on the other hand, fell on balance in relation to income during these 15 years. Unlike state taxes, they did not rebound as a proportion of personal income in the 1980s.

- Personal income taxes rose much faster than general sales taxes. Income tax revenue was not far behind sales tax revenue in fiscal year 1985, although income tax revenue was less than two-thirds as much as sales tax revenue in fiscal year 1970.

- The property tax, on the other hand, fell sharply as a proportion of personal income, after peaking in 1972.

Some of the relationships among the various categories of taxes changed by design rather than by accident. Many states deliberately increased their income taxes (and, to a smaller extent, sales taxes) in order to relieve property taxes. Although property tax revenue continued to grow in absolute terms, effective rates fell sharply and the property tax played a much smaller role in state-local fiscal systems. In terms of financing specific services, the major shifts were increased state responsibilities for schools and welfare. Reducing the local role in paying for these programs resulted in less pressure on the property tax.4

Table 6 shows how these patterns were reflected in the tax systems of each state. While no state exactly mirrored the national aggregates, the generalizations stated above do apply in most states. The table also demonstrates the tremendous diversity of the federal system, with great differences from one state to another in how they raise revenue and how much revenue they collect.

Table 6

TAX REVENUE PER $100 OF PERSONAL INCOME
SELECTED TAXES, SELECTED YEARS

State	Total State-Local Tax Revenue		Total State Tax Revenue		Personal Income Tax Revenue		Sales Tax Revenue		Property Tax Revenue	
	1971	1984	1971	1985	1971	1985	1971	1985	1971	1984
NEW ENGLAND										
Connecticut	$11.11	$11.17	$5.38	$6.76	$.07	$.58	$1.79	$2.95	$5.69	$4.51
Maine	12.75	12.59	7.07	8.05	.74	2.38	2.84	2.83	5.76	4.53
Massachusetts	12.71	11.75	6.03	7.71	2.29	3.69	.77	1.68	6.63	4.05
New Hampshire	10.75	9.26	4.45	3.49	.20	.19	-	-	6.36	5.65
Rhode Island	12.05	12.10	7.33	7.08	1.01	2.32	2.24	2.24	4.67	4.84
Vermont	14.68	12.86	9.13	8.02	2.77	2.54	1.26	1.54	5.47	4.95
MID-ATLANTIC										
Delaware	11.70	11.18	9.32	9.25	3.33	4.25	-	-	2.05	1.57
Maryland	12.11	11.69	6.88	6.87	2.47	2.81	1.57	1.75	3.97	2.95
New Jersey	11.00	11.67	4.54	6.64	.06	1.67	1.58	1.95	6.02	4.84
New York	14.54	16.46	7.17	8.46	2.91	4.30	1.35	1.71	5.46	5.02
Pennsylvania	11.39	11.44	6.68	6.93	.29	1.77	2.18	2.06	3.36	3.01
GREAT LAKES										
Illinois	11.47	11.35	6.27	5.78	1.54	1.64	2.04	2.00	4.46	4.15
Indiana	10.77	10.47	5.36	6.74	1.11	2.00	2.05	3.28	5.46	3.27
Michigan	12.24	13.75	7.04	7.10	1.32	2.46	2.43	2.09	5.04	5.24
Ohio	9.25	11.12	4.18	6.27	-	2.09	1.59	1.92	4.37	3.31
Wisconsin	14.64	13.75	8.70	7.99	3.10	3.11	2.08	2.22	6.34	4.50
PLAINS										
Iowa	12.34	11.91	6.16	6.51	1.11	2.33	2.04	2.14	6.15	4.61
Kansas	10.93	10.34	5.39	5.93	.96	1.87	1.85	1.69	5.51	3.84
Minnesota	13.25	14.39	7.54	9.49	2.54	4.05	1.46	2.44	5.61	3.93
Missouri	9.87	9.30	4.93	5.54	.97	1.74	1.88	2.34	4.02	2.15
Nebraska	11.72	11.05	5.29	5.15	.97	1.60	1.60	1.65	6.00	4.55
North Dakota	14.19	11.53	7.70	8.20	.91	.90	2.94	2.21	[illegible]	2.83
South Dakota	13.84	10.02	5.78	5.32	-	-	2.52	2.80	7.63	4.16
SOUTHEAST										
Alabama	9.76	9.99	7.23	7.24	.94	1.75	2.35	2.02	1.45	1.22
Arkansas	9.73	9.74	7.07	7.53	.82	2.05	2.24	3.00	2.49	1.92
Florida	10.58	9.51	6.37	5.65	-	-	2.87	3.06	3.58	3.10
Georgia	10.09	10.53	6.46	6.70	1.20	2.55	2.35	2.28	3.25	2.80
Kentucky	10.49	10.18	7.68	7.88	1.34	2.03	2.93	2.14	2.33	1.85
Louisiana	12.55	10.91	8.88	7.76	.74	1.07	2.10	2.45	2.38	1.62
Mississippi	12.30	10.80	9.07	8.08	.81	1.10	4.32	4.20	2.99	2.35
North Carolina	10.60	10.64	7.94	7.76	1.85	3.03	1.75	1.73	2.67	2.37
South Carolina	10.26	10.79	7.87	7.56	1.42	2.55	2.81	2.46	2.28	2.64
Tennessee	9.93	9.26	6.06	6.17	.10	.13	2.18	3.55	2.80	2.24
Virginia	10.43	10.14	6.18	5.98	1.86	2.60	1.36	1.2[illegible]	3.06	2.88
West Virginia	11.13	12.07	8.30	9.83	1.12	2.67	3.65	4.22	2.47	2.08
SOUTHWEST										
Arizona	13.32	12.05	8.15	8.33	1.15	1.68	3.02	3.89	5.14	3.39
New Mexico	12.65	12.60	9.98	9.80	1.12	.58	3.74	4.13	2.84	1.56
Oklahoma	9.93	10.57	6.37	7.73	.75	1.89	1.19	1.64	3.00	1.82
Texas	9.90	9.71	5.54	5.58	-	-	1.60	2.06	3.96	3.64
ROCKY MOUNTAIN										
Colorado	12.06	10.62	6.07	5.12	1.69	2.07	1.85	1.72	5.05	3.53
Idaho	12.64	10.10	8.10	7.27	2.44	2.56	1.96	2.36	4.45	2.71
Montana	12.74	12.93	5.78	7.36	1.80	2.08	-	-	7.08	5.97
Utah	12.47	12.86	7.87	8.82	1.81	2.72	2.97	3.99	4.50	3.59
Wyoming	13.90	20.89	7.90	13.11	-	-	2.89	2.92	6.57	9.17
FAR WEST										
Alaska	10.43	28.56	7.29	21.58	2.99	.01	-	-	2.36	5.30
Calafornia	13.73	11.54	6.39	7.75	1.43	2.90	2.03	2.61	6.75	2.96
Hawaii	14.06	12.93	10.75	10.06	3.37	3.17	5.16	5.05	2.55	2.33
Nevada	12.96	11.11	7.61	7.51	-	-	2.90	3.78	4.24	2.45
Oregon	11.55	12.35	5.71	6.41	2.91	4.22	-	-	5.65	5.34
Washington	12.28	11.76	8.24	8.28	-	-	4.50	4.78	4.26	3.28
U.S. Total	11.89	11.71	6.48	7.08	1.28	2.11	1.95	3.19	4.74	3.53

Sources: U.S. Census Bureau, Government Finances in 1983-84 (Washington, DC: U.S. Government Printing Office, 1985).
U.S. Census Bureau, Governmental Finances in 1970-71, (Washington, DC: U.S. Printing Office, 1972).
U.S. Census Bureau, Quarterly Summary of Federal, State, and Local Tax Revenues: April-June 1985, (Washington, DC: U.S. Government Printing Office, 1985).
U.S. Department of Commerce, Bureau of Economics Analysis, Survey of Current Business 65, No. 8 (August 1985): 18.

V. PERSONAL INCOME TAXES ON THE DEFENSIVE

Following decades of steady growth, state personal income taxes are under attack. Fourteen states reduced their income tax rates or increased exemptions last year, and the momentum away from the income tax appears likely to continue, at least for awhile. The first part of this section reviews trends in income tax policy and particularly examines the tax rates imposed by states on high-income individuals. It is in the states with the highest marginal and effective tax rates where the pressure for income tax reduction is strongest. The second part of this section discusses policy issues raised by recent tax changes.

Recent Income Tax Trends

Forty states levy broad-based personal income taxes. Income taxes have been the most dynamic state revenue source since 1970, rising from 19.2 percent of total revenue in 1970 to 29.8 percent in 1985. In nearly every year during that period income taxes rose faster than general sales taxes, the only revenue source more productive than the income tax. The most important reasons for this increased fiscal significance of the income tax are its responsiveness to inflation and its tendency to grow faster than personal income because taxpayers move into higher tax brackets as their income rises. Several new adoptions in 1971 (as well as by New Jersey in 1976) and tax rate increases also contributed to income tax growth.

A backlash against the income tax surfaced in calendar year 1984. In that year and in 1985 most of the personal income tax increases enacted during the previous two years as states fought to stave off budget deficits were repealed or partially rolled back. (See Appendix C). In contrast,

most of the sales tax increases of 1982 and 1983 were retained, and several more states raised the sales tax in 1984. These trends are reflected in revenue data for the 12 months ending in June 1985. For the first time in many years, general sales tax revenue growth significantly outstripped the rise of the income tax. The sales tax rose 10.5 percent, nearly 50 percent faster than the income tax's 7.5 percent gain.

These figures do not reflect the tax cuts enacted in calendar year 1985. Each of the five states with the highest income tax revenue per $100 of personal income--New York, Delaware, Oregon, Minnesota, and Massachusetts--reduced their income taxes significantly. Wisconsin and North Carolina--two of the other three states with the highest effective income tax rates--also lowered their income taxes. Only Hawaii, among the states with the eight highest income tax levels, did not trim its rates.

Two measures are used to compare income taxes. The effective tax rate is the ratio of tax paid to income; the discussion above concerning tax revenue per $100 of personal income dealt with effective rates. The marginal tax rate is the tax on the last dollar of income earned; the rates which appear in laws and income tax forms are marginal rates. Effective state income tax rates are usually considerably lower than marginal tax rates because most states allow numerous deductions and all income is taxed at lower rates before the maximum marginal tax rate is reached. Table 4 showed state effective income tax rates. In the most recent period, only four states had effective tax rates above 4 percent (Delaware, Minnesota, New York, and Oregon), and all of these states have since enacted tax cuts that are not reflected in the table.

Several of the states with the highest marginal tax rates have been lowering them. Since 1976, New York's top rate on earned income has fallen from 15 percent to 9.5 percent (and will be 9 percent in 1987), Wisconsin's has gone from 11.4 percent to 7.9 percent, and Delaware's from 19.8 percent to 9.7 percent. Minnesota's top rate was reduced from 16 to 14 percent this year.

Which states have the highest marginal tax rates? The answer to this question requires some analysis. The first two columns of Table 7 show the top marginal tax rate in each state and the lowest level of income at which it is paid. Eleven states have nominal marginal rates of 10 percent or more--California (11 percent), Hawaii (11 percent), Iowa (13 percent), Maine (10 percent), Minnesota (14 percent), Montana (11 percent), Nebraska (10 percent), Oregon (10 percent), Rhode Island (10.95 percent), Vermont (13.25 percent), and West Virginia (13 percent). These figures are not directly comparable for two reasons:

- The top rate is reached at different levels in each state. Maine's 10 percent rate is paid once taxable income reaches $50,000, but the highest rates in Nebraska, Rhode Island, and Vermont do not come into play until income exceeds $175,000. Each of the three latter states has a piggyback income tax which is levied as a percentage of federal income tax liability.

- Several of these states allow federal income tax payments to be subtracted from taxable income in computing the income that is subject to state tax. For very high income taxpayers, federal deductibility cuts the true marginal state tax rate in half, since the top federal rate is 50 percent. (For example, a taxpayer with income over $200,000 who

received an additional $1,000 of income would pay $500 in extra federal tax. State taxable income would therefore rise only $500 rather than $1,000. If the state's nominal marginal tax rate were 10 percent, state taxes would rise $50 rather than the $100 that would be the case if federal tax payments were not deductible. In this situation the true marginal tax rate would be 5 percent rather than 10 percent. Federal deductibility is not worth this much to all taxpayers; some taxpayers may be in the highest state tax bracket and still be below the 50 percent federal rate. For such taxpayers the highest "true" state marginal tax rate would be more than half of the nominal rate.)

The third column of Table 7 identifies the 11 states permitting federal income taxes to be deducted in full, so that the "true" marginal tax rate is half of the nominal marginal tax rate. Five other states permit federal income taxes to be deducted but they are not included in this column. In two of the states--North Dakota and Oklahoma--taxpayers have a choice of two different rate schedules, one with and the other without federal deductibility. Since the option with federal taxes deductible yields higher state tax liability in the great majority of cases, very few taxpayers choose it. The relevant tax rate is for the other option, without federal deductibility. Three other states--Delaware, Oregon, and South Carolina--limit the amounts of federal taxes that may be deducted (to $600, $7,000, and $500 respectively for joint filers). Since very high income taxpayers would normally pay considerably more federal income tax than the limit, the deduction does not affect their tax rate at the margin.

Three of the 11 states where federal deductibility does have an effect at the margin are among the 11 states listed above as having marginal tax

Table 7

MARGINAL TAX RATES FOR STATE PERSONAL INCOME TAXES, JOINT RETURNS, 1986

State	Highest Nominal Rate (Percent)	Highest Rate Starts At This Taxable Income* ($000)	Federal Deductibility Reduces Highest Rate	Highest Rate Adjusted for Federal Deductibility (Percent)
NEW ENGLAND				
Maine	10.00	50		10.00
Massachusetts	5.19 d,e	0		5.19
Rhode Island - c	10.95	175		10.95
Vermont - c	13.25	175		13.25
MID-ATLANTIC				
Delaware	9.70	40	a	9.70
Maryland	5.00	3		5.00
New Jersey	3.50	50		3.50
New York	9.50 e,g	16		9.50
Pennsylvania	2.20	0		2.20
GREAT LAKES				
Illinois	2.50	0		2.50
Indiana	3.00	0		3.00
Michigan	5.10 e	0		5.35
Ohio	8.55 e	100		8.55
Wisconsin	7.90	40		7.90
PLAINS				
Iowa	13.00	77	Yes	6.50
Kansas	9.00	50	Yes	4.50
Minnesota	14.00 f	32	Yes	7.00
Missouri	6.00	9	Yes	3.00
Nebraska - c	10.00	175		10.00
North Dakota - c	5.25	175	b	5.25
SOUTHEAST				
Alabama	5.00	6	Yes	2.50
Arkansas	7.00	25		7.00
Georgia	6.00	10		6.00
Kentucky	6.00	8	Yes	3.00
Louisiana	6.00	50	Yes	3.00
Mississippi	5.00	10		5.00
North Carolina	7.00	10		7.00
South Carolina	7.00	10	a	7.00
Virginia	5.75	12		5.75
West Virginia	13.00	120		13.00
SOUTHWEST				
Arizona	8.00	13	Yes	4.00
New Mexico	7.80	200		7.80
Oklahoma	6.00	15	b	6.00
ROCKY MOUNTAIN				
Colorado	8.00	15	Yes	4.00
Idaho	7.50	5		7.50
Montana	11.00	46	Yes	5.50
Utah	7.75	8	Yes	3.88
FAR WEST				
California	11.00	56		11.00
Hawaii	11.00	61		11.00
Oregon	10.00	5	a	10.00

Source: ACIR, Significant Features of Fiscal Federalism: 1984 Edition, and information obtained from states.

Table 7 Notes

The table does not reflect the deductibility of state taxes on federal income tax returns, which reduces effective marginal rates by 50 percent at high income levels. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming have no personal income tax; Connecticut, New Hampshire, and Tennessee tax only limited forms of income.

* **Income at which highest rate starts (column 2) is rounded to nearest thousand dollars.**

Some states that index tax rates had not yet established the income tax brackets for 1986 at the time this table was prepared. For those states, the second column refers to 1985.

a. Federal deductibility is limited, so it is rarely relevant to the marginal tax rate of high-income taxpayers.

b. Taxpayers may choose between two tax rate schedules, one of which does permit federal taxes to be deducted; the other schedule normally produces a lower state tax liability, so federal deductibility is not usually employed.

c. State tax is a percentage of federal income tax liability. Highest state marginal rate is found by multiplying that percentage by 50 percent (highest federal marginal rate).

d. This is rate on earned income. Unearned income taxed at 10.37 percent rate.

e. Rate is scheduled to be reduced in later years.

f. Taxpayers may choose between two tax rate schedules, one of which does permit federal taxes to be deducted; for high-income taxpayers that schedule normally produces lower state tax liability, so it is used in the table.

g. This is rate on earned income. Unearned income taxed at 13.5 percent.

rates of 10 percent or higher--Iowa, Minnesota, and Montana. Federal deductibility reduces their true marginal rates to below 10 percent for taxpayers with very high incomes.

Eight states remain with true marginal tax rates of at least 10 percent. In descending order, they are Vermont (13.25 percent), West Virginia (13 percent), California (11 percent), Hawaii (11 percent), Rhode Island (10.95 percent). Maine (10 percent), Nebraska (10 percent), and Oregon (10 percent).

Analysis of Income Tax Policy Options

The design of a personal income tax involves many features such as tax rates, deductions, exemptions, and so forth. Together these features determine how much revenue is raised and the incidence of the tax, that is, how its burdens fall on different groups. One important aspect of incidence is the extent to which the tax is progressive. A tax is progressive if its effective tax rate is greater on high-income than on middle- and low-income households.5

A thorough discussion of income tax design issues is beyond the scope of this report. It focuses on three of the major considerations in formulating income tax policy--the effects on the state's economy, the distribution of tax burdens, and the revenue available to state government. Particular attention is devoted to two issues--how much money the income tax raises and how progressive it is.

Effect on the economy. The effect of income taxes on the economy is controversial. One of the motivations for the shift away from the income tax is the view that "excessive reliance" on it may interfere with a state's

economic growth. A recent study by economists Michael Wasylenko and Therese McGuire found that job creation during the 1970s was greater in states that had relatively low effective income tax rates. (The multiple regression study also found that several other factors were statistically related to employment growth, including education spending, which had a positive effect.)6 Both Minnesota's Tax Commission and Wisconsin's Strategic Development Commission late in 1984 urged lowering the income tax because that would boost the economy.

Wisconsin's commission focused specifically on high marginal tax rates as an impediment to business investment. Other observers have also argued that high marginal rates discourage high-income individuals from locating in a state and suggested that if such individuals avoid a state, less investment will occur.7

The top marginal rate may have a significance beyond that which is logical. It may be viewed by some as a measure of a state's "liberalism," which in turn may simplistically be regarded as synonomous with anti-business sentiment. Viewed in this light, a high marginal rate may deter economic development.

Despite the Wasylenko-McGuire statistical findings, there is reason to be skeptical about the strength of the impact of income taxes on the economy. State income taxes are deductible for those who itemize deductions on federal income tax returns, so for taxpayers in the 50 percent bracket every $2 paid to the state reduces federal taxes by $1. Thus, even in Vermont, with the highest marginal state tax rate in the nation, the marginal cost of an additional $100 of state income tax is half of $13.25, or $6.625. This

is not such a large amount that it is likely to have a major effect on location decisions. People decide where to reside on the basis of many considerations, such as employment opportunities and proximity to recreation opportunities, family, and friends. Taxes are not that important. Besides, places with high income taxes may, other things being equal, tend to have lower sales and property taxes and provide better government services.[8]

How can we reconcile the research showing a link between income taxes and employment with the theoretical reasons why this relationship is unlikely to be strong? One answer is that econometric analysis shows statistical relationships, not causality; separating the influence of various factors is difficult, so even carefully done research should be accepted only with caution. Secondly, Wasylenko and McGuire found a statistically significant relationship in only three out of six industries studied, and not for their total sample.[9] Their results support the belief that high income taxes tend to reduce employment growth, but they do not necessarily indicate that the relationship is a strong one.

Distribution of tax burdens. One of the major roles of the personal income tax in state tax systems is to offset the regressivity of most other state and local taxes. The personal income tax is the most important progressive tax levied by states. Despite the progressivity of this tax, the great majority of state-local tax systems are regressive.[10]

Income tax reductions may affect progressivity in two ways. First, reducing the proportion of state revenue derived from the income tax has a regressive effect on the overall tax system because other taxes are on balance regressive while the income tax is progressive. Second, the manner

in which the income tax is reduced can either increase or decrease the progressivity of the income tax itself, or leave progressivity unchanged. Reducing the top marginal rate tends to diminish the progressivity of the tax because only relatively high-income households benefit. Increasing the personal exemption enhances progressivity because it reduces tax burdens for low- and middle-income households proportionately more than for high-income households.11

Massachusetts' 1985 income tax reduction illustrates the complexity of analyzing progressivity. Massachusetts' tax cut had three parts--a proportional rate reduction, an increase in the minimum level of income at which tax must be paid, and a reform of the personal exemption, with an increase in the exemption for lower income households and a phase out of the exemption as income increases. The second and third parts of the cut increase the progressivity of the income tax, but the rate reduction tends to diminish the role of the income tax in the total tax system. The paradoxical result is that high-income taxpayers received a much larger proportion of the tax savings than their proportion of the population, but the tax cut increased the progressivity of the income tax because the percentage tax reduction for low-income households was greater than for others.

Yet to be established is the extent to which recent tax structure changes have reduced the progressivity of personal income taxes. Some states, such as Ohio, Oregon, and Rhode Island reduced rates proportionately. Others, like Delaware and Wisconsin, reduced effective rates more at the high end of the income scale. In New York, nominal rates were reduced only at the highest level, but other changes in the tax may have benefitted lower income taxpayers more than others.

Effect on state revenue. An income tax reduction reduces state revenue both in the year when it becomes effective and in future years. Four of the income tax cuts enacted in 1985 (Massachusetts, New York, North Carolina, and Ohio) are being phased in over two- or three-year periods.

The form of an income tax reduction also affects the elasticity of the income tax. Revenue estimators define a tax's elasticity as the percentage growth of tax revenue for each 1 percent increase of personal income. If states reduce their top marginal tax rate but no other rates, the effect is to reduce elasticity. Such a change would not only lower revenue in the year the tax cut takes effect, but also would reduce the growth rate of revenue in future years. If all rates are reduced proportionately, elasticity is relatively unaffected.12

Reductions in top marginal tax rates are only one reason why the elasticity of state income taxes has tended to fall over the past decade.13 Indexation of the income tax in 10 states has also contributed to lower elasticity, as has the increasing proportion of taxpayers in each state's top marginal tax bracket. As Table 7 shows, in 17 states the top marginal rate begins at taxable income of $10,000 or less, so a large proportion of taxpayers are paying the highest marginal rate in many states.

VI. THE OUTLOOK

State tax systems seem to have reached an equilibrium position, at least for 1986, with few major tax changes likely this year. This quiet period follows turbulent years since 1978. Tax systems were first buffeted by the Tax Revolt and then by severe recessions. During the past two years, states

were busy eliminating the emergency tax increases passed in the previous years.

This period of inactivity may not last long. Among the forces that could stimulate a new wave of activity are federal aid reductions, federal tax reform, and a possible economic downturn. The year 1987 could see a new burst of tax activity if any of these forces materializes in 1986 or early 1987. Aside from these three potential problems, intense interstate tax competition could also stimulate tax policy change, as could a delayed response to the many state tax study commissions that were created over the past few years. Some of these commissions floated proposals for major reforms, and a consensus could develop to support such changes.

One of the major issues facing the states will be how to treat the personal income tax. If the system is allowed to operate as currently in place, the income tax will resume its climb as an ever more important source of state revenue because it has a higher elasticity than other major taxes. After 1984 and 1985, however, an assumption that states will allow the income tax to increase significantly is open to question.

NOTES

The author is very grateful for the helpful comments made on earlier versions of this report by Barbara Yondorf. She is not, however, responsible for any deficiencies of the report that may remain.

1. See Steven D. Gold, "State Tax Increases of 1983: Prelude to Another Tax Revolt?", National Tax Journal 37 (March 1984): 9-22; Steven D. Gold and Corina L. Eckl, State Budget Actions in 1984 (Denver: NCSL, 1984); and Steven D. Gold, Corina L. Eckl, and Max Price, State Budget Actions in 1985 (Denver: NCSL, 1985).

2. Similar estimates for FY1984 turned out to be within 3 percent of the U.S. Census Bureau figures in three-quarters of the states.

3. Alaska has a small amount of personal income tax revenue in Table 4 because of delayed payments from a tax repealed several years ago. New Hampshire has an income tax on interest and dividends but not on other income such as wages.

4. See Steven D. Gold, Property Tax Relief (Lexington, Mass.: D.C. Heath, 1979) for a discussion of how states reduced reliance on property taxes.

5. In analyzing progressivity, one should focus on the effective tax rates (tax as a proportion of total income) rather than nominal tax rates. Even a flat rate tax may be progressive because of personal exemptions. On the other hand, a tax in which marginal tax rates increase as income rises may be regressive if certain exemptions are concentrated at high income levels.

6. Michael Wasylenko and Therese McGuire, "Jobs and Taxes: The Effect of Business Climate on States' Employment Growth Rates," National Tax Journal 38 (December 1985): 497-512.

7. Hal Hovey, "Interstate Tax Competition and Economic Development," in Steven Gold, ed., State Tax Policy, forthcoming.

8. What is important is the differential in tax rates, not their absolute level. Thus, Vermont's disadvantage relative to neighboring New York is less than two percentage points difference in income tax rates after considering the federal deductibility of state taxes. Vermont's disadvantage relative to New Hampshire is the full 6.625 percent because the latter state has no broad-based income tax.

9. Income taxes were significantly related to employment growth in wholesale and retail trade and finance, but not in transportation, communications,

and public utilities, manfacturing, or services. Wasylenko and McGuire, "Jobs and Taxes," 506-508.

10. Donald Phares, Who Pays State and Local Taxes? (Cambridge: Oelgeschlager, Gunn and Hain, 1980).

11. In states with increasing marginal tax rates, personal exemptions reduce taxes more for high-income households than for others, but as a proportion of income, this tax reduction is greater for low-income households. The tax savings from a personal exemption are equal to the exemption times the marginal tax rate.

12. Elasticity equals the marginal rate divided by the average rate. If rates are reduced proportionately, elasticity would not be affected at all were it not for exemptions and other deductions. If the top marginal rate is reduced, this reduces the tax's average marginal rate more than it reduces the average effective rate, so elasticity is reduced.

13. Daniel Feenberg and Harvey Rosen have shown that the elasticity of the average state income tax fell between 1977 and 1983, but their estimates do not consider indexation, and they weight all taxpayers equally rather than counting more heavily those who pay the most taxes. See their Personal Income and Sales Taxes: 1977-83 (National Bureau of Economic Research Working Paper 1631).

Appendix A

Per Capita Versus Personal Income Measures

This report focuses on comparisons of tax revenue in relation to personal income rather than per capita. Such an approach has three advantages:

- o It suggests what percentage of people's income their governments are taking--which is one of the most common ways of looking at taxation.

- o It abstracts from one of the major factors influencing the level of tax revenue--a state's income. Affluent states tend to have higher spending and taxes simply because citizens demand more services and can afford to pay for them. For example, Connecticut will always tend to rank higher than Missisippi on per capita measures because its per capita income is 84 percent greater.

- o It partially adjusts for differences in price levels among states. To take an extreme example, one reason why Alaska has high spending and revenue is that things cost more there. Since both income and tax revenue are influenced by price levels, adjusting for income is more informative than adjusting for population.

Despite the advantages of relating taxes to personal income, the other perspective is also relevant. Some states may have a high tax effort relative to income and yet have only average tax revenue per capita. Such states (Vermont is an example) will not have particularly high levels of spending despite their high tax effort. The opposite is also true. For example, Connecticut's tax effort relative to income is slightly below the median, but its per capita taxes are far above average.

Table 8 shows how states ranked on the two different measures in 1984. In many states there is not much difference: 23 had ranks that are within five places on the two measures. But this is not always the case. Colorado, Connecticut, and New Jersey all rank much higher when taxes are measured on a per capita basis because they are high-income states. States in the opposite situation are Maine, Mississippi, New Mexico, Utah, West Virginia.

Neither the per capita nor the income measure is ideal since both are influenced by states' ability to export taxes. Both also represent averages and do not take into account geographic differences in tax levels within a state and differences in progressivity and regressivity across income levels.

Table 8

RANKINGS OF STATE-LOCAL TAX REVENUE PER CAPITA AND PER $100 OF PERSONAL INCOME, 1984
(low numbers indicate high rank)

State	Per Capita	Income
New England		
Connecticut	5	27
Maine	29	12
Massachusetts	9	19
New Hampshire	38	49
Rhode Island	15	14
Vermont	24	10
Middle Atlantic		
Delaware	16	26
Maryland	12	20
New Jersey	6	21
New York	3	3
Pennsylvania	21	24
Great Lakes		
Illinois	14	25
Indiana	37	38
Michigan	7	5
Ohio	27	28
Wisconsin	8	6
Plains		
Iowa	23	17
Kansas	25	39
Minnesota	4	4
Missouri	42	48
Nebraska	28	30
North Dakota	19	23
South Dakota	44	43

State	Per Capita	Income
Southeast		
Alabama	47	44
Arkansas	50	45
Florida	40	47
Georgia	39	37
Kentucky	45	40
Louisiana	35	31
Mississippi	49	32
North Carolina	41	34
South Carolina	43	33
Tennessee	48	50
Virginia	30	41
West Virginia	36	15
Southwest		
Arizona	26	16
New Mexico	31	11
Oklahoma	32	36
Texas	34	46
Rocky Mountain		
Colorado	18	35
Idaho	46	42
Montana	22	8
Utah	33	9
Wyoming	2	2
Far West		
Alaska	1	1
California	11	22
Hawaii	10	7
Nevada	17	29
Oregon	20	13
Washington	13	18

Source: U.S. Census Bureau, Governmental Finances in 1983-84, (Washington, DC: U.S. Government Printing Office, 1985).

Appendix B

Tax Versus General Revenue Measures

State and local governments obtain funds not only from taxes but also from charges and miscellaneous revenue. Some analysts prefer to compare each governments' total general revenue rather than its tax revenue alone. Both approaches have some merit, but if one is interested in comparing burdens imposed on citizens, tax revenue is the better choice. Much of the variation in charges and miscellaneous revenue is related to the scale of higher education and hospital operations in a jurisdiction, rents and royalties (particularly high in oil-rich states), and interest received. None of these factors have much to do with taxes paid. Some kinds of charges, for example for refuse collection, really are close substitutes for taxes, but the majority of charges and miscellaneous revenue are not.

State Government

In FY1984 (to which all of these data refer) states had total general revenue of $330.7 billion, of which $81.5 billion was intergovernmental. Since we are intersted in money that a government raises on its own, intergovernmental revenue should be subtracted, leaving $249.3 billion. This sum included $196.8 billion of taxes, $25.7 billion of charges, and $26.8 billion of miscellaneous revenue. (Incidentally, licenses are counted as taxes.) Thus 21 percent of own-source general revenue was in charges and miscellaneous revenue.

Charges consisted mostly of those for higher education ($14.4 billion) and hospitals ($5.7 billion), which together account for 78.3 percent of total charges. The variation in charges for these facilities depended heavily on whether a state had many or few of such facilities in operation.

The main components of miscellaneous revenue were interest (49.6 percent) and rents and royalties (23.1 percent). Other miscellaneous revenue included donations, fines and forfeits, and sales of property. Such revenue has to be counted if one is interested in comparing sources of funds for government, but it is not a burden on citizens as taxes are.

State and Local Governments

The situation is not quite as clear-cut when local governments are included because localities do rely to a greater extent than states on charges that are paid by citizens and businesses instead of taxes. Hospitals loom larger, however, and school lunches combine with higher education tuition as education-related charges not analogous precisely to taxes. Hospitals (16.4 percent), higher education and school lunches (15.0) percent, and interest received (21.9 percent) account for more than half of total charges and miscellaneous revenue.

Examples for Specific States

State local charges and miscellaneous revenue per $100 of personal income are highest in Alaska, New Mexico, Montana, and Wyoming, all of which have substantial mineral revenue. These states benefit not only from royalties, but also from interest received on their Permanent Funds that are fed by mineral revenues.

Oregon has the fourth highest state interest revenue per $100 of personal income because it has a particularly large mortgage subsidy program for veterans. Massachusetts' higher education charges are the third lowest (relative to income) because it has so many private and so few public colleges and universities.

Appendix C

Recent Income Tax Changes

Recent income tax changes have been so frequent that it may be difficult to keep track of them. This Appendix compares 1986 state income tax rates with where they were in 1982. It is concerned with nominal tax rates, personal exemptions or credits, and major changes in deductions. Effective tax rates are influenced by these changes but also may be affected by other factors, such as the elasticity of the income tax structure.

The analysis summarized below shows that most of the income tax increases enacted in 1982 and 1983 have been removed or reduced. In addition, four states lowered their income tax in 1984 or 1985 without having raised it during the two previous years.

Three states have maintained the full income tax increase enacted: Louisiana, Mississippi, and New Mexico.

Five states have maintained part of the income tax increase enacted: Indiana, Michigan, New Jersey, Ohio, and West Virginia.

Seven states have eliminated their entire income tax increase, and three of these states have lowered income tax rates below their 1982 level: Illinois, Kansas, Minnesota (lower), Oregon*, Pennsylvania, Rhode Island (lower), and Wisconsin (lower).

Three states where the income tax is a percentage of federal tax liability have raised the percentage, but not sufficiently to offset the 25 percent federal tax rate reduction that occurred during this period: Nebraska, North Dakota, and Vermont. (Rhode Island also has this kind of income tax, but it has reduced the percentage.)

Four states reduced the income tax although they did not have an earlier increase: Delaware, Massachusetts, New York, and North Carolina.

Eighteen states have not changed their income tax rates.

Ten states have no broad-based income tax.

The three states where income tax increases have remained fully in effect all have low effective income tax rates.

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*Oregon changed its personal exemption into a personal credit, resulting in about a 2 1/2 percent revenue increase. This change is not reflected in the text.

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A COMPARISON OF THE SENATE FINANCE COMMITTEE BILL WITH H.R. 3838 AND PRESENT LAW

by The Touche Ross & Co.
Washington Service Center

The Washington Service Center of the accounting firm Touche Ross & Co. has prepared the following comparison of the tax revision bill reported out of the Senate Finance Committee with current law and the House tax bill. The comparison includes those provisions Touche Ross considers the most important and far-reaching items in the Finance bill. Because many of the details of the bill are as yet unknown, the firm has inserted question marks following the provisions where information is missing or where the effective dates are uncertain.

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I. INDIVIDUALS

The dramatic drop in the top individual tax rate from 50 percent to 27 percent—which would be its lowest point in more than 50 years—would cut taxes for the average person by 6.2 percent. But the elimination of numerous tax benefits, such as individual retirement accounts and the deduction for two-earner couples, which middle-income taxpayers rely on, could more than offset the lower tax resulting from the decreased rates. Particularly affected will be taxpayers who invest in tax shelters, invest heavily in 401(k) plans, or pay large amounts of consumer interest. As under the House bill, the deductions would be repealed as of January 1, 1987, but rate cuts would not be effective until July 1 of that year. One important side effect is that with the broader tax base, income taxes in many states would rise—unless the states revise their rules or rates.

Rates and Brackets

Present Law

Maximum rate: 50 percent.

Individual brackets: 15; indexed.

Maximum long-term capital gain rate: 20 percent (60 percent exclusion).

Alternative minimum tax: 20 percent on excess of taxable income plus "preference" deductions over $40,000 (joint return) or $30,000 (single).

House Bill

Maximum rate: 38 percent. Effective: July 1, 1986.

Individual brackets: 4. Effective: July 1, 1986 (indexing effective 1987).

Maximum long-term capital gain rate: 22 percent. Effective: 1986. 50 percent exclusion in 1986. 42 percent exclusion starting 1987.

Alternative minimum tax: Retains present law, raises rate to 25 percent; adds preferences for gifts of appreciated property; interest on new exempt bonds; losses from passive investments; and others.

Senate Finance Committee

Maximum rate: 27 percent. Effective: July 1, 1987.

Individual brackets: 2; 15 percent and 27 percent. 27 percent starts at taxable income of $17,600 for individuals, $29,300 for joint returns, and $23,500 for heads of household. 15 percent phased out starting at $45,000 of adjusted gross income (AGI) for singles, $75,000 for joint filers, and $55,000 for heads of household.

Maximum long-term capital gain rate: 27 percent. Effective: (?) No exclusion.

Alternative minimum tax: 20 percent rate (same as present law). Exemption phased out for minimum taxable income over $150,000 (?). Preferences generally same as House except tax-exempt interest not a preference.

Exemptions

Present Law

Self, spouse; dependents: $1,080 (indexed).

Elderly, blind: $1,080 (indexed).

House Bill

Self, spouse; dependents: $2,000 for nonitemizers; $1,500 for itemizers. Effective: 1986. (Indexed in 1987.)

Elderly, blind: Extra $600 standard deduction (indexed). Effective: 1986.

Senate Finance Committee

Self, spouse; dependents: $1,900 in 1987, $2,000 in 1988 (indexed (?)). Phased out starting with AGI over $87,240 for individuals, $145,320 for joint returns, and $111,400 for heads of household. Dependent gets no exemption if claimable by another taxpayer.

Elderly, blind: Same as House. Effective: 1987.

Zero Bracket Amount/Standard Deduction

Present Law

Single return: $2,480 (indexed).

Married, joint return: $3,670 (indexed).

Head of household: $2,480 (indexed).

House Bill

Single return: $2,950. Effective: 1987 (indexed in 1988).

Married, joint return: $4,800. Effective: 1987 (indexed in 1988).

Head of household: $4,200. Effective: 1987 (indexed in 1988).

Senate Finance Committee

Single return: $3,000. Effective: 1988 (indexed in 1989 (?)).

Married, joint return: $5,000. Effective: 1988 (indexed in 1989 (?)).

Head of household: $4,400. Effective: 1988 (indexed in 1989 (?)).

Savings and Investment

Present Law

Dividend exclusion: $100 ($200 joint) exclusion of dividends.

Private-purpose tax-exempt bonds: Interest is exempt.

Life insurance and annuity contracts. Yearly earnings ("inside buildup") on contracts not taxed currently.

Insurance contracts; loans and partial withdrawals: Loans not taxed; withdrawals taxed if they exceed investment.

House Bill

Dividend exclusion: Repeal (but note proposed corporate deduction for dividends paid).

Private-purpose tax-exempt bonds: Interest exempt for most purposes.

Life insurance and annuity contracts: Retains present law except for corporate-owned annuities bought after September 25, 1985.

Insurance contracts; loans and partial withdrawals: Same as present law.

Senate Finance Committee

Dividend exclusion: Repeal. Effective: January 1, 1987.

Private-purpose tax-exempt bonds: Same as present law.

Life insurance and annuity contracts: Same as House except date could change to February 28, 1986 (?).

Insurance contracts; loans and partial withdrawals: Same as present law.

Deductions

Present Law

Charitable contributions: Deductible by individuals up to 30 percent or 50 percent of AGI; by corporations up to five percent or 10 percent of taxable income.

Interest deduction: All interest paid is deductible whether or not incurred in a business, for investment, or for personal reasons (except on loans to acquire tax-free bonds). Investment interest is limited to investment income plus $10,000.

State and local income taxes: Deductible.

State and local real and personal property taxes and sales tax. Deductible.

Miscellaneous deductions: Union dues, tax return preparation, other expenses related to earning income, etc. deductible if itemized. Employee business expenses subtracted to reach AGI.

Two-earner deduction: 10 percent of lower salary; $3,000 cap.

House Bill

Charitable contributions: Same as present law, except nonitemizer deduction made permanent for excess over $100.

Interest deduction: Interest on principal and second residence fully deductible. All other interest only to extent of passive investment income plus $20,000. Effective: 1986, with 10-year phase-in.

State and local income taxes: Same as present law.

State and local real and personal property taxes and sales tax. Same as present law.

Miscellaneous deductions: Combines all miscellaneous itemized deductions, plus above-the-line employee business expenses. Excess over one percent of AGI would be deductible.

Two-earner deduction: Repealed.

Senate Finance Committee

Charitable contributions: Same as present law for itemizers; no deductions for nonitemizers after 1986.

Interest deduction: Interest on principal and second residence fully deductible. Consumer interest not deductible. Investment interest expense in excess of investment income not deductible. Effective: 1987, with five-year phase-in.

State and local income taxes: Same as present law.

State and local real and personal property taxes and sales taxes: Same as present law except sales taxes not deductible after 1986 (?).

Miscellaneous deductions: Repealed. Above-the-line employee business expenses limited to itemizers and subject to floor of one percent of AGI.

Two-earner deduction: Repealed. Effective: 1987 (?).

Tax Shelters

Present Law

Limits on passive losses: Losses from tax shelters may be used to offset other income.

At-risk limitations on deductions: Applies to passive investments of closely held corporations and to all activities of individuals except real estate.

House Bill

Limits on passive losses: No provision (some passive losses treated as preferences for alternative minimum tax).

At-risk limitations on deductions: At-risk extended to seller-financed real estate. Old law applies if loans are made by financial institutions.

Senate Finance Committee

Limits on passive losses: Passive losses from tax shelters and losses from all rental activities could offset only income from those activities. Exception for working interests in oil and gas. Exception for some rental losses up to $25,000; phased out for income above $100,000. Effective: 1987, with five-year phase-in.

At-risk limitations on deductions: Same as House.

Family Income Shifting

Present Law

Clifford trusts: Income taxed to beneficiary.

Irrevocable trusts: Trust taxed as person; deduction for distributions.

Uniform Gifts to Minors custody accounts: Taxed to child.

House Bill

Clifford trusts: Taxed to grantor. Effective: all trusts funded after Sept. 25, 1985.

Irrevocable trusts: Only taxed to beneficiary if "Qualified Beneficiary Trust." Effective: trusts funded after September 25, 1985.

Uniform Gifts to Minors custody accounts: Taxed at parents' rate where income greater than child's personal exemption and child is under age 14.

Senate Finance Committee

Clifford trusts: Similar to House. Effective: March 1, 1986.

Irrevocable trusts: Present law, but brackets start at lower levels for retained income.

Uniform Gifts to Minors custody accounts: Same as House, except child might not get exemption.

II. CORPORATIONS

The corporate minimum tax proposed by the Senate Finance Committee includes an expanded list of preference items. Although tax-exempt income is not specifically listed, that income can still be taken into account under a catchall provision that includes as a preference one-half of a corporation's pretax book income not otherwise included in the minimum tax base.

Present Law

Maximum rate: 46 percent.

Corporate brackets (not indexed): Five brackets: 15 percent 18 percent, 30 percent, 40 percent up to $100,000, then 46 percent. Lower brackets phased out between $1 million and $1.4 million.

Long-term capital gain rate: 28 percent.

Minimum tax: 15 percent of amount by which 10 specific preferences exceed greater of $10,000 or regular corporate tax for year.

Deductions for dividends paid: Not deductible by corporations.

Corporate liquidations (distributions of appreciated assets in: (a) complete liquidations, (b) one-month liquidations, (c) 12-month liquidating asset sales, and (d) stock purchases treated as asset acquisitions): At corporate level no gain recognition; only recapture and tax benefit items included in income. Gain only at shareholder level.

Net operating loss carryovers: There are separate rules for stock purchases and tax-free reorganizations, and, if limitations apply, NOL carryovers are reduced or eliminated.

Structured settlement companies: Not taxed on earnings on amount received to fund annuity obligation.

House Bill

Maximum rate: 36 percent.

Corporate brackets (not indexed): Three brackets: 15 percent to $50,000, 25 percent to $75,000, then 36 percent. Lower brackets phased out between $100,000 and $350,000. Effective: July 1, 1986.

Long-term capital gains rate: 36 percent. Effective: 1986.

Minimum tax: Applies existing individual AMT at 25 percent on excess over $40,000. Possessions-tax-credit corporations exempt. Credit for minimum tax paid allowable against subsequent regular tax.

Deductions for dividends paid: Corporate deduction for 10 percent of distributed corporate profits, phased in one percent a year. Effective: 1987.

Corporate liquidations (distributions of appreciated assets in: (a) complete liquidations, (b) one-month liquidations, (c) 12-month liquidating asset sales, and (d) stock purchases treated as asset acquisitions): Full gain recognized at both corporate and shareholder levels, with certain exceptions (repeals General Utilities). Effective: plans adopted after November 19, 1985.

Net operating loss carryovers: One provision for stock purchases and tax-free reorganizations, allowing parent firm to absorb NOLs at rate base on long-term tax-exempt bond rate.

Structured settlement companies. Same as present law but settlement must be for physical injury or sickness.

Senate Finance Committee

Maximum rate: 33 percent.

Corporate brackets (not indexed): Three brackets: 15 percent to $50,000, 25 percent to $75,000, then 33 percent. Lower brackets completely phased out at $350,000. Effective: July 1, 1987 (?).

Long-term capital gain rate: Same as present law.

Minimum tax: 20 percent of taxable income plus 14 specific preferences, including one-half of book income over alternative minimum taxable income.

Deductions for dividends paid: Same as present law.

Corporate liquidations (distributions of appreciated assets in: (a) complete liquidations, (b) one-month liquidations, (c) 12-month liquidating asset sales, and (d) stock purchases treated as asset acquisitions): Same as present law (retains General Utilities).

Net operating loss carryovers: Allows absorption of NOLs up to two percent of purchase price per month for 60 months (?).

Structured settlement companies: Taxed on investment income on contracts purchased to fund settlement agreement.

III. BUSINESS

Capital Cost Recovery System

Present Law

Depreciation: All assets use 3-, 5-, 10-, 15-, 19-year ACRS tables.

Research credit: 25 percent of increase in research expenses over base period.

Investment tax credit: Generally, 10 percent credit on equipment purchases.

Sale of depreciable business property (Section 1231 property): Capital gain treatment for net gains, subject to depreciation recapture rules; ordinary loss treatment for losses.

Expensing costs of business assets: Up to $5,000 a year. Scheduled to increase in 1988.

Rehabilitation credit: 15 percent, 20 percent, or 25 percent credit on rehabilitation expenses.

Business energy credit: Expired December 31, 1985.

House Bill

Depreciation: New 10-class depreciation system. Basis partially indexed for inflation over five percent. Effective: property placed in service after 1985. Transition rule for binding contracts on September 25, 1985.

Research credit: Credit reduced to 20 percent; rules tightened.

Investment tax credit: Repealed for property placed in service after 1985. Transition rule for binding contracts on September 25, 1985.

Sale of depreciable business property (Section 1231 property): All gain over straight-line depreciation taxed as ordinary income.

Expensing costs of business assets: Up to $10,000 a year, restricted to taxpayers who put less than $200,000 of eligible property in service.

Rehabilitation credit: Reduced to 10 percent for buildings built before 1936; 20 percent for certified historic

structures. Transition rules for binding contracts on September 25, 1985.

Business energy credit: Solar and geothermal credits extended at reduced rates through 1988.

Senate Finance Committee

Depreciation: Similar to present law. More accelerated deductions for most equipment; real property depreciated by straight-line method over 27½ years for residential property and 31½ years for commercial property. Effective: 1987 (?).

Research credit: Present 25 percent credit extended through 1989; rules tightened.

Investment tax credit: Same as House bill. Transition rules for certain property placed in service after 1985. Unused investment tax credits reduced by 30 percent.

Sale of depreciable business property (Section 1231 property): Same as present law, but capital gain is taxed at maximum of 27 percent for individuals, 28 percent for corporations.

Expensing costs of business assets: Same as House bill, but deduction phases out when more than $200,000 of property placed in service.

Rehabilitation credit. Same as House bill; transition rules unknown.

Business energy credit: Business energy credit extended through 1988 for solar, geothermal, and ocean thermal; through 1987 for biomass. Rates of credit reduced.

Deductions

Present Law

Entertainment expenses and skyboxes: Deductible if for business purpose.

Meals and lodging away from home: Deductible if for business purpose.

Travel as education; seminars on cruise ship: Deductible if for business purpose.

House Bill

Entertainment expenses and skyboxes: 80 percent deduction for meals and entertainment, including sporting events; no deduction for skyboxes.

Meals and lodging away from home: No dollar limitation. One-year rule defines "away from home."

Travel as education; seminars on cruise ship: No deduction.

Senate Finance Committee

Entertainment expenses and skyboxes: 80 percent of business meals and entertainment deductible; rules tightened. Skyboxes retained (?).

Meals and lodging away from home: Same as House (?).

Travel as education; seminars on cruise ship: No deduction.

Accounting Methods

Present Law

Cash method: Acceptable for businesses without inventories, despite use of accrual method for financial reporting.

Bad-debt reserves: Deductible.

Business installment sales: Allows deferral.

Uniform capitalization rules: Manufacturers must capitalize most costs of production under "full absorption" method.

Long-term contracts: Completed-contract or percentage-of-completion method allowed.

House Bill

Cash method: Disallowed for corporations not rendering professional services if gross receipts exceed $5 million. Effective: years beginning after 1985, with five-year spread.

Bad-debt reserves: Deduction allowed only for actual losses written off. Exception for small banks (assets under $500 million). Effective: tax years beginning after 1985, with five-year spread.

Business installment sales: Pledge of installment note as security for loan triggers recognition of deferred gain except for short-term notes (payments in less than nine months). New anti-abuse rules. Pre-1986 pledges exempt.

Uniform capitalization rules: Would require manufacturers to capitalize indirect costs, including overhead.

Long-term contracts: Repeals completed-contract method. Percentage-of-completion method allowed based on costs incurred.

Senate Finance Committee

Cash method: Disallowed for financial institutions. Otherwise, retains present law. Effective: tax years beginning after 1986, with five-year spread.

Bad-debt reserves: Deduction allowed only for actual losses written off except for all financial institutions. Effective: tax years beginning after 1986, with five-year spread.

Business installment sales: Installment method denied for resolving credit plans and portion of sales by dealers in personal or real property or sales of publicy traded property. Effective: sales after 1986, with five-year spread.

Uniform capitalization rules: Same as House for all taxpayers except would apply to retailers and wholesalers with gross receipts of over $5 million. Effective: after 1986, with five-year spread.

Long-term contracts: Retains present law, with requirement to capitalize overhead costs on cost-plus or federal contracts. Effective: contracts after March 1, 1986 (?).

IV. EMPLOYEE PLANS AND BENEFITS

The Senate Finance Committee, like the House, did not set out to overhaul the taxation of employee benefits (for fringe benefits, that was done in the 1984 Act). It merely tightened various requirements to cut tax expenditures and help arrive at revenue-neutrality. One controversial change would curtail 401(k) plans significantly; other changes could be even more costly. Even though rules are tightened, many fringe benefit rules are left untouched by both the House and Senate Finance bills. These include employer-paid medical insurance, employer-paid group-term life insurance, employer-paid death benefits, and incentive stock options.

Fringe Benefits

Present Law

Employee awards for productivity, service, and safety: Employer deducts up to $400 value, but IRS has claimed this is income to employee.

Uniform fringe benefit nondiscrimination rule: Each tax-free fringe benefit (other than insured medical plans) subject to separate nondiscrimination rules.

House Bill

Employee awards for productivity, service, and safety: No provision.

Uniform fringe benefit nondiscrimination rule: Establishes uniform nondiscrimination rules for eligibility and benefits in six specific areas.

Senate Finance Committee

Employee awards for productivity, service, and safety: Awards of tangible personal property excluded to extent deductible by employer.

Uniform fringe benefit nondiscrimination: Nondiscrimination rules modified to make them more uniform.

Retirement Plans

Present Law

Individual retirement accounts (IRAs): Annual contribution limit for individuals is $2,000, for married couples $2,250 if one is working, $4,000 if both are working.

Distributions before age 59½: An additional 10 percent penalty income tax is charged on IRA distributions before age 59½.

Lump-sum distributions: Lump sums from pension and profit-sharing plans are taxed under 10-year averaging.

Employer securities: Appreciation in employer stock held by a pension or profit-sharing plan is taxed to employee as capital gain when the employee sells the stock.

401(k) plans (cash or deferred arrangements, or CODAs): Employees are not taxed currently on salary they elect to defer under employers' 401(k) profit-sharing plans. Annual deferral can be as much as 20 percent of pay or $30,000, if less.

Deferred compensation plans of states and tax-exempt employers: State and local government employees may elect to defer up to $7,500 a year in an unfunded plan.

Loans from retirement plans: Loans over the lesser of one-half of vested plan benefits or $50,000 treated as distribution.

Employee stock ownership plans (ESOPs): Special tax benefits for employer ESOP contributions, sales of employer stock to ESOP, dividends on ESOP stock, and interest received by banks lending to ESOP.

Pension plan reversions: Amounts reverting to employers on terminating overfunded plans are taxable income.

Vesting: Except for special situations, pension benefits can vest either after 10 years or gradually over five to 15 years.

House Bill

Individual retirement accounts (IRAs): Same as present law, except $2,000 limit is reduced dollar for dollar by employee deferrals under 401(k) plans. Effective: 1986.

Distributions before age 59½: Conforms early withdrawal rules to those for IRAs and increases penalty to 15 percent.

Lump-sum distributions: One-time five-year averaging allowed after age 59½.

Employer securities: Same as present law.

401(k) plans (cash or deferred arrangements, or CODAs): Limit cut to $7,000, but first $2,000 offsets employee's IRA contribution. Hardship distributions permitted. New nondiscrimination rules. Governments and tax-exempts can sponsor 401(k)s if IRS has approved plan. Effective: plan years beginning after 1985.

Deferred compensation plans of states and tax-exempt employers: Employees of tax-exempts could defer salary only on same basis as state employees, except that total salary deferred under 401(k) plan, tax-sheltered 403(b) annuity, and unfunded plan could not exceed $7,500. Effective: 1986.

Loans from retirement plans: Only the excess of loans over $50,000 limit treated as a distribution.

Employee stock ownership plans (ESOPs): Tax credit ESOP repealed effective for compensation after 1985. Repeals incentives for leveraged ESOPs and tightens rules on vesting, voting rights, nondiscrimination, diversification, etc.

Pension plan reversions: 10 percent deductible excise tax on reversions. Effective: terminations after 1985.

Vesting: No provision.

Senate Finance Committee

Individual retirement accounts (IRAs): No deduction if covered by a qualified retirement plan. Taxation of earnings on nondeductible contributions is deferred.

Distributions before age 59½: Similar to House, with exceptions for life annuities, hardships, early retirement after age 55, and transfers to ESOPs.

Lump-sum distributions: Same as present law for those age 50 by January 1, 1986 (?). Otherwise, same as House.

Employer securities: Same as present law.

401(k) plans (cash or deferred arrangements, or CODAs): Limit of $7,000 plus $2,500 more if paid to ESOP. Tax-exempt groups can have CODAs. No new government plans after March 1, 1986. Otherwise similar to House. Simplified Employee Plan can have CODA. Effective: plan years beginning after 1986.

Deferred compensation plans of states and tax-exempt employers: Generally, same as present law.

Loans from retirement plans: Same as House.

Employee stock ownership plans (ESOPs): Tax credit ESOP repealed effective for compensation after 1986. Retains present law leveraged ESOP incentives, etc. Minor modifications to other ESOP rules.

Pension plans reversions: Same as House unless reversion transferred to ESOP. Effective: termination after 1985 (?).

Vesting: Vesting must be at least as fast as five years of service or gradually over three to seven years. Effective: plan years beginning after 1988 (?).

V. SPECIFIC INDUSTRIES

Energy

Present Law

Intangible drilling costs: Deductible.

Percentage depletion: Qualified producers may deduct a percentage of gross income from the property.

House Bill

Intangible drilling costs: Deductible up to sinking of drilling pipe.

Percentage depletion: Three-year phase-out, except for stripper wells and royalty interests in them.

Senate Finance Committee

Intangible drilling costs: Same as present law.

Percentage depletion: Same as present law.

Financial Institutions

Present Law

Bad-debt reserves: Deduction allowed for formula additions to reserves.

Interest to carry tax-exempt bonds by depository institutions: Deduction allowed for 80 percent of interest to acquire or carry tax-exempt bonds.

Net operating taxes: Special NOL carryover rules apply.

(Continued on next page)

House Bill

Bad-debt reserves: Deduction allowed only for actual losses as incurred. Exception for banks with no more than $500 million in assets. Thrifts' percentage-of-income deduction limited to five percent.

Interest to carry tax-exempt bonds by depository institutions: No deduction.

Net operating losses: Special NOL rules repealed. General rules apply (three-year carryback; 15-year carryover).

Senate Finance Committee

Bad-debt reserves: Same as present law except thrifts' percentage-of-income deduction limited to 25 percent. Effective: 1987 (?).

Interest to carry tax-exempt bonds by depository institutions: Same as present law.

Net operating losses: Same as present law except thrifts' NOLs (from 1981 through 1986) may be carried forward eight years.

Life Insurance Companies

Present Law

Reserve deduction: Deduction for increase in reserves.

Special and small-company deduction: Deductions for percentage of taxable income.

House Bill

Reserve deduction: Same as present law.

Special and small-company deduction: Repeals special deduction; retains small-company deduction.

Senate Finance Committee

Reserve deduction: Same as present law.

Special and small-company ded' tion: Same as House.

Property and Casualty Insurance Companies

Present Law

Unpaid losses: Deduction for estimate of losses to be paid in future.

Unearned premiums and acquisition expenses: Premiums not taxed until earned; acquisition expenses currently deductible.

Protection against loss (PAL) account. Additional deduction for contributions to special account for mutual P/Cs.

Policyholder dividends: Deduction for dividends paid by mutuals.

Blue Cross-Blue Shield; TIAA-CREF: Certain organizations providing insurance benefits to members are tax-exempt.

House Bill

Unpaid losses: Minimum tax of 20 percent of adjusted statement gain from operations.

Unearned premiums and acquisition expenses: Acquisition expenses currently deductible; 20 percent of annual increase in unearned premiums taxable; 20 percent of unearned premiums at beginning of year taxable over five years.

Protection against loss (PAL) account: Repealed, with existing account balance taxable over five years.

Policyholder dividends: Treasury study required.

Blue Cross-Blue Shield; TIAA-CREF: Repeals exemption BC-BS and TIAA-CREF.

Senate Finance Committee

Unpaid losses: Pretax discounting rule on each line of business (including A&H); rate starts of five percent and changes to 75 percent of applicable federal rate.

Unearned premiums and acquisition expenses: Same as House except beginning-of-year balance taxable over 7½ years; for bond insurance, 10 percent rate used.

Protection against loss (PAL) account: Same as House.

Policyholder dividends: Same as present law.

Blue Cross-Blue Shield; TIAA-CREF: Same as present law.

VI. INTERNATIONAL

The Senate recommendations specifically affecting international transactions would have fewer far-reaching consequences than earlier proposals. An important "non-change" is retention of the present title-passage test for determining the source of income from sales of inventory. The overall foreign tax credit would be retained, with the addition of a "passive income" basket. For U.S. multinationals, the drop to a 33 percent rate and new rules allocating deductions will significantly increase excess foreign tax credits. For foreign investors in U.S. real property, there is the prospect of tax-free gain on the sale of that property (i.e., FIRPTA would be repealed).

Present Law

Foreign tax credit; source of income; allocation of deductions; deemed-paid credits: Foreign tax credit is computed on overall basis and allows income from sales of inventory and intangibles to be foreign source based on title passage. Dividend income is generally sourced in the country where the paying corporation is incorporated.

Subpart F: Limited amounts of tax haven income taxed currently to U.S. shareholder of CFC. "CFC" means more than 50 percent voting control in U.S. persons, 10 percent *de minimis* protection.

U.S. expatriates: Exclusion of up to $80,000 of foreign earned income.

House Bill

Foreign tax credit; source of income; allocation of deductions; deemed-paid credits: Retains overall limitation with new "low-tax income" (foreign personal holding company income but not active rent and royalties) and banking and insurance baskets. Adopts source rule changes and pooling proposal, and requires consolidation for all allocation of deduction rules.

Subpart F: Voting control test changed to 50 percent vote or value test, "partnerships" become related persons, and types of "tax haven" income expanded significantly.

U.S. expatriates: Exclusion is reduced to $75,000 and made a preference item for the minimum tax.

Senate Finance Committee

Foreign tax credit; source of income; allocation of deductions; deemed-paid credits: Retains overall limitation but with new "passive" income limitation (does not apply to banking, shipping, or insurance activities). Adopts some source rule changes and requires some consolidation for allocating all types of deductions.

Subpart F: Certain passive income taxed currently. Five percent *de minimis* protection.

U.S. expatriates: Exclusion is reduced to $70,000, but would not be a preference item for the minimum tax.

VII. PENALTIES AND INTEREST

Present Law

Failure to pay tax: One-half percent per month up to 25 percent. Applies after notice of levy.

Fraud: 50 percent of total underpayment.

Negligence: Five percent of total underpayment.

Substantial understatement: 10 percent of underpayment due to understatement.

Interest rate on deficiencies and refunds: Same rate for both.

House Bill

Failure to pay tax: Jumps to one percent per month up to 25 percent after notice of levy.

Fraud: 75 percent of underpayment due to fraud.

Negligence:

- Five percent applies to all types of taxes.
- Five percent of underpayment due to negligence.
- Ten percent if item subject to information reporting.

Substantial understatement: Same as present law.

Interest rate on deficiencies and refunds: Rate on deficiencies one percent higher than on refunds.

Senate Finance Committee

Failure to pay tax: Same as House (?).

Fraud: Same as House (?).

Negligence:

- Same as House (?).
- Same as House but applies only to portion due to negligence at 10 percent rate.
- Same as House (?).

Substantial understatement: Increases to 20 percent (?).

Interest rate on deficiencies and refunds: Same as House.

WASHINGTON ROUNDUP

PRICE WATERHOUSE RELEASES FINANCE COMMITTEE TAX BILL SUMMARY. The accounting firm of Price Waterhouse released a study May 15 which summarizes the major proposals in the Senate Finance Committee's tax revision bill. The summary explains how the lower individual and corporate rates are financed and details the major revenue raising devices used, such as: the repeal of the capital gains exclusion for individuals, the elimination of the deduction for contributions to individual retirement accounts for persons covered by a pension plan, the limitation of the amount of passive losses that can be used to offset other income, and the implementation of an alternative minimum tax.

The 35-page Price Waterhouse study has been placed in the June 2, 1986 *Tax Notes Microfiche Database* as *Doc 86-3988.*

CENTER FOR RURAL AFFAIRS OUTLINES FINANCE TAX REVISION PROPOSALS. The May newsletter of the Nebraska-based Center For Rural Affairs (CRA) outlines provisions in the Senate Finance Committee tax bill which may prove beneficial to the family farm operator. According to the newsletter, "Several harmful tax shelters would be reduced or repealed." The article discusses farm-related provisions such as depreciation, tax loss cattle feeding, tax-exempt bonds, conservation incentives, and expensing.

The CRA newsletter has been placed in the May 26, 1986 *Tax Notes Microfiche Database* as *Doc 86-3921.*

ABA TAXATION CHAIRMAN SEES QUALITY PROBLEMS WITH IRS PERSONNEL. Hugh Calkins, Chairman of the American Bar Association's (ABA) Section of Taxation, testified before Congress May 15 that the IRS urgently needs more funding, especially to upgrade the quality of the IRS's examinations personnel, according to an ABA press release. Calkins said, "Too many examining agents are unable to comprehend the documents which they are expected to understand, and unable to interpret correctly detailed provisions of the Code and the regulations." Calkins added that IRS's personnel is critical to tax compliance. "If these agents are unable to understand the law, how can they enforce it?" he asked.

The ABA press release has been placed in the May 26, 1986 *Tax Notes Microfiche Database* as *Doc 86-3924.*

SBA SUMMARIZES SMALL BUSINESS RELATED PROVISIONS IN SENATE FINANCE COMMITTEE BILL. The Small Business Administration (SBA) recently compiled a summary of provisions in the Senate Finance Committee tax revision bill that would affect small businesses. Positive highlights of the bill, according to the SBA, include the three-bracket rate structure, the new 50 percent deduction of health-care cost premiums for owner-employees, and the 33 percent top rate for corporations.

Other provisions which may or may not be negative, depending on the type of business, according to the SBA, include the repeal of the investment tax credit, the disallowance of all consumer interest, the faster depreciation schedule for equipment, and the slower depreciation schedule for real estate.

The SBA also studied the repeal of the capital gains differential, the changes in the alternative minimum tax, and the restrictions on passive income losses. The summary does not discuss the effects of these provisions on small business, and is based on the Joint Committee on Taxation summary of the Finance Committee bill.

The SBA's summary has been placed in the June 2, 1986 *Tax Notes Microfiche Database* as *Doc 86-3987.*

READER COMMENTS WELCOMED

Advice from readers has contributed greatly to the development of Tax Notes. If you have comments, suggestions, or criticisms, please take a moment to drop us a note. Address your letter to Thomas F. Field, Publisher, Tax Notes, 6830 North Fairfax Drive, Arlington, Virginia 22213. Thanks, in advance, for your help.

FINDINGS OF THE 1981 PENNSYLVANIA TAX COMMISSION

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I. INTRODUCTION

A number of states have systematically reviewed their overall tax structure from time to time with the objective of achieving tax reform through legislation and executive fiat. Professor Brazer's work for Michigan[1] in the 1950's is but one example of a continuing interest by state officials and academics in the revision of state and local tax laws.

Such tax studies may be characterized in terms of their clients and in terms of the amount of time available and time horizon for recommendations. Governors or state legislatures typically create commissions to report back to them with recommendations and lengthly analyses. With regard to timing, some serve to define and collect a consensus on how to meet immediate revenue needs; some take a very long-run perspective and propose far-reaching goals and change; and, others have provided a menu of proposed reforms which address both long and short-run problems. Those with a long term perspective often take several years to complete and as such justify legislative reticence to act until the study is available. Those with a short term perspective are often more concerned with identifying revenue sources than any particular principle of finance; these succeed more often in obtaining legislation. Few of any category consider simultaneously the expenditure and revenue sides of the budget, due in part to the sheer complexity of both tasks as well as the intractable nature of measuring the benefits of state and local public goods. One may conjecture that had there been more publically supported studies which examined both taxes and spending, there would be less enthusiasm for expenditure and/or tax limitations, and those limitations put in place would be more administratively manageable.

Pennsylvania is among those states which have periodically reviewed their tax system. Since 1889, Pennsylvania has averaged a state tax study every 6.4 years,[2] and in the view of some, such tax commissions have become something of a cottage industry. Undoubtedly the major reason for their frequency is the inadequacy of public revenues resulting from the constitutional prohibition against progressivity. The State's revenue elasticity could be unity at best. Since Pennsylvania's appetite for public goods is not materially different from most other states, chronic revenue shortfalls vis-a-vis desired expenditures have required a wide variety of emergency revenue measures over the years. Moreover, since the lack of revenue elasticity prevails at the local level as well, local governments have constantly been at the doorstep of the General Assembly to have various tax rate ceilings raised and/or lowered to obtain new taxing authority.

In the summer of 1979, Governor Richard Thornburgh of Pennsylvania invited Richard M. Cyert, President of Carnegie-Mellon, to chair a major study of the state's taxes, and created the Pennsylvania Tax Commission. The invitation was tendered at a time when the State's finances were stable. Over the period October, 1979–March, 1981, I served as its Director of Research. Three aspects of the work of the Commission are of greatest likely interest, (i) the assumptions, process, and organization of the Commission; (ii) the major substantive tax issues which were addressed and recommendations made by the Commission; (iii) and the methodology and data bases that were used. Given the recent Federal cuts in aid to the states, and likely tax reductions due to state reliance on Federal depreciation schedules, the market for state tax studies is likely to be quite strong in the next five years.

II. ORGANIZATION OF THE TAX COMMISSION, KEY ASSUMPTIONS, AND GOALS

In forming the Commission, the Governor sought to make the appointed membership representative politically (prominent Republicans and Democrats were appointed), geographically (residents of the Philadelphia and Pittsburgh SMSA's were well represented), demographically (there were two black representatives, and one woman out of 11 appointees), and professionally (large and small industry were represented; labor and management were represented; and the accounting and legal professions were represented). Achieving balance in each of these areas was thought essential for the final work of the Commission to be taken seriously throughout the state and in the General Assembly. In order to involve the legislature per se, the majority and minority leaders of the House and Senate were made *ex officio* members, as were the Secretaries of Revenue and Budget. Also, the Governor appointed an executive

director from his office to serve as liaison to the executive branch.

The purview of the Commission was quite broad. The Governor charged it to:

> . . . gather the best available advice, recommendations, and data on tax policy, make a comprehensive assessment of our tax system . . . [have task forces report to the Commission on] . . . local tax reform, local tax problems in the Delaware Valley, the state corporate net income, and capital stock and franchise tax, state taxation of utilities, financial institutions, and insurance companies, transportation taxes, personal income, inheritance, estate, fiduciary, and personal taxes, sales, cigarette and alcohol taxes, the administration and enforcement of tax laws, and the impact of the tax system on economic development, community conservation, and energy conservation and development.[3]

In addition, the Governor asked that the matters of unemployment and workmen's compensation not be reviewed by the Commission as they were currently before the legislature, that the overall effective rate of state and local taxation, as measured by the ratio of state and local taxes to personal income in the state, should in the aggregate remain constant, and that consideration be given to not raising the matter of the constitutional prohibition against progressivity.

I should note parenthetically Pennsylvania is roughly a median state in terms of per capita spending and taxation. In terms of overall tax burden, Pennsylvania is also close to the median. It relies at the local level on reasonably broad based taxes, and taxes business principally at the state level.

Given 15 months to perform the study, the Commission organized its schedule into three distinct phases: public hearings, task force research and reports to the Commission, and Commission deliberations on its final recommendations.[4] Also, in order to develop expert assistance to the Commission, academicians in Pennsylvania with interests in public finance were recruited to serve as research directors to the various task forces and to assist the full Commission subsequently. (See Table 1)

As may be evident, this three step process ensured that the public and interested parties could make their views on state and local taxes publically known to the Commission, and ensured that the Commission members would become expert in at least one area of taxation as a result of leading a task force group. Since it was expected that representatives of various organizations would serve on these task forces to provide expert and practical advice about particular areas of taxation, the three step process served both to educate and build concensus within the Commission and among interested parties on the definition of tax reform. The presence of the academicians in the task forces served not only to get the research and writing done, but also to educate representatives of organizations on the first principles of public finance. Finally, the separation of the task force efforts from the final Commission deliberations served to make the Commission more independent of particular interests.

The Commission identified six goals of a desirable tax system: simplicity, certainty, equity, economic efficiency, economy of administration, and revenue adequacy. In addition, the Commission required that the reformed system's tax components be justified either by the ability to pay or benefit principles. The Commission also viewed the matter of tax administration quite seriously and was repeatedly concerned about the administrative details of various taxes and the overall appeals process.

During the public hearings, representatives from industry and labor reminded the Commission of the 1968 Commission's recommendation[5] (which industry and labor endorsed) that the burden of taxation on industry and labor should be 30% and 70% respectively. While the 1981 Commission was cognizant that the real issue of burden involved the ultimate incidence of various taxes on capital and labor, and so stated in the *Final Report*, the tacit acceptance of this additional constraint by Commission members (in conjunction with the one that the effective overall rate of taxation should remain constant) insured that the total revenue from major state taxes would remain the same, and that enhancements at the state level would have to come from *within* each major state tax. Also during the public hearings, mention was made by some witnesses of the desirability of tax and expenditure limitations being within the purview of the Commission. However, a number of Commission members objected strongly to considering the expenditure side of the budget in addition to the tax side of the budget. Others noted that because Pennsylvania had a median effective tax rate, there was not a compelling need to consider tax limitations. Both matters were ultimately dropped as topics for final commentary by the Commission.

III. Major Tax Issues and Recommendations of the Pennsylvania Tax Commission

The Commission reviewed tax issues in five major areas (local taxation, state taxation of individuals, transportation taxation, business taxation, and tax administration) and made numerous recommendations in each. Without going through every issue and recommendation,[6] let me sketch the major areas of concern and the recommendations.

TABLE 1

Organization of the Pennsylvania Tax Commission

	Affiliation		
Richard M. Cyert	President, Carnegie-Mellon		
Robert P. Strauss	Carnegie-Mellon	Director of Research	
Raymond P. Pepe	Governor's Office	Executive Director	
		Task Force	Academic Research Director
Donald Y. Clem	President, McConway & Torley Corporation, Pittsburgh	Taxation of Small Business	Professor Jack Ochs, University of Pittsburgh
Charles G. Kopp	Senior Partner, Wolf, Block, Schorr & Solis-Cohen, Philadelphia	Personal and Inheritance	Professor Robert P. Strauss, Carnegie-Mellon
Richard J. McConnell	Vice-President, Girard Bank, Philadelphia	Local Property Tax	Professor Otto A. Davis & Denise DiPasquale, Carnegie-Mellon
Henry Nicholas	President National Union of Hospital Workers, Philadelphia	Transportation	Professor Frederic L. Pryor, Swarthmore College
Farrell Rubenstein	Managing Partner, Touche-Ross & Company, Pittsburgh	Utilities, Financial Institutions & Insurance	Professor Edward L. Symons, University of Pittsburgh
Herman Schneebeli	Former U.S. Congressman, Williamsport	Sales & Excise	Professor Michael Wasylenko, Penn State
Carol S. Smith	League of Women Voters of Pennsylvania	Local Non-Property	Professor James R. Rogers, Penn State
Ralph S. Snyder	Partner, Schnader, Harrison, Segal & Lewis, Philadelphia	Tax Administration	Professor Patrick Larkey, Carnegie-Mellon University
Robert W. Sorrell	President, Urban League of Phildelphia	Delaware Valley Tax Problems	Professor Robert P. Inman, University of Pennsylvania
W. Bruce Thomas	Vice President for Finance, U.S. Steel	Taxation of Large Business	Professor Earl W. Adams, Allegheny College

A. Local Taxation

The major problems of local Pennsylvania taxes include: (i) the worst property tax assessment system of any major state in the U.S., (ii) continuing controversy over whether or not local school districts should be forced onto the local wage tax base and forced off of the local property tax, (iii) the imposition of a bewildering variety of local head and occupation taxes which are allowed under state law which is broadly permissive as to the type of taxes localities can impose; (iv) the absence of a local tax on unearned income, and the lack of a consistent policy toward commuters; and (v) the taxation of resident and non-resident wages at 4 5/16% in Philadelphia which has had the demonstrated effect of driving business out of the city.

Given that Pennsylvania has over 500 school districts, 2500 cities and boroughs, and 67 counties, fashioning a series of coherent local tax recommendations proved to be quite challenging. The political importance of Philadelphia and the magnitude of their unique tax problems further complicated the creation of a rational series of recommendations. However, I think that the Commission made the greatest progress of any study group in recent experience, and am optimistic that its structure of local tax reform will be endorsed and enacted by the legislature.

The basic thrust of the local tax reform recommendations can be summarized as follows: (i) increased access for school districts to the income tax (as contrasted to the current wage tax) but without a mandatory decrease in property taxes; (ii) reform of the assessment and appeals process as relates to the property tax in specific, and operational ways with attending financing and state supervision; (iii) elimination of the various head and occupation taxes and other "nuisance taxes" such as the residential construction tax, and the recommendation that localities be permitted only to use enumerated taxing powers provided under state law; (iv) reduction in Philadelphia's tax on commuters from 4 5/16% to 2.9% which could be locally financed as a result of the broader local tax base (replacement of the earnings tax by an income tax) and the elimination of Philadelphia's $32 million contribution to the regional transit authority, SEPTA; (v) a consistent policy toward commuters by the imposition of a tax on their earnings of .25%, except in Philadelphia which would be 2.9%, and the elimination of all crediting arrangements; (vi) provision for municipalities of a local income tax base in lieu of the current earnings base; (vii) the recommendation of state administration or piggybacking of the local income tax on to the state; and (viii) a modest liberalization of the state's property tax circuit breaker.

The local tax recommendations thus simplify and broaden the tax base of local governments, inherently increase their revenue elasticity, and move the entire local tax structure in the state toward a more uniform structure. Generally, municipalities would have access to a local income tax up to 1% maximum rate, while school districts would generally have access to a local income tax up to 1.5% maximum rate. The provision of separate ceiling rates represents a change as under current law geographically overlapping schools and municipalities share the current wage tax.

This rather dramatic reshuffling of taxes was costed out, and the ceiling rates were set so that no municipality, school district, or county government, would be worse off in the sense of having access to smaller revenues than under current law.

B. State Taxation of Individuals

Pennsylvania's personal income tax has a broader base than its Federal counterpart; i.e., all capital gains are taxed as ordinary income; and as a result, it has a low nominal rate (2.2%). While the Pennsylvania Constitution requires that the rate be proportional, there is some lattitude for tax forgiveness to low income individuals. With regard to the sales tax, the Commission reviewed the current exemption of clothing from taxation—Pennslyvania is one of 4 states which excludes clothing from the sales tax base—and reviewed the overall burden of the tax as measured in static terms. Finally, the Commission reviewed the inheritance tax and found that 50% of the inheritance tax returns pay only 10% of total receipts of the inheritance tax.

The issues identified in these areas of taxation involved how to provide more generous tax forgiveness for low income taxpayers, how to provide the Federal treatment of capital gains on the sale of a residence for those over age 55, and whether or not a small estate exclusion was warranted. In addition, a number of issues raised by various State Supreme Court decisions in the personal and inheritance taxes were reviewed.

The Commission made a series of recommendations which required that the state rate be raised from 2.2% to 2.28%; this kept whole personal and inheritance tax receipts. In particular, the Commission recommended that the low income tax relief be increased by the inflation experienced between 1974, when the forgiveness tables were enacted, and the present, that the Federal tax-free roll-over on the sale of a residence be provided, and that $15,000 of clear value be excluded from the value of estates. The

Commission did not recommend that any changes be made in the state sales tax which was found to be proportional in effective tax burden through a fairly wide range of economic income.

C. Transportation Taxation

Pennsylvania's roads and bridges are in a state of rapid decay. The depreciation of these assets occurred because dedicated gas and motor fuel taxes have decreased in nominal terms while repair costs have increased faster than the general cost of living. Also, local governments have responsibilities for road maintenance without the financing to support it. The Commission found that the State's estimates of likely maintenance costs were 50% lower than those obtained by using historical trends. These considerations suggested that the system of fees and charges should be radically overhauled to be more elastic, and to be more in relation with actual state-local divisions of responsibilities.

A review of the formulas used by the state to reimburse mass transit agencies for their operating deficits indicated that they provide an incentive to run deficits since they are essentially open-ended matching formulas. Also, it was observed that the current method of setting fares results in large subsidies to middle income riders.

Finally, in briefly reviewing airport financing, the Commission found that the state currently subsidizes local airports as do some cities and counties.

The Commission recommended a variety of changes in the area of transportation finance which are increasingly germane in view of the significant Federal reductions in aid to transportation. In particular, the Commission recommended that fuel taxes be raised 2 cents/gallon, and various user fees raised 20%; these changes would raise dedicated revenues by $170 million. Thereafter, the Commission recommended that all taxes and fees should be indexed to maintain a constant volume of road maintenance and reconstruction. The index should be based on the Federal cost index of highway construction and on the deviation between the predicted and actual flow of revenues into the dedicated road repair trust fund.

The Commission also recommended that vehicles should be taxed in relation to the estimated damage they impose on roads and bridges, and local roads be administered whenever possible by local governments. Allocation of necessary funding of the proposed road turnback should be based on mileage, cost, condition, and type of roads administered. There is a significant lack of reliable data on empirical damage relationships, and the Commission urged the State to do its own studies, rather than wait for Federal studies which are long overdue.

There were also several innovative proposals in the area of mass transit. First, it was recommended that the mass transit subsidy be made on the basis of a lump sum amount per passenger. Second, the Commission recommended that regional mass transit authorities be given access to their own tax base. In particular, the Commission recommended that SEPTA be given a small surcharge on the individual income tax base in return for the elimination of county subsidies to it. Third, it was suggested that an experiment be performed with transit stamps which would provide to Food Stamp recipients subsidized transit tokens, and would permit more realistic pricing for all other riders.

D. Business Taxation

Taxation of business in Pennsylvania, as in many other states, is composed of a series of special profit, property, and excise taxes imposed on various industries. The Commission reviewed the issue of whether or not such taxes are in a sense too high in Pennsylvania compared to other industrial states and act as a deterrent to new investment. While no definitive empirical evidence was found on the issue, the general feeling of tax practitioners is that the overall effective rate of state and local taxation in Pennsylvania is not dissimilar to other major states. Relatively modest local property taxes offset some of the disadvantages of a high state profits tax. The academic survey studies on the matter are generally inconclusive as to whether taxes are pivotal in location decisions.

That is not to say that there are not problems with these various business taxes. With respect to the net income or profits tax, the absence until 1981 of any loss carry-over provision and the absence of a subchapter S provision were viewed as impediments to new investment in the state. Also, the definition of business income was found to require clarification in line with that of other states.

Two special taxes were singled out as failing to meet any defensible criteria of taxation: the tax on the value of corporate loans made to residents within state, and the tax on the value of a firm's capital stock. Administration of the capital stock tax has been increasingly difficult in the last 10 years as valuation in periods of double digit inflation has been problematical. As a long run objective, the Commission recommended that the state move to a single income tax on businesses of all types; however, due to revenue considerations the recommendations made were more modest in nature, although a variety of changes were suggested in the future should additional revenues become available.

No business tax in Pennsylvania has been more criticized than the Capital Stock and Franchise Tax. As noted, inflation has made valuation difficult. Also, because the tax is literally a "negotiated tax," taxpayers continually find themselves in conflict with the Pennsylvania Department of Revenue as to their final liability. It has been estimated that 60% of the Department's legal staff is devoted to negotiating the Capital Stock levy, which brings in less than 5% of total state revenues in the general fund.

With regard to the special excise taxes imposed on various industries, a number of problems were identified. Various financial institutions pay one of four different types of taxes, several of which are problematical. Under the excise income tax imposed on savings banks and savings and loans, a form of reverse revenue sharing is permitted as the tax allows the deduction from the state base of all Federal taxes paid. Since the Federal tax is considerable, the effective rate of tax on these financial institutions is lower than others which are taxed on the basis of their Bank Shares tax. The current tax on the value of bank stock is being challenged in the courts on the basis of a successful challenge in Montana, and several past years of collection could be at risk.

Insurance companies are currently taxed on the basis of their gross premiums (2% rate), and are not subject to either the profits or property taxes levied on corporations per se. Also, exemption of Blue-Cross Blue Shield premiums from this tax results in considerable revenue loss to the state.

Several issues were raised about the taxation of utilities. Currently, a 4.5% excise is levied on the sale of residential electricity and gas; sales to manufacturing entities are also under the 4.5% excise, and both are exempt sales under the state sales tax. However, commercial and nonmanufacturing uses of utility services are subject to both the retail sales tax (6%) and the 4.5% gross receipts tax. With regard to the taxation of local utility realty under the property tax, Pennsylvania requires that the state levy a 30 mil tax on the book value of utility property, and share back part of the proceeds to jurisdictions on a formula basis. Localities are asked to assess utility property and report to the state what they would have collected had the tax been locally imposed. These local amounts are aggregated, and then shared back on the basis of total local revenues collected. Historically, the amounts localities would have collected has been less than the 30 mils imposed on book value which is paid by the utilities to the state. Considerable controversy has surrounded the state's payments to localities over the years. In periods of inadequate cash flow, the state has not promptly paid over the amounts to the localities. Also, some localities have underassessed utility property by considerable amounts. Another issue raised with regard to gas, electric, and telephone utilities in the state is whether or not they are more heavily taxed than their counterparts in other states.

The Commission recommendations in the business tax area involve a series of mainly incremental reforms. With regard to the profits tax, it was recommended that loss-carry-over be provided prospectively for three years; also, it was recommended that all business income be apportioned except income resulting from the sale or disposition of real or tangible personal property which would be allocated on a normal situs basis. The Commission also took issue with the emerging practice in New York and Massachusetts of double weighting the sales factor in the interstate apportionment formula for the profits tax as a way to export state taxes. With regard to the capital stock tax, the Commission recommended that new firms not be taxable until their third year of operation, and that valuation of all firms be based on a fixed valuation formula which capitalized at 9% the average of the past six year's earnings. Since the rate is .01, the tax would be a 10.5% tax on averaged earnings. With regard to the Corporate Loans tax, the Commission recommended its elimination.

With respect to financial institutions, the Commission recommended that the various taxes be replaced with a single excise income tax, and that interest from both Federal and state obligations be included in the base. Favorable transition rules were recommended to permit institutions to alter their portfolios in a systematic manner.

The Commission did not make any recommendations in the area of insurance taxation, partly because of the automatic retaliation provisions in other state's insurance tax laws, and partly because movement to a system of apportioned income and capital stock taxation of insurance companies would involve considerable revenue losses. Similarly, the Commission did not make any recommendations for the change in taxation of public utilities, although it did observe that the combined impact of Pennsylvania's state and local taxes treats utilities in a relatively beneficial manner in comparison with other states such as New Jersey, California and New York.

E. Tax Administration

As noted earlier, a major focus of the Commission was in the area of tax administration. Review of current state and local practices revealed both general and specific areas for reform; some could be achieved through administrative regulation while others required legislation. A number of reforms were

immediately made as the Commission reviewed current practice and brought issues to the attention of the Department of Revenue.

Perhaps the most obvious administrative problem taxpayers face in Pennsylvania is the fact that there is no single code of tax law which puts in one physical place all state and local taxes and all rules of administration. The legislative practice has been to enact tax laws which amend earlier acts of the legislature. Such amendments contain a consistency rider at the end which states that all other previous acts not amended specifically, but which are inconsistent with the changes or the intent of the current act, are null and void. Not surprisingly, significant litigation results on the issue of just what is consistent and what is inconsistent. For those familiar with the Internal Revenue Code, dealing with Pennsylvania tax law can be quite time consuming, and has resulted in the development of a highly specialized tax bar in Harrisburg and Philadelphia.

Other administrative issues identified include the absence of automatic cash refunds to corporate taxpayers on a analogous basis to refunds made to individuals. Corporate taxpayers currently must fill out separate petition for refund, and the state does not pay interest for the elapsed time during the petition period. Another problem with the current state tax administrative rules is that the interest rates for deficiencies vary among taxes (between 6 and 9%) and are well below market rates of interest. As a result, taxpayers have often been delinquent in paying their taxes and in turn caused cash flow problems for the state. Finally, the state has not purged its uncollectable accounts because there is not enabling legislation to do this. As a result, the Department of Revenue has open literally hundreds of thousands of small accounts which cause significant paperwork and computer problems.

Examination of the wage levels of Department of Revenue professional staff positions indicated that they are well below market in the areas of computer specialists, accountants, and attorneys. The Department has experienced significant turnover in these positions, and has increasingly had to recruit junior professionals in each of these areas.

Beyond these general administrative issues, the Commission found that the appeals process was time consuming and expensive. Also, the Commission observed that the state does not automatically accord reasonable extensions to taxpayers whose Federal tax status changes.

The Commission made a series of recommendations to remedy these and related administrative problems. Thus, the Commission recommended that the Department of Revenue in conjunction with the professional staffs of the legislature draft a tax code which would be similar to the Internal Revenue Code. Also, the Commission recommended that the various interest rates now used be made uniform and reflect current market interest rates in order to permit the state to more promptly collect its taxes. With respect to the internal operations of the Department, the Commission recommended that salary levels be made more competitive with those in the private sector, and that the operation of the inheritance tax be parallel to other state taxes. The Commission also recommended that taxpayers have more and more current information available and that a Pennsylvania Tax Register be published monthly along with information booklets.

The Commission was unable to agree on how to reform the appeals process, but did outline general principles and called for further study.

IV. Data and Methodology

A major reason why earlier Pennsylvania tax studies have not resulted in significant reform is that they frequently did not document the revenue implications of their recommendations, either in terms of the aggregate amounts of revenues raised or lost as a result of proposals or in terms of the relative impact of the proposals on individuals and firms. Unfortunately, most states do not have large-scale machine readable data bases which can readily provide analysis of alternative tax proposals. For those who wish to use Federal tax data sources, Section 6103 of the Internal Revenue Code can provide significant impediments to analysis. Accordingly, a major research objective of this Commission was to make use of all related Federal and state data bases, and, where necessary, develop new ones from administrative records.

It should be noted that all of the analysis done for the Commission by the various academics was static. That is, we did not speculate about the feedback effects of various tax changes on the tax base in question. Collecting and tabulating relevant data proved to be sufficiently challenging.

Data on local taxation came from several sources. The 1977 *Census of Governments* in conjunction with state data permitted the analysis of various types of local taxes. Estimation of the income base for school districts and municipalities was based upon state tabulations of state personal tax collections by school district, and the per capita income projections by municipality created for the general revenue sharing program by the Census Bureau. Micro-simulation of alternative property tax circuit breaker schemes was performed on the SMSA samples of households available from the Annual Housing Survey which is collected by the Census Bureau. The housing surveys are rather underutilized in my judgement,

and provide an excellent Federal data source on household income, taxes, and housing services.

Data on personal taxes was obtained by matching the Federal Statistics of Income sample for Pennsylvania with state tax returns by social security number. Such matched samples, when made anonymous, were available to the Commission for 1974 and 1977. Consideration of sales tax alternatives was performed through the use of the 1972 BLS Consumer Expenditure Survey. Analysis of alternative small estate exclusions was obtained through tabulations of administrative files by the Department of Revenue.

Analysis of various business tax reforms required the creation of a new data base. A random, stratified sample of Corporate Net Income and Capital Stock taxpayers was designed by the Commission staff and drawn, coded, and keypunched by the Department of Revenue. The stratification was based on the size of final, settled tax payments made under these two taxes, and on the basis of the major industry of the firm. The sample numbered slightly over 1,000 firms, and was drawn as a panel for 1977, 1976, and 1975. Tabulations of the universe of taxpayers from the Department's online administrative record system permitted the extrapolation of the 1975 sample to 1977 levels. Better than 450 variables were collected from the state and Federal returns.

V. Concluding Remarks

The impact of most earlier Pennsylvania tax commissions on actual legislation has depended primarily on the fiscal condition of the state and localities. When revenues were needed, recommendations have been actively legislated.

A number of recommendations of the Commission have already been put in place. In late 1980, the General Assembly enacted a business loss-carryforward provision, principally on the strength of the revenue estimates obtained from the corporate data base collected for the Commission. Early this summer, the Department of Revenue revised through regulation its administration of the inheritance tax, and made it a truly self-assessed tax in line with Federal practice. Thus, the local Register of Wills no longer determines which debts and deductions are allowable, although the Register continues to be financed by a fraction of the tax collections obtained. These reforms were based in main on recommendations of the Commission. A number of major reforms of the local tax system are now before the General Assembly; I would expect that several of the Commission's recommendations will be enacted.

The type of tax reform contemplated by the Pennsylvania Tax Commission falls between the two extremes of raising emergency revenues or of stating a long-range set of philosophic objectives to move toward. The emphasis throughout the work of the Commission was to look systematically and empirically at all of the State's taxes with first principles of finance in mind, and to make a series of recommendations which could be acted upon in modules by the legislature.[7]

The process of deliberation and recommendation of any tax commission is inherently political. In a sense, for a blue-ribbon study of a state's tax system not to face external and internal pressures for certain recommendations would mean that it was not to be taken seriously by legislators. Strategic awareness of these pressures was necessary throughout the life of the Pennsylvania Tax Commission to maintain an overall coherence in outlook. I would guess that many other states will be reviewing their tax structures over the next few years, and would urge that serious thought be given by those involved to the strategic matters of representation, organization, and the method of consensus building, as well as the systematic development and analysis of relevant data bases.

Footnotes

[1]See Harvey E. Brazer (editor), *Michigan Tax Study Staff Papers* (Lansing, 1958) or Committee on the District of Columbia, U.S. House of Representatives, 95th Congress, *Technical Aspects of the District's Tax System* (Washington, D.C. U.S. Government Printing Office, December 1, 1978).

[2]Jared Lobdell, *A Century of Pennsylvania Tax Revision by Commission* (Unpublished manuscript prepared for the Pennsylvania Tax Commission, Carnegie-Mellon University, Department of Applied History, April, 1980), Chapter 1.

[3]Commonwealth of Pennsylvania, Governor's Office, Executive Order 1979-14, *passin*.

[4]Publications of the Pennsylvania Tax Commission include:

Public Hearings before the Pennsylvania Tax Commission: Philadelphia, Pittsburgh, Harrisburg, Erie and Scranton; June, 1980.

Executive Summary; Final Report of the Pennsylvania Tax Commission; March, 1981.

Final Report of the Pennsylvania Tax Commission; March, 1981.

A Task Force Report to the Pennsylvania Tax Commission: Business Taxation and Business Taxation With Special Reference to the Problems of Small Business; March, 1981.

A Task Force Report to the Pennsylvania Tax Commission: Financial Institutions, Insurance and Utility Companies; March, 1981.

A Task Force Report to the Pennsylvania Tax Commission: Local Property Taxation: March, 1981.

A Task Force Report to the Pennsylvania Tax Commission: Local Nonproperty Taxation; March, 1981.

A Task Force Report to the Pennsylvania Tax Commission: Local Nonproperty Taxation with Special Reference to the Problems of Delaware Valley; March, 1981.

A Task Force Report to the Pennsylvania Tax Commission: Sales, Cigarette and Liquor Taxation; March, 1981.

A Task Force Report to the Pennsylvania Tax Commission: Tax Administration; March, 1981.

A Task Force Report to the Pennsylvania Tax Commission: Transportation Taxation; March, 1981.

[5]See *Report of the 1968 Tax Study and Revision Commission*, (Harrisburg, 1968).

[6]See *Final Report of the Pennsylvania Tax Commission* (Harrisburg, PA, 1981) for the complete set of recommendations.

[7]While the incrementalism of its proposals reflects initial Commission assumptions and constraints, it also is consistent with the pace of possible legislative consideration.

TAX STUDIES IN MICHIGAN: PAST IMPACT AND CURRENT ISSUES

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The University of Michigan

Until about ten months ago I was content in the knowledge that the Michigan Tax Study, for which I served as research director in 1957–1958, seemed to have achieved one of my major objectives. It promised to be the last large scale tax study undertaken in the State of Michigan. But before the end of December 1980 it became clear that something had gone wrong. I had agreed again to direct a study of the State's fiscal and economic structure.

During the 1950s, when it was common to find half or more of the states undertaking tax studies simultaneously, state expenditures were rising rapidly and revenues were not keeping pace. The dominant motive for these studies, therefore, was the widespread acceptance of the view that more revenue was needed than the existing tax system or level of rates was capable of producing. At that time most of the states had adopted either an income tax or a sales tax and the leading candidate to provide the additional revenue needed was typically the one of these two taxes that the state in question did not already levy. Thus, for example, the Governor's Minnesota Tax Study Committee recommended the adoption of a sales tax in 1956, and the Michigan Tax Study advocated personal and corporate income taxes in 1958.

A second motivation behind the tax studies of the '50s was reform. Reform, generally, meant three things, not always easy to reconcile. They were first, changes in the tax structure designed to remove what were seen to be elements that dissuaded new firms from entering the State or that encouraged existing firms to move elsewhere. For many, at least as important was the objective of achieving a more equitable tax system, one that would treat the poor less harshly while increasing the relative tax load carried by the well-to-do. Reform also meant removing discriminatory features in the tax laws that often were remnants of provisions in taxes that may have been appropriate to the circumstances of the 19th century, but which, in the 20th century, had become irrational anachronisms.

The Citizens' Advisory Committee to which the staff studies of the Michigan Tax Study were initially addressed produced a set of recommendations that was bold and far-reaching.[1] Its recommendations were aimed at improving equity by reducing the regressivity of the tax system; changing the tax system so as to make it more conducive to economic growth in the State; increasing revenue by enough to eliminate the growing deficit and to finance expansion of both direct state expenditures and aid to subordinate jurisdictions; and increasing the flexibility, simplicity, and rationality of the tax system.

The Committee recommended the introduction of new taxes and modest changes in existing taxes that were expected to yield an increase in revenue of over $390 million. At the same time its tax reductions would have reduced revenues by about $250 million, for a net increase of nearly $140 million. This sum represented approximately 18 percent of total tax revenues realized by the State in 1958.

The Committee recommended the introduction of personal and corporate income taxes, retention of the corporate franchise tax at a sharply reduced rate and only as a minimum alternative to the income

Alaska Department of Revenue
Various Tax Types, Statutes, Rates, Incidence, Revenues
1986

Statute / Tax Type	Yr. Estab. (Last Am.)	Effective Tax Rate	Tax Incidence	Revenues (projected) FY 85	FY 86	FY 87	FY 88
AS 10.25.550 - 555 Elec. & Tele. Coop. Tax	Elec. 1960 Tele. 1959 (1980)	1% under 5 yrs. 2% over 5 yrs.	gross receipts	1,600	1,800	1,600	1,600
AS 16.51 Seafood Marketing Assessment	1981	.002%	Purchase Price or Value	1,000	1,000	1,000	1,000
AS 21.09.210 Insurance Premium Tax	1939 (1986)	2.7% for Domestic and Foreign 6. % Hospital and Medical Service Corp's	Premium	17,500	18,000	18,000	18,000
AS 43.20 Corporate Income Tax	1949 (1982)	1% to 9.4%	Net Income	204,600	220,000	200,000	190,000
AS 43.31 Alaska Estate Tax	1919 (1980)	limited to Fed. credit for state tax	Estate	500	600	600	600
AS 43.35 Coin Operated Devices and Punchboards	1947						
AS 43.40 Motor Fuel Tax	1945 (1983)	Marine 5¢ per gallon Highway 8¢ per gallon Aircraft 4¢ gas 2.5¢ jet fuel	Excise	4,300 23,700 8,000	4,600 22,500 8,000	4,700 22,500 8,000	4,700 23,000 8,000
AS 43.50 Tobacco Tax	1955 (1985)	8 mills (16¢ per pack)	Excise	2,000	5,700	7,500	7,500

Statute Tax Type	Yr. Estab. (Last Am.)	Effective Tax Rate	Tax Incidence	Revenues (projected) FY 85	FY 86	FY 87	FY 88
AS 43.55 Oil & Gas Properties Production Tax	1955 (1981)	12.25% or 15% of gross value (or 80¢ per barrel) at point of production multiplied by E.L.F.	Severance	1,388,700	1,114,300	770,500	533,000
AS 43.56 Oil & Gas Exploration, Production & Pipeline Transportation Property Tax	1973 (1981)	20 mills	Property	128,400	98,900	89,000	81,000
AS 43.57 Oil & Gas Regulation and Conservation Tax	1955 (1973)	one eighth of one cent per barrel	Severance	700	700	700	700
AS 43.60 Excise Tax on Intoxicating Liquors	1933 (1983)	malts 35¢ per gallon wines 85¢ per gallon distilled $5.60 per gallon	Excise	13,900	13,900	13,900	13,900
AS 43.65 Mining License Tax	1913 (1980)	3% to 7%	Net Income	300	300	300	400
AS 43.70 Alaska Business License Tax	1949 (1984)	$25.00 fee	Annual Fee	38,000*	2,000	2,000	2,000
AS 43.75 Fisheries Business Tax	1913 (1986)	Canned Salmon, shore/based 45% shore/based 3.0% Floating 5.0%	Purchase Price or Value	5,600 8,300 4,800	5,200 9,000 5,000	5,200 9,000 5,000	5,200 9,000 5,000
AS 43.76 Salmon Enhancement Tax	1980 (1981)	Cook Inlet 2% Prince William Sound 2% Northern Southeast 3% Southern Southeast 3%	Purchase Price or Value	2,600	4,200	4,200	4,200

* The large amounts in FY 85 are the result of litigation in favor of the State on gross receipts taxes for years prior to 1979.

Overview of Experience with Recent State Tax Studies

Steven D. Gold
Director of Fiscal Studies
National Conference of State Legislatures

New Jersey State and Local Expenditure and Revenue Policy Commission
Trenton, New Jersey
October 18, 1985

I have been requested to cover four topics today:
- o General objectives of state tax studies and areas covered;
- o Mechanics of the studies, including budget, duration, procedures, etc.;
- o General and specific problems encountered;
- o Short and long term benefits realized or anticipated.

To address these issues, it is necessary to emphasize the diversity of experiences that come under the rubric "tax study." You should realize that your New Jersey study resembles those elsewhere in some respects and also differs from many studies that have been conducted recently elsewhere. Here are some of the ways in which tax studies differ:

o Purpose: some are broad, covering a wide variety of tax issues; others are narrow.
o Context: some are highly political; others operate in a virtual political vacuum.
o Resources: some have had budgets in excess of $600,000; others have had $25,000 or less.
o Time horizon: some have lasted for only a few months; others have been in existence for more than three years (e.g., New York).
o Organization: some have relied primarily on internal staff; others have used many consultants, and one delegated the work to a consulting firm. I recommend the use of consultants working with a core staff with several professionals.
o Membership: some have been composed solely of legislators; others have had a mixture of public officials and private citizens, and others have been completely private citizens.
o Thoroughness: some have been relatively thorough and systematic in explaining their assumptions, procedures, and objectives; others have been partial and unsystematic, with policy recommendations not well grounded in supporting analysis. I commend to you the explicit discussion of assumptions and principles in Minnesota and Hawaii. I recommend that the New Jersey commission discuss underlying assumptions and principles at an early stage of its work.
o Care in presenting analysis and recommendations.
o Innovativeness of analysis.
o Results: some have had major success in having their recommendations implemented; others have been partially successful; and yet others have had no success yet. A major caution is that significant reform often takes years to accomplish; it is too early to conclude anything about the long-run effects of most recent tax studies.

Objectives

The most important motivation for recent tax studies has probably been state fiscal problems. Important focuses of the recommendations have been tax simplification, modernization of outdated provisions, and stimulating economic development. Coping with technological change, actual or prospective federal tax changes, and legal challenges to tax provisions have been relatively minor objectives. Some tax studies have also been concerned with improving tax administration. Equity concerns have frequ tly been addressed, but they have seldom been a principal motivator for initiating the tax study. It is probably accurate to say that equity has receded as a primary concern of state tax policy.

Mechanics

I suggest that you consult with persons who have worked on tax study commissions in other states for advice about mechanics. It would probably be wise to consider both successful and unsuccessful tax studies for guidance on mechanics. I would identify the following studies as among the more successful ones:

o Minnesota: produced recommendations that have been approved by many parties, although in most important respects not yet by the majority of the legislature; and produced well-researched reports, including some innovative analyses in areas like the role of taxes in influencing employment trends and the long-run prospects for various taxes.

o Hawaii: produced well-constructed analysis of tax system based on explicit premises; however, recommendations failed politically in first year.

o Pennsylvania: produced good analysis of issues under study and resulted in reform of a major business tax; however, operated under numerous constraints that limited issues that could be studied.

o New York: produced strong analyses in numerous areas, including both administration and policy areas, particularly related to simplification and modernization; however, produced no unified report and continues to be of indefinite duration.

o West Virginia: resulted in reform of major business taxes.

The reason I single out these states is that they had tax studies that either had strong analyses that could be helpful in New Jersey or they resulted in significant reforms. In addition, this year's Wisconsin income tax reform is an important outcome that was helped along by a recommendation from that state's strategic development commission.

My impression is that New Jersey is off on the right foot: it has a reasonable timeframe and budget, an executive director who can successfully manage the study, and a commission membership reflecting important state interest groups. These ingredients are necessary but not sufficient for a successful tax study. Tax reform is a political process, and many pitfalls could derail it.

The budget necessary for a tax study depends upon the types of issues to be considered. Construction of large data bases such as Bob Strauss developed in West Virginia and Pennsylvania is expensive. The breadth of the tax issues to be considered also will have an important effect on the necessary budget.

My final comment about mechanics is that no universal pattern is applicable to all tax studies. What is successful in one state may fail in another state, and vice versa.

Problems Encountered

The problems encountered can be divided into the technical and the political.

Technical: It is important to identify the principal issues to be investigated and to devote sufficient resources to exploring these issues. Some tax studies have attempted to do too much and therefore spread their resources too thin. Time may be as much of a constraint as money.

A thorny issue is how detailed to make recommendations. As discussed below, a commission can be helpful by dealing with issues that are too sensitive for the legislature to confront. Considerable benefit can result from attention to a large number of relatively minor issues. But a danger exists of dissipating influence and attention if too many issues are addressed.

A common technical problem is that researchers may not be sufficiently familiar with the fine points of a particular state's tax system. A related problem is that the cooperation between the tax study's staff and the tax department may leave something to be desired.

Political: Timing is a key to the receptivity for tax reform. It is probably most feasible to implement reform at times when a state has a large surplus or is threatened by a deficit.

Implementing reform is a very difficult political process. If the reform involves significant issues, it is likely to encounter opposition from powerful entrenched interests. An important issue is the extent to which the commission's recommendation's are shaped by perceived political constraints. Unless the commission ignores some political factors that have governed the legislature in the past, its recommendations may not be sufficiently bold. On the other hand, if too many politically unrealistic proposals are endorsed by the commission, it may be quickly written off.

The media are frequently a major problem for tax study commissions. They tend to report recommendations in a superficial manner, emphasizing "gainers" and "losers." Many people get the impression that they will lose due to particular proposals (e.g., eliminating tax preferences), while the gains that come from other proposals (e.g., tax rate reductions) are less appreciated.

With skillful leadership and a cooperative attitude among interest groups, a feasible compromise that embodies tax reform can be developed.

Benefits of Tax Studies

1. Raising the level of discourse about tax issues.

2. Addressing issues that are too politically sensitive for the legislature to confront, thereby broadening the scope of the politically feasible (e.g., property tax classification in Kansas this year).

3. Producing new data.

4. Producing new research.

5. Breaking a political logjam that has thwarted improvements in tax policy.

6. Taking a fresh look at how the tax system has gradually developed as a result of economic change and incremental legislative decisions. (According to Richard Pomp, state tax systems tend to "mutate" over time.)

7. Producing sensible recommendations that may not be adopted at once but will be referred to in the future when a crisis situation develops.

8. Taking an in-depth look at emerging issues that are not handled well in the customary legislative process, e.g., reform of state-local relations, impacts of federal tax reform, and technological changes. The tax study commission can take a longer term view than is customary and may be less concerned about how a proposal affects the outlook for the next election.

STATE TAX STUDY COMMISSIONS:
AN OVERVIEW OF FOUR APPROACHES

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Legislative Finance Paper #48C

April 1985

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SUMMARY

This document contains four papers written by directors of recent state tax study commissions. They are adapted from remarks presented at a session of the Annual Conference on Taxation of the National Tax Association-Tax Institute of America (NTA-TIA) held in Nashville, Tennessee, November 27, 1984. Although they will be published in the Proceedings volume from that conference later in 1985, NCSL is distributing them at this time because of widespread interest in the process and findings of tax study commissions. NTA-TIA has generously granted NCSL permission to use the papers in this manner.

Six authors have contributed to this document. Steven Gold, the editor, served as moderator of the session and placed the papers within the context of other tax studies that have recently been conducted. Richard Pomp is the director of the New York Legislative Commission on Modernization and Simplification of Tax Administration and the Tax Code. Robert Ebel has directed two tax studies, one in the District of Columbia completed in 1978 and one in Minnesota completed in 1984. Sylvia Dennen and Susan Gutchess directed a tax study in Iowa. W. Norton Grubb played a key role in a Texas tax study.

Under a grant from the Ford Foundation, NCSL will produce a series of reports in 1985 and 1986 about tax study commissions. NCSL does not necessarily endorse the views of the authors of these papers but rather has published this document to stimulate discussion of tax studies and to assist states that may be contemplating the creation of such a study.

STATE TAX REFORM AND
FORMAL STATE TAX STUDIES: AN OVERVIEW

Steven D. Gold
National Conference of State Legislatures

Our subject today is a timely one--state tax studies. 1984 has seen more tax studies than any other year in more than a decade--perhaps any year in history. We can learn from these studies in two ways. First, their substantive research may be of interest in many states as well as the one where the study takes place. Second, they can improve our understanding of the process of tax reform. Conducting a successful tax study is a difficult endeavor, facing many pitfalls.

There is great variety in what falls under the rubric of a "tax study." Some have an army of consultants; others have none. Some have large budgets, exceeding $500,000; others get along with $25,000 or less. Some have lasted for only a few months; others have extended for two years or longer. Some are associated with commissions, either of private citizens, public officials, or a combination; others operate without commissions.[1]

One has to draw some lines somewhere, and I suggest that the following characteristics are useful in analyzing tax studies:

- o They cover a broad set of tax policy issues, not limiting themselves to a single tax, nor are they concerned simply with tax administration.

- They have significant resources for research, which may include in-kind services of government agencies.
- They last at least six months but no longer than three years.
- They are created by the state government.
- They focus on state policy issues.

Many so-called tax studies do not meet one or more of these tests, including one of those on this program, but these characteristics help to identify serious state tax studies.

The four tax studies represented on today's program reflect the diversity of purposes and approaches in recent tax studies:

- New York's is especially concerned with modernization and simplification of the state tax system. It was created by the legislature and is directed by a lawyer.
- Minnesota's was motivated by an extended period of state fiscal stress and a desire to re-examine some of the complex fiscal innovations adopted over the period since 1970. Like most studies, it was created by the governor and is directed by an economist.
- Iowa's was created because of serious economic problems hanging over the entire state and state government in particular. The initiative for the study came from the legislature, but it was not controlled by the legislature. The most unusual aspect of Iowa's tax study is that its research has been done by a large profit-making consulting company.
- Texas' was a short-term, low-budget study initiated because of a state government fiscal crisis. It was directed by an economist.

In order to provide a context for this program, I will list the other state tax studies of which I am aware and offer a capsule description. This list is probably not exhaustive, nor are many details known about some of the commissions. First I'll list the commissions currently in operation or those which completed their work this year. Then I'll turn to other state tax studies since 1978.

California: a low budget study with little original research.

Hawaii: an unusual study in that the state constitution mandates periodic tax studies; numerous consultants assist a small staff. Directed by Jack Suyderhoud.

Kansas: a low budget study with little original research; chaired by the Lieutenant Governor, with other members representing powerful interest groups.

Massachusetts: a study which has taken nearly two years to get underway; recommendations expected following 1986 election. Directed by Robert Tannenwald.

Tennessee: a legislative study staffed primarily by state officials; reducing high sales tax rates, perhaps by adoption of state income tax, is an important focus.

Utah: a study just getting under way.

West Virginia: a conventional study which reported early in 1984. Directed by William Dodge.

Wisconsin: a study focused on "strategic planning" for the state, expected to recommend reform and reduction of the state income tax.

Other recent studies include:

Connecticut: a study with a relatively small budget; considered but did not recommend a state income tax; concluded in January 1983. Directed by Will McEachron.

District of Columbia: a study with numerous consultants; many recommendations approved; concluded in 1978. Directed by Robert Ebel.

Georgia: a multi-year study with relatively little impact.

Illinois: a study with a relatively small budget; limited impact; concluded in January 1983. Directed by Sylvia Dennen.

Indiana: one of two recent studies without a commission; directed by James Papke, with research by faculty at Indiana universities; two volumes published in 1982 and 1984.

Louisiana: a brief, low-budget study directed by William Oakland in 1983.

Michigan: a study directed by Harvey Brazer in 1982 with chapters written by faculty at Michigan universities; not accompanied by a commission; report published.[2]

Ohio: a low-budget legislative study with little original research; conducted work primarily in 1982.

Pennsylvania: a study directed by Robert Strauss with research by faculty at Pennsylvania universities; concluded in 1981.[3]

Rhode Island: a study with research conducted by Rhode Island Public Expenditure Council.

Washington: a seven-month study conducted in 1982.

I have asked the four panelists on today's program to describe the approaches taken in their respective studies and to explain the reasons why their own study took the shape that it did (e.g., resource constraints, political setting, etc.) I also posed a series of questions for them to discuss:

- What can a state reasonably expect to gain by conducting a major tax study and what lessons can be drawn from the successes and failures of your own study?
- Is the role of a tax study different now than it was 20 years ago? Harvey Brazer has pointed out that the studies of the 1950s and 1960s often proposed adoption of either a sales or income tax, whichever the state in question did not already levy. Today states have more balanced tax systems and larger and better trained tax analysis staffs, so the nature of the task facing a tax study is different.
- How often should a state have such a study?
- What is the best way to organize a tax study today?
- What are the appropriate measures of success for a study?

In addition to these process kinds of questions, the panelists may also address the substantive conclusions of their study. However, I requested that they not deal exclusively with the substantive conclusions because there are numerous discussions of tax issues but very few assessments of tax studies themselves.

1985 may be a watershed year for state tax policy, with some states making major changes in the design of their tax systems, and state tax studies are likely to contribute to these changes.[4] Since the federal government will probably be making significant revisions in its own tax system and in its fiscal relations with states and localities over the next few years, state fiscal systems will probably be reexamined more closely than in many years. The "tax study business" will continue to be active for years

to come, and states may broaden their focus to include issues like state-local fiscal relations.

NOTES

1. Mary M. Lynch, a doctoral student in planning at Massachusetts Institute of Technology, has described many of these differences in an analysis of ten recent state tax studies for the Massachusetts Tax Reform Commission, "Tax Review Commissions in the United States: The Process and the Issues."

2. For a discussion of this study, see Harvey E. Brazer, "Tax Studies in Michigan: Past Impact and Current Issues," in National Tax Association-Tax Institute of America, Proceedings of the Seventy-fourth Annual Conference: 1981, pp. 218-20.

3. For a discussion of this study, see Robert P. Strauss, "Findings of the 1981 Pennsylvania Tax Commission," in National Tax Association-Tax Institute of America, Proceedings of the Seventy-fourth Annual Conference: 1981, pp. 210-218.

4. Steven D. Gold, "A Pivotal Year for State Finance", State Legislatures (January 1985), pp. 20-25.

State Tax Reform New York Style

Richard D. Pomp*

I. INTRODUCTION

The impetus for creating the New York Tax Study Commission was not an impending fiscal crisis, a court decision declaring some aspects of the tax structure unconstitutional, or any short-term pressures. Instead, the creation of the Commission was a testament to the law of entropy: Over time, tax systems move toward an increasing state of disarray, chaos, and internal inconsistency. These problems were particularly acute in New York, which has one of the oldest tax systems in the country. For example, the state's franchise tax has its origins in the nineteenth century.[1] A significant feature of the personal income tax, the use of separate returns by married couples, was adopted in 1919.[2] The basic structure of the state sales tax was developed in 1935 and contains a host of rather problematic or moralistic judgments.[3] Some are petty and chauvinistic: New York State flags, for example, are exempt from the sales tax but other state flags are not.[4] Other provisions distinguish between big and small marshmallows, Tang and Awake,[5] and between Prell and Head and Shoulders,[6] hardly burning social issues.

New York legislators were acutely aware that the tax system had evolved (perhaps mutated would be more appropriate) through a series of poorly researched or drafted laws, which were often adopted in the closing days of a legislative session. These changes, typically bandaids rather than major surgery, were superimposed upon existing law with which, in many cases, they

were actually working at cross-purposes. Moreover, statutes that had long outlived their usefulness nonetheless remained memorialized. In short, the tax system had grown through a process of accretion rather than deletion. Regrettably, the result was too familiar--a tax structure that was uncoordinated, complex, cumbersome, and lacking any conceptual framework.

New York policymakers were also wondering whether the existing tax structure was well-suited to deal with the dynamic nature of the existing economy. Legislators have had to cope with changes in the judicial climate;7 a relaxation of federal controls especially in the areas of transportation8 and banking; startling advances in technology that have facilitated innovative business practices;9 a flurry of federal legislation;10 the rise of multinational corporations and conglomerates; and the shift in the economy from manufacturing to services. These developments and trends challenge the premises that underlie much of the state's tax structure, which makes it increasingly difficult to continue tinkering with the sales, corporate, and income taxes and underscores the need for reform.

Legislators were also worried that they were worshipping a false god--the Internal Revenue Code. Probing questions were being raised about whether the state should simply mimic every federal provision. Thoughtful legislators suspected that the substantial differences in perspective between New York and the federal government required that the State re-examine its income tax.11

Many officials were also concerned with the impact of the state's tax structure on business.12 Numerous changes had been made in the law in order to attract and maintain corporations, especially manufacturing firms. A few key legislators, however, started to express private doubts about whether

using the tax system was an effective means of encouraging economic growth. Moreover, the Legislature had never even demanded an annual accounting of the loss in revenue attributable to special provisions like the investment tax credit, the employment incentive tax credit,[13] or the double-weighted receipts factor.[14] Questions about these provisions led logically to concerns over the extent of waste or slippage throughout the entire tax system.

This panoply of concerns provided the impetus for creating the Legislative Tax Study Commission, which consists of five Democrats and five Republicans, half from the Assembly and half from the Senate.[15] Not all tax study commissions consist exclusively of legislators. The weakness in having only legislators is nicely captured by a comment made by a Commissioner during a discussion of a provision in the New York personal income tax: "Yes, that provision certainly appears asinine, but that's a provision that I just sponsored and I'll be damned if it's going to be eliminated."

II. PROCEDURAL ISSUES

However a commission is structured, it is critical in a state as large as New York that a wide spectrum of "movers and shakers" be involved. To further this goal, the Tax Study Commission created various advisory groups, consisting of representatives from academia, big business, small business, labor, public interest groups, and the legal and accounting professions. These advisory groups helped shape the Commission's agenda, which is the most ambitious ever undertaken by any state. Put simply, the Commission was to overhaul the personal income tax, the corporate franchise tax, the sales tax, and the taxation of transportation. In addition, certain issues, specific to New York, were placed on the agenda.[16]

Several "marching orders" were issued. First, the Commissioners did not want a "Readers Digest" report, full of platitudes and glittering generalities. Simplistic approaches, such as comparing state tax burdens using measures like taxes per thousand dollars, taxes per capita, or nominal rates, all of which fail to capture the diversity of a tax system, were to be avoided.17 Second, issues of tax administration were to be prominently emphasized because "good" tax policy and "bad" tax policy, however those terms are defined, can look remarkably similar if the law requires a higher order of administrative capacity than actually exists. Taxes are what they turn out to be in the real world and not what a legislature intended them to be in an ideal world. Issues of administration have too frequently played the role of the favored child of tax policy.18 Much of the work of the Commission reflects this philosophy by identifying what the applicable administrative constraints are and then designing a system that can function fairly and efficiently within those constraints.19 Third, in keeping within the spirit of not hiding behind broad recommendations, the staff was instructed to have legislation prepared to accompany its proposals. Moreover, the revenue impact and distributional implications of each recommendation were to be identified, which required building a computer model of the personal income tax and of the corporate tax.20

These marching orders were rather intimidating for a full-time staff of lawyers and economists that has never exceeded four. Equally intimidating were the procedures agreed upon for the review of staff reports prior to their submission to the Commission. Preliminary drafts, depending on subject matter, were to be reviewed by some--or all--of the Commission's advisory groups and other selected persons. After this review, a rewritten

draft was released as a "Staff Report" to over 600 persons. A subsequent version was then formally submitted to the Commission.

This review process was tedious and painstaking. As one exasperated and frustrated staff member decried, "Our work must stand up in a court of law." In a state like New York, however, exactly such a standard was required to win the confidence and respect of the tax bar, the tax accountants, the various legislative committees and agencies, and the Fortune 500, many of whom are headquartered in New York. Each of these groups is capable (and willing) to second-guess the staff's analysis of most issues. This elaborate review process, besides ensuring a high standard of quality, had the additional benefit of facilitating a dialogue among different constituencies, which is a vital step in building a consensus for reform.

Undoubtedly, the participation of these various groups, although vexing at times, especially for some consultants hired by the Commission, resulted in a series of Staff Reports that established the Commission's reputation for objective and critical analysis. As a result, long before the Commission had formulated its own reform proposals, its advice was being solicited informally by legislators on bills they were proposing. Although this additional set of responsibilities was an unwanted diversion for the staff, the alternative was to remain aloof and passively watch legislation being adopted that could only make it harder to achieve the Commission's ultimate goals. Consequently, during the major research phase of the Commission's work--from August 1982 to August 1983--the staff was an active, although not a highly visible, participant in the legislative process. Somewhat ironically, the staff's early successes were best measured by the legislation that it prevented from being adopted. Indeed, in some cases, the staff became a useful scapegoat for a legislator who, on one hand, was forced to

sponsor a constituent's tax proposal but, on the other hand, recognized the bill's serious shortcomings. With clear conscience, such a legislator could assure a constituent that although the bill was introduced, it was opposed by the Commission's staff and thus did not receive the support of legislative leadership.

III. EVOLUTION IN ISSUES STUDIED

Since the Staff will shortly be unveiling its proposals for restructuring major components of the New York tax system, it is an appropriate time to consider two questions raised by Steve Gold in his introductory remarks to this session. First, are today's tax study commissions tackling problems similar to those of earlier groups? To be sure, we all stand on the shoulders of those who have come before us. In a field like taxation, which has traditionally attracted some of the ablest minds in law and economics, we are especially fortunate to have a rich legacy to draw upon. Nevertheless, tax commissions today are plowing new ground that was outside the purview of earlier studies. For example, most of the areas that are of interest in New York have not been addressed in any depth by other commissions, or even by most commentators. For example, should a state adopt ACRS? How should the taxation of transportation companies respond to the federal deregulation of that industry? Is a graduated corporate tax rate an effective means of assisting small business? What is the economic impact of a state's investment tax credit? How should a state corporate tax treat interest, capital gains, or dividends? Is a double-weighted receipts factor an efficient way of encouraging export industries? Do itemized deductions have a role to play in a state income tax? Although a few of these subjects are unique to New York, most of the others clearly indicate how the issues

faced in the 1980's are different from those of earlier commissions. Reading some of the earlier studies makes one yearn for the halcyon days when the most significant issue was whether a state should adopt a sales tax or a personal income tax. This evolution in agenda is entirely natural, and future commissions will undoubtedly pine for the uncomplicated days of the 1980's. One safe prediction is that future commissions will deal with the tax repercussions of the on-going technological evolution, an area which the New York Tax Commission has addressed,21 but not with the rigor or urgency that will be imposed on future studies.

IV. MEASURING THE SUCCESS OF A COMMISSION

Steve Gold's second question is more difficult and involves evaluating the "success" of a commission. One tempting criterion for success is whether a commission's recommendations were actually adopted. That test should be rejected, however, because the vagaries of the political process are independent of whether a commission or its staff discharged successfully their tasks. It is more important to bring people to their senses rather than to their feet.

If legislative adoption of a commission's recommendations were the most relevant criterion, the New York Tax Commission could easily be an overnight success by pursuing the following precepts. First, parade forth the commonly used tax burden studies, relying on over-simplified aggregate measures such as taxes per capita, or taxes per thousand dollars of income to show how "high" New York taxes are. Second, hire an accounting firm or some other group not versed in polling techniques to ask businesses whether taxes

are too high and to ask them to rank the importance of taxes in their decisions about where to locate.22 Third, conduct a regression analysis "proving" that high taxes have caused low growth in the state. Finally, wave the banner of business climate and economic development and recommend that taxes be reduced. In a year like the present, in which New York has a surplus, such a recommendation would be irresistible, but should that fact alone indicate that the Tax Study Commission was "successful"? Certainly, the quality of a commission's work must be factored into the "success" quotient.

Rejecting the criterion of whether a commission's recommendations were adopted, however, is easier than formulating the appropriate indicia for success. New ideas usually need a gestation period and a commission's impact on future developments might not be obvious. A commission can easily alter the contours of subsequent debate over state tax policy and be the progenitor of future legislation, yet the relationship may not always be obvious.23 Further, a commission may influence the course of events elsewhere, as well as in its own state.24 Even measuring the quality of a commission's work is difficult without completely understanding the budgetary, political, and time constraints imposed on its staff.

IV. INSTITUTIONALIZING TAX REFORM

Time constraints are probably the most serious impediments that can be imposed on a Tax Study Commission. Developing a data base, building computer models, performing sophisticated analyses, negotiating with various constituencies, and drafting legislation are inherently time-consuming tasks.

Our work in New York has convinced the staff that a short-term tax study is not an adequate response to the kinds of issues that have suffered from benign neglect throughout the years. Moreover, the U.S. Treasury's recent bold and courageous study of the federal tax system, which will be the centerpiece of future debate over federal reform, may have dramatic implications for most states. Unless the states have the capacity to analyze the repercussions of the Treasury's recommendations and any likely Congressional response, they might be forced to respond to major perturbations in their tax structure without an adequate "game plan." The prospect of serious federal tax reform provides one more justification for institutionalizing the process of state tax reform, that is, imposing some kind of permanent management system on the process of tax planning.[25]

Most states lack any meaningful institutional leadership regarding tax planning and policy. One of the agencies that might be considered a candidate to assume that role--the state tax department--is typically too busy responding to other crises and is usually one crisis behind. Legislative committees on ways and means or finance usually fare no better. Consequently, few states have a permanent body capable of monitoring and providing oversight of the tax system.

Needed instead of an ad hoc, short-term commission is a permanent body, perhaps akin to the U.S. Congress' Joint Committee on Taxation, which is respected for its nonpartisan expertise. A permanent body, charged with protecting the integrity and intrinsic harmony of a state's tax structure, might be able to reduce the frequency of piecemeal legislation and to coordinate the different viewpoints of affected groups. This type of ongoing group could undertake necessary research and analysis, educate a legislature

about how the law is operating, evaluate alternatives, initiate proposals, and draft legislation more carefully than is usually possible.

Perhaps even more importantly, a permanent body would provide a balance to studies that occur in most states, which are usually sponsored by various vested interests, such as labor, business, or public interest groups. While the quality of these studies varies greatly, many are short on analysis but typically long on rhetoric and, in some cases, distortions. Repeated often enough without being challenged, however, the line between rhetoric and reality can become blurred. A Chinese proverb states that "in the land of the blind, the one-eye is king." Without a counter-weight, it is too easy for one of these groups to become "king" and exert a disproportionate influence on public debate over state tax policy. A permanent body can provide exactly that needed balance. In any event, institutionalizing the process of tax reform and planning is unlikely to be less effective than the already feeble attempts that most states make in this area.

* Richard D. Pomp, Director, New York Tax Study Commission, Visiting Scholar, Harvard Law School; and President, Institute on Taxation and Economic Policy. The text is based on a transcript of Professor Pomp's oral remarks at the Conference. Footnotes have been added.

1. See The Article 9-A Franchise Tax: The Alternative Tax on Capital, Staff Report of the New York Tax Study Commission.

2. See The State Personal Income Tax: Taxation of the Family and Low Income Relief, Staff Report of the New York Tax Study Commission.

3. The state sales tax was adopted in 1965 and appears quite modern if compared with the rest of the tax system. The state sales tax, however, was modeled after New York City's sales tax, which was enacted in 1934. This 1934 law was based on a sales tax that the state had used temporarily during the Depression. See, the New York Sales Tax: An Introduction, Staff Report of the New York Tax Study Commission.

4. New York Tax Law (NYTL) s1115(a)(11). This provision may be unconstitutional if anyone cares enough to challenge it.

5. New York State Department of Taxation and Finance, Publication No. 880, List of Taxable Exempt Foods and Beverages (1983).

6. New York State Department of Taxation and Finance, Publication No. 820, Taxable Exempt Drugs, Medicine, and Toiletries (1979).

7. See, e.g., Container Corp. of America v. Franchise Tax Board, 103 S. Ct. 2933(1983); F.W., Woolworth Co. v. Taxation & Revenue Dep't., 102 S. Ct. 3128(1982); Asarco, Inc. v. Idaho Tax Commission, 102 S. Ct. 3103(19820; the Article 9-A Tax; The Taxation of Investment Income, Staff Report of the New York Tax Study Commission.

8. See, e.g., Transportation Taxes in New York State, Staff Report of the New York Tax Study Commission.

9. See, e.g., The Article 9-A Franchise Tax: The Taxation of Investment Income, Staff Report of the New York Tax Study Commission.

10. See, e.g., The Article 9-A Franchise Tax: Should New York Adopt ACRS?, Staff Report of the New York Tax Study Commission.

11. The results of that re-examination appear in a lengthy series of Staff Reports on the personal income tax.

12. For a complete discussion, see Interstate Business Locational Decisions and the Effect of the State's Tax Structure on After-Tax Rates-of-Return of Manufacturing Firms, Staff Report of the New York Tax Study Commission.

13. See The Article 9-A Franchise Tax: The Investment and Employment Tax Credits, Staff Report of the New York Tax Study Commission.

14. See The Article 9-A Franchise Tax: The Double-Weighted Receipts Factor, Staff Report of the New York Tax Study Commission.

15. Members of the Commission are: Assemblyman Daniel B. Walsh, Chairman; Senator Mary G. Goodhue, Vice Chairman; Assemblymen Jerrold Nadler, Barbara A. Patton, William J. Larkin, Jr. and Robert A. Straniere; and Senators Joseph L. Bruno, Walter J. Floss, Jr., Donald M. Halperin, and Andrew Jenkins. Although not a member of the Commission, Stanley Fink, Speaker of the Assembly, was instrumental in its creation.

16. See, e.g., The Article 9-A Franchise Tax: The Interest Add Back Rule, Staff Report of the New York Tax Study Commission; The New York State Tax Appeals System, Staff Report of the New York Tax Study Commission; the Article 9-A Franchise Tax: The Income-Plus-Compensation Alternative, Staff Report of the New York Tax Study Commission; A Graduated Corporate Franchise Tax, Staff Report of the New York Tax Study Commission.

17. See Interstate Tax Comparisons: An Introduction, Staff Report of the New York Tax Study Commission; Interstate Tax Comparisons of Individuals, Staff Report of the New York Tax Study Commission; Interstate Tax Comparisons of Corporations, Staff Report of the New York Tax Study Commission.

18. See Gold, The Legislative Role in State Tax Policy Making, Proceedings of the 1983 NTA-TIA Conference, p. 226. Issues of tax administration often provide a large payback for a small amount of effort. In one afternoon, the staff of the New York Tax Study Commission uncovered millions of dollars in taxpayer errors by performing a rather simple computer match. See The Article 9-A Franchise Tax: The Investment Credit, Staff Report of the New York Tax Study Commission. For some of the Commission's work on tax administration, See Blueprint for Progress in Tax Administration (forthcoming Saga Press); An Evaluation of the Sales Tax Audit Program of the New York State Department of Taxation, Staff Report of the New York Tax Study Commission.

19. See, e.g., The Personal Income Tax: Introduction, Staff Report of the New York Tax Study Commission, in which the concepts of facial or recordkeeping conformity are developed.

20. The staff quickly came to appreciate the typical lament of a tax study commission--the lack of data for policy analysis. See Strauss, Findings of the 1981 Pennsylvania Tax Commission, Proceedings of the 1981 NTA-TIA Conference, p. 216. Logically, a tax department should be a cornucopia of useful data. Often, however, the criterion used for compiling data is whether they will be useful in auditing taxpayers. Information critical for policy analysis may be unavailable if it is not needed by tax auditors.

21. See, e.g., The Article 9-A Franchise Tax: The Property Factor, Staff Report of the New York Tax Study Commission.

22. The defects of such surveys are well known. See Interstate Business Locational Decisions and the Effect of the State's Tax Structure in After-Tax Rates-of-Return or Manufacturing Firms, Staff Report of the New York Tax Study Commission; Interstate Tax Comparisons: An Introduction, Staff Report of the New York Tax Study Commission.

23. Compare, for example, Governor Cuomo's recent proposals on ACRS and reforming the personal income tax with The Article 9-A Franchise Tax: Should New York Adopt ACRS?, Staff Report of the New York Tax Study Commission, and The State Personal Income Tax: Taxation of the Family and Low Income Relief, Staff Report of the New York Tax Study Commission.

24. Legislators in California, for example, are drafting bills based on the staff's proposal to limit losses from registered tax shelters. See The New York Personal Income Tax: Tax Shelters, Staff Report of the New York Tax Study Commission; Legislators in Florida have expressed interest in the staff's proposal to deny a deduction for franchise taxes paid to other states. See The Article 9-A Tax: The Deduction for Corporate Income Taxes Paid to Other States, Staff Report of the New York Tax Study Commission.

25. For an exhaustive and perceptive treatment of this proposal, See McIntyre & Oldman, Institutionalizing the Process of Tax Reform; A Comparative Analysis (1975).

STATE TAX REFORM: The Role of The Tax Study Commission

by

Robert D. Ebel

Executive Director,
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Minnesota Tax Study Commission (1983-84)

Remarks Before the

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Tax Institute of America
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One of the growth components of the state and local sectors may be that of the major Tax Study Commission, which is generally charged with providing a learned, systematic and comprehensive analysis and set of recommendations for tax policy. Such commissions are likely to become even more important in the next few years if at least two circumstances occur: the Congress makes the kind of sweeping changes in the federal tax code such as those that have been recently suggested (December 1984) and the work of the present set of tax study commission's are judged as having been successful in their particular political environments.

Although the structure of these Commissions varies from state to state, they typically consist of a group of distinguished citizens, most of whom are not tax practitioners, and who are broadly representative of diverse interests throughout the State (Exhibit 1). They are appointed by the Executive and/or legislative leadership and charged to hire staff, adopt rules for conduct and procedure, and then report out a set of policy recommendations.

The substantive issues these tax study commissions address vary according to their times as well as their particular (state/local) context. Accordingly, there is no easily transferrable set of lessons regarding policy outcomes. Thus, what is important -- and, in fact, what might be labeled as the first of three "principles" of tax study commissions -- is that process matters. Without early agreement on process, then the quality of everything else the Commission does, ranging from the production of technical papers to its final decisions, is compromised.

The second principle, which if it were not so important could be omitted since it is so obvious, is that that Commission process be well directed. And that direction must

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come from the members, generally, and, especially, the Commission Chair (I'll bet you thought I was going to say the Executive Director!) Because these commissions are fundamentally political -- in the sense here that politics means people bringing to bear their interests and values on issues of public policy -- their success ultimately depends on a chair and a membership that understands how their role and their final tax policy solutions will fit into the overall fiscal and political context of the State. It is the ability to recognize and exploit this characteristic that will make the effort a credible one.

A third principle is that the Commission be established with broad political support. That way the community sends a signal to the Commission that their work is important. Usually the commission members serve without pay and yet put in hundreds of hours; thus, at the very least, the public service aspect of the membership be recognized. One way to show this is for the State to provide an adequate budget for the Commission operations. Both of the Commissions that I have worked with, fared well in this general regard. The District of Columbia Commission ($250,000) was the first such group of its type that was established by the post-1975 "Home Rule" D.C. government. D.C. was proud of its new status, and people wanted it to do well. Similarly, there was much agreement in Minnesota that a major state/local tax study was needed. The Minnesota Tax Study Comission ($625,000), which was patterned after a similar 1956 effort (and along with the Harvey Brazer's 1958 Michigan study, provides the "model" for the subsequent generations of tax study Commissions)[1] was created by a Democratic governor, and had support of the previous Republican Administration, credible public interest groups such as the Minneapolis - St. Paul Citizen's League and the Minnesota Taxpayer's Association, and some key legislators.

Commission Membership

In the last few years the state/local tax study has usually taken one of two variants with respect to its membership. The membership either includes elected representatives of the legislature or Executive branch, or of citizens who represent the various interests in the State.

Both D.C. and Minnesota were citizen groups. The advantage in the citizen's commission is that it minimizes two problems: having a membership that feels it must defend past tax law decisions because "that is the way it worked in the conference committee" and the temptation to tailor the study scope and recommendations toward (or against) the appointing authority's interests. Although institutionalizing this distinction between Commissioner and Lawmaker may ultimately provide the sort of Report the appointing authority wishes had never been released, from a community perspective that risk is certainly well worth taking. In the case of the Minnesota Commission, some particularly difficult and bold choices were made. The Report, which was signed by all members, included recommendations for sales tax base expansion to clothing and services to persons, major property tax reform including reducing the number of tax classification for 70 to 3, the elimination of all but one of eleven tax relief credits and refunds, federal personal income tax conformity, and a 20% cut in personal tax rates. In a state where the Senate Majority leader proclaims that "a simple tax cannot be fair and a fair tax not simple," these recommendations are indeed heavy stuff, I assure you.[2]

Perhaps the same sort of bold and unanimous outcome could work with a group that includes Commissioner-Legislators. But I would expect that to be unlikely. At the very least, there is always the temptation (indeed, the necessity?) for a legislator to position onself for the

bargaining that will occur in the session. If there is agreement that tax commissions are not lawmaking bodies, then it follows that the membership should not consist of lawmakers.

The Schedule and Process

In its early stages a study commission must reach agreement on two related points: first what will the Final Report look like? And, second, what sort of work schedule does the membership have ahead in order to accomplish that goal? Again, perhaps these questions seem too obvious to mention. But, in fact, a lot of policy is implicit in the answers since it requires that decisions must be made not only on procedures, staff size and budget, but also on the calendar and thus, the study scope. Setting the calendar was a particularly important part of the Minnesota Commission's process since it was clear from the outset that there was to be no extension of its 15 month existence (October 1983 -- December 15, 1984). Accordingly, in order to avoid what was labeled the "accordion effect" -- viz, a concern that as the project neared completion that the research product and list of decisions to be made would be too great to permit informed policy judgments to be made -- in October 1983 the Minnesota Commission set (and then stuck to) a year long calendar that detailed 24 meetings by a date, length, place and substantive topic for discussion. Agreement on these points was not only important for the reasons already mentioned, but also for purposes of determining staff size (a combination of ten in-house staff persons plus 20 consultants who provided technical papers) and then organizing a clear set of staff deadlines, which were never, never missed (well, hardly ever).

The Minnesota calendar made explicit the following four part process:

- Public hearings and workshops. Public hearings were held in six locations throughout the State in November and December. Since Minnesota is a State where good government is taken very seriously and the media and private sectors sense of community responsibility is high, the hearings generated a voluminious amount of testimony and coverage. These hearings also set the precedent of having all subsequent Commission deliberations held in an open meeting format (although after those six hearings all other public testimony other than that submitted in written form was excluded). In addition to receving testimony from the public, the Commission met in technical workshops organized by the tax section of the Minnesota Bar Association and the Society of CPAs.

- Principles and Goals. Rather than immediately delve into specific tax issues, the Commission members spent fully half of its existence educating themselves on broader issues. The first task was to debate and then unanimously agree upon a set of guiding principles and normative goals for state/local tax policy. This part of the process was most important since it provided an intellectual discipline for the subsequent discussions relating to the choosing between alternative recommendations for tax policy. By the time the Commissioners came to discussing, say, the appropriate tax treatment of health insurance, all were comfortably debating the tradeoffs with respect to such objectives as neutrality and equity. This is, of course, not to say that each Commissioner gave equal weight to the tradeoffs associated with the policy choices; but that there was a common understanding on what basis the final recommendations would ultimately be made. At this point the Commission had already emerged as something quite different

from the conference committee. An explicit set of long term principles and goals were "in" and logrolling was "out." That this characteristic was achieved in the early stages of the Commission was a key (though not the only) factor that permitted the membership to avoid the end-of-year accordion effect.

- Research and Development Specific Tax Policy. Once the principles and goals were established, the research presentations and policy deliberations were divided in two parts. The Commission first thoroughly examined the (non-tax) institutional arrangements and the long term economic, demographic and technological trends that characterized the State. Topics included relationship between the States's economic base and alternative tax bases (consumption, personal income, business receipts, consumption) state-local intergovernmental linkages (70% of Minnesota State taxes are passed through localities), and the relationship between Minnesota taxes and changes in private sector employment. Only once this research was presented and discussed did the attention then turn to specific taxes and their alternatives. Here the topics ranged from the big three taxes (with the property tax and its interplay with direct and indirect local aid emerging as Minnesota's equivalent of the Gordian knot) to how to tax telephone companies in an era of degregulation and rapid technological change. Although some observers worried that by putting off any discussion of specific tax reform until its last five months the Commission could never get its work done, quite the opposite proved true. By organizing itself to first thoroughly understand the framework for judging fiscal policy, the Commission membership achieved a (high) level of expertise that made its subsequent decision process on tax structure most efficient.

- Voting. Here is a tough one: should the Commission vote as it goes through its calendar on a topic-by-topic basis; or, wait until the end and make it a long day?

The District Commission took the first path by "tentatively" voting on each topic and then reaffirming the whole set on the last meeting day. This process worked well, with only one of about 65 recommendations being reversed from its tentative vote. There were two reasons for this success. First, although all D.C. meetings were open to the public, very little attention was paid to the Commission's deliberations until the very end. Why this is true is not clear, although one hypothesis is that it can be explained by the fact that since D.C. was new at home rule, people simply did not think about attending District government meetings.

The second reason the D.C. voting procedure worked is that the tax system there was (and still is) not of the overlapping variety. Thus, one could make a decision on property tax relief (the basic choice was circuit breaker vs. specific dollar homestead exemption) without raising the state vs. local aid and accountability issue. The most troublesome accountability issue in the District pertained to the "Federal Payment," the District's substitute for state to local aid.

Quite the opposite of these two conditions exists in Minnesota. First, to announce an open meeting in Minnesota at which taxes will be discussed can draw hundreds of people. Its not quite the crowd one gets on Mille Lacs lake on the first day of fishing season; but its something like that. Moreover, unlike

the Washington papers, local tax issues are thoroughly (and, in our experience, very accurately) covered in great detail. The very fact that the Minnesota Commission even discussed broadening the sales tax (in August) generated news articles and then an outcry from part of the public. Suffice it to say that although this openness was not a reason for not voting on issues on a tax-by-tax basis (as noted above, the Commission did vote to adopt a set of goals), it gave some members reason to consider whether waiting to the end might not make life easier.

However, more important to the decision to wait until the end to vote was a recognition that because the Minnesota system of income, sales, and property taxes and state aids are so intertwined, that any tax-by-tax process would have had to have been probably overhauled in the end anyway. So, rather than look indecisive by appearing to reverse itself on earlier votes once new information of the tax interplay became available from staff research, the Chair's recommendation to only vote at the end was agreed to. The alternative, which was prefered by some Commissioners, was to vote on a tax-by-tax basis with respect to the equal yield structure whenever possible. If that path had been chosen with an exception made to delay the vote on the property tax, things would have probably worked out. However, the Chair's approach turned out quite successfully and had the added dividend of letting the Commission approve a tax <u>package</u> in a manner that made the tradeoff among the goals explicit. For example, those Commissioners who were especially uncomfortable with higher sales tax burdens were able to show that in combination with lower income tax rates that the net effect was an overall reduced burden and increased fiscal stability.

Judging A Commissions Work

What are the criteria to be used for judging whether a tax study commission is "successful"? An appropriate way to begin the answer to that question is to first comment on one of the least important of the criteria -- viz, how well the recommendations fare in the next legislative session. Since the Commission took as its charge to make its recommendations in the context of long term trends and broad policy goals, what happens in the "next session" is not that important. Indeed, many recommendations will not even be designed for immediate enactment (the taxation of telephone companies is an excellent example).

What, then, might be an appropriate set of criteria for judging a tax study commission? By borrowing from and then supplementing a list that Paul Peterson provides in the Winter 1983 issue of the Brookings Review, let me suggest the following four.

- Did the Commission raise the level of the State's tax policy discussion? That is, did it provide the kind of information that cut through the veil that is often placed upon tax discussions with such popular devices as the anecdote, the survey respondent reporting bias, and the state ranking game. This is not to say that the Commission must, or even can, clear up all the local folklore relating to taxes; only that it should raise the level of and set the parameters for the discussion.

  Recognizing that as Executive Director of the District of Columbia and Minnesota studies, I may have a respondent reporting bias in judging these two efforts, I think the verdict on whether these Commissions satisfied this criterion was probably "yes" in D.C. and, based on initial reactions, will definitely be "yes" for Minnesota.

In the District, nearly all of that Commission's sixty plus recommendations have been debated and with one expert (D.C. Associate Revenue Director, Bill Cook) documenting that with respect to those issues that the Commission examined, the Report was a key part of these discussions.[3] Again, this certainly does not mean that the Commission's view will necessarily prevail. For example, the District Commission recommended (1977) that the city not abandon the standard of assessment uniformity with respect to the real property tax. During the next two years, however, the D.C. Council did adopt a system of three classes -- an outcome that Cook notes would probably have been more complex had the 1977 Commission not urged uniformity.

It is much too soon to say whether the Minnesota study will be judged successful according to the above criterion. One will know much more about that over the next few years. But, the Report is off to a good start. While keeping clear of endorsing the whole range of the recommendations of the Tax Study Commission, the Democratic Governor and the Republican Chair of the House Tax Committee have both indicated that the Report will be a working document. The Governor has already (January 1985) followed up on two key Commission recommendations regarding the individual income tax; and the House Tax Committee has announced plans to use the Commission's document as a basis for educating the House regarding Minnesota state/local taxes. Furthermore, as of this writing, one public interest group that includes in its member academic, union, business, community, and elected state/local leaders has tentatively voted to endorse the report as "a basis for Minnesota tax policy discussions over the next decade." To quote one of its members, "at least everyone will be singing from the same song sheet."[4]

- <u>Did the Commission Ask the Right Questions?</u> In creating the Minnesota Commission, Governor Rudy Perpich called for a "systematic, and learned review of economic and tax policies in order to provide ... directions for Minnesota into the twenty first century." That charge not only set the tone of the tax study, but brought into focus a characteristic that a tax study must have in order to be pronounced a success: did it correctly identify the right set of economic, institutional, and technological developments that will impact the tax system in the years (e.g., decade) ahead? In D.C. and Minnesota it was certainly the intent to accomplish this goal. This was done by first designing the research agenda in order to address these topics and then, subsequently relating these research findings to specific tax issues throughout the policy deliberation process. Again, it will take some time before the judgement regarding the degree of the Minnesota success can be made.

- <u>Did the Report adequately document and publish its Findings and Recommendations?</u> The job of the staff is to document a problem and lay out the policy options. But that is not enough. In addition the Commission must make explicit why it reached the conclusions it did. This includes making explicit the policy tradeoffs and philosophical values that are inherent in its recommendations. I am confident that a reading of the final documents of both the D.C. and Minnesota studies will show that this criterion was met. Indeed, in the case of the Minnesota study, especially close attention was paid to this feature due to the fact that the Commissioners had to take on some hotly debated but largely unanalyzed views on specific topics (e.g., "business climate,"

the effect of state-financed property tax relief on mill rates). Because the Commission knew that its findings and recommendations were certain to stir controversy, it wrote the language of its recommendations in a manner that was designed to educate the public regarding the tradeoffs it had made in reaching a particular decision.

- Did the Commission make explicit how its solutions could be accomplished? One has to be careful in expecting too much regarding this last criterion. One cannot let a Commission become so bogged down in operational detail that it runs the risk of not only wasting its time (which, in turn, may mean missing deadline) but also failing to identify broad principles, goals, and policy directions for the year ahead. For example, in Minnesota, there is good evidence that due to the design of the property tax relief system, there is a local expenditure stimulation effect that over time generates even higher property tax burdens (which in turn leads to legislation providing for additional relief, and so it goes). Accordingly, in its recommendations, the Commission proposed an alternative property tax system designed to provide tax relief in a manner that would significantly reduce the built-in incentive for local units to increase mill rates. The alternative included a credit targeted to persons with low incomes and to owners of low valued homesteads and small farms. Because there are a large number of possible credit schedules (matrices) that could accomplish this task, the Commission stopped short of endorsing any single matrix as the "correct" one. What it did do, however, was provide an upper bound estimate of the cost to the state treasury assuming that most persons in the targeted class would be held harmless.

However, when it came to addressing the issue of the correct state/local "mix" of taxes among property, sales and individual income, the Commission concluded that because of the importance of their specific recommendations for achieving their broadly stated principles and goals, that it was necessary to show that its recommendations could be made operational, that is, that the numbers "worked" (Exhibit 2). In order to accomplish this, the major recommendations were carefully costed out on the basis of 1985 data. By doing this, the Commission did not mean to imply, however, (and there has been some misunderstanding on this), that it was therefore recommending immediate action on its package. What it did want to do was to show that their's had not been an "ivory tower" exercise.

EXHIBIT 2

THE PROPERTY TAX

Future Policy Directions	Implementation ($ FY 85)
• Simplify and make explicit the tax structure and its impact. • Give preferential treatment to homeowners and farmers. • Eliminate the "expenditure stimulation" effect of a tax credit system that automatically encourages higher property tax levels.	• Reduce the number of classifications (estimates range from 20 to 70) to three [residential homestead and agriculture; residential non-homestead and apartments; and all other property with assessed to market value ratios of 1/3, 2/3, and 3/3, respectively.].
• Improve the accountability of the intergovernmental system. • Add to property tax equity by designing a tax that more closely approximates a tax on wealth as measured by real estate value.	• Eliminate the nine existing property tax credits and three refund programs, thereby creating a windfall to the state General Fund of approximately 30% of gross property tax collections ($803 million).
• Directly and explicitly address the need to reduce the property tax burden on low and middle income households and small farm homesteads.	• Relieve this fiscal windfall in the form of tax relief through a combination of reduced mill rates and grants to equalize fiscal disparities among localities ($624 million) and an income/wealth property tax credit ($180 million) targeted to low income homeowners and small farm homesteads (520 acres and below).
• Free local assessors from administrative encumbrances of carrying out the task of fairly and accurately assessing property.	• Classification reform plus retention of the comparable sales approach to agricultural land.

Personal Income Tax

Future Policy Directions

- Reduce use of taxes shown to have negative effects on employment growth.
- Make Minnesota's tax system more competitive by reducing taxes that exhibit tax efforts well above the other states.
- Use the progressive personal income tax as a tool for offsetting tax regressivity inherent in other parts of the Minnesota fiscal system.
- Simplify the tax in order to facilitate taxpayer compliance and government administration.
- Add to the certainty and predictability of revenues.
- Promote accountability.

Implementation ($ CY 85)

- Reduce the level of the income tax and lower effective tax rates on all income classes (20% or $477 million).
- Concentrate tax cuts in low and middle income groups; fund a property tax credit targeted to low - middle income homeowners, farmers, and renters designed to offset the additional tax burden for those least able to pay.
- Conform to federal taxable income while maintaining a separate Minnesota tax rate schedule.
- Eliminate the "federal deductibility" provisions and reduce effective tax rates accordingly.
- Adopt complete tax indexing.

GENERAL SALES AND USE TAX

Future Policy Directions

- Increase horizontal tax equity (equal treatment of equals).
- Add to the overall stability of the Minnesota fiscal system.
- Change the Minnesota tax mix by relying more heavily on sources for which there is an "excess capacity to tax" relative to the other states.

Implementation ($ FY 85)

- Broaden the sales tax (now among the nation's most narrowly based) to personal services and new clothing.
- Maintain the present 6% tax rate ($177 million in new revenues).

E N D N O T E S

1. *Report of the Governor's Minnesota Tax Study Committee (Minneapolis: Colwell Press, 1956).* The Committee was chaired by J. Cameron Thomson and Directed by Harvey E. Brazer. Harvey E. Brazer, Ed., *Michigan Staff Study Papers* (Lansing: *Michigan House of Representatives, 1958).*

2. Senate Majority Leader, Roger Moe on Minnesota Public Television's *Minnesota Issues*, December 16.

3. Memorandum to the Minnesota Tax Study Commission, January 1984.

4. St. Paul *CityBusiness*, December 19-21 issue.

THE COOPERS & LYBRAND APPROACH TO THE IOWA TAX STUDY

Case Study on the Benefits
Brought by a Consulting Firm
to a
State Tax Study

(Speech Presented to the NTA-TIA Conference,
Session on State Tax Studies,
November 27, 1984

by
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THE COOPERS & LYBRAND APPROACH TO THE IOWA TAX STUDY

The purpose of my discussion today is to review the benefits that can be gained from using an outside consulting firm to perform a review of a state's tax structure - either evaluating the structure as a whole or assessing the effectiveness of a specific aspect of the tax structure. To provide a framework for the discussion, I will focus on an analysis of the work Coopers & Lybrand performed for the State of Iowa and I will provide some background information on the study, describe the methodology we followed, and then make some observations on the benefits of outside consultants.

BACKGROUND

In the face of general worries about the fiscal health of the state, the tax burden borne by its citizens and the effect of the tax structure on economic development, the General Assembly of Iowa created a Tax Study Committee on June 1, 1983. The purpose of the Committee was to:

* examine who pays state and local taxes in Iowa;

* evaluate the impact of taxes on the economy, employment, state treasury and citizens;

* assess changes which could raise revenues more equitably and improve the performance of the State's economy;

* determine the enforceability of tax laws;

* compare Iowa's tax structure with that of other states; and,

* examine tax preference items.

The Committee was composed initially of nine representatives of the general public (two additional members were appointed early in 1984) and four ex-officio sitting legislators. Although the Committee could rely on the services of general state government offices and agencies, no research staff were appointed directly to serve the Committee. In effect, the role of the consultant was to serve as the research staff. The Committee issued an RFP for a consultant to assist in the study and C&L was awarded the contract. Coopers & Lybrand relied on three of its offices to conduct the study: the Chicago-based state and local tax practice; the Economic Development consulting practice located in Washington, D.C.; and, of course, the Des Moines practice office.

Our interaction with the Committee was extremely important to the conduct of the study. During the course of our participation which ran from February 1 to mid-December, 1984, we held fourteen meetings with the Committee.

During the meetings we would review the actual tasks we had performed in the interim period and discuss the significant findings resulting from these tasks. In addition, we would develop the framework for further analyses and obtain agreements from the Committee that these were areas of concern.

METHODOLOGY

The study was conducted in three distinct phases:

Phase I: Organization and Data Collection

Phase II: Data Analysis

Phase III: Policy Analysis and Report Preparation

The methodology used in conducting each of these phases is described below.

Phase I: Organization and Data Collection

The purposes of this phase were to establish the formal goals and objectives of the study, to develop an analytical framework for conducting the study, and to collect data to be used in the study in an appropriate format. This phase was organized into seven tasks.

Task 1: Project Initiation Meeting

During this meeting on February 1, the Tax Study Committee established the method of communication between the Committee and Coopers & Lybrand and agreed to the policy determinants, burden study categories, and study work plan as set forth in the proposal.

Task 2: Meetings with Representatives of Key State Agencies

During Phase I, the Coopers & Lybrand study team members met with members of the following state agencies:

* Comptroller's Office
* Department of Revenue
* Legislative Service Bureau
* Department of Job Services
* Office for Planning and Programming
* Iowa Development Commission

During these meetings we assessed the availability of data both on tax revenues and on economic parameters within Iowa, gained information on the specific components of the tax structure, and discussed the impact of the tax structure on the economy.

Task 3: Literature Search

A literature search was conducted during the initial stages of Phase I to gain a thorough understanding of issues pertinent to the study. Major topics covered by the literature search were:

* Theoretical issues relating to tax incidence and tax capacity;
* Changes in state taxes over the past five years, including an assessment of unitary taxation;
* Relationships between tax structure and incentives on economic growth and development;
* Significance of the underground economy; and,
* U. S. and state court decisions on the constitutionality of various state and local taxes.

The result of the literature search provided us with a framework for analyzing key issues in the current Iowa tax structure and with guidelines for developing areas to be evaluated during the policy analysis.

Task 4: Collect Data Regarding Iowa's Economic Growth and Development

Data on Iowa's growth and development were collected at the state level from the Office for Planning and Programming, the Department of Job Services, and the Development Commission. These data were augmented on the national level by statistics collected from the Bureau of Labor Statistics, the Department of Commerce, and the Internal Revenue Service.

Task 5: Aggregate Data for Tax Burden Study

Task 6: Aggregate Data for Tax Expenditures Impact Analysis

(Because the work in each of these tasks was quite similar, they will be described together.) The initial work in this task was to determine for each tax (individual income, corporate income, sales and use, motor fuel, estate and inheritance and property) and each tax expenditure item the categories for analysis and the definition of terms. Matrices for both the tax burden analysis and the tax expenditure analysis were compiled providing, by tax, a list of types of analysis and a description of each analysis. The matrices were distributed and discussed with the Tax Study Committee at the progress meetings on April 26 and June 20.

Categories for analysis were chosen to provide measures of both horizontal and vertical equity for each tax and tax expenditure item and to show the total impact of each tax expenditure item. Data were collected for the period 1978 to 1982 in order to gain information on historical changes and to assess the effect of these changes on the economy.

Data were provided to us by the Department of Revenue according to the specifications detailed in the matrices. The Comptroller's Office provided us with data, by county, detailing taxable value and levy value by urban and rural property class. As part of this task, data on property tax were input into a computer model for further analysis.

Task 7: Obtain Information Regarding Auditing and Collection Activities

To conduct this task, interviews were held with officials representing the Department of Revenue in Iowa and other states to obtain information on the administration of each tax. This information was presented during Phase III, Policy Analysis.

Phase III: Data Analysis

The purpose of this phase was to evaluate the data collected during Phase I to provide a quantitative description of the impact of the current tax structure.

Task 8: Analysis of Tax Burden Data

Each tax was evaluated to determine the impact on vertical and horizontal equity and the relationship between tax revenues received and the performance of the state economy.

Each tax was evaluated as follows:

* Personal income tax: Vertical equity was measured by dividing net taxes paid by Iowa Net Income by income bracket. Horizontal equity was measured by determining the impact of the tax structure by filing status, family size, urban and rural counties and geographical area.

* Corporate income tax: Vertical equity was measured by dividing net income taxes paid by Iowa Taxable Income by income bracket. The impact of apportioning or non-apportioning status, type of business, and geographical area on tax revenues was evaluated.

* Sales and use tax: Sales and use taxes were evaluated by type of business and by geographical area.

* Motor fuel tax: Revenues received by type of fuel were measured.

* Inheritance and estate tax: Taxes paid by type of beneficiary were measured.

* Property tax: We evaluated taxes paid by urban/rural classifications. Revenues received before credits were compared to assessment values after equalization and rollbacks for all categories.

Task 9: Analysis of Tax Expenditure Data

The following tax expenditure items were evaluated:

Personal Income Tax:	Personal Credits
	Dependent Credits
	Federal Tax Deduction
Corporate Income Tax:	Federal Tax Deduction
	Venture Capital Credit
	R&D Credit
Sales & Use Taxes:	Food Exemption
	Prescription Drug Exemption
	Fuel Subject to Motor Fuel Tax Exemption
Motor Fuel Tax:	Gasohol

Estate and Inheritance Taxes:	Individual Exemptions Surviving Spouse Credits
Property Tax:	Limitations (Rollbacks) Personal Property Exemption Urban Revitalization Tax Exemption Agricultural Land Credit Elderly and Disabled Credit Homestead Tax Credit Machinery and Computer Credit Military Service Exemption

For each tax expenditure item, we measured the total dollar amount of "lost" revenues, or the revenues that would result if the expenditure item were not allowed. In addition, for the personal income tax expenditure items, we estimated the impact of each expenditure on horizontal equity. Also, when a possible modification was analyzed involving elimination of any expenditure item, the specific amounts attributable to the expenditures were calculated.

Task 10: Comparison of Iowa Tax Capacity and Tax Burdens with Those of Other States

Data on the tax structures of other states were collected during this task and added to tax capacity data collected during Phase I. Comparative data were gathered from Annual Reports produced by the Revenue Departments of the surrounding states for each of the last five years; from Commerce Clearing House and Prentice Hall State and Local Tax publications; from various papers published by the National Association of Tax Administrators, the International Association of Assessing Officials, and the Institute of Property Taxation; from the Journal of State Taxation; and from telephone interviews with state tax officials. These data were arrayed to compare Iowa's tax structure with that of competing states.

Task 11: Examination of the Relationship Between Tax Structure and Burden and the State's Economic Performances

As part of this task we evaluated the changes in tax revenues received from specific taxes compared to changes in measures of economic performance such as growth in personal income or gross state product.

To evaluate the impact of possible modifications to the system, a list of modifications which would require further analysis was developed. The list was based on discussions held at progress meetings throughout the course of the study on an evaluation of current trends in state taxes. It was presented to the Committee at progress meetings held on August and September. After discussions with the Committee, we arrived at a final list of modifications for further evaluation.

Each modification was assessed for the probable impact it would have on the policy criteria factors.

Where possible, the impact of the modification on equity and yield was quantified. To quantify the impacts we relied upon analyses performed during Phase II, previous reports prepared by the Iowa Department of Revenue and the Legislative Fiscal Bureau, and special analyses performed for specific modifications by the Department of Revenue and by Coopers & Lybrand.

In conducting the analysis, Coopers & Lybrand developed computer models to evaluate the impact of changes in the corporate income tax structure on total revenues and on hypothetical firms, representative of Iowa's industry, and to estimate the impact of modifications to the property tax.

In addition, we surveyed companies located in Iowa to gain an understanding of the impact of specific taxes on business location and expansion decisions. The survey results were compiled and presented at the September progress meeting.

Phase III: Policy Analysis and Report Preparation

This phase drew upon the results of the previous phases to provide the Tax Study Committee with an assessment of the current tax structure and a framework for evaluation of possible modifications to the tax structure.

Task 12: Conduct of Policy Analysis

This task was conducted in two steps: an analysis of the existing tax structure and an evaluation of possible modifications to the system.

To assess the current structure, we drew upon the work accomplished during Phase I and Phase II to provide a description of each tax and an evaluation of each tax in relation to four policy criteria factors: equity (both horizontal and vertical), neutrality, yield, and simplicity. In addition, the impact of tax expenditure items on the appropriate tax was discussed. The analysis of the current structure was presented to the Committee during progress meetings in September.

OBSERVATIONS

Those were the legislative goals and the methodology we used in meeting them but any study which is directed by a Committee takes on a life of its own and differs intrinsically from a study which is done either totally in-house or is totally turned over to outside consultants. The diverse backgrounds of committee members is one factor (members generally being chosen to represent various segments of the community) and the dynamics of Committee interaction is another. What emerges from such a study may be something more than the legislative act creating it envisioned.

In Iowa the enabling legislation stressed burden and yield. The Committee members, as they become more aware of the theories behind taxes became much more involved with horizontal equity and the "perception" versus "reality" aspect of the economic development issue.

As stated previously, the Committee was composed of eleven citizen members and four ex-officio members who were sitting legislators. At the beginning of the process the legislators played the dominant role due to their greater familiarity with taxes and to their desire to have their own issues become a part of the study. By the end of the process they had become a true part of the group and their input was valuable, but not controlling.

The evaluation of the impact of possible modifications was presented to the Committee at progress meetings in October and November.

Task 13: Draft Final Report

Task 14: Final Report

The annotated outline for this final report was presented to and agreed upon by the Committee at the progress meeting held on September 27. As the policy analysis was conducted, the results were compiled as sections of the draft report and were submitted to the Committee on an on-going basis in September, October and November. The final report was submitted on November 16.

Task 15: Assistance in Presentation of Final Report

Members of the Coopers & Lybrand study team met with the Tax study Committee to provide assistance in preparation of their final report to the Governor and members of the General Assembly through December 17. In addition the appropriate officials within the state government were provided with computer models developed during the study and with instructions on their use.

The advantages of using a citizen committee are many: those most effected by changes in the tax structure are put in charge of recommending those changes; different segments of the community do the actual voting and are less likely to be influenced by lobbyists for those interests; conclusions reached have more credibility since they arise from a disinterested body not subject to the need to seek votes.

The major disadvantage is the amount of time it takes to familiarize the members with the details of the tax system and with the intracicies of tax policy.

Using an outside consultant also has advantages and disadvantages. The major disadvantage is the inability of the consultant to work directly with tax returns and the need to rely on state revenue officials to aggregate the data in ways which will yield the maximum amount of information needed while respecting confidentiality. The advantages are: the neutrality afforded by use of a disinterested third party; the ability to combine expertise in economics, economic development and taxes; and, the familiarity with other state tax and development aspects.

In the case of the Iowa Tax Study, we believe that the advantages of using a committee to make recommendations and an outside consulting firm to conduct the study far outweigh the disadvantages involved. The Committee members are intelligent and care about the state - both its citizens and its business climate. The consulting firm brings a familiarity with taxes not only at a theoretical level, but at a true working level based on experience with businesses and individuals who deal with the effects of the tax systems of all fifty states.

A comprehensive study, properly done, can lead to better decision-making at a state level for years to come. Such a study lays a theoretical foundation that transcends the necessary "snapshot-in-time" nature of the specific data used. The Committee is still in the process of reaching its conclusions. What these will be and how the Legislature and Governor will deal with them in the political process, are unknown at this time but we do know that the study will have served its purpose as a reference point for the present system and a policy base for future changes to it.

TEXAS EXAMINES ITS TAXES

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Texas has a particular way of studying state issues. A legislative resolution establishes a commission to examine a specific problem. The membership of this commission usually includes the political "leadership"—the Governor, the Lieutenant Governor, the Speaker of the House, the heads of the budget committees in the House and Senate, other prominent legislators, and often the Comptroller, the Treasurer, and other non-legislative elected officials. Sometimes citizens are included, usually individuals with considerable political power; H. Ross Perot, the head of the Select Committee on Public Education, is the archetype of the citizen-member. The commission is then staffed by staff members to the politicians and by individuals borrowed from state agencies.

The conventional reasons for using this method include the need for any study to get the attention of the political "leadership", since political power in Texas is highly concentrated in a small group of elected officials. In addition, in a state chary of spending public money, this method costs very little. Marginal outlays for these commissions are often zero, though the opportunity costs can be substantial.

The Joint Select Committee on Fiscal Policy, created in October 1983 to study tax and expenditure issues, followed this general pattern. The Committee members include the Lieutenant Governor, the Speaker of the House, the Secretary of State, and the heads of the Senate Finance Committee, the

State Affairs Committee, and the House Ways and Means Committee. Ex-officio members include the Governor, the Treasurer, and the Comptroller. The staff to the Joint Select Committee was assembled from the offices of the Governor, Lieutenant Governor, Legislative Budget Board, Comptroller's Office, and the Texas Advisory Commission on Intergovernmental Relations. The only staff members from outside state government included the head of the Texas Research League, a business-supported group that studies public policy issues; a staff member of the Texas Association of Taxpayers, another business group dedicated to low taxes; the Dean of the LBJ School, an ex-state senator; and me, an economist.

The general motive behind the Joint Select Committee was the fiscal "crisis" of 1983. Severance and sales tax revenues had declined, and the legislature in its 1983 session was forced to curtail appropriations since the House—which must originate all tax legislation—refused to increase taxes. With special pressure from teacher groups and highway interests for more funding, as well as some pressing needs for increased social welfare spending, most observers expected a special legislative session to consider tax increases. Another reason behind the Joint Select Committee was the perception of a key staff member to the Lieutenant Governor that revenue prospects in Texas had changed permanently, and that a study of long-run changes was necessary. A third and more pragmatic reason was that several important members of the House were unconvinced that a fiscal shortfall existed; the Joint Fiscal Committee was a vehicle for bringing the magnitude of the shortfall to their attention. The Joint Select Committee was envisioned as the beginning of a longer-run process to analyze fiscal issues in the state with some short-run results, rather than being focused

exclusively on the immediate issues of how to raise taxes. It was also one of several studies and commissions analyzing the state's fiscal problems; others included the Select Committee on Public Education, an independent study of highway financing, and the Comptroller's own study of revenue alternatives.

The original staff plans were to prepare three monographs: one on tax and other revenue issues; one on expenditure patterns and the long-run causes behind them; and one on state-local fiscal relations, concentrating on non-education spending. None of these three areas has been extensively studied in Texas, and all three monographs would have broken new ground. In early discussions, the staff agreed that the results would be comprehensive, free-wheeling, and independent, and would include chapters on alternative revenue sources and other fiscal policies. I interpreted this description to include the standard, garden-variety form of policy analysis—outlining problems, identifying their causes suggesting various solutions, presenting their pros and cons, and making recommendations where the evidence strongly favors one alternative over the others.

My role was to serve as editor and coordinator. Other staff members would write initial drafts in the areas of their expertise. I would criticize and edit these drafts, as well as writing some analytic sections and summaries. Therefore I was not a director in the sense that most state tax studies have had directors with full control over staff. Nor did I have any power over other staff members except the power to cajole and nag. The marginal outlay of the Joint Select Committee was about $25,000, to support three months of my time plus research assistance; all other time spent on staff work was borrowed from other duties of staff members.

Unlike tax studies in many other states, the Joint Select Committee held no hearings at which citizens could present their opinions, although all meetings were open to the public. The Committee did hold one hearing to which it invited several businessmen and economists to discuss the future of the Texas economy. The other hearings of the Committee were staff briefings of Committee members; these were effective in bringing the magnitude of the state's fiscal problems to the attention of important legislators, but these hearings were not designed either to present information to a larger public or to allow citizens to express their concerns. I had pressed for public hearings because of a personal belief in open government and citizen participation, and because the potential role of the Joint Select Committee in educating the public as well as legislators could have been started through public hearings.

One important result of the Joint Select Committee was its effect in changing the opinions of several legislators about fiscal conditions; this paved the way for a large tax increase during the summer of 1984 to fund expenditures for schools and highways. (However, the Joint Select Committee did not participate as a committee in the decision about which taxes to raise.) The staff of the Joint Select Committee also analyzed several specific tax issues: the taxation of bank stock, resolved in the summer of 1984; and the taxation of the telecommunications industry, hazardous waste, and advertising, issues certain to arise during the 1985 legislative session.

A third concrete result of the Joint Select Committee is the publication of a monograph entitled Funding Texas State Government: An Analysis of Taxes and Non-Tax Revenues. (The table of contents for this monograph is included as an appendix.) This monograph presents little new research, because of time

and money constraints, and instead summarizes what is already known about revenues in general and in Texas specifically. At the insistance of other staff members, the monograph foregoes the usual analysis of tax and revenue alternatives. Since it was restricted to being purely educational document, I concentrated on several issues about which there is little information within Texas, or on which conventional wisdoms have developed that need clarification. These include the following:

1. Texas has a tax system with a low income elasticity, masked by a decade of booming severance taxes. The implication, given stagnant energy prices, is that fiscal crises will continue to occur and that the sales tax (with a surprisingly high elasticity) will increasingly dominate state revenues. The first of these has already occurred: the 1985 legislative session faces another fiscal "crisis" despite the large tax increases of 1984.

2. The incidence of taxes is almost never examined within Texas. In fact, Texas has one of the country's most regressive tax structures, since it relies heavily on consumption taxes and has no income taxes.

3. The issue of how high taxes are is a source of frequent complaint in Texas. One chapter of the monograph addresses this issue by showing that real tax burdens have declined since the mid 1970s, and are among the lowest in the fifty states.

4. One powerful convention within Texas is that increasing taxes will ruin the state's good "business climate" and reduce growth. A

chapter of the monograph reviews the empirical evidence on location and business climate, showing that tax levels are generally marginal influences on interstate location decisions.

5. A chapter on non-tax revenues suggests that there are alternative ways to structure highway user taxes and fees, especially truck fees, and that tuition at state colleges and universities is probably too low. These are revenue sources that have been especially impervious to change.

6. Texas receives lower federal grants per capita than most states, and a convention has developed that this is due to federal formulas discriminating against the Sunbelt and in favor of the Snowbelt. One chapter decomposes the differences in federal grants per capita, in order to show that three other causes are important: failure to receive funds allocated as project grants; federal formulas based on need (unemployment rates, for example), where Texas has lower levels of need than other states; and low spending in Texas for Medicaid and Aid to Families with Dependent Children (AFDC), with low matching federal funds as a result.

My hope is that this monograph will generate increased public attention to tax and revenue issues. There is now woeful ignorance about fiscal issues among both legislators and citizens (as there is in every part of the country), and any increased information about taxes and fees would be a step in the right direction. A second potential effect of this Committee is that staff members in state government—particularly those in agencies like the

Legislative Budget Board and the Office the Comptroller—become more skilled at longer-run, analytic research and writing; other observers claim that this process has already started to take place. The effect of a tax study in educating state staff members, in addition to legislators and the public, is a result more easily achieved by including these individuals in a study, rather than having the study done by a group of "outsiders" formed specifically for a one-shot study.

Still another advantage of the Texas model of performing a tax study is that it is cheap. The marginal outlays for this study were as little as five percent of those in other states (like New York and Minnesota) with large budgets and staffs. In a state wedded to low spending, the low-budget approach is generally considered the only "realistic" method. At the same time, the true cost of borrowing staff members from state agencies is never calculated; in some cases (though not the Joint Select Committee on Fiscal Policy) the real costs can be quite large.

On the other hand, the results of the Joint Select Committee were not as substantial as originally envisioned, because of inherent limitations in the model of "borrowing" staff members from their regular jobs. The original three monographs shrank to one, as monographs on expenditure patterns and on state-local fiscal relations were abandoned. The reasons included the inability of staff members to complete their writing assignments on time, and the uneven quality of some early drafts. These problems were in turn due to the constraints of the jobs held by state staff members. For staff members who have to respond to political crises, or whose other work allows them little spare time, delays in writing are inevitable. For example, the Comptroller's staff has the greatest technical expertise and knowledge about

taxes of any state agency, but as these individuals are constantly being reassigned to new projects they are sometimes unable to complete work they have started; the staff of the Legislative Budget Board was unable to work for long on material for the Joint Select Committee because they had to prepare budget analyses for the special legislative session of 1984. In addition, staff members borrowed from state agencies are often accustomed to doing very different kinds of work from that required by a longer-run policy analysis. Staff members who have become used to and expert at examining the details of agency budgets or specific tax provisions are not necessarily able to shift to the more critical longer-run analysis appropriate for a general study.

Another problem, in my view, of the staff work for the Joint Select Committee was a restriction on the scope of writing. My own assumption that the staff would do a conventional policy analysis—posing alternative solutions to fiscal problems and arguing their pros and cons—was not shared by any other staff members. Instead, others insisted that the results of any staff writing should be purely informational, describing the current revenue structure with no alternatives mentioned, and without any suggestion that problems in the Texas revenue structure might imply the need for reform. Other staff members held that suggesting alternatives was the province of politicians, not staff members. The reason for this position is inherent in using staff members who are in essentially political positions to carry out analytic studies. A staff member to a politician is unlikely to write about issues that his (more rarely, her) boss doesn't want to hear about. The reluctance of staff members to "get out in front" of the politicians reflects an unwillingness to identify as problems issues which their bosses don't view as problems, or to pose alternatives which their bosses do not want to consider.

The educational role of purely informational and descriptive writing is important, of course, and the role of the Joint Select Committee in educating the legislature and the citizenry of Texas should be substantial. Still, there is also a need in state government for more wide-ranging and independent analysis of policy issues and alternatives. Episodes of "crisis" like the one that generated the Joint Select Committe arise precisely because old policies no longer work. In such situations, the analysis of alternatives should be as unconstrained as possible because otherwise some possible improvements may be overlooked.

Appendix

FUNDING TEXAS STATE GOVERNMENT: AN ANALYSIS OF TAXES AND NON-TAX REVENUES

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STATE TAX STUDY COMMISSIONS*

STATE	TYPE OF COMMISSION	YEAR	MAJOR RECOMMENDATIONS
California	G	1985	Decrease role of personal income tax in state finance (i.e., use a flat rate with a flat rate surcharge for higher income taxpayers; retain stiff add-on minimum tax and indexing of brackets; exclude from taxation $16,000 on a joint return/$12,000 on a head of household return/$8,000 for a single return); reduce corporate income tax rate at least 10 percent; eliminate all sales tax exemptions and exclusions; create a refundable sales tax credit; include all retail sales and services in sales tax base
Connecticut	L	1983	Refuse adoption of a personal income tax; a package of reforms to enhance administration and collection efforts and to increase the information given to taxpayers; adopt a transportation benefits tax system, dedicating revenues to highway construction and maintenance
Hawaii	C	1984	Sunset all tax exemptions by 1987 to encourage review and possible elimination of existing tax expenditures; maximize tax exporting (e.g., adopt a short-term transient accommodations tax); establish a lottery; revise income tax brackets and standard deduction to restore equity
Illinois	G	1982	Reject graduated personal income tax rate; sunset all statutory property tax exemptions; consider replacing homestead and senior citizens property tax exemptions with a state grant program (e.g., a circuitbreaker); broaden sales tax base to include services but exempt food and drugs fully
Indiana	A	1982 & 1984	None
Iowa	L	1984	Spurn modified flat rate personal and corporate income tax; rebuff broadening of sales tax base to include services; exempt agricultural and manufacturing equipment (including replacement parts) from sales tax base; abolish personal property tax; eliminate homestead property tax credit; extend existing property tax credit for elderly and handicapped owners to all low-income taxpayers; revise assessment formula for agricultural land

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STATE	TYPE OF COMMISSION	YEAR	MAJOR RECOMMENDATIONS
Kansas	G	1985	Perform statewide property tax reappraisal; adopt property tax classification scheme with three classes (i.e., public utility property; other income producing real and personal property; and single and multi-family residential real estate)
Michigan	A	1982	None
Minnesota	G	1984	Reduce personal income tax burden by lowering effective tax rate 20 percent; concentrate income tax relief in low and middle income groups; create an income/wealth based property tax credit for low and middle income homeowners/farmers/renters; adopt complete indexation of income taxes; reform property tax classification system to include only three categories (i.e., residential homestead and agricultural property; residential non-homestead property and apartments; and all other property); broaden sales tax base to include personal services and new clothing
New York	L	Ongoing	
Ohio	L	1982	Avoid income tax indexation; adopt a separate income tax rate schedule for single and joint returns; broaden sales tax base to cover most recreational/entertainment services; repeal intangible personal property tax; abolish tangible personal property tax if a revenue replacement can be found; exempt interspousal transfers from estate tax
Pennsylvania	G	1981	Reform property tax assessment program; eliminate numerous local, non-property taxes; authorize local income taxes for municipalities and school districts (1 percent and 1.5 percent respectively; allow Philadelphia to impose an income tax on residents and non-residents, with no rate cap given by the state); let other municipalities outside Philadelphia impose an earnings and net profits tax on non-residents; allow regional income tax of up to 2 percent in the five county area around Philadelphia, earmarked to fund mass transit; index quarterly all transportation taxes and fees (using Federal Highway Administration cost index and the actual level of taxes collected); move toward a user financed transportation system (e.g., increase user fees; adjust taxes to reflect costs imposed by various classes of vehicles; phase out most exemptions); adopt numerous reforms to enhance tax collection and administration

STATE	TYPE OF COMMISSION	YEAR	MAJOR RECOMMENDATIONS
Rhode Island	G	1982	Develop a new personal income tax system not piggybacked on federal tax liability and without indexing of rate brackets (unless that's specifically authorized by the legislature) broaden sales tax base (e.g., tax admissions to entertainment events) but do not include services; devise property tax relief program including an expanded state aid program and an "in lieu of taxes" program for tax-exempt property; target state aid to distressed communities; tie all property tax exemptions to need; consider enactment of a circuitbreaker (available to all low income property owners) to provide property tax relief
Tennessee	L	1985	Restructure taxes but without increasing overall tax burden and without revenue loss to local governments; simplify business taxes, perhaps by adoption of a single business tax (e.g., a value-added tax)
Texas	L	1985	None
Washington	G	1983	Adopt a personal income tax; use a single rate for the income tax but provide generous personal exemptions; base the income tax on federal adjusted gross income; enact a corporate income tax (also using a single rate and based on federal adjusted gross income); reduce existing business and occupation taxes and allow them to be credited against corporate income taxes; set minimum rates for both income taxes in the Constitution; exempt food from sales tax; increase existing property tax exemption for low-income elderly property owners; consider a circuitbreaker (unlimited by the age of the owner)
West Virginia	L	1984	Adjust income tax tables to remove inequities for single taxpayers; reduce nominal income tax rates; replace current business taxes with a new systems of privilege and profits taxes, including a severance tax, a utilities and carrier tax, and a general, apportioned franchise tax; replace credit for business privilege taxes with a deduction to equalize treatment of incorporated and unincorporated businesses; provide property tax relief through a state financed circuitbreaker program, available to all needy individuals regardless of age; collect payments in lieu of taxes from all tax exempt property; give municipalities and counties authority to impose selected general taxes; allow municipalities and counties to

STATE	TYPE OF COMMISSION	YEAR	MAJOR RECOMMENDATIONS
			collect a hotel occupancy tax; expand the amusement tax; authorize counties, school districts and municipalities to charge user fees where individual costs can be determined; adjust at least every two years registration fees and motor fuel excise taxes based upon federal construction or maintenance indices; increase automobile and truck registration and license fees to finance roads; enhance administration, enforcement and collection of transportation taxes; reform tax administration and appeals system

Key:
- A=Undertaken by an academic institution
- C=Mandated by the state Constitution to be conducted every five years
- G=Created by gubernatorial order
- L=Created by legislative action

*Other states just beginning tax studies include Colorado, Florida, Massachusetts, New Jersey and Utah

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The National Conference of
State Legislatures

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TAX COMPETITION BETWEEN THE STATES
A SOLUTION OR A PROBLEM

Welcome: Representative Ron Micheli (WY)

We would like to welcome you to this session dealing with tax competition beween the states. My name is Ron Micheli, I serve as the chairman of the Western Legislative Conference Revenue and Taxation Committee. It is a pleasure to be here and I'm looking forward to this session.

State and local governments today are becoming more and more active participants in their economies. Increasingly, state and local governments are taking actions to try to attract industries and to stimulate employment in their respective jurisdictions. As a result of these actions, an intense competition has developed between jurisdictions for economic activity. In this competition, state and local governments find themselves pitted against each other for industry, in what really amounts to a high stakes bidding game for jobs and income. State and local governments see it necessary to offer a range of incentives to businesses, often out of fear that the businesses will locate in other areas that are offering more.

Today's panel will be examining one of the more controversial incentives that governments have used to attract business activities — tax incentives. Tax incentives are not new, they have been around for sometime. Even in the early years of this country, state governments used tax policy along with direct expenditure, regulation, and public relations to try to attract businesses to take residence within their borders. In recent years states and local governments have refined the application of tax incentives and broadened their use. While tax incentives have become very popular, a debate rages whether they really accomplish what they are designed to do. Increasingly, the efficiency and effectiveness of tax incentives have been called into question.

We have with us today three speakers who will help us examine tax incentives and the role that tax incentives play in economic development.

Our first speaker is L. Clinton Hock, Executive Vice President of Marketing and Long Range Planning for the Fantus Company. Mr. Hock's work for Fantus has concentrated in the area of facility site selection and economic geography. Mr. Hock has written

extensively and lectured on transportation, physical distribution, industrial development, and plant location. Prior to joining the Fantus Company in 1950, he was a transportation consultant and practitioner before the Interstate Commerce Commission. He is a faculty member of New York University, and also lectures at Columbia University, Elmhurst College, and Princeton University.

Our next panelist is Gary Cornia, who is a member of the Utah State Tax Commission. As a Commissioner, his primary concerns are in the areas of tax management and tax policy. Mr. Cornia is also an Associate Professor at the Graduate School of Management at Brigham Young University. Prior to joining the State Tax Commission, he was a research associate at the Academy for Contemporary Problems in Columbus, Ohio. He has also served as a lecturer and a professor at two universities. He has conducted research and written numerous articles and papers on budgeting, taxation, and economic development.

Our final speaker is Bill Hamilton, founder and senior partner at ASLAN Associates. ASLAN Associates is an economic development consulting firm based in Washington, D.C. Mr. Hamilton's work at ASLAN focuses on state and local economic development activity. He was formerly a consultant for the Urban Institute and he served as project manager for the National Association of State Development Agencies. He also spent time as a legislative assistant to U.S. Senator Wendell Ford.

Speaker: L. Clinton Hock

I am glad that you noted in your introductory remarks that tax incentives, while we all consider them the current rage, are nothing new in this country. As a matter of fact, tax incentives have played a key role in the economic development of our country, going back all the way to early colonial days, and they have been used as an instrument of government policy to foster investment and to designate where new facilities should be located.

I find that going back in history that as early as 1789 there was a notation in George Washington's diary that he had just come back from Beverly, Massachusetts, where he had been visiting with a gentlemen whose name was Mr. Cabot. Mr. Cabot was putting in the first textile mill in the United States in Beverly. What the diary failed to mention was that the town of Beverly and of the Commonwealth of Massachusetts actually had

been encouraging Mr. Cabot in this endeavor by giving him a tax forgiveness so he could meet competition from English imports of textiles. George Washington's friend, Alexander Hamilton, at the same time was developing the first industrial park in the United States in Patterson, New Jersey. We find that Patterson had given to Alexander Hamilton a tax holiday for 50 years. The Erie Canal, which opened in 1825, had a guarantee of no taxes anywhere along the route, locally or by the state, anywhere in the state of New York. Coming home here to the Western States, of course tax incentives played a very key role in the development of Land Grant Railways which opened the West to economic development.

In the 20th century we have used tax incentives very extensively. In World War I, for example, the federal government gave tax incentives to domestic industries so that they could develop new sources for strategic materials. In World War II, we used tax incentives again to take industries from the states of California and Washington and move them to places like Wichita, Kansas out of range of the enemy submarines and naval guns. In the post-war period, tax incentives were used to steer jobs into areas of substantial unemployment, into rural proverty areas in Appalachia, and even onto Indian reservations. Currently, as you all are aware, we're using tax incentives to rebuild our inner-cities, through enterprise zone legislation.

But unquestionably, the greatest tax incentive program ever to hit the American scene, is the so called tax-exempt bond issue. We can credit the development of tax-exempt bonds to Mr. Felix Fantus, founder of my company, who, in 1936, along with Governor Luke White, Governor of the State of Mississippi, invented a program called (BAWI) "balance agriculture with industry." With the help of the legislators of the State of Mississippi, they developed a program of issuing general obligation bonds to build plants — just like building a school or building a town hall — with the full faith and credit of the State of Mississippi pledged to back the bonds. The neighboring states of Tennessee and Louisiana soon picked that up as part of their development programs. General obligation bonds fell out of favor in 1938, still in this depression period when tenants went broke. The pioneer states of Mississippi, Tennessee, and Louisiana responded by inventing the revenue bond. Still tax exempt, the revenue bonds were much safer than the general obligation bonds because instead of using the full faith and credit of the state to back the bond, the lease of the tenant was used as collateral. By the 1960's the use of industrial revenue bonds, as they then began to be called, really began to go wild. I recall a situation in Kentucky, where a little town of Cloverport, with 960 residents, floated a

bond issue for $96 million to build an aluminum mill.

All through the Southeast the industrial revenue bonds were considered government owned property, and so ad valorem or local property taxes were not applied and the tenants were also permitted to buy their own bonds. We had a situation of quadruple benefits: 1) there was a low interest mortgage arrangement with the tax-exempt bond, 2) the owners of the company as individuals could go out and buy the bond issue (and they usually did for their own portfolio, with no taxes), 3) there was a full deduction of the rent as a business expense, and 4) there was also exempted local ad valorem taxes. But that wasn't enough — there was another sweetener. At the end of the bond period, when the bonds had been fully retired, the company would buy its own plant back for one dollar. The IRS was not very happy with that. It struck back, with the aid of the Congress, by putting a tax on the industrial revenue bonds. President Reagan would like to get rid of these bonds entirely.

We find at Fantus that over the years the use of tax incentives has tended to run in trends or fads. At the federal level it has become a fashion to tinker with the fortunes of selected industries with tax policy. In the closing years of the Carter Administration, the executive departments were beginning to espouse industrial policy. I recall a full-day conference in the White House, when members of my company were called in with the leaders of each of the major departments of the executive branch, to try to figure out how to give favorable tax treatment, on the basis of needs, for job protection to certain industries. The industries we designated were the automobile industry, the textile mills, steel mills, and paper companies. Nothing ever happened. Today the Reagan Administration, again with tax incentives, is leaning toward high-tech and entrepreneurs, at the expense of those very industries (the "smoke stack" industries), that we were talking about. Present tax reform plans call for hitting the banks and the insurance companies, as well as the entire real estate fraternity.

At the state level the trend is to neutralize any competitive advantage of adjacent states by enacting tax legislation offering incentatives and inducements. Here in the Western region for example, California phased out its punitive inventory taxes to stem the loss of distribution industries to the neighboring state of Nevada. Maryland recently enacted laws favoring the entry of certain banking operations in competition with adjacent Delaware. Many of the Western States represented in this room are now funding educational and/other activities to attract high tech investment, imitating a successful

program that has been put in place in Texas. Every once in a while, however, these copy-cat legislation pieces fail miserably. A good example is Florida, which used the model statutes of some Western States to enact a unitary tax provision in 1983. Governor Graham was finally forced to seek the repeal of the law when Sony, Westinghouse, and other multi-nationals threatened to close down their Florida plants and foreign direct-investment in Florida declined.

Indeed, the actions of foreign direct investors have become a serious factor in dictating domestic tax policies today. European and Asian investors, who are accustomed to grants and tax incentives at home and abroad, have been demanding the same treatment here in the United States in return for their new payroll. In taking note of the sizable sums which states have pledged to foreign direct investors, domestic companies are now seeking similar concessions. Such inducements have emerged as important factors in the site-selection process.

The GM Saturn situation is a good case in point. Thirty-six states, including twenty-six governors, made a pilgrimage to Detroit in the hopes of winning 20,000 jobs for their area from GM. The offers in the Saturn sweepstakes included not only free land, but millions of dollars in tax breaks. GM finally selected Tennessee. The billion dollar, "let's make a deal" really wasn't about building cars. It was about jobs and it was about taxes. Tennessee could hardly refuse GM, because the state had given a deal of the same magnitude to Nissan only 40 miles away from the GM site.

Currently the inter-fiscal competition among states and legislatures has reached a fever pitch. Legislators in some states that are flushed with a surplus are using this particular time to try to make themselves more competitive and attractive within their own region. This year alone, about 20 states have cut taxes, with the largest reductions coming in the highest tax states, New York, Minnesota, and Ohio. But memories of the grim 1981-1982 recession, which left many of the states short of revenues, remain very vivid in many legislators' minds. Some of the states who have been pressured to reduce taxes have instead cut back on spending growth. In those state where taxes were actually raised, the increases were very small and they involved increases in excise taxes or small changes in exemptions. In some of the embattled farm states, including those here in the West, the polls are saying that there is voter hostility to any tax increases, and therefore you should not try to pass any. A good example of what happens occured right here in Oregon a few weeks ago, when the voters soundly defeated a proposed 5%

sales tax that was backed by many of the state's top political leaders.

A dollar-for-dollar offset of income taxes is now allowed in many states to encourage business development and growth. I went into my records and found that 21 states have adopted some type of investment credit, 10 states have some type of work incentive credit, 36 states encourage new jobs with income tax credits, 9 provide an offset of fuel taxes and 35 offer some polyglot group of other credits to encourge business development. One of the problems that we have in our business of locating facilities around the country is this comparison of one state's taxes against the other.

One of the serious areas we have for investments of industrial projects involves depreciation rules as they affect state taxes. Unfortunately, the federal government keeps changing its definitions of depreciation. While your states are just catching up now with the old "fast" depreciation system, the federal government went ahead with its new ACRS system, and then made a change in that again last year. Now the president is proposing to eliminate the ACRS system of depreciation entirely.

The states have moved well ahead of the federal government in terms of helping to stimulate industry and create jobs. The most exciting situation in all the areas of incentives involves the direct financing today by the states of capital construction, and this is far beyond the amounts which were granted under industrial revenue bonds. We're finding that economic development authorities (primarily in the Northeastern part of our country where states are setting the trend in this area) are making direct loans at subsidized interest rates and using state employee pension funds to invest in venture capital situations. Many states for the first time are taking an equity participation position. Programs are being aimed at the support of entrepreneurs and the fostering of export trade. Many states are committed to underwriting the development of new industries based upon the commercialization of the research taking place in their own state universities. Finally, among new incentives, we find many new public-private partnerships under state sponsorship, and we also see financial support of local development organizations with state funds.

As we examine state tax incentives, however, it's important to keep all of them in the proper perspective. It's here where we argue most with the publishers of the business climate studies, who we believe are doing the states tremendous disservice by distorting your perception as legislators of what's important in the whole site-selection process.

The published ratings, no matter who is putting them out, are developed by putting a lot of emphasis on low-cost jurisdictions — those states that have relatively low industrialization, and as a result, low wages and low unionization. Further, the business climate studies will reward a state with a high rating if it offers inadequate welfare payments, inadequate unemployment insurance, and inadequate payments to injured workers. The raters' own business game as publishers is very facinating, because every year the ratings are changed and that means that every year states rank differently, and every year you as legislators go out and buy their books to find out where your state stands. Yet a state's ranking may change even if it does nothing whatsoever to make that change occur. The legislatively controlled items in these business climate studies count for less than 40% of the factors which are included in the surveys. The balance of factors you as legislators can do nothing at all about, including such things as the wage rates prevailing in manufacturing or the extent of unionization in your state.

So what is important in the decision process? I strongly urge you to keep a proper perspective in considering this whole area of tax incentives, because contrary to the impression given by the state business climate studies, the key factors influencing site selection are really quite stable. Although exemptions and credits are becoming increasingly important, they still rank well below other business considerations. In the April 1985 issue of Industry Week, a survey was reported of 1,000 leading manufacturing executives, in which the executives were asked to rank the site-selection factors for manufacturing plants. Their rankings may surprise you because ranked number one was geographic location (i.e., where in the country would the facility be located), and ranked number two was workers productivity.

A review of the entire list of site selection factors reveals where tax exemptions and tax credits rank:

1) geographic location
2) worker productivity
3) trucking costs
4) union activity
5) stability of state government
6) skilled labor availability
7) long-term financing
8) energy and energy sources
9. raw material availability
10. tax exemption
11. tax credits
12. unskilled labor availability

13. air transportation
14. water supply
15. rail transportation
16. worker training programs
17. sea transportation

Our experience at The Fantus Company confirms that Industry Week study of priorities. In the current business environment there has been a notable shift away from wage-rate differential towards the long-term importance of strategic location and improved productivity. While the ranking of tax incentives is lower in priority, nevertheless, there are some factors that you can control as legislators which are becoming increasingly important in the site selection process. First, is the stability of state government. What industry means by that is policies towards commerce and industry. Next, is assistance in long-term financing through the use of the state's borrowing capacity and the availability of pension funds, freeing them up so that they can be utilized for private investment and support of entrepreneurial activity. Tax exemptions and tax credits are important, but should be targeted for expanding and new businesses. Finally, the support of vocational and business education programs, including the funding of research handled through your state universities, can make a difference. In conclusion, we at the Fantus Company would urge you not to yield to the current panic of inter-fiscal competition, but rather to tailor your legislative programs to encourage the expansion of your economic base through appropriate credits and funding mechanisms.

Speaker: Gary Cornia

Today I would like to talk about some important criteria we should use when we evaluate or talk about tax systems. These criteria are typically found in any public finance text book. First, the distribution of the tax burden should be equitable, with everybody should paying their fair share. Second, taxes should be chosen so as to minimize interference

with economic decisions. By that we mean that no politician or elected official is as smart as the free market in making business location decisions. Third, the tax system should permit efficient and not abitrary administration. Fourth, compliance cost should be kept at a minimum. Fifth, the tax system should generate adequate revenue to fund programs. Sixth, the tax system should be characterized by balance and diversification. Property taxes, severance taxes, income taxes and sales taxes are all part of typical tax system. There is no clear pattern about which tax is right or what mixture of taxes is right, but states are realizing that excessive reliance on a single tax can result in adverse economic and fiscal consequences. The Advisory Commission on Intergovernmental Relations (ACIR) suggests a mixture like this: one fourth of the revenue from the property tax, one fourth of the revenue from the sales tax, one fourth of the revenue from the income tax, and the remaining quarter coming from corporate income taxes and miscellaneous taxes. But again, there is no clear pattern anywhere in the country. Seventh, the tax system should be conducive to economic growth.

In some cases the objectives come into conflict. The movement in the direction of one objective means that we may have to compromise on achieving another objective. For example, there are some things we can do to ease our administrative burden. Unfortunately, easing our administrative burden would increase the compliance cost of the business community as well as of personal income tax filers. Consequently, easing administrative burden is an objective that we have to balance against compliance cost.

Specifically, I see five postive effects that we can identify with economic development activities:

- o Expanded employment opportunities: as new businesses enter a state or a locality or when existing firms expand, the number of jobs increase. Additional increase may be affected in secondary employment such as services and retailing. Some of these jobs may be filled by new

immigrants into the community, but others are likely to go to workers who might otherwise have been unemployed or working at a lower paying job.

- reduced expenditures: as employment opportunities expand, benefits paid to the unemployed may be expected to decrease. To the extent that these funds come from the state's own sources, fiscal burdens would decline.

- decreased tax burdens: if the growth of employment enhances the community's tax revenue more than it enhances increases of local costs, the tax burden of existing residents can be reduced. Moreover, if the business has a large portion of non-residents among its customers and owners, and if its competitive position is reasonably strong, the taxes it pays will tend to be exported.

- expanded services and profits: demand for services and products of existing firms is likely to increase and along with it profitability.

- increased land value: the area surrounding the new plant may increase in values as suppliers or employees attempt to locate near the operation.

Related to tax and spending policies, I see four major approaches to economic development. The goal of these four approaches is to influence business decisions and to make the state more attractive than other states (or at minimum to keep the state as attractive as other states). The first is tax climate. It is imperative that a state maintain an overall tax structure and rate of taxes which are attractive to industry. Second, is tax incentives. Specific exemptions, temporary tax abatements, or preferencial assessments can lower business operating costs. Third, is industrial development bonds. Industrial development bonds essentially allow businesses to take advantage of lower borrowing costs enjoyed by the states and localities because of their tax exempt status. Last, is the policy of providing new firms with certain public services, such as roadways or utility hook-ups at zero or reduced cost.

The question thus becomes, do the incentives work? If so, why? If not, why not? I approach answering such questions with considerable misgiving. I have found the answers to these questions tend to raise serious doubts about the effectiveness of certain policies

that appear to be articles of faith to the true believers of economic development. Anyone who questions such policies is immediately labeled anti-business. Frankly, given the high emotions in the area of economic development and state politics, the mere possiblity of a mention of an anti-business attitude is enough to send most public officials scrambling for the exits. In the jargon of the legislature, they "take a walk" rather than answering or even raising the questions. Such responses are unfortunate.

Economic development can be influenced by fiscal incentives. However, the evidence shows that not every approach works and each suggested policy must be carefully evaluated. I find the anti-business label unfortunate, but I consider myself similar to talking to my old maid aunts about all-star wrestling. I suggest to them that there are some gimmicks there and that it's not as authentic as they sometimes believe. The same can be said about the anti-business attitude.

Mr. Hock was talking about economic incentives, going back into the history of colonial America to find whether or not incentives work. Perhaps it is my Utah background or my association with Brigham Young University, but I can go further than that. In fact if I go to the Old Testament in the Book of Kings, we found that after Solomon died his son Rehoboam was concerned with taxes. The people who dealt with Rehoboam, the tribes of Israel, said to him, "we think our yoke is too heavy". Rehoboam sought the counsel of his advisors. The old advisor said they're probably right. The young advisor said, "you must show you're stronger than Solomon, and we think that you should increase the yoke". Rehoboam decided to follow the young advisor's counsel, and he increased the yoke. The result was what are commonly refered to among biblical scholars as the twelve lost tribes. They fled. We can quibble about the authenticity of all of this, but we do know that taxes do influence economic behavior.

Back to the basic question, do fiscal policies work in economic development? The bottom line answer to the question is that they probably don't. Why is the answer they probably don't? The decision to locate a business is a very complex process. There are innumerable factors that matter: site availability, access to financing, access to transportation, cost of transportation, quality of labor, cost of labor, proximity to markets, cost of utilities, cost of housing, level and quality of public services, proximity to supplies, and proximity to other companies.

I'd like to focus on several of the items I just listed. First, wages. Wages are often the most significant cost of doing business. In 1978 I completed a study at the Academy for Contemporary Problems in which we compared taxes per hundred of dollars of business profits and wages per hundred dollars of business profits. While there was a difference between taxes between the states, the range was generally about $25 from high to low. There was a very significant difference between the cost of hiring employees per hundred dollars of business profits. The range was in the area of $250. What that means is that if you live in a high wage state, and you're going to attempt to attract industries to come to your state by offering tax concessions, the tax concessions will have to be larger than the wages they're now paying. That would mean tax concessions as high as $250 per hundred dollars of profit, when the average tax per $100 of business profits in 1978 was in the range of $20-$25. In other words, you would have to give a direct subsidy to somebody to convince them to come to your state if your wages are "higher or out-of-line". A recent study by the State of New York reports, based upon corporate income tax returns, that labor costs are 53 times as large as state corporate tax payments. In other words, a 2% wage differential is equivalent in its effect on profits to a 106% tax differential.

Construction costs vary easily by as much as 30% around the country. It's very difficult

to find the tax incentive that can offset a difference in construction cost of 30%. Energy costs vary by an even larger factor all over the country. In the water rich Northwest, with federal policies, you have some very attractive energy rates. In other parts of the country, energy costs are quite high. Land cost differences are significant. In the final analysis the location decision rests on the availability of a suitable site at a reasonable price. You can have raw materials, markets, and all the essential service, but if you can't find suitable land, your economic development plan simply will not work. A study was made of 80 corporations which left downtown Cleveland and moved to the suburbs during the period of 1958 to 1973. When questioned in depth about the reason they left Cleveland, they responded, and I quote, "the lack of sufficient and efficient industrial space in Cleveland to expand."

Given the uncertainty of the location process, each policy or suggestion needs review and review is the key in this area. I would like to offer some guidelines on review. First, policymakers like yourselves should insist that the burden of proof on the desirability of special business tax incentives be on those who propose or support their use. No tax incentives should be adopted without a complete review of it's impact. For example, what will it do to the criteria of equity? Any narrowly focused tax incentive will almost by definition violate the principal of equity. New companies get it, old companies don't. Expanding companies get it, but shrinking companies don't. Large companies tend to get them, small companies tend not to qualify. Capital intensive companies get them, labor intensive companies tend not to get them. All clear violations of the equity principal.

When you lower taxes paid by one group, unless you are willing to cut expenditures or reduce the rate of increase in expenditures, you have to increase tax rates to make up the revenue lost. It is a simple mathematical rule. On one side of the equation, you have

revenues. On the other side of the equation you have a tax base times the tax rate. If you want to keep revenues the same, and you lower the base, then you have to increase the rate. Mr. Hock mentioned the repeal of a unitary tax in Florida. One of the things he didn't mention was that at the same time they repealed the unitary tax, they increased the corporate tax on domestic corporations in Florida by, I think, 3/4%. It is a fact of life that if you lower the base or narrow the base and you don't reduce expenditures, you're going to have to increase the rate and this causes a number of problems.

Minnesota recently completed an excellent study of economic development problems in their state. They determined from the study, comparing Minnesota growth rates to the other 49 states, that their income tax probably was detrimental in their economic development plans. I might add, however, that Minnesota, with its very high income tax, has outpaced the rest of the country in terms of growth and employment over the previous ten years. But they did realize that the econometric equation gave a clear and a statistically significant signal that their income tax rates were out of line. The response of course was to lower the income tax. The other thing they found that was very positive for economic development in Minnesota was the fact that there was a positive correlation on expenditures for education and the state's economic growth. They found that business people viewed the kind of money being spent on education as a positive factor in the state's development. The policymakers in Minnesota were confronted with a serious problem that I suspect that many of you are confronted with. They could lower income taxes, but at the same time they would have to cut expenditures and if they cut expenditures, they may well be shooting themselves in the foot. Less expenditures means less services and hard choices about educational services as well. The revenue loss must be carefully evaluated.

I would like to give two good examples and one bad example from the State of Utah. Within the past 24 months, the Utah Mining Association proposed exemptions on sales of equipment used in mining and exemptions from the property tax for property under construction. Obviously, the Utah mining industry is much like the mining industry throughout the entire United States — they've seen better times and they've made a good pitch for the need for some kind of relief. It was a very emotional and political issue. The governor came to the Tax Commission, and we suggested to him in the true spirit of bureaucrats that we thought somebody else ought to do the study. We just didn't want the enjoyment of explaining what the outcome was. The legislature gave us about $60,000 — these studies are not cheap, to get the right people you're going to pay for it. We hired a group out of San Francisco that did a thorough evaluation of the mining industry in Utah, a thorough evaluation of the sales tax exemption, and a thorough evaluation of the property tax exemption. The conclusion from the study was there may be some argument for the sales tax exemption (and, in fact, the sales tax exemption did pass), but said no way on the property tax exemption. They were able to convince the governor that if the property tax exemption did pass, he should veto it. There were constitutional questions and there were clear questions about whether or not it would do what it was supposed to do. I might add, as a result of that, the State Tax Commission has adopted a construction work-in-progress regulation that we think is a model for all other states. We now have a process which equally offers tax benefits.

The second example involved a proposal to exempt new manufacturing equipment from the sales tax. Such a tax on manufacturing equipment tends to be a pyramid tax and those kinds of taxes cause some distortion throughout the economy. The first time the proposal was made, we put a fiscal note on it of about $130 million. Obviously a tax cut of that size wasn't going to go very far, so the business groups which were supporting it came back with a proposal that would only cost $4 million. We looked at their numbers

and assumptions and concluded it was $20 million. We convinced them that we were going to stand by our fiscal note of $20 million, and we did that because we have professional economists on the staff who had solid data and solid assumptions. They finally agreed that we were probably right. We ended up with a bill that was very tightly written and the total cost to the state will be in the neighborhood of $4-6 million dollars.

In the process of evaluating whether or not we should exempt manufacturing equipment from the sales tax, I surveyed all the states. There were well over 35 that now exempted business from the sales tax on manufacturing equipment. I surveyed the revenue departments, and the economic development departments, and I could find only one department among those 35 states that could tell me the impact of their exemption on sales taxes from manufacturing equipment. They gave it away. Generally it gets marketed as economic development reasons. However, unfortunately nobody in those states knows if its working or not. You must remember once you get a tax exemption, it's really similar to giving a subsidy. A subsidy in perpetuity in my opinion should occasionally be evaluated. I might add that we think that $4-6 million estimate will hold, although at the tax commission we are being placed under incredible pressure to expand our interpetation of the regulation.

I think both of the above are good examples. They demonstrated a review and they demonstrated a reasonable response to that review. Now I'm going to give you a bad example. An interstate air carrier came to the state legislature during the special session and said "if you will allow us to exempt from the sales tax the machinery and equipment we buy to repair our equipment, we will locate a repair facility in Salt Lake City." The special session lasted a couple of days and the bill was passed. It was crazy, there was no analysis, there was no study, no estimate on the impact of the state. And

so far no repair facility has appeared. I later explained the situation to a fellow tax administrator from California, and he simply said to me "the state of Utah has been had." A major part of the revenue from that particular organization comes from repairing similar equipment for an international air firm which terminates service in Los Angeles. It is unlikely they will ever move to Salt Lake City and give up that revenue.

We should be careful about the many unintended consequences which often dominate the original objective of tax incentives. For example, the mining property tax exemption was going to reduce the bottom line (or increase the bottom line) for the mining companies by about $20 million. That means they will have $20 million more to play with than they had if this exemption wasn't given. Now if the federal government taxes at a rate of approximately 50%, the federal government will end up getting $10 million of those $20 million. This amounts to revenue sharing in reverse. There's something else that I often find as an unintended consequence -- revenue administration. There is the principle of taxation that goes something like this: business tax liabilities should be readily determined by the application of clear-cut rules, not by negotiation or arbitrary action of administrative officials. Let me make an editorial comment on the property tax while I'm on this topic. The property tax by far is the largest tax paid by the business community. The business community should insist on accurate and frequent assessments and reappraisals of all property in the state. They should insist on trained and qualified local assessors. They should insist that residential tax payers pay their fair share. And they should insist that there are no tricks in the property tax system. It is clearly in the interest in the business community to have those four things happen, because if they don't happen, and the economic studies are very clear, they end up paying more than their fair share in taxes over time. There should be a rule in tax administration that non-voting taxpayers should never become the largest taxpayer in a taxing district. Unfortunately, it happens.

I would like to conclude by offering some quick observations about this entire area of economic development. First, benefits may be short lived. Fiscal and tax incentives are tools that all governments have at their disposal. As soon as one state offers concessions that may cause businesses to relocate and take advantage of that tax break or subsidy, neighboring states have strong incentives to offer tax concessions that meet or exceed those of the first state. In the final analysis, all states can play the tax concession game, thus eliminating any long-term advantages from tax concessions or fiscal incentives. Simply put, if the State of Utah offers a variety of tax concessions that really work, then I would imagine that the State of Wyoming could do the same. The bottom line is that once we've narrowed the tax base to further encourage industrial location, we will have to continue down the road of tax incentives.

Second, benefits may flow largely to non-residents. Since benefits from industrial growth often spread beyond the boundaries of the sponsoring government, the community that bears the cost or offers the concession, may not reap the benefits. There's no guarantee where workers will come from or where they will stay. Development efforts should be targeted. A policy designed to aid a community or state that has largely unskilled, unemployed workers, should recognize that, and not go after the kind of industrial development that requires skilled workers. You need to recognize your strengths and weaknesses.

Back to the criteria, which I listed earlier. Fairness in taxation and fiscal concessions implies that businesses with similar situations should be taxed the same, old businesses should be taxed the same as new businesses, growing businesses taxed the same as shrinking businesses. To the extent that fiscal and tax concessions distorts economic location decisions, they tend to reduce the efficiency of the total economy. That's not a

problem for the individual states, its a national decision. It's really a national policy. My two years on the Tax Commission has also convinced me that business are concerned about administrative ease and cost of compliance. They are very, very unhappy with tax gimmicks which increase the cost of complying with tax laws. Finally, the goal of taxation in the final analysis is revenue. We should not apologize for that. We should recognize that. And my assertion is that the best way to raise revenues for a state is to have a broadly based tax system. A broadly based tax system results in low overall rates, and I think low rates are a significant factor in business location decisions.

Speaker: Bill Hamilton

State and local governments, over the last decade, have developed extensive and increasingly sophisticated programs to achieve public economic development objectives. The most frequently employed instruments of subnational economic development programs are a variety of direct incentives to firms including tax exemptions, loan subsidies and guarantees, below-cost facilities, services and worker training. These industrial subsidies have the primary objective of assisting in retention and expansion of existing firms, stimulating new firm starts, and attracting relocating businesses.

The rapid proliferation of state and local programs testifies to the widespread belief among policy makers and practitioners that an arsenal of development incentives is considered critical to interjurisdictional, interstate and regional competition for industry and jobs. Despite the creativity demonstrated by state and local governments in providing sophisticated financial assistance packages to firms involving both public and private funds, subsidation of private enterprise to achieve public objectives remains a malnourished art form. Little progress has been made in identifying the effective value of different types of incentives to recipient firms. Governments find it difficult to

measure how the behavior of firms has changed as a result of the financial assistance. Further, governments are often unaware of the real cost to the public sector of administering different forms of incentives.

The United States Office of Management and Budget, after a two year study concluded:

> ....The relative effectiveness of different forms of assistance such as grants, loan, and risk assumption for meeting different types of program objectives has not been systematically reviewed in public literature. In the light of the scope, magnitude and importance of assistance as a tool of national leadership, much more needs to be known.

This dichotomy between the relief of many policymakers and practitioners in the efficacy and need for financial incentives and the findings of existing research literature is paradoxical. Clearly, measures of the cost-effectiveness of alternative forms of industrial subsidies are needed to guide public policy and practice. Some measure of benefit per dollar of government expenditure is required. ASLAN has developed a methodology for evaluating the cost-effectiveness of industrial subsidies and findings to date of applications of this approach.

Cost-effectiveness for present purposes is defined as the ratio of actual benefits receieved by the assisted firm to the real cost of the assistance to the administering government. Use of this measure would permit state and local governments to identify the benefit derived by the firm per dollar of public expenditure and to allocate scarce development resources to their most cost-effective uses.

Actual benefit to the firm of any form of public assistance is the difference between operating costs in the absence of the government award and these costs in the presence of this assistance. The real or net cost to the administering government is the sum of direct outlays, any tax revenues foregone, minus increased tax revenues paid by the firm as a result of increased net revenues attributable to the public assistance. Calculation of the value of benefits to firms requires identification of the flow of gross benefits from the incentive, the appropriate discount to compute present values of flows accruing over time, and any offsetting costs of accepting the assistance.

The value of a financial incentive to a firm is reduced by cost-offsets. The major offsetting cost is the loss of tax benefits for which the firm would have been eligible in the absence of the development incentive or tax-offsets. Firms pay both state and federal corporate income taxes on net revenues, the effective rate of taxation varying with the levels of profitability and the tax policies of the state. An incentive treated as revenue for tax purposes is directly taxed, reducing the benefits to the firm of the assistance. For example, if a firm's marginal tax rate under current federal rates is 46 percent, the actual value of a dollar of public assistance to a firm making a profit is $.54. Incentives that reduce operating costs of firms that would otherwise be tax deductible if incurred by the firm from its own resources decrease the value of assistance in the same manner. For example, forms of assistance which subsidize depreciable assets such as plant and equipment reduce the amount of depreciation deductible from the firm's income.

Costs to government of development incentives include direct outlays and revenues forgone. When the subsidy involves a flow of government commitments over time (as in the case of tax abatements) the present value of the cost is determined by discounting the time stream of direct costs. The net cost to government, however, may be less than the gross outlay because subsidies increasing firm revenues or reducing operating costs also raise the tax liability of the firm.

Calculation of the cost of development incentives is complicated by the multilevel structure of the U.S. federal system. Changes in tax revenues resulting from incentives — both positive and negative — may accrue to both state and federal governments, and the full public sector cost of a development subsidy is the combined federal and state cost. For example, the most cost-effective instrument of industrial finance available to state and local governments, by far, is industrial development bonds. Costs of IDBs are borne by the federal government in the form of tax expenditure, while the benefits to the firm may be great. This situation results in a low (that is favorable) cost-to-government/benefit-to-firm ratio from the state and local government perspective. Consequently, use of IRBs has proliferated. Inclusion of federal tax expenditures in the IRB cost-effectiveness calculations, however, reduces the effectiveness of this instrument below several other tools of industrial finance.

A general principle emerging from this is that the federal system diminishes the cost-effectiveness of many forms of development incentives. Whenever a form of assistance

raises profits or lowers costs, the aided firms faces an increased income tax liability. Since the federal government receives most income tax revenues, the states, in effect, subsidize the federal government when they assist business firms.

Changes in federal tax codes enacted in the Economic Recovery Tax Act (ERTA) directly affected the value of assistance to firms of state and local development incentives. Reductions in corporate income tax rate schedules of smaller firms increased the effective value of most state and local development incentives to these firms. Sale-leaseback provisions, in conjunction with the corporate tax revisions for smaller firms, diminished the benefits of further state and local tax abatements. In addition, the new accelerated depreciation schedule sharply reduced the value to firms of all forms of state and local incentives for depreciable capital investments.

TAX INCENTIVES

- State and local governments confront increasing pressures to provide industrial financing for firm retention and attraction.

- Public subsidies of private firms is a nontraditional role for subnational governments. In most cases, local public officials have little experience or substantive information to guide them in decisions involving requests for financial subsidies to private enterprises. Conventional wisdom regarding industrial incentives is misleading and, often, simply wrong.

- The problem is compounded by the increasing sophistication of industry in playing off subnational governments against one another. A particularly pernicious dimension of this problem is those cases in which states and their local governments work at cross-purposes.

- An inevitable consequence has been burgeoning in competition for enterprise through industrial incentives and, often, wasteful use of scarce public economic development resources.

Principles to Guide State and Local Industrial Tax Policy

1. The primary responsibility of state and local governments is to provide the level and quality of public services and public infrastructure consistent with the preferences and requirements for basic welfare of its citizens, and to ensure the revenue base necessary to this end.

2. The appropriate concern of state and local governments is the overall tax structure, its capacity to generate necessary revenues, equity in the distribution of tax burdens between citizens and businesses, and the effect of business taxes on the competitiveness of the local business environment.

3. Subsidization of business enterprise lies beyond the conventional scope of responsibilities of state and local government and should only be considered in exceptional circumstances in which the essential welfare of the jurisdiction is at issue.

4. Revenues forgone through tax concession should be regarded as costs to the state or local government no less real than direct expenditures.

5. Costs of government actions should be paid by the jurisdictions that receive the resulting benefits. Where benefits spillover beyond the confines of local governments, the next highest level of government which contains these benefits should assume the associated costs.

6. Industrial subsidies should not be awarded to businesses to underwrite actions that would be undertaken in pursuit of their own financial self-interests in the absence of the subsidy.

7. State governments should establish overall policies on industrial subsidies and avoid operating on an ad hoc or case-by-case basis. These policy guidelines should be overridden only in exceptional circumstances.

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THE FOLLOWING DOCUMENT HAS NOT BEEN FILMED BUT IS AVAILABLE IN THE ORIGINAL FILE

Final Report of the Pennsylvania Tax Commission

March 1981

Commonwealth of Pennsylvania
Dick Thornburgh, Governor

Richard M. Cyert
Chairman

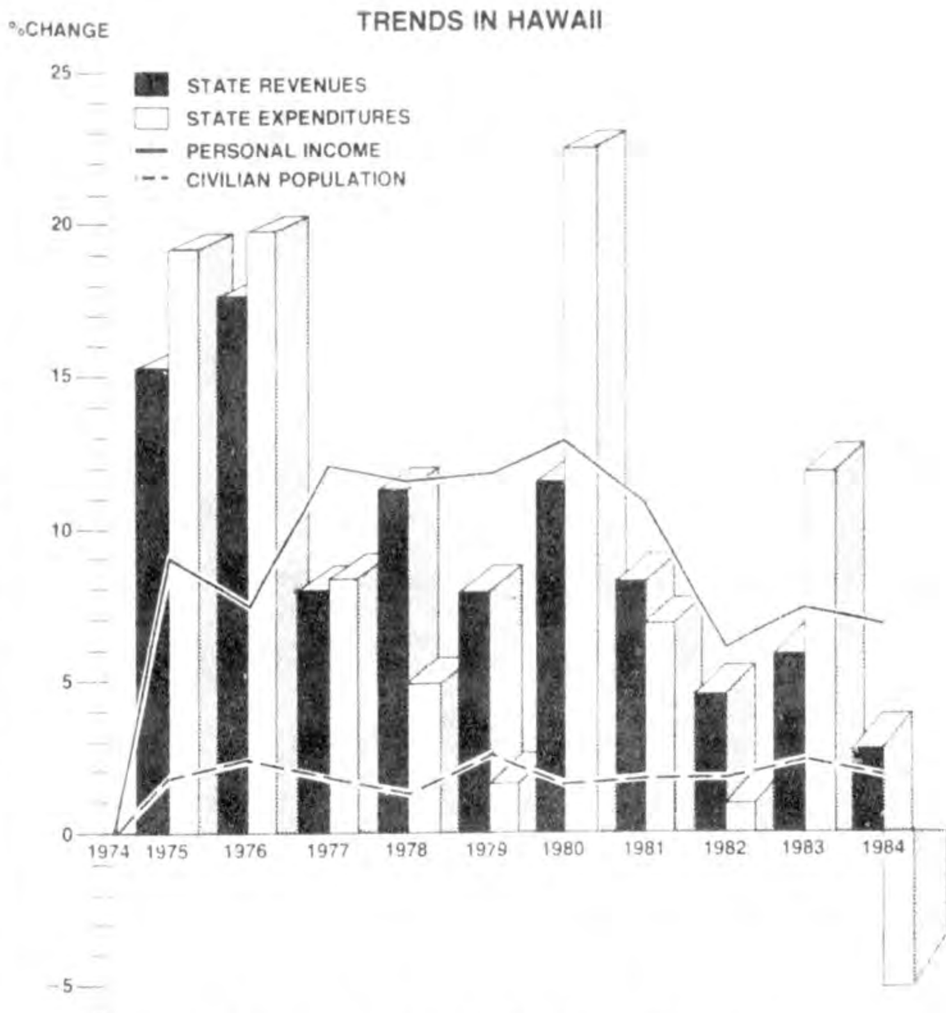
GOVERNMENT IN HAWAII

A HANDBOOK OF FINANCIAL STATISTICS

1985

THIRTY-SECOND EDITION

TRENDS IN HAWAII



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A private, non-profit, non-partisan, educational organization serving our island state since 1953, the Tax Foundation of Hawaii is governed by a 25-member Board of Trustees who represent the entire state and is financed by concerned and interested corporate and individual members. Its purpose is to foster efficiency and economy in government, to promote an equitable tax system that will encourage the economic growth and stability of Hawaii, and to assist in the improvement of public administration.

Collecting and analyzing data concerning governmental finances and taxation, the Foundation serves as a clearing house and disseminates this information to the public through reports, pamphlets, newspaper articles, and radio and television broadcasts. To further achieve its purposes, the Foundation also channels its efforts through working with governmental officials, private organizations and individuals to improve the methods, systems and procedures of public administration.

Other regular publications of the Tax Foundation, in addition to GOVERNMENT IN HAWAII, include: HAWAII FINANCE IN BRIEF, a wallet-sized resume of Hawaii's fiscal pulse; THE TAX BURDEN OF THE ARNIE ALOHA FAMILY; and weekly commentaries in several of the local media. The LEGISLATIVE TAX BILL SERVICE provides an analysis of all tax legislation introduced during the legislative session, and the LEGISLATIVE REVIEW, published at the conclusion of the session, reports on all legislation which passed and examines the changes in the fiscal outlook.

GOOD GOVERNMENT DEPENDS ON AN INFORMED PUBLIC

FOREWORD

The importance of understanding how government functions and the process by which its decisions are made becomes apparent only when one realizes how extensively government influences our everyday lives. Whether in the home or at work, government taxation and regulation affects all under its aegis. Only through involvement in the process can the citizen-taxpayer insure that government will work for the true benefit of the community.

Becoming involved in the process takes on greater import today, as government begins to look beyond the traditional methods of public financing, whether through creative debt financing or diversifying existing tax sources. In order to obtain and maintain the maximum public benefit from shifts occurring in the structure of government, the community, the taxpayer - corporate and individual, must be kept aware and informed of the impact of "modern" methods and the alternate choices. With this understanding, the citizen-taxpayer is then prepared to be involved in government's decision-making process, whether at the state, county, or federal level.

GOVERNMENT IN HAWAII provides the basic foundation for understanding our state's financial health. The statistics presented in this publication and the graphic depictions in the charts contains both historical and current information about Hawaii's economy, state and county government revenues and expenditures, and public indebtedness. In concert with the Tax Foundation's other publications, Government in Hawaii is the keystone to understanding the public finance puzzle.

The Tax Foundation wishes to extend its gratitude for those whose cooperation and assistance aided the publication of this booklet. The data provided within would not have been presented without the help of many public employees in the federal, state, and county governments. A warm mahalo goes out to the directors and staffs of the State of Hawaii Departments of Accounting and General Services, Budget and Finance, Commerce and Consumer Affairs, Education, Labor and Industrial Relations, Planning and Economic Development, Taxation, and Transportation; the Finance Directors of the four counties; the Internal Revenue Service; Hawaiian Sugar Planters' Association; First Hawaiian Bank; and the Bank of Hawaii.

Phil Z. Chang, President
Tax Foundation of Hawaii

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HAWAII'S ECONOMY

Hawaii's economic prospects brightened considerably as the state's dominant industry, tourism, registered its highest growth rate since 1976 with a 10.6% increase in visitor traffic during 1984. More than 4.8 million tourists spent an estimated $4.0 billion in the economy, which was 5.2% higher than in 1983.

Following dramatic increases during 1982 and 1983, military expenditures grew by 1% during 1984. Despite the slowdown in growth, federal military and civilian expenditures for national defense constituted Hawaii's second largest source of personal income.

Higher foreign import quotas in the U.S. and growing use of high fructose corn syrup and artificial sweetener combined to dampen the sugar industry's recovery. Although sugar cane acreage declined during the past year, sugar production in the state grew 2% to 1.06 million tons due to higher yields per acre; however, the value sold, as measured by the general excise tax base, fell 5.5%. Despite the shutdown of a cannery in 1984, the state's other major agricultural crop, pineapple, showed an increase in canning value, up 8.2% to $198 million, due to intensified promotional efforts. Fresh pineapples sales growth, which had displayed moderate growth during the previous two years, flattened.

Faced with high real interest rates and a weakened demand for commercial and multi-unit residential property, the construction industry was further hampered by three labor disputes during 1984. These factors contributed to the 8% decline in construction value completed.

Although labor disputes idled workers during 1984, overall employment in the state grew 1.2% in contrast to a slim growth of 0.4% in the civilian labor force. This lowered the state's unemployment rate from 6.5% to 5.9%. The trend from agriculture-oriented employment to service occupations became more apparent with the closure of a major sugar plantation and a pineapple canning plant forcing layoffs on Hawaii, Oahu, and Molokai. The layoffs, however, were offset by jobs created by the surge in tourism.

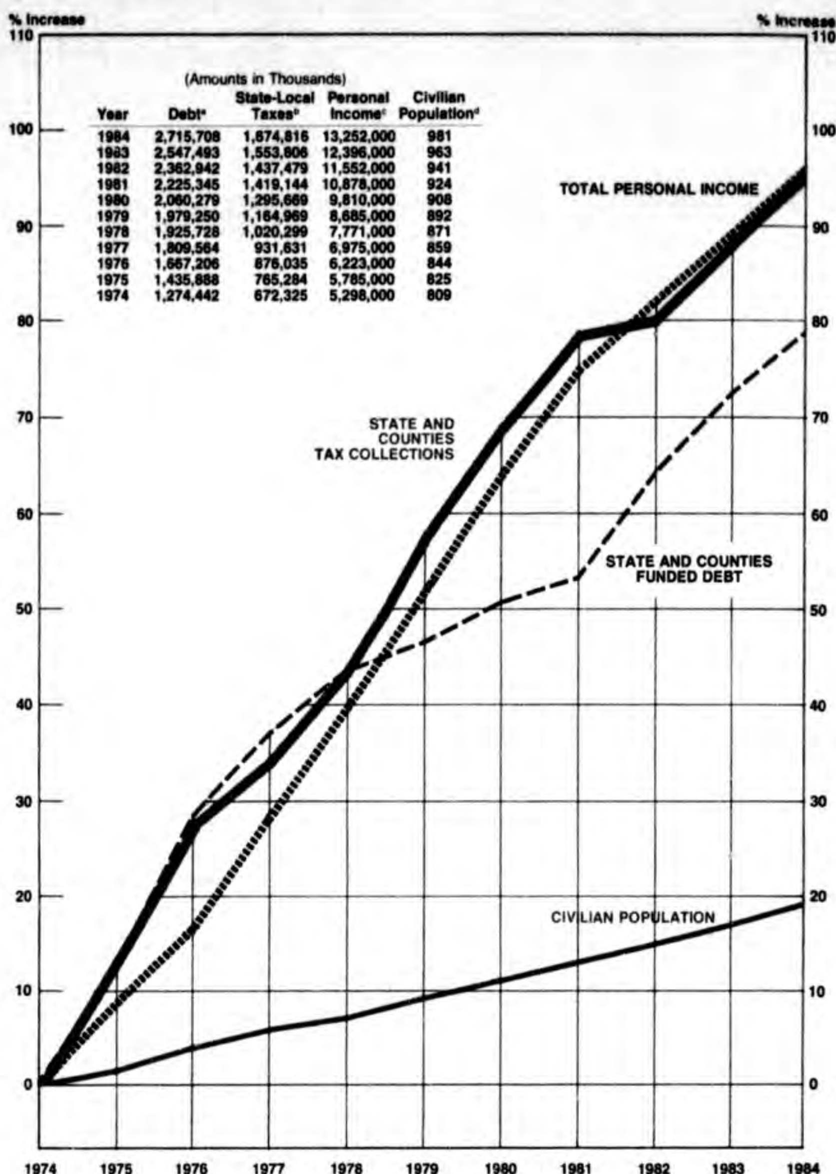
Hawaii's total personal income sustained a 6.9% growth during 1984 after posting a 7.3% gain in 1983. Personal income from services represented 15.6% of total personal income for 1983, whereas it had comprised only 14.1% of total personal income ten years earlier. Farming, manufacturing, as well as construction provided smaller proportions of income than recorded in 1973. Income generated by government employment fell from 26.6% in 1973 to 24.6% in 1983, reflecting the slowdown in spending growth caused by tight budgets.

CHART 1

TRENDS IN HAWAII

Population, Taxes, Personal Income & Debt

1974-1984



(Amounts in Thousands)

Year	Debt[a]	State-Local Taxes[b]	Personal Income[c]	Civilian Population[d]
1984	2,715,708	1,674,816	13,252,000	981
1983	2,547,493	1,553,806	12,396,000	963
1982	2,362,942	1,437,479	11,552,000	941
1981	2,225,345	1,419,144	10,878,000	924
1980	2,060,279	1,295,669	9,810,000	908
1979	1,979,250	1,164,969	8,685,000	892
1978	1,925,728	1,020,299	7,771,000	871
1977	1,809,564	931,631	6,975,000	859
1976	1,667,206	876,035	6,223,000	844
1975	1,435,888	765,284	5,785,000	825
1974	1,274,442	672,325	5,298,000	809

[a]State and county general obligation bonds outstanding at December 31.

[b]Fiscal year collections; unemployment compensation collections included.

[c]Calendar years; 1984 preliminary estimate, 1978-83 data revised August 1984, 1974-77 data revised August 1982.

[d]Midyear resident civilian population except 1980 at April 1.

SOURCE: State Departments of Budget and Finance, Accounting and General Services, Taxation, Economic Development and Planning, County Finance Departments; U.S. Department of Commerce, Bureau of Economic Analysis, "Survey of Current Business."

TABLE 1

GROWTH IN THE HAWAIIAN ECONOMY

Selected Calendar Years

Economic Indicators	Amount					Percent Change 1984 from		
	1984	1983	1982	1979	1974	1983	1979	1974
Population[a]	1,038,600	1,023,000	996,700	914,700	854,100	1.52	13.55	21.60
Labor Force[b]	472,900	472,000	458,000	399,000	359,090	0.19	18.52	31.69
Employment[b]	446,000	442,000	428,000	374,000	331,930	0.90	19.25	34.37
Unemployment Rate[b]	5.6%	6.4%	6.7%	6.3%	7.6%	(12.50)	(11.11)	(26.32)
Cost of Living[c]	284.8	273.5	267.6	204.5	141.9	4.13	39.27	100.70
Motor Vehicle Regis.[d]	706,972	640,798	660,196	607,560	487,647	10.33	16.36	44.98
Total Housing Units[e]	359,654	353,414	348,980	324,261	250,697	1.77	10.91	43.46
Total Hotel Rooms	64,588	60,198	58,765	54,246	39,632	7.29	19.07	62.97
Number of Visitors	4,855,580	4,357,184	4,242,916	3,960,531	2,786,489	11.44	22.60	74.25
Electricity Sold[f]	6,606	6,426	6,332	6,197	5,114	2.81	6.60	29.18
SNG Sold[g]	30,928	31,307	32,224	35,264	34,363	(1.21)	(12.30)	(10.00)
Per Capita Per. Inc.	12,760	12,114	11,652	9,129	6,010	5.33	39.77	112.31
Per Capita Taxes	1,556	1,457	1,431	1,194	765	6.79	30.32	103.40
			AMOUNTS IN MILLIONS					
Visitor Expenditures	$ 4,582	$ 4,000	$ 3,700	$2,620	$1,225	14.55	74.89	274.04
Military Expenditures	2,053	1,885	1,675	1,310	935	8.91	56.71	119.56
Total Personal Income	13,252	12,396	11,579	8,643	5,069	6.91	53.33	161.43
Bank Deposits	7,184	6,584	6,020	4,363	2,553	9.11	64.66	181.39
Savings & Loan Deposits	3,862	3,614	3,332	2,557	1,146	6.86	51.04	237.00
Sugar Processing[h]	414	436	318	306	455	(4.95)	35.29	(9.01)
Pineapple Canning[h]	198	183	185	164	104	8.20	20.73	90.38
Retail Sales[h]	8,467	7,716	6,875	5,753	3,063	9.73	47.18	176.43
Wholesale Sales[h]	6,050	5,314	5,204	4,832	2,248	13.85	25.21	169.13
Diversified Manufact.[h]	520	512	531	565	376	1.60	(7.96)	38.30
Construct. Val. Completed	1,227	1,334	1,324	1,342	1,044	(8.03)	(8.57)	17.53

NOTE: 1984 data are preliminary estimates; subject to revision.

a. Resident population at July 1; includes armed forces personnel. All data revised.

b. Annual average.

c. Honolulu consumer price index for all urban consumers. Year 1967 = 100.

d. At December 31. Excludes military vehicles, motorcycles, and scooters; after 1975, includes nontaxable, nonresidential vehicles not formerly registered.

e. At April 1.

f. Million kilowatt hours.

g. Synthetic natural gas in thousand of therms; does not include bottled gas.

h. General excise tax base.

SOURCE: State Departments of Planning and Economic Development, Commerce & Consumer Affairs, Labor and Industrial Relations, Taxation, and Transportation; County Finance Directors; Hawaii Visitors Bureau; U.S. Department of Commerce; First Hawaiian Bank; and Bank of Hawaii.

TABLE 2

SOURCES OF PERSONAL INCOME

Hawaii (Selected Years): U.S. Average (1973 to 1983)
(Dollars in Millions)

Income Source	State of Hawaii 1983 Amount	1983 % of Total	1982 Amount	1982 % of Total	1973 Amount	1973 % of Total	% Change 1983 from 1973	U.S. Average % of Total 1983	% of Total 1973	% Change 1983 from 1973
Labor & Prop. Income: By Industry										
Farms	$ 264	2.1	$ 262	2.3	$ 131	2.8	101.5	0.9	3.5	(31.2)
Contract Construction	537	4.3	490	4.2	377	8.1	42.4	3.7	5.0	91.9
Wholesale and Retail Trade	1,392	11.2	1,316	11.4	587	12.6	137.1	11.6	13.0	130.0
Manufacturing	449	3.6	431	3.7	226	4.9	98.7	16.9	20.8	110.4
Finance, Insurance & Real Estate	625	5.0	543	4.7	228	4.9	174.1	4.5	4.1	186.1
Transportation and Utilities	791	6.4	788	6.8	319	6.9	148.0	5.5	5.8	145.7
Services										
Hotels & Other Lodgings	426	3.4	383	3.3	135	2.9	215.6	0.5	0.5	171.1
Personal & Household	80	0.6	77	0.7	44	0.9	81.8	0.8	1.1	85.0
Business & Repair	307	2.5	271	2.3	102	2.2	201.0	3.2	2.3	260.6
Amusement & Recreation	75	0.6	65	0.6	32	0.7	134.4	0.5	0.5	169.8
Health & Legal	658	5.3	582	5.0	174	3.7	278.2	6.1	4.6	245.1
Other Services[a]	392	3.2	369	3.2	171	3.7	129.2	3.2	3.2	154.6
Government										
Federal, Civilian	851	6.9	791	6.8	395	8.5	115.4	2.7	3.3	113.6
Federal, Military	1,129	9.1	1,057	9.1	418	9.0	170.1	1.3	1.6	105.5
State & Local	1,070	8.6	1,016	8.8	425	9.1	151.8	8.1	8.8	136.2
Other Industries[b]	37	0.3	35	0.3	14	0.3	164.3	1.5	1.1	251.9
Total Labor & Proprietor's Income	$ 9,083	73.3	$ 8,477	73.4	$3,777	81.2	140.5	71.1	79.2	131.7
Income By Type:										
Wages & Salaries	$ 8,070	65.1	$ 7,606	65.8	$3,367	72.4	139.7	60.4	65.8	136.8
Other Labor Income	680	5.5	613	5.3	171	3.7	297.7	6.3	4.6	255.1
Proprietor's Income: Farm	31	0.3	22	0.2	23	0.5	34.8	0.5	3.1	(59.9)
Non-Farm	302	2.4	237	2.1	216	4.6	39.8	3.9	5.8	77.0
Dividends, Interest, & Rental	2,248	18.1	2,102	18.2	628	13.5	258.0	18.5	13.5	253.1
Transfer Payments	1,658	13.4	1,523	13.2	454	9.8	265.2	14.8	11.3	238.9
Sub-Total	$12,989	104.8	$12,103	104.8	$4,859	104.5	167.3	104.4	104.0	159.1
Less: Employees' Soc. Ins. Contrib.	(593)	(4.8)	(550)	(4.8)	(209)	(4.5)	183.7	(4.4)	(4.0)	181.6
TOTAL PERSONAL INCOME	$12,396	100.0	$11,553	100.0	$4,650	100.0	166.6	100.0	100.0	158.2

NOTE: 1982 data revised in 1984 and 1973 data revised in 1983; percentages may not add to total due to rounding.
a. Includes educational and social services, museums, botanical gardens, membership organizations, and misc. services.
b. Includes agricultural services, forestry, and mining.
SOURCE: "Survey of Current Business," Vol. 64, No. 8 and Vol. 56, No. 8, U.S. Department of Commerce, Bureau of Economic Analysis, August 1984 and August 1976, Washington, D.C.

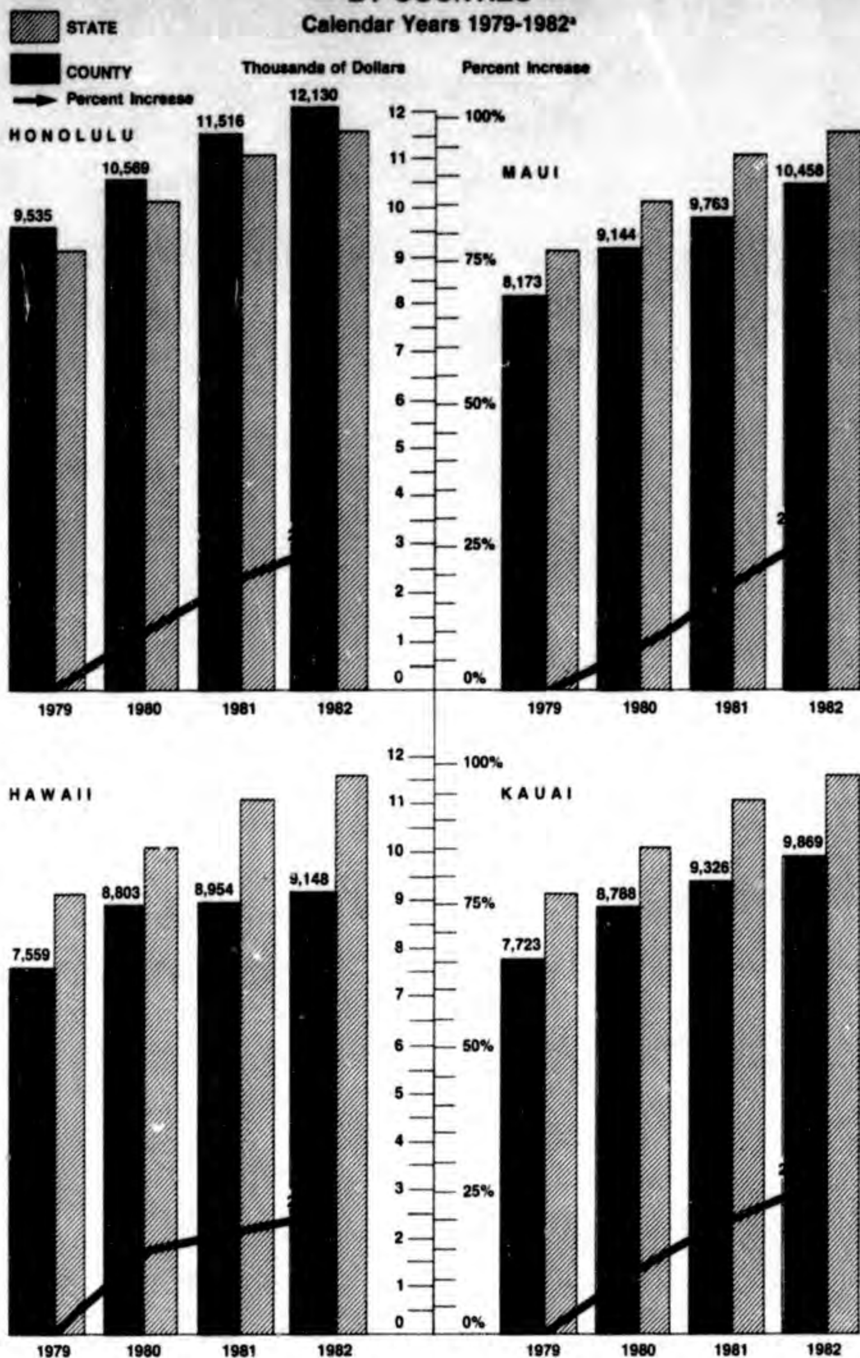
TABLE 3
THE COUNTIES OF HAWAII
Calendar Years 1983 and 1984

Economic Indicators	Honolulu 1984	Honolulu 1983	Maui 1984	Maui 1983	Hawaii 1984	Hawaii 1983	Kauai 1984	Kauai 1983
Population[a]	748,200	737,600	83,000	79,800	106,300	102,700	43,800	42,900
Labor Force[b]	360,400	359,100	43,900	44,100	46,800	46,600	21,800	22,200
Employment[b]	341,300	338,500	41,200	40,600	43,100	42,300	20,400	20,500
Unemployment Rate[b]	5.3	5.7	6.2	7.8	8.0	9.2	6.8	7.6
Hotel Rooms	38,358	35,761	13,592	12,586	6,944	7,243	5,694	4,608
Motor Vehicle Regis.[c]	517,355	468,129	74,783	67,996	79,834	72,524	35,000	32,149
Housing Units	263,448	259,574	38,904	38,201	39,763	38,702	17,539	16,937
Electricity Sold[d]	5,330,931	5,230,658	558,790	519,147	487,583	466,060	228,951	209,713
SNG Sold[e]	28,089	28,487	768	709	2,011	2,047	60	65
Sugar Production	154,220	160,631	299,828	287,146	390,320	391,857	216,946	204,570
			AMOUNTS IN THOUSANDS					
Tax Revenues[f]	$ 253,361	$ 243,146	$ 30,348	$ 28,259	$ 42,383	$ 41,189	$ 16,644	$ 16,555
Government Expend.	402,419	373,675	59,728	51,507	64,882	59,001	31,409	27,963
Bank Demand Deposits	1,050,573	1,033,155	84,986	76,764	86,171	84,182	32,674	31,932
Selected Tax Bases[g]								
Sugar Processing	87,506	146,126	109,610	114,711	145,813	94,228	71,282	80,514
Pineapple Canning	120,960	120,314	77,306	62,644	--	--	--	--
Retailing	7,150,455	6,507,540	593,261	533,666	513,155	482,071	209,641	192,374
Wholesaling	5,470,579	4,799,927	195,485	171,899	311,751	278,953	72,543	63,535
Manufacturing	459,360	452,437	12,995	9,802	41,247	43,807	5,999	5,777
Contracting	1,069,386	1,161,171	65,584	67,378	80,733	79,370	27,226	45,486
Services	2,010,945	1,804,853	144,738	131,677	161,090	146,248	51,642	51,746
Rentals	2,297,205	2,079,181	242,356	205,137	148,072	139,451	56,222	47,051

NOTE: 1984 data are preliminary estimates; subject to revision.

a. Civilian population at July 1; excludes armed forces personnel.
b. Annual average.
c. At December 31; includes taxable and nontaxable registered motor vehicles, excludes motorcycles and scooters.
d. 1,000 Kilowatt hours.
e. Synthetic natural gas in 1,000 therms; does not include bottled gas.
f. Fiscal year data.
g. General excise tax base.

SOURCE: State Departments of Planning and Economic Development, Commerce & Consumer Affairs, Labor and Industrial Relations, Taxation, and Transportation; County Finance Directors; Hawaii Visitor's Bureau; Hawaiian Electric Company, U.S. Department of Commerce; and the Hawaii Sugar Planters' Association.



[a]1981 and 1980 data revised in 1984; 1979 data revised in 1983.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis, Washington, D.C.

TABLE 4
PER CAPITA PERSONAL INCOME
By States — Selected Years[a]

State	1983 Amount	1983 Rank	1982 Amount	1982 Rank	1978 Amount	1978 Rank	1973 Amount	1973 Rank	% Change 1983 from 1982	% Change 1983 from 1973
Hawaii	$12,114	16	$11,590	16	$ 8,367	12	$ 5,524	10	4.5	119.3
U.S. Av.	11,658	--	11,113	--	7,772	--	5,010	--	4.9	132.7
Ala.	9,242	46	8,684	48	6,228	48	3,825	49	6.4	141.6
Alaska	17,194	1	16,854	1	11,150	1	6,104	2	2.0	181.7
Ariz.	10,656	33	10,053	34	7,071	33	4,698	33	6.0	126.8
Ark.	8,967	50	8,444	50	6,028	50	3,791	50	6.2	136.5
Calif.	13,257	6	12,617	5	8,857	6	5,496	11	5.1	141.2
Colo.	12,770	9	12,239	8	8,028	16	5,079	20	4.3	151.4
Conn.	14,895	3	13,939	3	9,092	3	5,993	4	6.9	148.5
Del.	12,665	10	11,912	13	8,209	14	5,676	7	6.3	123.1
Fla.	11,593	23	10,929	22	7,383	29	4,951	25	6.1	134.2
Ga.	10,379	35	9,637	36	6,671	37	4,370	37	7.7	137.5
Idaho	9,555	43	9,012	45	6,827	36	4,521	35	6.0	111.3
Ill.	12,405	12	12,027	11	8,798	7	5,752	6	3.1	115.7
Ind.	10,476	34	10,019	35	7,563	25	4,962	24	4.6	111.1
Iowa	10,705	32	10,635	29	7,897	19	5,401	13	0.7	98.2
Kans.	12,247	13	11,850	14	7,994	17	5,269	17	3.4	132.4
Ky.	9,397	45	9,122	43	6,377	45	3,997	44	3.0	135.1
La.	10,270	36	10,065	33	6,631	38	3,855	48	2.0	166.4
Me.	9,847	39	9,264	41	6,297	47	4,124	41	6.3	138.8
Md.	12,994	7	12,280	7	8,409	11	5,465	12	5.8	137.8
Mass.	13,264	5	12,287	6	8,098	15	5,364	14	8.0	147.3
Mich.	11,466	24	10,751	27	8,426	10	5,333	15	6.7	115.0
Minn.	11,913	18	10,290	31	7,935	18	5,243	18	15.8	127.2
Miss.	8,098	51	7,733	51	5,474	51	3,453	51	4.7	134.5
Mo.	10,969	29	10,403	30	7,305	32	4,724	32	5.4	132.2
Mont.	9,949	38	9,617	37	7,004	34	4,762	31	3.5	108.9
Neb.	11,212	28	10,886	25	7,546	26	5,302	16	3.0	111.5
Nev.	12,451	11	11,919	12	8,981	4	5,646	9	4.5	120.5
N. H.	12,021	17	11,131	19	7,356	31	4,689	34	8.0	156.4
N. J.	14,122	4	13,164	4	8,877	5	5,849	5	7.3	141.4
N. M.	9,640	42	9,285	40	6,451	43	3,944	45	3.8	144.4
N. Y.	12,990	8	12,204	10	8,289	13	5,656	8	6.4	129.7
N. C.	9,787	41	9,147	42	6,467	41	4,241	40	7.0	130.8
N. D.	11,666	22	10,886	24	7,375	30	6,435	1	7.2	31.3
Ohio	11,216	27	10,659	28	7,811	21	5,011	23	5.2	123.8
Okla.	10,963	30	11,071	20	6,963	35	4,284	39	(1.0)	155.9
Ore.	10,740	31	10,148	32	7,855	20	4,835	28	5.8	122.1
Pa.	11,448	25	10,928	23	7,675	23	4,928	26	4.8	132.3
R. I.	11,670	21	10,930	21	7,395	28	4,773	30	6.8	144.5
S. C.	9,187	47	8,613	49	6,056	49	3,903	46	6.7	135.4
S. D.	9,847	40	9,332	39	6,625	39	5,027	22	5.5	95.9
Tenn.	9,549	44	9,029	44	6,449	44	4,111	42	5.8	132.3
Texas	11,685	20	11,380	17	7,486	27	4,476	36	2.7	161.1
Utah	8,993	49	8,693	47	6,453	42	4,072	43	3.5	120.8
Vt.	9,979	37	9,518	38	6,572	40	4,291	38	4.8	132.6
Va.	12,116	15	11,353	18	7,623	24	4,844	27	6.7	150.1
Wash.	12,177	14	11,694	15	8,470	9	5,101	19	4.1	138.7
W. Va.	9,159	48	8,966	46	6,373	46	3,902	47	2.2	134.7
Wisc.	11,352	26	10,774	26	7,706	22	4,816	29	5.4	135.7
Wyo.	11,911	19	12,222	9	8,650	8	5,039	21	(2.5)	136.4
D. C.	15,744	2	14,743	2	9,859	2	6,062	3	6.8	159.7

NOTE: 1983 data are preliminary estimates.
a. 1983-1978 data revised in August 1984, 1973 data revised August 1983.

SOURCE: "Survey of Current Business," Vol. 64, No. 8 and Vol. 62, No. 8, U.S. Department of Commerce, Bureau of Economic Analysis, Washington, D.C.

TABLE 5

EMPLOYMENT IN HAWAII

Positions Filled in Selected Industries

Selected Years at December

	Number of Positions					Percent Change 1984 over		Percent of Total Employment		
Type of Employment	1984[a]	1983	1982	1979	1974	1983	1974	1984	1983	1974
GOVERNMENT										
State	48,800	45,600	45,600	44,300	38,510	7.02	26.72	10.73	10.34	10.32
County	12,900	13,300	13,200	12,700	11,120	(3.01)	16.01	2.84	3.02	2.98
Sub-Total Local Government	61,700	58,900	58,800	57,000	49,630	4.75	24.32	13.57	13.36	13.30
Federal - Air Force	2,650	2,650	2,660	2,700	3,250	0.00	(18.46)	0.58	0.60	0.87
- Army	5,000	4,850	4,650	4,100	5,260	3.09	(4.94)	1.10	1.10	1.41
- Navy	12,950	13,350	13,100	12,100	11,100	(3.00)	16.67	2.85	3.03	2.97
- Other	11,400	11,250	11,100	11,200	11,080	1.33	2.89	2.51	2.55	2.97
Sub-Total Federal Government	32,000	32,100	31,510	30,100	30,690	(0.31)	4.27	7.04	7.28	8.22
Sub-Total Government	93,700	91,000	90,310	87,100	80,320	2.97	16.66	20.61	20.64	21.52
PRIVATE INDUSTRY										
Agriculture - Sugar[b]	4,300	4,500	4,700	4,700	5,160	(4.44)	(16.67)	0.95	1.02	1.38
- Pineapple[b]	2,100	2,300	2,450	1,700	1,910	(8.70)	9.95	0.46	0.52	0.51
- Other	4,400	4,400	4,150	3,900	2,440	0.00	80.33	0.97	1.00	0.65
Food Processing	10,100	11,100	11,100	10,500	9,670	(9.01)	4.45	2.22	2.52	2.59
Other Manufacturing	10,800	11,100	11,300	12,200	12,430	(2.70)	(13.11)	2.38	2.52	3.33
Transport., Comm., & Utilities	32,300	30,700	31,200	31,000	25,260	5.21	27.87	7.10	6.96	6.77
Wholesale Trade	18,800	18,100	18,500	18,800	16,380	3.87	14.77	4.13	4.11	4.39
Retail Trade	94,900	87,600	86,300	89,500	69,320	8.33	36.90	20.87	19.87	18.57
Contract Construction	14,700	17,900	17,800	23,300	29,010	(17.88)	(49.33)	3.23	4.06	7.77
Hotel Services	28,600	26,800	26,500	26,200	18,970	6.72	50.76	6.29	6.08	5.08
Other Services	81,000	77,000	74,700	77,900	53,140	5.19	52.43	17.81	17.46	14.24
Self-Employed & Domestics	27,100	26,800	25,750	23,000	26,020	1.12	4.15	5.96	6.08	6.97
Finance, Ins., & Real Estate	31,900	31,600	31,500	30,900	23,180	0.95	37.62	7.02	7.17	6.21
Sub-Total Private Industry	361,000	349,900	345,950	353,600	292,890	3.17	23.25	79.39	79.36	78.48
Total Positions Filled	454,700	440,900	436,260	440,700	373,210	3.13	21.83	100.00	100.00	100.00

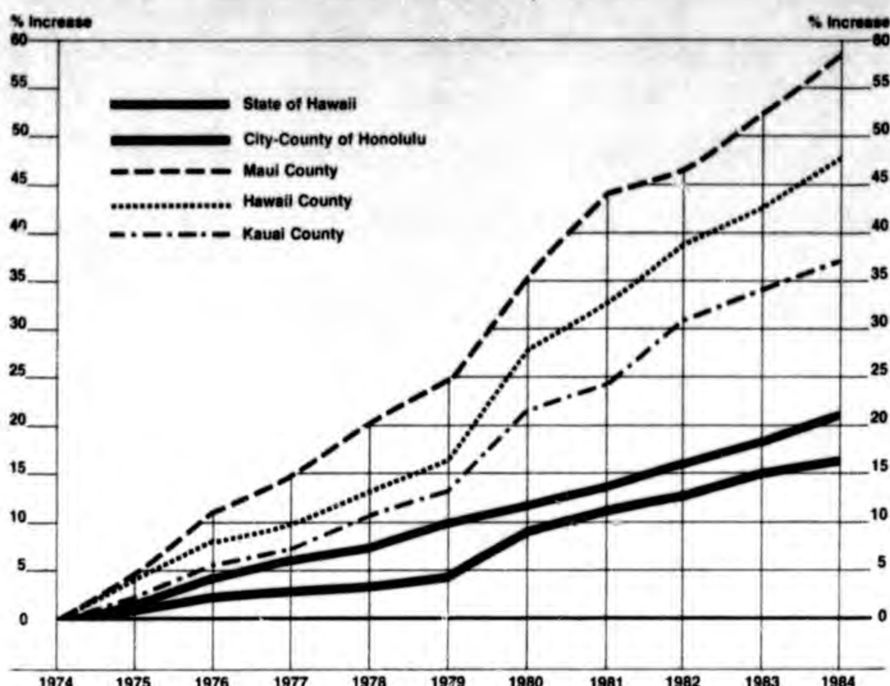
NOTE: Detail may not add to total due to rounding. Data reports positions filled in each industry.

a. 1984 revised preliminary data; table reflects revisions in prior years' data made by the state Department of Labor and Industrial Relations.

b. Sugar mill and pineapple cannery workers included in food processing.

SOURCE: Research and Statistics Office, Department of Labor and Industrial Relations, State of Hawaii.

CHART 3
TRENDS IN CIVILIAN POPULATION
State of Hawaii & Counties
Mid-Year Estimates 1974-1984



SOURCE: Table 6.

TABLE 6
POPULATION TRENDS IN HAWAII
Mid-Year Estimates of Resident Population

July 1	City-County Honolulu	Maui County	Hawaii County	Kauai County	Civilian Total[a]	% Annual Increase	Armed Forces[b]	State Total
1984	748,200	83,000	106,300	43,800	981,300	1.90	57,300	1,038,600
1983	737,600	79,800	102,700	42,900	963,000	2.32	55,200	1,018,200
1982	724,200	76,900	100,000	41,800	941,200	1.83	54,900	996,700
1981	711,700	75,500	95,600	39,700	924,300	1.84	56,600	980,900
1980	701,900	71,000	91,900	38,900	907,635	1.74	57,056	964,691
1979	671,500	65,400	83,600	36,300	892,100	2.46	57,900	950,000
1978	664,100	63,100	81,600	35,400	870,700	1.30	58,300	929,000
1977	661,400	60,200	79,000	34,200	859,500	1.81	56,500	916,000
1976	656,000	58,200	77,700	33,800	844,200	2.31	57,800	902,000
1975	646,900	55,000	75,200	32,600	825,100	1.93	58,900	884,000
1974	640,300	52,400	72,000	31,900	809,500	2.09	57,500	967,000

NOTE: 1980 data at April 1. 1984 data are preliminary estimates, subject to revision.

a. Includes military dependents living in Hawaii; county detail may not add to civilian total due to different source.

b. Includes shore based armed forces for all years and home ported in Hawaii 1974-1984.

SOURCE: Provisional Estimates of the Population of Hawaii, Department of Planning and Economic Development, State of Hawaii.

TABLE 7

STATE AND LOCAL TAX BURDEN

Tax Collections Related to Population and Personal Income By States: Fiscal Years 1983 and 1984

State	Per Capital Tax Collections[a]					Per Capita Tax as a % of Per Capita Income[b]			
	Fiscal 1984[c]		Fiscal 1983		% Change	1984		1983	
	Amount	Rank	Amount	Rank	from 1983	%	Rank	%	Rank
HAWAII	$1,556	11	$1,457	6	6.78	12.84	12	12.57	8
U.S. Av.	1,388	--	1,216	--	14.17	11.91	--	10.94	--
Ala.	925	48	806	48	14.66	10.00	45	9.29	44
Alaska	4,536	1	4,908	1	(7.57)	26.38	1	29.12	1
Ariz.	1,267	28	1,064	32	19.04	11.89	20	10.59	26
Ark.	880	50	771	50	14.14	9.81	47	9.13	46
Calif.	1,513	13	1,337	13	13.14	11.41	28	10.60	25
Colo.	1,401	18	1,166	23	20.13	10.97	31	9.53	41
Conn.	1,735	5	1,434	8	21.01	11.65	24	10.28	30
Del.	1,402	17	1,273	16	10.17	11.07	29	10.69	24
Fla.	1,109	38	968	38	14.63	9.57	49	8.85	50
Ga.	1,079	41	973	36	10.86	10.39	40	10.10	35
Idaho	958	46	875	47	9.45	10.02	44	9.71	39
Ill.	1,468	14	1,255	17	16.93	11.83	21	10.44	29
Ind.	1,142	35	905	44	26.14	10.90	32	9.04	47
Iowa	1,301	24	1,171	21	11.10	12.15	17	11.01	19
Kans.	1,283	26	1,129	26	13.69	10.48	38	9.53	42
Ky.	953	47	888	45	7.27	10.14	43	9.74	38
La.	1,080	40	1,051	33	2.76	10.51	37	10.44	28
Me.	1,266	29	1,082	31	16.97	12.85	11	11.68	13
Md.	1,520	12	1,350	12	12.62	11.70	23	10.99	20
Mass.	1,604	10	1,425	9	12.58	12.09	18	11.59	14
Mich.	1,671	9	1,370	11	21.95	14.57	6	12.75	7
Minn.	1,725	6	1,473	5	17.11	14.48	7	13.05	5
Miss.	868	51	769	51	12.79	10.72	33	9.95	36
Mo.	1,068	42	931	41	14.68	9.73	48	8.95	48
Mont.	1,326	21	1,179	20	12.45	13.33	8	12.26	9
Neb.	1,235	30	1,146	24	7.70	11.01	30	10.53	27
Nev.	1,313	22	1,214	19	8.14	10.54	36	10.19	32
N. H.	1,201	33	951	40	26.31	9.99	46	8.54	51
N. J.	1,687	8	1,457	7	15.81	11.95	19	11.07	18
N. M.	1,208	32	1,041	34	16.00	12.53	13	11.21	15
N. Y.	2,188	4	1,889	4	15.80	16.84	3	15.48	3
N. C.	1,034	43	911	43	13.51	10.57	35	9.96	21
N. D.	1,419	16	1,100	28	28.97	12.16	16	10.13	34
Ohio	1,303	23	1,100	29	18.44	11.62	26	10.32	43
Okla.	1,140	37	1,123	27	1.50	10.40	39	10.15	33
Oregon	1,267	27	1,229	18	3.17	11.80	22	12.11	10
Pa.	1,331	20	1,169	22	13.85	11.63	25	10.70	23
R. I.	1,434	15	1,295	15	10.77	12.29	15	11.85	12
S. C.	981	45	878	46	11.63	10.67	34	10.20	31
S. D.	1,000	44	914	42	9.49	10.16	42	9.79	37
Tenn.	893	49	804	49	11.13	9.36	51	8.90	49
Texas	1,106	39	1,033	35	7.09	9.46	50	9.13	45
Utah	1,159	34	963	39	20.41	12.89	10	11.07	17
Vt.	1,301	25	1,138	25	14.30	13.04	9	11.96	11
Va.	1,233	31	1,094	30	12.64	10.17	41	9.64	40
Wash.	1,400	19	1,306	14	7.22	11.50	27	11.17	16
W. Va.	1,140	36	972	37	17.35	12.45	14	10.84	22
Wisc.	1,691	7	1,393	10	21.33	14.89	4	12.93	6
Wyo.	2,677	2	2,443	2	9.55	22.47	2	19.99	2
D. C.	2,344	3	2,132	3	9.91	14.89	5	14.46	4

a. Population excluding armed forces overseas at July 1 as estimated by the U.S. Department of Commerce.

b. Fiscal year taxes as a percentage of prior calendar year personal income.

c. Computed from preliminary state tax collections according to estimates by the U.S. Department of Commerce.

SOURCE: "State Tax Collections in 1984," GF 84, No. 1, "Governmental Finances in 1982-83," GF 83, No. 5, and "Survey of Current Business," Vol. 64, No. 8, U.S. Department of Commerce, Washington, D.C.

WHERE GOVERNMENT GETS ITS MONEY

Hawaii's highly centralized state government is reflected in the taxing authority relationship between the state and counties. In 1984, nearly 80% of all state and local taxes collected in Hawaii accrued to the state government, which derives the bulk of its collections from the individual and corporate income tax, the general excise tax, and the public service companies tax. On the other hand, Hawaii's four county governments depend primarily on the real property tax, motor vehicle and fuel taxes, and public utility franchise tax.

The largest tax revenue generators in Hawaii are the general excise tax, a multi-rate, multi-stage tax on the gross revenue of business, which constituted 38% of total tax collections; and income taxes on individuals and corporations, which accounted for 26%. The real property tax represented the third largest tax revenue source in the state chipping-in nearly 17% of the total. Growth in these taxes roughly mirror the overall growth in the Hawaiian economy and the inflation rate; with a healthy state economy in 1984, these major tax sources had a combined growth rate of 9.6% without any major changes in tax rates.

Hawaii's earmarked taxes such as the fuel, motor vehicle weight, and utility franchise taxes, and the unemployment compensation tax are collected and expended for specific purposes, primarily highway construction and maintenance and provision of unemployment benefits. These taxes comprise 9% of the total state tax collection picture in 1984 and represent a declining share of total tax revenues due to their relative inelasticity or unresponsiveness to changes in economic growth or prices. This is especially true of the state gasoline tax which is based on the number of gallons of fuel sold as opposed to the price of fuel which is subject to external economic pressures.

Real property tax revenues are the foundation for county government finances, representing nearly 50% of total county revenue sources. The growth rate in the real property tax collections slackened from 7.8% in fiscal year 1982 to 5.2% in 1984 due to a combination of a poor real estate market and a hesitancy to increase property tax rates by local officials.

Federal tax collections in Hawaii grew by 4.4% during 1984 after rising a meager 1.1% during 1983. Individual income tax revenues accounted for the bulk or about 87% of federal taxes collected while corporate income taxes contributed 9%, followed by a host of excise taxes, estate and gift taxes, and the federal unemployment tax.

TABLE 8
FEDERAL TAX COLLECTIONS[a]
By Source — Selected Fiscal Years
(Dollars in Thousands)

Source	1984	1983	1982	1979	1974
Income and Profits Taxes					
Individual Income & Employment	$556,049,684	$519,164,239	$517,975,744	$361,437,731	$203,516,708
Corporate Income & Profits	74,179,370	61,779,556	65,990,832	71,447,876	41,744.444
Sub-Total Income & Profits	$630,229,054	$580,943,795	$583,966,576	$432,885,607	$245,261,152
Excise Taxes					
Alcoholic Beverages	$ 5,402,467	$ 5,634,853	$ 5,459,810	$ 5,647,924	$ 5,358,477
Tobacco	4,663,610	4,139,810	2,539,495	2,495,517	2,437,005
Manufacturers' Excise					
Gasoline	9,026,745	4,904,580	4,214,373	4,525,065	4,087,669
Tires and Tubes	423,315	677,966	616,785	878,283	827,257
Lubricating Oils[b]	--	48,688	106,483	108,647	105,723
Others[c]	647,182	720,606	560,414	356,448	75,153
Retailers' Excise					
Motor Vehicle Parts & Access.	932,645	424,182	884,845	1,189,169	646,352
Others[d]	1,686,925	831,196	628,625	553,291	416,244
Miscellaneous Excise					
Telephone & Teletype	2,034,965	1,048,317	919,749	1,362,193	1,892,731
Air Transportation of Persons	2,241,203	1,757,412	1,154,863	1,272,003	659.177
Others[e]	9,014,018	16,422,219	22,738,443	588,837	602,416
Unclassified Excise[f]	1,944,411	(844,291)	(3,044,455)	72,126	1,648
Sub-Total Excise Taxes	$ 38,017,486	$ 35,765,538	$ 36,779,430	$ 19,049,503	$ 17,109.852
Estate	$ 6,024,985	$ 6,077,202	$ 8,035,335	$ 5,344.176	$ 4,659.825
Gift	151,682	148,675	108,038	174,899	440,849
Unemployment	6,052,023	4,311,582	3,351,128	2,958,000	1,480,574
TOTAL	$680,475,229	$627,246,793	$632,240,506	$460,412,185	$268,952,254

NOTE: Detail may not add due to rounding; 1983 data revised; retailers' excise reclassified for 1984 and prior years.

a. Gross Internal Revenue collections.

b. Repealed January 7, 1983.

c. Includes taxes for the black lung disability fund, sport equipment and firearms excise taxes, vehicle fuel economy levies, and amounts collected or adjusted for taxes which have expired or been repealed.

d. Includes taxes on noncommercial aviation fuels, diesel and special motor fuels, inland waterway fuel, and amounts collected or adjusted for expired or repealed taxes.

e. Includes taxes on windfall profits, highway vehicles over 26,000 lb., penalties on exempt organizations and employee pension plans, environmental taxes, and amounts collected or adjusted for expired or repealed taxes.

f. Amounts paid into depositories but not yet classified into excise detail; negative amounts represent reclassification of amounts previously reported as unclassified excise taxes.

SOURCE: Annual Reports, Commissioner and Chief Counsel, Internal Revenue Service, U.S. Department of the Treasury.

TABLE 9

DISTRIBUTION OF GENERAL REVENUE SOURCES

State and Local Government — Fis[illegible]83[a]

(Dollars in Millions)

State	Total Amount	Percent of Total								
			Taxes							
		Fed. Grants	Total	Income[b]	Sales	Prop.	Vehicle[c]	Others	Current Charges[d]	Misc. Revs.[e]
HAWAII	$ 2,467.3	19.7	60.4	15.0	24.4	11.1	3.3	6.6	11.0	8.8
U.S.	$486,752.9	18.5	58.4	14.3	13.3	18.3	3.5	9.0	12.9	10.2
Ala.	$ 6,594.3	21.5	48.4	11.1	14.2	6.0	4.7	12.5	20.8	9.3
Alaska	5,686.4	8.0	41.3	4.7	0.7	7.1	1.0	27.8	5.5	45.2
Ariz.	5,630.5	13.3	56.0	11.4	18.5	16.6	4.5	5.0	13.4	17.3
Ark.	3,454.3	24.2	51.9	13.8	13.6	10.9	5.8	7.8	14.5	9.4
Calif.	56,966.2	18.9	59.1	17.9	16.9	15.3	2.6	6.4	12.7	9.4
Colo.	6,512.7	15.5	56.2	10.9	17.3	19.7	3.2	5.1	15.2	13.1
Conn.	6,671.5	15.5	67.4	8.0	16.5	29.0	3.5	10.3	8.2	8.8
Del.	1,474.6	18.3	52.3	24.2	--	7.7	4.4	16.1	15.9	13.5
Fla.	17,890.2	15.5	57.8	2.1	18.6	19.8	4.2	13.0	16.5	10.2
Ga.	11,081.2	21.9	50.3	14.3	13.3	13.8	3.7	5.3	10.4	7.3
Idaho	1,616.5	21.7	53.5	15.8	10.2	14.6	7.1	5.9	15.0	9.8
Ill.	23,066.5	19.2	62.5	12.2	14.5	23.8	3.4	8.7	9.6	8.6
Ind.	8,957.7	18.2	55.4	11.3	17.0	19.2	4.9	3.0	18.9	7.5
Iowa	5,731.5	16.7	59.4	15.1	10.0	23.8	5.9	4.6	16.9	7.0
Kans.	4,853.3	16.0	56.4	13.8	11.3	22.3	3.8	5.1	14.0	13.6
Ky.	5,825.3	23.6	56.6	17.6	12.0	10.2	4.8	12.0	11.2	8.6
La.	9,098.0	18.4	51.3	6.1	18.7	7.2	2.7	16.6	12.9	17.5
Me.	2,071.8	23.3	59.9	13.0	13.0	22.7	4.3	6.9	9.5	7.4
Md.	9,756.7	18.3	59.5	23.5	8.9	15.6	3.3	8.3	12.0	10.2
Mass.	13,180.4	21.9	62.3	23.8	8.0	22.9	2.6	5.1	9.0	6.8
Mich.	21,348.7	19.1	58.2	18.0	9.2	24.2	3.4	3.3	14.1	8.6
Minn.	10,664.2	16.6	57.3	20.9	9.3	16.1	4.2	6.7	14.0	12.1
Miss.	4,140.8	23.9	48.1	6.5	18.4	10.3	4.5	8.4	20.8	7.3
Mo.	7,861.8	19.6	58.9	14.4	16.9	15.4	4.0	8.1	13.3	8.2
Mont.	1,991.8	20.0	48.4	9.4	--	23.0	4.2	11.7	8.6	23.0
Neb.	3,313.5	16.2	55.3	10.0	12.3	22.9	5.2	4.8	17.0	11.5
Nev.	1,972.9	14.9	54.8	--	18.7	10.6	5.6	20.0	18.6	11.7
N.H.	1,585.8	20.0	57.5	5.7	--	36.5	5.7	9.6	12.0	10.6
N.J.	16,675.3	15.1	65.2	12.6	10.0	28.4	3.3	11.0	9.9	9.8
N.M.	3,702.9	23.4	39.3	2.1	14.5	5.4	3.6	13.7	9.7	27.6
N.Y.	51,593.1	18.0	64.7	23.2	12.4	20.8	1.5	6.7	9.4	7.9
N.C.	9,706.5	21.0	57.1	19.1	11.0	13.4	5.5	8.2	14.1	7.9
N.D.	1,576.3	19.7	47.5	4.2	9.3	13.7	4.1	16.2	18.3	14.6
Ohio	19,689.7	16.9	60.0	17.3	11.3	19.4	4.6	7.5	13.9	9.2
Okla.	6,111.3	17.6	60.6	12.3	13.1	10.2	5.1	20.0	14.8	7.0
Ore.	6,120.6	19.0	53.4	21.4	--	22.0	3.6	6.5	13.2	14.4
Pa.	22,880.6	20.7	60.8	17.9	10.3	16.3	4.0	12.2	9.4	9.1
R. I.	2,214.7	21.4	55.8	13.7	9.6	23.2	3.0	6.4	10.1	12.6
S. C.	5,247.6	20.0	54.6	16.1	13.2	13.4	4.9	7.0	16.4	9.0
S. D.	1,311.4	24.7	48.8	0.2	15.3	20.8	6.0	6.5	12.6	13.9
Tenn.	7,381.3	23.0	51.0	3.5	21.0	13.1	5.7	7.8	17.5	8.4
Texas	27,906.5	14.7	58.2	--	14.5	21.4	3.1	19.1	14.1	13.0
Utah	3,120.6	19.9	49.9	12.1	15.4	14.6	3.6	4.3	12.8	17.4
Vt.	1,084.6	25.5	55.1	12.8	6.1	21.9	5.1	9.2	11.0	8.5
Va.	9,936.2	16.9	61.1	17.4	9.8	18.1	5.2	10.6	15.0	7.0
Wash.	9,669.4	17.9	58.1	--	27.6	16.9	3.8	9.8	13.5	10.5
W. Va.	3,428.5	21.8	55.7	10.4	21.7	10.3	4.8	8.4	14.0	8.5
Wisc.	10,854.4	18.1	61.0	19.1	11.1	22.1	3.8	4.8	14.4	6.5
Wyo.	1,970.7	20.5	63.7	--	11.7	26.3	3.7	22.1	11.6	24.7
D. C.	2,700.9	42.2	49.2	16.3	10.1	13.6	1.5	7.8	4.4	4.2

NOTE: Totals may not add due to rounding.

a. Excludes revenues from insurance trust funds, utility enterprises, and monopoly liquor stores.
b. Includes individual and corporate income taxes.
c. Includes motor fuel taxes and motor vehicle license fees.
d. Includes revenues from hospital charges, higher education institutional fees and charges, school lunch programs, and sewerage charges.
e. Includes interest earnings.

SOURCE: "Governmental Finances in 1982-1983," Series GF 83, No. 5, U.S. Department of Commerce, Bureau of the Census, Washington, D.C., October 1984.

TABLE 10
GENERAL EXCISE TAX COLLECTIONS
State of Hawaii — Selected Calendar Years

Activities	1984	1983	1979	Change 1984 from 1983 Amount	Change 1984 from 1983 Percent
Retailing	$324,475,683	$297,527,750	$220,795,541	$26,947,933	9.06
Services	94,736,738	85,380,811	56,487,818	9,355,927	10.96
Contracting	49,717,096	54,136,217	53,018,411	- 4,419,121	- 8.16
Theater, Radio, and Amusement	6,148,877	5,763,843	4,365,715	385,034	6.68
Interest	8,297,096	7,395,988	5,329,661	901,108	12.18
Commissions	11,990,217	10,726,700	12,295,641	1,263,517	11.78
Hotel Rentals	39,380,782	35,048,948	26,883,938	4,331,834	12.36
All Other Rentals	70,373,548	63,783,668	41,113,929	6,589,880	10.33
Use (4$)	14,184,858	11,098,385	9,324,649	3,086,473	27.81
All Others	12,376,683	10,515,442	6,017,994	1,861,241	17.70
Sub-Total	$631,681,578	$581,377,752	$435,633,297	$50,303,826	8.65
Sugar Processing	$ 2,071,051	$ 2,177,871	$ 1,528,690	-$ 106,820	- 4.90
Pine Canning	991,336	914,836	821,000	76,500	8.36
Sub-Total	$ 3,062,387	$ 3,092,707	$ 2,349,690	-$ 30,320	- 0.98
Producing	$ 1,213,202	$ 1,101,472	$ 784,367	$ 111,730	10.14
Manufacturing[a]	2,598,011	2,559,104	2,826,105	38,907	1.52
Sub-Total	$ 3,811,213	$ 3,660,576	$ 3,610,472	$ 150,637	4.12
Wholesaling[b]	$ 20,126,622	$ 18,471,100	$ 14,004,757	$ 1,655,522	8.96
Intermediary Services	644,380	511,137	221,508	133,243	26.07
Use (1/2$)	10,125,168	8,100,437	10,154,723	2,024,731	25.00
Disabled Vendors	--	--	44,963	--	--
Sub-Total	$ 30,896,170	$ 27,082,674	$ 24,425,951	$ 3,813,496	14.08
Insurance Solicitors	$ 354,140	$ 322,434	$ 358,497	$ 31,706	9.83
Penalties and Interest	--	--	141,817	--	--
Sub-Total	$ 354,140	$ 322,434	$ 500,314	$ 31,706	9.83
TOTAL	$669,805,488	$615,536,143	$466,534,650	$54,269,345	8.82

NOTE: Total for 1979 reflects net adjustments and collections not assignable by source of $14,926.

a. Includes canning other than pineapple.

b. 1983 and 1984 revised data includes disabled vendors.

SOURCE: Reports of the Department of Taxation, State of Hawaii.

TABLE 11
DISTRIBUTION OF FEDERAL REVENUE SHARING FUNDS
State and Local Governments: Fiscal Years[a]

Unit of Government	1984	1983	1982	Change 1984 from 1982 Amount	Change 1984 from 1982 Percent
State of Hawaii	$ --	$ 200,109	$ --	$ --	0.00
County of:					
Honolulu	15,510,472	16,811,730	16,037,997	(527,525)	(3.29)
Maui	1,814,344	1,868,426	1,356,837	457,507	33.72
Hawaii	2,985,399	3,259,036	3,123,732	(138,333)	(4.43)
Kauai	1,266,464	1,342,212	1,208,762	57,702	4.77
TOTAL	$21,576,679	$23,481,513	$21,727,328	$(150,649)	(0.69)

a. Established by the "State and Local Fiscal Assistance Act of 1972," as amended, to distribute assistance moneys to state and local governments.

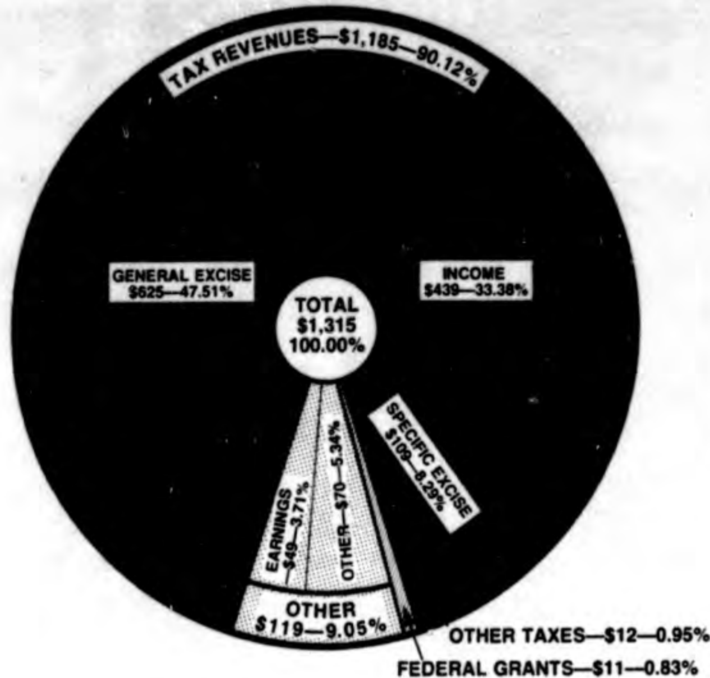
SOURCE: Compiled by the Tax Foundation of Hawaii from reports of the Department of Accounting and General Services, State of Hawaii and the various County Finance Directors' Annual Financial Reports.

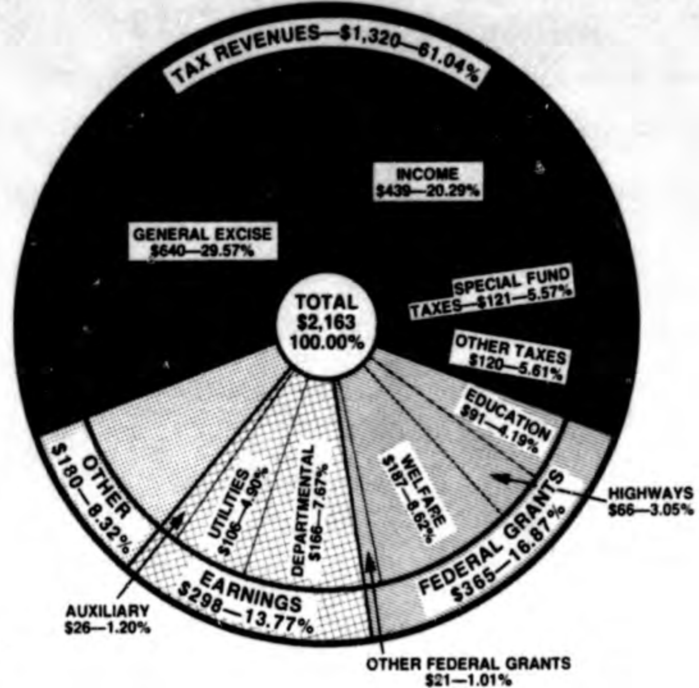
CHART 4

SOURCES OF STATE GOVERNMENT OPERATING REVENUES

STATE OF HAWAII — FISCAL 1984

(Dollars in Millions)





NOTE: See Table 12 for further detail.

SOURCE: Compiled by the Tax Foundation of Hawaii from the 1984 Annual Report of the Comptroller, State of Hawaii.

TABLE 12
STATE REVENUE RECEIPTS
Hawaii — Fiscal Years 1984 and 1983

Source of Revenue	Fiscal 1984 General Fund	Fiscal 1984 Special Fund	Fiscal 1984 Total	Fiscal 1983 General Fund	Fiscal 1983 Special Fund	Fiscal 1983 Total
Tax Revenues						
General Excise	$ 624,508,072	$ 15,122,114	$ 639,630,186	$ 585,947,523	$ 15,538,477	$ 601,486,000
Specific Excise[a]	108,919,275	43,577,447	152,496,722	122,982,734	42,500,699	165,483,433
Individual Income	402,419,191	--	402,419,191	346,950,980	--	346,950,980
Corporate Income	36,430,729	--	36,430,729	24,466,503	--	24,466,503
Unemployment Compensation	--	76,296,605	76,296,605	--	67,625,037	67,625,037
Other Taxes, Lic. & Permits[b]	12,424,065	664,201	13,088,266	8,151,631	308,941	8,460,572
Sub-Total Taxes	$1,184,701,332	$135,660,367	$1,320,361,699	$1,088,499,371	$125,973,154	$1,214,472,525
Fines, Forfeitures & Escheats	$ 8,695,788	$ 824,276	$ 9,520,064	$ 8,401,760	$ 816,624	9,218,384
Federal Grants-in-Aid	10,864,813	354,130,782	364,995,595	10,300,855	376,503,855	386,804,710
Revenues from Other Agencies	1,941,435	7,385,237	9,326,672	1,181,100	6,921,022	8,102,122
Rents, Royalties, & Land Income	49,358,015	12,997,817	62,355,832	46,591,271	54,909,306	101,500,577
Earnings - General Departments	47,992,116	117,986,021	165,978,137	41,669,786	105,877,281	147,547,067
- Auxiliary Enter.	--	25,967,358	25,967,358	--	25,591,274	25,591,274
- Public Service Enter.	--	105,926,811	105,926,811	--	102,215,658	102,215,658
Interest Earned	755,035	--	755,035	1,085,600	--	1,085,600
Miscellaneous	10,229,133	87,746,417	97,975,550	14,789,219	94,272,117	109,061,336
TOTAL[c]	$1,314,537,667	$848,625,086	$2,163,162,753	$1,212,518,962	$893,080,291	$2,105,599,253

a. Includes public service companies, tobacco, liquor, insurance, and fuel taxes.

b. Includes franchise tax, inheritance and estate taxes, and conveyance tax.

c. Excludes transfers and repayments except as shown.

SOURCE: Compiled by the Tax Foundation of Hawaii from Annual Reports of the Comptroller, Department of Accounting and General Services, State of Hawaii.

TABLE 13
STATE AND COUNTY TAX COLLECTIONS IN HAWAII
Selected Fiscal Years

Unit of Government Source	1984	1983	1982	1979	1974
State of Hawaii					
General Excise & Use	$ 639,630,187	$ 601,486,001	$ 577,264,805	$ 430,849,901	$244,554,768
Fuel	54,909,051	53,635,554	52,579,890	48,318,750	29,649,393
Liquor	(209,040)	9,299,285	7,701,098	20,433,985	11,414,478
Tobacco	19,948,572	17,608,579	14,010,696	11,855,701	8,304,732
Insurance	26,606,444	26,355,858	27,756,730	18,466,002	9,533,689
Public Service Companies	59,559,375	66,395,288	56,987,473	33,924,866	21,167,132
Banks & Other Financial Corp.	547,143	(2,441,046)	3,888,230	7,602,035	3,629,739
Corporate Income[a]	36,430,730	24,466,504	39,314,134	32,273,128	18,166,034
Individual Income[b]					
Net Income	403,076,248	347,015,648	283,000,194	264,557,220	151,733,833
Inheritance and Estate	6,651,792	6,415,597	5,105,869	4,141,033	2,661,186
Real Property[c]	100	153,369	670,529	174,343,109	121,864,482
Conveyance	1,797,394	1,514,888	1,446,145	1,857,695	1,037,260
Licenses, Permits & Others	6,306,846	5,479,833	4,649,170	3,595,007	1,969,838
Unemployment Compensation	76,296,605	67,625,037	58,324,482	75,458,288	25,168,413
Sub-Total	$1,331,551,447	$1,225,010,395	$1,132,699,446	$1,127,676,720	$650,854,977
Counties					
Real Property[c]	$ 289,114,082	$ 274,919,659	$ 255,058,407	$ --	$ --
Liquor Licenses & Fees	3,076,614	2,853,991	2,408,112	2,269,330	1,428,900
Utility Franchise	16,966,534	18,444,360	17,266,811	8,022,829	3,203,234
Motor Vehicle Weight[d]	25,581,880	24,834,700	23,832,507	21,948,319	12,488,072
Licenses, Permits & Others	8,525,616	7,743,266	6,213,374	5,051,862	4,350,132
Sub-Total	$ 343,264,726	$ 328,795,976	$ 304,779,211	$ 37,292,340	$ 21,470,338
TOTAL	$1,674,816,173	$1,553,806,371	$1,437,478,657	$1,164,969,060	$672,325,315

a. Includes payments of estimated taxes less refunds.
b. Includes withheld and estimated taxes less refunds, and delinquent compensation taxes (repealed 1/1/58).
c. Article VIII, section 3 of the State Constitution, as amended in 1978, mandated the transfer of real property tax administration to the counties, effective July 1, 1981. State collections after fiscal year 1981 represent taxes for prior years and are distributed to the respective county funds.
d. Includes state motor vehicle weight tax from 1978.

SOURCES: Department of Taxation and Department of Accounting and General Services, State of Hawaii and the County Finance Directors' Annual Reports.

TABLE 14
ALLOCATION OF STATE AND COUNTY TAXES
Hawaii — Fiscal Years 1984 and 1983
(In Thousands)

Type of Taxes	1984 State	1984 Allocated to Honolulu	1984 Allocated to Maui	1984 Allocated to Hawaii	1984 Allocated to Kauai	1984 Total
State Collections						
General Excise[a]	$ 621,458	$ 7,734	$ 2,994	$ 4,328	$ 3,116	$ 639,630
Fuel	34,559	15,581	2,022	2,104	642	54,909
Liquor	(209)					(209)
Tobacco	19,949					19,949
Insurance	26,606					26,606
Public Service Co.	59,559					59,559
Banks & Fin. Corp.	547					547
Income - Corp.[b]	36,431					36,431
- Indiv.[c]	403,076					403,076
Inheritance & Estate	6,652					6,652
Real Property[d]	--					--
Conveyance	1,797					1,797
Unemploy. Comp.	76,297					76,297
Licenses & Other	6,307					6,307
Sub-Total - State	$1,293,029	$ 23,315	$ 5,016	$ 6,432	$ 3,758	$1,331,551
County Collections						
Real Property[d]	$ --	$212,270	$25,620	$37,142	$14,082	$ 289,114
Liquor Licenses	--	1,616	761	457	243	3,077
Utility Franchise	--	13,868	812	1,464	823	16,967
Motor Vehicle Weight	9,272	11,642	1,893	1,672	1,102	25,582
All Others	--	6,460	866	850	349	8,526
Sub-Total - Counties	$ 9,272	$245,855	$29,952	$41,586	$16,599	$ 343,266
TOTAL	$1,302,302	$269,170	$34,968	$48,018	$20,357	$1,674,817

Type of Taxes	1983 State	1983 Allocated to Honolulu	1983 Allocated to Maui	1983 Allocated to Hawaii	1983 Allocated to Kauai	1983 Total
State Collections						
General Excise[a]	$ 583,314	$ 7,734	$ 2,994	$ 4,328	$ 3,116	$ 601,486
Fuel	33,765	15,310	1,928	2,002	631	53,636
Liquor	9,299					9,299
Tobacco	17,609					17,609
Insurance	26,356					26,356
Public Service Co.	56,395					66,395
Banks & Fin. Corp.	(2,441)					(2,441)
Income - Corp.[b]	24,467					24,467
- Indiv.[c]	347,016					347,016
Inheritance & Estate	6,416					6,416
Real Property[d]	153					153
Conveyance	1,515					1,515
Unemploy. Comp.	67,625					67,625
Licenses & Other	5,480					5,480
Sub-Total - State	$1,186,969	$ 23,044	$ 4,922	$ 6,330	$ 3,747	$1,225,012
County Collections						
Real Property[d]	$ --	$201,004	$23,693	$36,159	$14,064	$ 274,920
Liquor Licenses	--	1,476	680	446	251	2,853
Utility Franchise	--	15,512	789	1,390	754	18,445
Motor Vehicle Weight	8,921	11,320	1,849	1,638	1,107	24,835
All Others	--	6,106	695	746	196	7,743
Sub-Total - Counties	$ 8,921	$235,418	$27,706	$40,379	$16,372	$ 328,796
TOTAL	$1,195,890	$258,462	$32,628	$46,709	$20,119	$1,553,808

NOTE: Detail may not add to total due to rounding.

a. Act 114, SLH 1973 provided fixed amounts for county grants-in-aid subject to transfer of county functions.

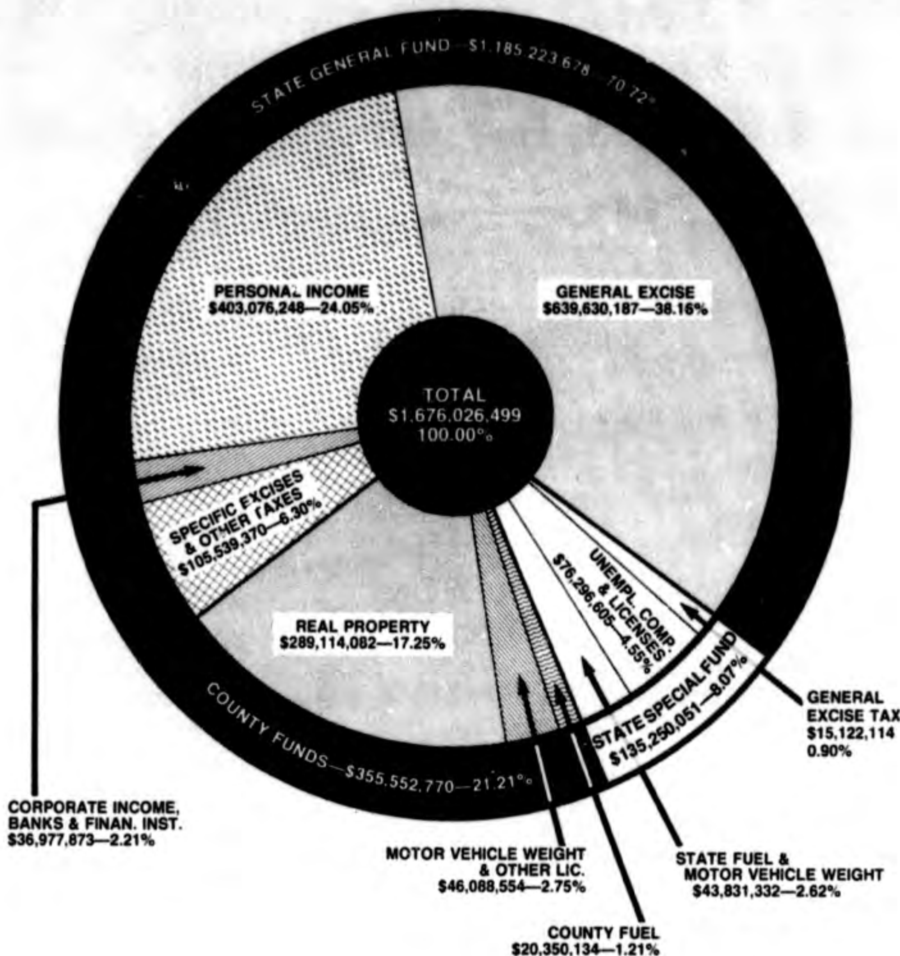
b. Includes amounts paid on declared estimated taxes less refunds.

c. Includes delinquent collections from Compensations and Dividends Tax, repealed 1/1/58, and Personal Net Income Tax including payments for withheld and declared estimated taxes less refunds.

d. Article VIII, Section 3 of the State Constitution, as amended in 1978, mandated the transfer of real property tax administration (including collection of the tax) to the counties, effective July 1, 1981. State collections represent real property taxes for prior years; less than $1,000 in state collections for fiscal 1984.

SOURCE: Department of Taxation and Department of Accounting and General Services, State of Hawaii; the County Finance Directors' Annual Reports, and Table 13.

CHART 5
HAWAII STATE AND COUNTY TAX COLLECTIONS
Fiscal Year 1984



NOTE: Details do not agree with Tables 13 and 15 due to different sources.
SOURCE: Departments of Taxation, and Accounting and General Services, State of Hawaii, and County Finance Directors' Annual Reports.

TABLE 15
LIQUID FUEL TAX COLLECTIONS
State of Hawaii — Selected Fiscal Years

Type of Fuel	Tax Per Gal. Fiscal 1984[a]	1984	1983	1982	1979
		STATE TAX REVENUES			
OAHU					
Gasoline	8.5	$19,498,162	$19,190,682	$18,638,434	$20,510,535
Other Highway[b]	6.0 & 8.5	1,080,405	1,025,097	986,602	1,018,227
Other Non-Hwy.	1.0	413,714	421,159	384,537	453,226
Aviation	1.0	4,726,513	4,754,214	4,846,467	4,636,770
Small Boat[c]	1.0 & 15.0	17,311	29,008	39,906	23,118
TOTAL OAHU	--	$25,736,106	$25,420,160	$24,895,946	$26,641,876
MAUI					
Gasoline	8.5	$ 2,757,195	$ 2,402,713	$ 2,531,810	$ 2,665,752
Other Highway[b]	6.0 & 8.5	142,589	360,813	147,912	114,846
Other Non-Hwy.	1.0	246,600	281,444	326,742	242,341
Aviation	1.0	151,644	40,523	28,273	48,634
Small Boat[c]	1.0 & 14.5	--	1	684	464
TOTAL MAUI	--	$ 3,298,029	$ 3,085,494	$ 3,035,421	$ 3,072,037
HAWAII					
Gasoline	8.5	$ 3,364,176	$ 3,222,770	$ 3,246,565	$ 3,243,903
Other Highway[b]	6.0 & 8.5	251,181	216,7[illegible]	200,266	245,143
Other Non-Hwy.	1.0	128,088	119,168	112,847	129,666
Aviation	1.0	59,623	54,479	44,132	168,433
Small Boat[c]	1.0 & 13.5	10,105	5,805	22,594	31,522
TOTAL HAWAII	--	$ 3,813,172	$ 3,618,926	$ 3,626,404	$ 3,818,667
KAUAI					
Gasoline	8.5	$ 1,343,060	$ 1,287,824	$ 1,331,035	$ 1,306,809
Other Highway[b]	6.0 & 8.5	38,263	70,511	67,869	59,581
Other Non-Hwy.	1.0	132,867	93,267	102,353	230,030
Aviation	1.0	2,227	2,007	4,931	7,217
Small Boat[c]	1.0 & 12.5	--	--	700	223
TOTAL KAUAI	--	$ 1,516,417	$ 1,453,609	$ 1,506,888	$ 1,603,860
ALL COUNTIES					
Gasoline	--	$26,962,593	$26,103,989	$25,747,844	$27,726,999
Other Highway	--	1,512,437	1,673,125	1,402,649	1,437,797
Other Non-Hwy.	--	921,270	915,038	926,479	1,055,263
Aviation	--	4,940,008	4,851,223	4,923,803	4,861,054
Small Boat[d]	--	27,416	34,814	63,884	55,327
TOTAL ALL COUNTIES	--	$34,363,724	$33,578,189	$33,064,659	$35,136,440
		COUNTY TAX REVENUES			
OAHU					
Gasoline	6.5	$14,907,808	$14,672,339	$14,249,877	$ 8,443,723
Other Highways[b]	4.0 & 6.5	824,196	779,068	749,591	414,953
TOTAL OAHU	--	$15,732,004	$15,451,407	$14,999,468	$ 8,858,676
MAUI					
Gasoline	6.0	1,942,347	$ 1,692,315	$ 1,731,726	$ 1,562,811
Other Highways[b]	4.0 & 6.0	100,518	254,846	99,764	66,989
TOTAL MAUI	--	$ 2,042,865	$ 1,947,161	$ 1,831,490	$ 1,629,800
HAWAII					
Gasoline	5.0	$ 1,975,450	$ 1,892,169	$ 1,905,542	$ 1,906,439
Other Highways[b]	3.0 & 5.0	147,154	126,878	117,202	143,767
TOTAL HAWAII	--	$ 2,122,604	$ 2,019,047	$ 2,022,744	$ 2,050,206
KAUAI					
Gasoline	4.0	$ 630,491	$ 604,414	$ 624,425	$ 613,044
Other Highways[b]	3.0 & 4.0	18,067	33,240	31,999	28,089
TOTAL KAUAI	--	$ 648,559	$ 637,654	$ 656,424	$ 641,133
ALL COUNTIES					
Gasoline	--	$19,456,097	$18,861,237	$18,511,570	$12,526,017
Other Highway	--	1,089,936	1,194,032	998,556	653,798
TOTAL ALL COUNTIES	--	$20,546,032	$20,055,269	$19,510,126	$13,179,815

NOTE: Detail may not add to total due to rounding.
a. Rate in cents per gallon.
b. Low rate for liquid petroleum gas, higher rate for diesel fuel.
c. Fuel other than gasoline at 1 cent per gallon.
d. Includes $19,582 in 1982 and $15,958 in 1979 allocated to the counties.
SOURCE: Reports of the Department of Taxation, State of Hawaii.

TABLE 16
STATE GENERAL SALES TAX DATA
Tax Rates as of January 1, 1985

	Retail Rates[a]		Other	Credit Granted Against	Food	Drugs
State	State	Local	Rates[b]	Income Taxes	Taxable[c]	Taxable[d]
HAWAII	4.0%	--%	0.5%	Yes	Yes	Yes
Ala.	4.0	3.0	--	No	Yes	No
Alaska	--	6.0	--	No	Yes	Yes
Ariz.	5.0	2.0	--	No	No	No
Ark.	4.0	2.0	--	No	Yes	No
Calif.	4.75	1.75	--	No	No	No
Colo.	3.0	4.0	--	No	No	No
Conn.	7.5	--	--	No	No	No
Del.	No state or local sales tax					
Fla.	5.0	1.0	--	No	No	No
Ga.	3.0	1.0	--	No	Yes	Yes
Idaho	4.0	--	--	No	Yes	No
Ill.	5.0	2.0	--	No	No	No
Ind.	5.0	--	0.325	No	No	No
Iowa	4.0	--	--	No	No	No
Kans.	3.0	1.0	--	Yes[e]	Yes	No
Ky.	5.0	0.5	--	No	No	No
La.	4.0	3.0	--	No	No	No
Me.	5.0	--	--	No	No	No
Md.	5.0	--	--	No	No	No
Mass.	5.0	--	--	No	No	No
Mich.	4.0	--	--	No	No	No
Minn.	6.0	1.0	--	No	No	No
Miss.	6.0	--	0.125	No	Yes	No
Mo.	4.125	1.0	--	No	Yes	No
Mont.	No state or local sales tax					
Neb.	3.5	1.5	--	No	No	No
Nev.	2.0	3.75	--	No	No	No
N. H.	No state or local sales tax					
N. J.	6.0	--	--	No	No	No
N. M.	3.75	1.875	--	Yes	Yes	Yes
N. Y.	4.0	4.25	--	No	No	No
N. C.	3.0	1.5	--	No	Yes	No
N. D.	4.0	--	--	No	No	No
Ohio	5.0	2.5	--	No	No	No
Okla.	3.0	4.0	--	No	Yes	No
Ore.	No state or local sales tax					
Pa.	6.0	0.4	--	No	No	No
R. I.	6.0	--	--	No	No	No
S. C.	5.0	--	--	No	Yes	No
S. D.	4.0	3.0	--	Yes[e]	Yes	No
Tenn.	5.5	2.25	--	No	Yes	No
Texas	4.125	1.0	--	No	No	No
Utah	4.625	1.125	--	No	Yes	No
Vt.	4.0	--	--	Yes	No	No
Va.	3.0	1.0	--	No	Yes	No
Wash.	6.5	0.925	0.44	No	Yes	No
W. Va.	5.0	--	0.88 & 0.27	No	No	No
Wisc.	5.0	0.5	--	No	No	No
Wyo.	3.0	1.0	--	Yes[e]	Yes	No
D. C.	--	6.0	--	No	No	No

a. Generally on tangible personalty only, although a few states (including Hawaii) tax selected services. Local rate is highest allowed or imposed.
b. Hawaii levies tax on wholesaling, producing and manufacturing; Indiana on wholesaling; Washington and West Virginia on manufacturing and wholesaling.
c. Food for home consumption; restaurant meals are generally taxable.
d. Generally limited to prescription medicine and drugs, although some states exempt various other medical items such as patent medicines, baby supplies, eyeglasses and artificial limbs.
e. Refund granted to low income elderly or disabled persons.

SOURCE: State Tax Guide, All State Unit, Commerce Clearing House, Inc.

TABLE 17
STATE FUEL, TOBACCO AND LIQUOR TAXES
Tax Rates as of January 1, 1985

State	Motor Fuel Tax[a] (¢ Per Gallon) State	Local	Tobacco Taxes: Cigarettes (¢ Per Pack)	Other Products	Liquor[d] (Per Gal.)
HAWAII	8.5	7.5	40% Whlse.[c]	40% Whlse.	20% Whlse.
Ala.	11.0[b]	3.0	16.5	Yes	48% Retail[e]
Alaska	8.0		8.0	No	$5.60
Ariz.	13.0		15.0	Yes	3.00
Ark.	9.5[b]		21.0	16% Whlse.	$2.00+3% Retail
Calif.	9.0		10.0	No	2.00
Colo.	12.0[b]		15.0	No	2.28
Conn.	15.0		26.0	No	3.00
Del.	11.0		14.0	30% Whlse.	2.25
Fla.	4.0	4.0	21.0	No	6.50
Ga.	7.5+3% Retail		12.0	Yes	3.79
Idaho	14.5		9.1	35% Whlse.	15% Retail[e]
Ill.	12.0[b]	4.0	12.0	No	2.00
Ind.	11.1		10.5	No	2.68
Iowa	13.0[b]		18.0	10% Whlse.	15% Whlse.[e]
Kans.	11.0[b]		16.0	10% Whlse.	2.50
Ky.	10.0		3.0	No	1.92+9% Whlse.
La.	16.0		16.0	Yes	2.50
Me.	14.0		20.0	No	75% Whlse.+62.5¢
Md.	13.5		13.0	No	1.50
Mass.	11.0		26.0	No	4.05
Mich.	15.0		21.0	No	9.85% Retail[e]
Minn.	17.0		18.0	20% Whlse.	4.39
Miss.	9.0[b]	3.0	11.0	Yes	$2.50+3% Retail[e]
Mo.	7.0		13.0	No	2.00
Mont.	15.0[b]		16.0	12.5% Whlse.	26% Retail[e]
Neb.	14.5		18.0	No	2.75
Nev.	10.25[b]	5.75	15.0	30% Whlse.	2.05
N. H.	14.0		17.0	No	(e)
N. J.	8.0		25.0	No	2.80
N. M.	11.0		12.0	No	3.94
N. Y.	8.0[b]	1.0[f]	21.0	No	4.09
N. C.	12.0		2.0	No	22.5% Retail
N. D.	13.0		18.0	11% Whlse.	2.50
Ohio	12.0		14.0	No	(e)
Okla.	9.0		18.0	Yes	4.00
Ore.	10.0	3.0	19.0	No	(e)
Pa.	12.0		18.0	No	$1.00+18% Retail[e]
R. I.	13.0		23.0	No	2.50
S. C.	13.0		7.0	Yes	$2.72+9% Surtax
S. D.	13.0		15.0	No	3.80
Tenn.	9.0[b]		13.0	6% Whlse.	4.00
Texas	10.0[b]		19.5	Yes	2.00
Utah	14.0		12.0	25% Retail	13% Retail[e]
Vt.	13.0[b]		17.0	20% Whlse.	25% Retail[e]
Va.	11.0		2.5	No	20% Retail[e]
Wash.	18.0		23.0	48.15% Whlse.	(e)
W. Va.	10.5		17.0	No	(e)
Wisc.	16.5		25.0	20% Whlse.	3.25
Wyo.	8.0[b]		8.0	No	0.95[e]
D. C.	--	15.5	13.0	No	1.50

a. Gasoline for use on public highways. Local rate is highest imposed. Additional tax of 3% of retail imposed in Georgia.
b. Rate for diesel for use on public highways differs in Texas, 6.5¢; Mississippi and New York, 10¢; Arkansas, 10.5¢, Alabama, Nevada and Tennessee, 12¢; Colorado and Kansas, 13¢; Vermont, 14¢; Illinois, 14.5¢; Iowa, 15.5¢; Montana, 17¢; tax exempt in Wyoming.
c. Tax is approximately 21.5¢ per pack in Hawaii.
d. Rates apply on distilled spirits not in excess of 100 proof.
e. Monopoly states. Revenues received through markup plus taxes except markup only in New Hampshire and Oregon.
f. On leaded gas in New York City.

SOURCE: State Tax Guide, All States Unit, Commerce Clearing House, Inc.

TABLE 18
STATE PERSONAL INCOME TAX DATA
At January 1, 1985

State	Federal Inc. Tax Deduct.[a]	Tax Rate Min.	On First	Max	Over	Steps In Range	Personal Exemption or Credit[b] Single	Dependent
HAWAII	No	2.25%	$ 800	11.0%	$ 30,800	11	$1,000[c]	$1,000[c]
Ala.	Yes	2.0%	$ 500	5.0%	$ 3,000	3	$1,500	$ 300
Alaska	No personal income tax							
Ariz.	Yes	2.0	1,061	8.0	6,366	7	1,834[c]	1,100[c]
Ark.	No	1.0	2,999	7.0	25,000	6	17.50[b,c]	6[b]
Calif.	No	1.0	1,580	11.0	26,600	11	40[b,c]	13
Colo.[d]	Yes	3.0	1,420	8.0	14,150	11	1,200[c]	1,200
Conn.[d]	No personal income tax							
Del.	Yes	1.4	1,000	13.5	50,000	15	600	600
Fla.	No personal income tax							
Ga.	No	1.0	1,000	6.0	10,000	6	1,500	700
Idaho	No	2.0	1,000	7.5	5,000	6	1,000	1,000
Ill.	No	2.5% of modified federal AGI					1,000	1,000
Ind.	No	3.0% of modified federal AGI					1,000[c]	500
Iowa	Yes	0.5	1,023	13.0	76,725	13	20[b,c]	15[b]
Kans.	Yes	2.0	2,000	9.0	25,000	8	1,000	1,000
Ky.	Yes	2.0	3,000	6.0	8,000	5	20[b]	20[b]
La.	Yes	2.0	10,000	6.0	50,000	3	4,500	1,000
Me.	No	1.0	2,000	10.0	25,000	8	1,000[c]	1,000[c]
Md.	No	2.0	1,000	5.0	3,000	4	800	800
Mass.[d,f]	No	5% flat rate + 7.5% surtax					2,200[e]	700
Mich.	No	5.35% of modified federal AGI					1,500[c]	1,500
Minn.	Yes	1.6	690	16.0	37,920	12	70[b,c]	70[b]
Miss.	No	3.0	5,000	5.0	10,000	3	6,000	1,500
Mo.	Yes	1.5	1,000	6.0	9,000	10	1,200[c]	400
Mont.	Yes	2.0	1,300	11.0	43,900	10	1,000[c]	1,000[c]
Neb.	No	19% of adjusted federal liability					1,000	1,000
Nev.	No state income tax							
N. H.	No	5.0% of interest and dividend income over $1,200						
N. J.	No	2.0	20,000	3.5	50,000	3	1,000	1,000
N. M.	No	0.7	1,000	7.8	100,000	19	1,000[c]	1,000
N. Y.	No	2.0	1,000	14.0	23,000	13	800[c]	800
N. C.	No	3.0	2,000	7.0	10,000	5	1,100[c]	800
N. D.	Yes	2.0	3,000	9.0	50,000	8	1,000	1,000
Ohio	No	0.95	5,000	9.5	100,000	8	650	650
Okla.	Yes	0.5	1,000	17.0	49,000	18	1,000[c]	1,000
Ore.	Yes	4.2	500	10.8	5,000	7	85[b,c]	85[b,c]
Pa.	No	2.35% flat rate						
R. I.	No	23.65% of adjusted federal liability					1,040[c]	1,040
S. C.	Yes	2.0	2,019	7.0	10,093	6	807[c]	807[c]
S. D.	No personal income tax							
Tenn.	No	6.0% on dividend and interest income						
Texas	No state income tax							
Utah	Yes	2.75	1,500	7.75	7,500	6	750	750
Vt.	No	26.5% of federal liability					1,040[c]	1,040
Va.	No	2.0	3,000	5.75	12,000	4	600	600
Wash.	No state income tax							
W. Va.[f]	No	2.1	2,000	13.0	200,000	24	800	800
Wisc.	No	3.4	3,900	10.0	51,600	8	20[b,c]	20[b]
Wyo.	No state income tax							
D. C.	No	2.0	1,000	11.0	25,000	10	750[c]	750

a. Generally limited to federal taxes paid on income taxed by state. Maximum amounts deductible limited by certain states.
b. States granting tax credits in lieu of personal exemptions.
c. Additional credits deducted directly from tax liability and designed to relieve the burden of taxes other than income taxes; i.e., sales, property, and/or local income taxes. Limited to elderly in some states. Adjusted for inflation in Arizona, California, Iowa, Maine, Minnesota, Montana and South Carolina.
d. Additional rates: Colorado, 2% on interest and dividends over $15,000; Connecticut, graduated tax levied on capital gains and dividends if federal adjusted gross income exceeds $50,000; Massachusetts, 10% on interest, dividends and capital gains.
e. No exemptions for joint returns.
f. Surtax imposed.
SOURCE: State Tax Guide, [illegible] States Unit, Commerce Clearing House, Inc.

TABLE 19

STATE CORPORATION NET INCOME TAX

Rates and Estimated Burdens on Selected Incomes

January 1, 1985

State	State/Federal[a] Corporation Tax Deductible	Tax Rate	Net Operating Loss[b]	Estimated State Income Tax on Net Taxable Income[c] of $5,000	$50,000	$500,000
HAWAII	Yes/No	5.85% to $25,000				
		6.435% over $25,000	CF-15, CB-3	$ 276	$ 2,886	$ 30,092
Ala.	No/Yes	5.0%	CF-4	$ 214	$ 2,106	$ 14,854
Alaska	No/No	1% to $10,000				
		9.4% over $90,000	CF-15, CB-3	50	1,500	43,040
Ariz.	Yes/Yes	2.5% to $1,000				
		10.5% over $6,000	CF-5	186	3,778	28,576
Ark.	No/No	1% to $3,000				
		6% over $25,000	CF-3	70	2,440	29,440
Calif.	No/No	9.6%	--	480	4,800	48,000
Colo.	No/No	5.0%	CF-15	250	2,500	25,000
Conn.	No/No	11.5%	CF-5	575	5,570	57,500
Del.	No/No	8.7%	CF-15, CB-3	435	4,350	43,500
Fla.	No/No	5.5%	CF-15	275	2,750	27,500
Ga.	No/No	6.0%	CF-7, CB-3	300	3,000	30,000
Idaho	No/No	7.7% + $10	CF-10, CB-3	395	3,860	38,510
Ill.	No/No	4% + 2.5%[d]	CF-15, CB-3	325	3,250	32,500
Ind.	No/No	7%	CF-15, CB-3	350	3,500	35,000
Iowa	No/Yes[a]	6% to $25,000				
		12% over $250,000	CF-15, CB-3	279	3,193	41,048
Ka.	No/No	4.5% to $25,000				
		6.75% over $25,000	CF-7, CB-3	225	2,813	33,188
Ky.	No/No	3% to $25,000				
		6% over $100,000	CF-15, CB-3	150	1,750	28,250
La.	No/Yes	4% to $25,000				
		8% over $200,000	CF-5, CB-3	171	1,845	20,214
Me.	No/No	3.5% to $25,000				
		8.93% over $250,000	CF-15, CB-3	175	2,858	41,743
Md.	No/No	7.0%	CF-15, CB-3	350	3,500	35,000
Mass.	No/No	8.33% + 14% surtax	CF-5	475	4,748	47,481
Mich.	No/No	Special business tax of 2.35% levied in lieu of corporate income tax				
Minn.	No/No	6% to $25,000				
		12% over $25,000	CF-5, CB-3	300	4,500	58,500
Miss.	No/No	3% to $5,000				
		5% over $10,000	CF-5	150	2,350	24,850
Mo.	Yes/Yes	5.0%	CF-15, CB-3	204	2,005	14,131
Mont.	No/No	6.75%	CF-7, CB-3	338	3,375	33,750
Neb.	Yes/No	4.75% to $50,000				
		6.65% over $50,000	CF-15, CB-3	227	2,267	30,286
Nevada	No state corporation income tax					
N. H.	No/No	8% + 13.5% surtax	--	454	4,540	45,400
N. J.	No/No	9.0%	--	450	4,500	45,000
N. M.	Yes/No	4.8% to $1,000,000				
		7.2% over $2,000,000	CF-15, CB-3	229	2,290	22,901
N. Y.	No/No	10%	CF-15, CB-3	500	5,000	50,000
N. C.	No/No	6.0%	CF-5	300	3,000	30,000
N. D.	No/Yes	3% to $3,000				
		10.5% over $50,000	CF-15, CB-3	172	2,889	30,273
Ohio	No/No	5.1% to $25,000				
		9.2% over $25,000	CF-5	255	3,575	44,975
Okla.	Yes/No	4.0%	CF-15, CB-3	192	1,923	19,231
Ore.	No/No	7.5%	CF-5	375	3,750	37,500
Pa.	No/No	9.5%	CF-3	475	4,750	47,500
R. I.	No/No	8.0%	CF-15, CB-3	400	4,000	40,000
S. C.	No/No	6.0%	CF-5	300	3,000	30,000
S. D.	No state corporation income tax					
Tenn.	No/No	6.0%	CF-3	300	3,000	30,000
Texas	No state corporation income tax					
Utah	No/No	5.0%	CF-5, CB-3	250	2,500	25,000
Vt.	Yes/No	6% to $10,000				
		9% over $250,000	CF-15, CB-3	283	3,487	39,523
Va.	No/No	6.0%	CF-15, CB-3	300	3,000	30,300
Wash.	No state corporation income tax					
W. Va.	No/No	6.0% + 15% surtax to $50,000				
		7.0% + 15% surtax over $50,000	CF-15, CB-3	345	3,450	39,675
Wisc.	No/No	7.9%	CF-5	395	3,950	39,500
Wyo.	No state corporation income tax					
D. C.	No/No	10% + 5% surtax	--	525	5,250	52,500

a. Deduction limited to federal tax on income taxed by the state. Limited in Iowa to 50% of federal taxes paid.

b. Number of years carried forward and/or carryback of net operating loss; carrybacks usually limited to enactment year. Some states also grant new businesses further relief.

c. "Net taxable income" is income net of all deductions and exemptions except any allowed for federal or state corporate income taxes paid.

d. Additional personal property replacement tax on net income.

SOURCE: State Tax Guide, All States Unit, Commerce Clearing House, Inc. Estimated tax liability computed by the Tax Foundation of Hawaii.

TABLE 20

REAL PROPERTY VALUATIONS IN HAWAII

Fiscal 1985 — By Counties[a]
(Dollars in Thousands)

Type of Property	Honolulu	Maui	Hawaii	Kauai	Total	Percent
Government: Federal	$ 2,307,705	$ 6,956	$ 19,913	$ 12,859	$ 2,347,435	4.04
State	4,528,522	201,149	410,418	104,280	5,244,369	9.03
Counties	1,200,001	111,441	45,641	39,534	1,396,617	2.40
Public Utilities[b]	244,708	25,555	19,361	5,040	294,664	0.51
Churches	415,015	43,167	37,106	1[illegible],904	515,192	0.89
Charitable Organizations	267,436	23,092	26,280	6,564	323,372	0.56
Schools	284,201	7,091	15,037	217	306,546	0.53
Hospitals	233,167	21,109	--	4,683	258,959	0.45
Miscellaneous Exempt[c]	3,819,431	385,956	597,474	218,666	5,021,527	8.64
All Others	30,344,935	5,656,194	4,095,690	2,289,366	42,386,185	72.96
Total Gross Valuations	$43,645,121	$6,481,712	$ 5,266,920	$2,701,113	$58,094,866	100.00
Exempt Properties						
Government	$ 8,036,228	$ 319,548	$ 475,972	$ 156,673	$ 8,988,421	15.47
Public Utilities[b]	244,708	25,555	19,361	5,040	294,664	0.51
Churches	415,015	43,167	37,106	19,904	515,192	0.89
Charitable Organizations	267,436	23,092	26,280	6,564	323,372	0.56
Schools	284,201	7,091	15,037	217	306,546	0.53
Hospitals	233,167	21,109	--	4,683	258,959	0.45
Others[c]	3,819,431	385,956	597,474	218,666	5,021,527	8.64
Sub-Total Exemptions	$13,300,186	$ 825,518	$ 1,171,230	$ 411,747	$15,708,681	27.04
Taxable Values	$30,344,935	$5,656,194	$ 4,095,690	$2,289,366	$42,386,185	72.96
Less 50% of Appeals	409,123	90,357	14,658	199,435	713,573	1.23
Net Taxable Values	$29,935,812	$5,565,837	$ 4,081,032	$2,089,931	$41,672,612	71.73

NOTE: Detail may not add due to rounding.

a. Gross valuations assessed at 100% of fair market value.

b. Exempt from property taxation; subject to selective sales public service companies tax.

c. Includes residential home exemption, exemptions for disabled and handicapped, government leases, property used for low-moderate income housing, Hawaiian homes, cemetery, alternate energy, co-ops, etc.

SOURCE: Reports of the Property Technical Office, Real Property Assessment Division, Department of Finance, City and County of Honolulu.

TABLE 21

TRENDS IN REAL PROPERTY TAX BASE

State of Hawaii: By Counties[a]
(In Thousands)

Fiscal Year		Honolulu	Maui	Hawaii	Kauai	All Counties[b]
1985		$(29,935,812)	$(5,565,837)	$(4,081,032)	$(2,089,931)	$(41,672,612)
Improved Residential	- Land	10,659,541	970,851	641,392	502,082	12,773,866
	- Bldg.	4,916,364	502,649	436,449	261,268	6,116,730
Unimproved Residential	- Land	365,949	185,473	126,771	104,561	782,754
	- Bldg.	31,097	4,708	19,970	5,062	60,837
Hotel/Resort	- Land	455,805	289,590	41,265	51,586	838,246
	- Bldg.	1,378,273	492,472	230,121	87,591	2,188,457
Apartment	- Land	1,363,749	386,081	156,497	224,041	2,130,368
	- Bldg.	3,941,297	1,477,266	506,553	348,554	6,273,670
Commercial	- Land	1,675,589	167,633	123,514	103,975	2,070,711
	- Bldg.	2,290,308	130,142	148,841	88,024	2,657,315
Industrial	- Land	1,609,125	142,766	57,379	48,224	1,857,494
	- Bldg.	841,352	120,190	96,555	30,272	1,088,369
Agricultural	- Land	277,165	478,490	1,116,313	165,109	2,037,077
	- Bldg.	84,655	196,862	325,117	37,153	643,787
Conservation	- Land	30,552	15,846	49,563	31,687	127,648
	- Bldg.	14,991	4,818	4,732	742	25,283
1984		28,004,554	5,633,710	4,020,278	1,849,693	39,508,235
1983		25,063,750	5,251,198	3,634,760	1,713,345	35,663,053
1982		20,751,402	4,823,618	2,898,718	1,415,822	29,889,560
1981		17,653,348	3,711,258	2,281,458	1,073,337	24,719,402
1980		15,673,688	2,961,878	1,985,620	892,433	21,513,620
1979		14,510,773	2,109,747	1,791,142	807,478	19,219,140
1978		13,009,917	1,602,810	1,557,382	687,843	16,857,952
1977		12,613,372	1,533,937	1,527,777	668,835	16,343,920
1976		11,139,475	1,360,280	1,506,740	617,015	14,623,510

NOTE: Detail may not add to totals due to rounding.

a. Net assessed valuations for tax rate purposes increased to 100% of fair market value in fiscal 1984; prior years adjusted to 100% basis.

b. Excludes federal leased property assessable to lessee but not included for tax rate purposes.

SOURCE: Compiled by the Tax Foundation of Hawaii from reports of the Property Technical, Real Property Assessment Division, Department of Finance, City and County of Honolulu and the Department of Taxation, State of Hawaii.

TABLE 22
TRENDS IN REAL PROPERTY TAX COLLECTIONS
State of Hawaii: By Counties

Fiscal Year	Honolulu	Maui	Hawaii	Kauai	All Counties
1985 (Est.)[a]	$(223,380,894)	$(24,898,918)	$(37,195,725)	$(15,781,208)	$(301,256,742)
Improved Res.	105,137,359	6,483,400	9,161,649	4,756,396	125,538,803
Unimprov. Res.	2,680,061	855,815	1,437,455	703,828	5,677,159
Hotel/Resort	18,340,780	3,519,279	2,368,679	1,171,424	25,400,161
Apartment	35,809,061	8,385,062	5,870,671	4,824,727	54,889,520
Commercial	35,693,073	1,339,988	2,500,289	1,630,781	41,164,130
Industrial	22,054,293	1,183,302	1,394,508	669,293	25,301,395
Agricultural	3,256,380	3,039,084	13,926,625	1,742,961	21,965,049
Conservation	409,887	92,988	535,852	281,798	1,320,525
1984	212,269,921	25,620,492	37,141,879	14,081,790	289,114,082
1983	201,003,749	23,693,234	36,158,715	14,063,961	274,919,659
1982	189,838,546	21,804,283	30,301,000	12,433,773	254,397,602
1981	166,301,144	16,661,599	24,797,746	9,496,130	217,256,619
1980	145,002,528	11,626,644	21,602,726	7,977,389	186,209,287
1979	135,047,817	12,055,703	19,821,901	7,408,160	174,333,581
1978	120,707,945	11,577,622	16,982,147	6,148,490	155,416,204
1977	114,326,276	11,725,735	16,943,416	6,207,789	149,203,216
1976	117,124,133	11,896,154	18,781,089	5,982,956	153,784,332

NOTE: Detail may not add to totals due to rounding.

a. Totals include tax on certain federal leased property not allocated by class, but excludes minimum tax.

SOURCE: Compiled by the Tax Foundation of Hawaii from reports of the Property Technical Office, Real Property Assessment Division, Department of Finance, City and County of Honolulu and the Department of Taxation, State of Hawaii.

TABLE 23
TRENDS IN REAL PROPERTY TAX RATES
State of Hawaii: By Counties
(Rates for $1,000 Taxable Values)

Fiscal Year		Honolulu	Maui	Hawaii	Kauai	Average[a]
1985 Average Rate[b]		$ 7.46	$ 4.47	$ 9.11	$ 7.55	$ 7.23
Improv. Resid.:	Land	6.75	4.40	8.50	6.45	9.83
	Bldg.	6.75	4.40	8.50	5.81	6.64
Unimp. Resid.:	Land	6.75	4.50	10.00	6.45	6.70
	Bldg.	6.75	4.50	8.50	5.81	7.07
Hotel/Resort:	Land	10.00	4.50	10.00	8.70	8.02
	Bldg.	10.00	4.50	8.50	8.25	8.53
Apartment:	Land	6.75	4.50	10.00	8.70	6.79
	Bldg.	6.75	4.50	8.50	8.25	6.44
Commercial:	Land	9.00	4.50	10.00	8.70	8.68
	Bldg.	9.00	4.50	8.50	8.25	8.73
Industrial:	Land	9.00	4.50	10.00	8.70	8.68
	Bldg.	9.00	4.50	8.50	8.25	8.44
Agricultural:	Land	9.00	4.50	10.00	8.70	8.47
	Bldg.	9.00	4.50	8.50	8.25	7.33
Conservation:	Land	9.00	4.50	10.00	8.70	8.76
	Bldg.	9.00	4.50	8.50	8.25	8.03
1984 Average Rate		7.60	4.50	9.19	8.05	7.34
1983 " "		13.43	7.50	16.68	14.50	12.94
1982 " "		15.23	7.50	17.90	14.50	14.21
1981 " "		15.23	6.47	17.90	14.50	14.28
1980 " "		15.23	9.09	17.90	14.50	14.25
1979 " "		15.23	11.96	17.90	14.50	14.78
1978 " "		15.37	12.50	17.90	14.50	15.25
1977 " "		15.37	12.50	17.90	14.50	15.31
1976 " "		15.37	14.00	17.90	14.50	15.34

a. State average rates computed by dividing "taxes to be raised" by total county taxable values.

b. Tax rate at 100% net assessed value; 1977-1983 rates at 60% net assessed value; all prior years' rates at 70% of net assessed value.

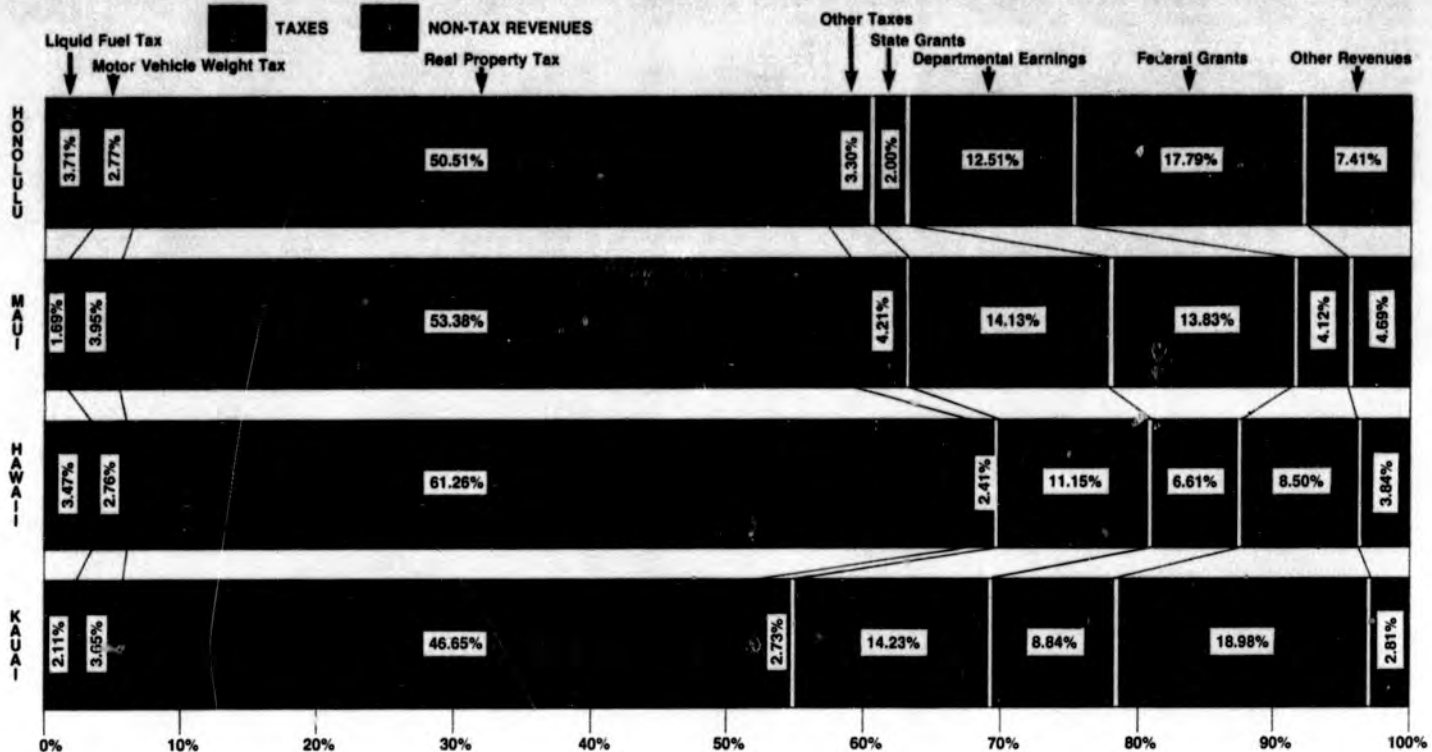
SOURCE: Compiled by the Tax Foundation of Hawaii from reports of the Property Technical Office, Real Property Assessment Division, Department of Finance, City and County of Honolulu and the Department of Taxation, State of Hawaii.

CHART 6

SOURCES OF COUNTY GOVERNMENT REVENUE

Percentage Distribution — By Counties

Fiscal Year — 1984



SOURCE: Tables 24-27.

TABLE 24
OPERATING REVENUES[a] — CITY AND COUNTY OF HONOLULU
Selected Fiscal Years

Source of Revenue	1984	1983	1982	1979	1974
Taxes					
Real Property	$212,269,921	$201,003,749	$189,838,546	$135,047,817	$ 96,624,744
Liquid Fuel	15,581,185	15,310,410	14,898,569	8,797,372	7,599,540
Utility Franchise	13,867,639	15,511,595	14,550,684	6,561,935	2,604,931
Motor Vehicle Weight	11,642,137	11,320,390	11,015,318	10,414,179	9,926,041
Sub-Total Taxes	$253,360,882	$243,146,144	$230,303,117	$160,821,303	$116,755,256
Liquor, Licenses & Fees	$ 1,615,655	$ 1,476,242	$ 1,146,405	$ 1,380,147	$ 948,577
Parking Meter Fees	2,646,501	2,598,835	2,606,269	2,376,626	1,717,922
Other License & Fees	6,459,913	6,106,251	4,834,036	3,508,365	3,337,810
Fines, Forfeits & Penalties	140,838	123,032	108,509	65,369	62,472
Departmental Earnings[b]	52,550,921	53,127,894	46,733,711	25,547,669	8,527,123
State Grants					
Pensioners	--	--	--	--	321,532
Act 155[c]	7,734,416	7,734,416	7,734,416	7,734,416	8,785,664
Others	681,782	1,558,727	1,183,890	1,482,474	785,270
Sub-Total State Grants	$ 8,416,198	$ 9,293,143	$ 8,918,306	$ 9,216,890	$ 9,892,466
Federal Grants	$ 74,774,670	$ 69,765,337	$ 63,454,834	$106,586,114	$ 28,657,394
Hawaii Housing Authority	190,609	95,052	124,068	246,153	166,354
Land Sales	--	--	--	--	2,089,800
Miscellaneous	20,090,712	$ 20,113,769	$ 14,472,100	$ 3,030,782	$ 4,333,171
TOTAL	$420,246,899	$405,845,699	$372,701,375	$312,779,418	$176,488,346

NOTE: Detail may not add to totals due to rounding.

a. Excludes loan, bond, revolving, improvement district, and trust funds, and Board of Water Supply revenues.
b. Includes rentals, interest, and other earnings.
c. Act 155, SLH 1965, repealed general excise tax sharing and authorized state-aid grants based on each county's "relative fiscal capacity and relative fiscal need" as defined by the legislature. Amended in 1973 to provide fixed grants equal to the amount granted in 1972 unless a county function was subsequently incorporated as a state function.

SOURCE: Finance Director's Annual Financial Reports, City and County of Honolulu, State of Hawaii.

TABLE 25
OPERATING REVENUES[a] — COUNTY OF MAUI
Selected Fiscal Years

Source of Revenue	1984	1983	1982	1979	1974
Taxes					
Real Property	$25,620,492	$23,693,234	$21,804,283	$12,055,703	$ 7,842,451
Liquid Fuel	2,022,437	1,928,104	1,817,937	1,617,721	1,011,575
Utility Franchise	812,111	788,951	676,885	332,547	127,032
Motor Vehicle Weight	1,892,679	1,848,636	1,691,763	1,108,541	784,449
Sub-Total Taxes	$30,347,719	$28,258,925	$25,990,868	$15,114,512	$ 9,765,507
Liquor, Licenses & Fees	$ 760,743	$ 679,840	$ 589,272	$ 585,465	$ 177,808
Other License & Fees	865,992	695,228	439,231	605,555	415,414
Fines, Forfeits & Penalties	304,805	202,800	141,614	4,355	1,534
Departmental Earnings[b]	6,635,407	5,739,784	6,227,864	4,064,877	1,894,838
State Grants					
Pensioners	--	--	--	--	152,923
Act 155[c]	2,994,474	2,994,474	2,994,474	2,994,474	3,001,232
Others	3,788,060	5,009,555	2,040,238	4,667,359	826,547
Sub-Total State Grants	$ 6,782,534	$ 8,004,029	$ 5,034,712	$ 7,661,833	$ 3,980,702
Federal Grants	$ 1,976,277	$ 2,204,048	$ 3,173,842	$ 5,14[illegible],662	$ 1,674,817
Hawaii Housing Authority	10,434	10,278	10,273	22,314	4,124
Miscellaneous	308,407	323,581	384,421	194,027	2,927,311
TOTAL	$47,992,318	$46,118,513	$41,992,097	$33,199,600	$20,842,054

NOTE: Detail may not add to totals due to rounding.

a. Excludes loan, bond, revolving, certain trust funds, and water revenues.
b. Includes rentals, interest, garbage collection charges, and other earnings.
c. Act 155, SLH 1965, repealed general excise tax sharing and authorized state-aid grants based on each county's "relative fiscal capacity and relative fiscal need" as defined by the legislature. Amended in 1973 to provide fixed grants equal to the amount granted in 1972 unless a county function was subsequently incorporated as a state function.

SOURCE: Finance Director's Annual Financial Reports, County of Maui, State of Hawaii.

TABLE 26

OPERATING REVENUES[a] — COUNTY OF HAWAII

Selected Fiscal Years

Source of Revenue	1984	1983	1982	1979	1974
Taxes					
Real Property	$37,141,879	$36,158,715	$30,301,000	$19,821,901	$13,276,493
Liquid Fuel	2,104,439	2,002,448	2,013,661	2,045,387	921,953
Utility Franchise	1,464,117	1,390,116	1,284,200	740,739	320,367
Motor Vehicle Weight	1,672,464	1,638,084	1,600,555	1,446,924	1,100,175
Sub-Total Taxes	$42,382,899	$41,189,363	$35,199,416	$24,054,951	$15,618,988
Liquor Licenses & Fees	$ 456,888	$ 446,464	$ 430,859	$ 330,817	$ 211,566
Parking Meter Fees	99,321	45,336	39,773	42,692	46,794
Other Licenses & Permits	850,402	746,164	688,435	678,771	421,408
Fines, Forfeits & Penalties	3,655	2,974	800	872	11,688
Departmental Earnings[b]	4,004,074	3,752,601	4,285,234	2,193,601	1,590,249
State Grants					
Pensioners	--	--	--	--	222,399
Act 155[c]	4,327,834	4,327,834	4,327,834	4,327,834	4,469,834
Others	2,432,890	2,545,883	2,821,692	1,325,559	398,684
Sub-Total State Grants	$ 6,760,724	$ 6,873,717	$ 7,149,526	$ 5,653,393	$ 5,090,918
Federal Grants	$ 5,155,624	$ 5,711,796	$ 6,394,396	$ 7,596,392	$ 3,441,926
Hawaii Housing Authority	25,588	39,834	65,169	35,999	13,496
Miscellaneous	893,557	752,984	730,135	353,252	109,469
TOTAL	$60,632,732	$59,561,233	$54,983,743	$40,940,740	$26,564,502

NOTE: Detail may not add to totals due to rounding.

a. Excludes loan, bond, revolving, certain trust funds and water revenues, Hilo hospital, and Act 97 special funds.
b. Includes rentals, interest, charges for culture and recreation, highways and streets, sewer, sanitation, and miscellaneous revenues.
c. Act 155, SLH 1965, repealed general excise tax sharing and authorized state-aid grants based on each county's "relative fiscal capacity and relative fiscal need" as defined by the legislature. Amended in 1973 to provide fixed grants equal to the amount granted in 1972 unless a county function is subsequently incorporated as a state function.

SOURCE: Finance Director's Annual Reports, County of Hawaii, State of Hawaii.

TABLE 27

OPERATING REVENUES[a] — COUNTY OF KAUAI

Selected Fiscal Years

Source of Revenue	1984	1983	1982	1979	1974
Taxes					
Real Property	$14,081,790	$14,063,961	$12,453,773	$ 7,408,160	$ 4,118,448
Liquid Fuel	636,929	630,944	642,039	631,374	483,923
Utility Franchise	822,667	753,698	755,042	387,608	150,904
Motor Vehicle Weight	1,102,184	1,106,535	1,045,702	976,451	677,407
Sub-Total Taxes	$16,643,571	$16,555,138	$14,896,556	$ 9,403,593	$ 5,430,682
Liquor, Licenses & Fees	$ 243,328	$ 251,445	$ 241,5[illegible]	$ 172,901	$ 90,949
Other Licenses & Permits	349,309	195,623	251,652	259,172	175,500
Fines, Forfeits & Penalties	3,772	3,662	6,017	1,770	--
Departmental Earnings[b]	2,669,638	2,556,567	3,197,780	1,613,452	1,048,813
State Grants					
Pensioners	--	--	--	--	76,194
Act 155[c]	3,123,821	3,116,321	3,116,321	3,116,321	3,190,821
Others	1,171,585	847,324	327,015	885,610	20,652
Sub-Total State Grants	$ 4,295,406	$ 3,963,645	$ 3,443,336	$ 4,001,931	$ 3,287,667
Federal Grants	$ 5,727,974	$ 4,949,488	$ 3,748,001	$ 2,981,251	$ 1,716,131
Miscellaneous	252,490	963,662	407,650	517,148	77,726
TOTAL	$30,185,488	$29,439,232	$26,192,568	$18,951,218	$11,827,468

NOTE: Detail may not add to totals due to rounding.

a. Excludes loan, bond, revolving, certain trust funds and water revenues.
b. Includes rentals, interest, garbage collection charges, developer contributions, and other earnings.
c. Act 155, SLH 1965, repealed general excise tax sharing and authorized state-aid grants based on each county's "relative fiscal capacity and relative fiscal need" as defined by the legislature. Amended in 1973 to provide fixed grants equal to the amount granted in 1972 unless a county function is subsequently incorporated as a state function.

SOURCE: Finance Director's Annual Reports, County of Kauai, State of Hawaii.

TABLE 28
TAXES LEVIED IN HAWAII
As of January 1, 1985

KIND OF TAX, LEGAL REFERENCE, BRIEF DESCRIPTION AND REVENUE DISTRIBUTION[a]	REPORTS DUE & % OF TOTAL COLLECTIONS[b]	
PERSONAL INCOME TAX (Chapter 235) - On net incomes of individuals. Rates are: first $800, no tax; next $500, 2.25%; next $500, 3.25%; next $500, 4.5%; next $500, 5%; next $1,000, 6.5%; next $2,000, 7.5%; next $5,000, 8.5%; next $4,000, 9.5%; next $6,000, 10%; next $10,000, 10.5%; and over $30,800, 11%. Capital gains taxed a maximum 4.4%. Deductions generally follow federal law; including among others, state and local taxes (federal taxes not deductible), contributions, interest paid, medical expenses, union and professional dues. Exemptions are: individuals, $1,000 per personal exemption (double for those over 65); blind, deaf, or disabled persons, $7,000; estates, $400; simple trusts, $200; complex trusts, $80; and 1st $500 income from service as a military reservist. Military pay of residents is taxable. Joint returns with split income permitted. Taxes withheld by employers; other taxpayers must file estimated income returns and pay estimated taxes quarterly. Distribution: State general fund. Individual credits based on adjusted gross income and granted to resident taxpayers are inversely graduated from a maximum of $48 per qualified exemption when AGI is less than $5,000 to $8 when AGI is from $14,000 to $19,999. Additional credit of $50 per qualified exemption granted to renters with AGI of less than $20,000. Credits (double for those 65 and over) are deducted from tax liability and refunds are granted when credits exceed liability.	20th day of 4th month after close of income year. Withholding returns due on or before 15th day of following month. Estimates of income on 20th of April, June, September and January.	**25.22%**
CORPORATE INCOME TAX (Chapter 235) - On net income of corporations up to $25,000 at 5.85%, and 6.435% over $25,000. Capital gains rate is 3.08%. Deductions include bad debts, depreciation, business expenses, interest on loans, losses from operations (carried backward three years and forward fifteen years), and state and local taxes (federal income taxes are not deductible). Distribution: State general fund. A credit of 4% of the selling price of glue, solvents and paints is granted if the products have been treated to deter abuse by inhalation.	20th day of 4th month after end of income year. Income estimates due 20th of September and January.	**2.28%**
ESTATE & TRANSFER TAX (Chapter 236D) - On shares of net estates having situs in Hawaii and federal estate tax liability. Tax is equal to the credit for state death taxes allowed on the federal estate tax return. Where an estate has no federal estate tax liability, then there is no state tax liability. Applicable to estates of persons dying after 6/30/83. Distribution: State general fund.	Personal representative of estate to file return. Return and payment due nine months after death.	**0.42%**
GENERAL EXCISE (Gross Income) TAX (Chapter 237) - On gross income, gross receipts, or gross proceeds of all business activities at following rates: 0.5% on wholesaling, intermediary services, manufacturing, producing, canning, and blind, deaf or totally disabled persons; 0.15% on insurance solicitors; 4% on retail sales of goods, services, and other activities.[c] Distribution: State general fund (except on fuel to State highway fund).	Monthly by the end of the following month. Annual summary and reconciliation return by 20th day of 4th month following the tax year.	**38.64%**
USE TAX (Chapter 238) - On tangible personal property imported or purchased from an unlicensed seller. Rates are 0.5% on goods imported for resale at retail; 4% on all other imports. Distribution: State general fund.	Monthly by the end of the following month.	**1.38%**
PUBLIC SERVICE COMPANIES TAX (Chapter 239) - On public utility gross incomes at graduated rates based on ratio of net to gross income. Minimum rate, 5.885%; maximum 8.2% except that land carriers are taxed at 5.35%. Utilities are exempt from general excise and property taxes. Motor carriers, common carriers by water, and contract carriers taxed at 4% of gross income and are subject to property tax but exempt from general excise tax. Distribution: State general fund.	On or before April 20th.	**3.73%**
PUBLIC UTILITY FRANCHISE TAX (Chapter 240) - On gross operating income of certain public utilities (electric and gas companies) at 2.5% rate. Distribution: County highway funds.	One month after end of calendar year.	**1.06%**

BANKS AND OTHER FINANCIAL CORPORATIONS TAX (Chapter 241) - On net incomes, as defined, at 11.7% on banks, building and loan associations, industrial loan companies and other financial corporations. Federal income taxes upon income from sources in the state are deductible. Distribution: State general fund.	April 20, or 20th of 4th month after fiscal year ends. Other installments due 20th of 2nd, 5th, and 8th months.	0.93%
FUEL TAX (Chapter 243) - On distributors at 12.5¢ per gallon in Kauai County to 16¢ in Honolulu for highway use (includes 8.5¢ state tax) except LPG at 2/3 of rates. Off-highway rates for diesel, LPG and aviation fuel at 1¢ per gallon. Agricultural equipment refunds on gasoline for off-highway use granted. Distribution: Aviation to state airport fund; small boat fuel to boating special fund; county fuel to county highway fund; and balance to state highway fund.	Monthly on or before end of following month.	3.43%
LIQUOR TAX (Chapter 244D) - On dealers at 20% of wholesale price. Distribution: State general fund.	Monthly on or before end of following month.	(0.01)%
TOBACCO TAX (Chapter 245) - On wholesalers at 40% of wholesale price of all tobacco products. Distribution: State general fund.	Monthly on or before end of following month.	1.25%
PROPERTY TAX (County Ordinances) - On real property, land and improvements. Assessments at 100% of "fair market value." Maximum exemption for owner-occupied homes is $20,000, with multiple exemptions allowed for those over 60. Various rates for land, improvements, and classes of property. Average fiscal year 1985 rates per $1,000 net assessed value are: Oahu, $7.46; Maui, $4.47; Hawaii, $9.11; and Kauai, $7.55. Personal property not taxed. Distribution: Respective county general funds.	Assessment notices to taxpayer by March 15. Appeals filed by April 9. Tax base and rates certified by May 1. June 20 last day to amend rates. Semi-annual payments.	18.09%
CONVEYANCE TAX (Chapter 247) - On actual and full consideration paid for the transfer of realty, including leases and subleases, a tax of 5¢ per $100 is imposed. Minimum tax on each transaction is $1.00. Certain exemptions allowed. Distribution: State general fund.	Not later than 90 days after the taxable transaction.	0.11%
MOTOR VEHICLE WEIGHT TAX (Chapter 249) - On weight as follows: Oahu, commercial vehicles, 1.5¢/lb.; passenger vehicles, 0.75¢/lb.; minimum $12 annually on motor vehicles, $1 on other vehicles. Hawaii, commercial 1.0¢/lb.; passenger 0.50¢/lb. and a $6 minimum on motor vehicles. Maui, commercial 1.5¢/lb.; passenger 0.75¢/lb. and a $6 minimum on motor vehicles. Kauai, commercial 2.0¢/lb.; passenger 0.50¢/lb. with a $12 minimum. State tax of 0.45¢/lb., and $2 annual minimum. Distribution: State tax to state highway fund, and county tax to respective county highway funds.	Monthly, quarterly, or annually, depending on prior year's liability.	1.60%
INSURANCE PREMIUMS TAX (Chapter 431) - In lieu of general excise and net income taxes, on gross premiums as follows: life insurance, 1.918% for domestic and 3.197% for foreign firms; surplus lines brokers, 4.68%, casualty and other insurance, 2.9647% for domestic and 4.2824% for foreign firms. Cash surrender values not deductible. Ocean marine insurance 0.8775% of gross underwriting profits. Distribution: State general fund.	Variable by month.	1.86%
LICENSES, FEES AND PERMITS - Various business, occupation, and nonbusiness licenses, fees and permits are imposed by either the state or county governments. Distribution: State and counties' general and special funds, depending on levy.		1.11%

a. Legal reference is to Hawaii Revised Statutes (1968), as amended.
b. Based on fiscal 1984 State and county tax collections (see Table 13), excluding unemployment compensation.
c. The 4% tax on retail sales of goods and certain services is deductible as "sales tax" in computing state and federal income taxes.

SOURCE: Compiled from the Hawaii Revised Statutes (1968), as amended.

TABLE 29
FEDERAL TAX COLLECTIONS IN HAWAII
Selected Fiscal Years
(In Thousands)

Source	1984	1983	1982	1979	1974
Income and Profits Taxes					
Indiv. Income, Employment[a]	$1,729,041	$1,681,194	$1,662,349	$1,211,243	$710,004
Corporate Income & Profits	180,576	154,877	157,750	199,747	96,814
Sub-Total Income and Profits	$1,909,617	$1,836,071	$1,820,099	$1,410,990	$806,818
Excise Taxes					
Alcohol[b]	$ 6,708	$ 3,303	$ 431	$ 668	$ 3,787
Tobacco[b]	2	85	2	1	2
Manufacturers' Excise					
Gasoline	3,601	2,098	3,020	1,385	(1)
Other Manufact. Excise[c]	294	330	359	418	303
Retailers' Excise[d]	1,067	532	(635)	473	314
Miscellaneous Excise					
Telephone & Teletype	6,736	4,362	3,921	4,104	7,280
Air Trans. of Persons	14,219	10,415	5,340	5,266	2,890
Other Misc. Excise[e]	1,748	1,886	1,208	2,080	1,377
Unclassified Excise[f]	(765)	1,445	3,864	872	(390)
Sub-Total Excise Taxes	$ 33,610	$ 24,456	$ 17,510	$ 15,265	$ 15,562
Estate	$ 20,373	$ 22,830	$ 26,604	$ 17,702	$ 11,263
Gift	1,046	1,320	226	1,271	1,523
Unemployment Insurance	15,822	13,181	12,188	9,997	4,923
TOTAL	$1,980,467	$1,897,858	$1,876,628	$1,455,225	$840,089

NOTE: Totals may not add due to rounding; retailers' excise reclassified for 1984 and prior years.

a. Includes withholding, FICA, individual income, and railroad retirement taxes.

b. Includes receipts from customs.

c. Includes taxes on tires, sporting goods, firearms, and vehicle fuel economy.

d. Includes taxes on diesel and special fuels and motor vehicle chassis, parts, etc.

e. Includes taxes on highway vehicles over 26,000 lb., exempt organization and pension fund penalties, amounts collected or adjusted for repealed or expired taxes.

f. Contains amounts paid into depositories but not yet classified; negative data represents reclassification of amounts previously reported as unclassified.

SOURCE: Annual Reports, Commissioner and Chief Counsel, Internal Revenue Service, U.S. Department of the Treasury, Washington, D.C.

TABLE 30
FEDERAL GRANTS TO HAWAII
Grants to State General and Special Funds
Selected Fiscal Years

Purpose	1984	1983	1982	1979	1974
Highways	$ 65,975,414	$ 53,268,411	$ 46,274,876	$ 51,902,594	$ 40,055,610
Airports	6,620,992	9,999,402	7,083,442	7,794,233	8,212,266
National Guard	411,972	571,855	313,282	292,023	17,829,778
Health & Hospitals					
Hospital Construc.	--	--	5,295	--	(2,425)
Public Health	12,925,258	11,773,581	11,704,463	10,322,388	4,899,153
Hansen's Disease	1,411,824	1,889,088	1,789,776	1,348,448	799,151
Education					
Elem. - Secondary Act	6,407,258	8,152,682	8,913,372	8,145,027	3,815,296
Other Education	84,262,254	84,053,562	78,607,406	74,633,304	51,563,763
Public Welfare					
Dependent Child	47,679,035	48,584,786	50,888,963	45,279,754	27,362,723
Aged and Other	138,824,631	131,013,309	131,021,688	68,791,159	22,502,597
Natural Resources	5,462,520	4,839,886	5,514,892	4,526,629	2,738,373
Employment Security	17,539,615	1,999,268	1,694,698	87,635	6,382,860
Unemp. Comp. Benefits	8,120,320	10,974,550	32,600	(306,305)	7,868,715
Emergency Employment	7,403,917	3,968,847	5,301,563	20,727,080	913,889
East-West Center	--	--	--	--	7,740,238
Economic Opportunity	--	--	153,433	116,000	2,170,884
Revenue Sharing	--	200,109	--	11,229,255	8,971,520
Miscellaneous	20,378,969	31,647,405	26,635,087	32,474,516	10,964,829
TOTAL	$423,423,979	$402,936,742	$375,934,836	$337,363,741	$224,789,221

NOTE: Detail may not add to total due to rounding.

SOURCE: Compiled by the Tax Foundation of Hawaii from the Annual Reports of the Comptroller, Department of Accounting and General Services, State of Hawaii.

TABLE 31

FEDERAL GRANTS-IN-AID AND ESTIMATED FEDERAL TAX BURDEN

Fiscal Year 1984
(In Millions)

State	Federal Grants[a]	Federal Tax Burden[b]	Burden per $1.00 of Grant: Amount	Burden per $1.00 of Grant: Rank
Hawaii	$ 458.8	$ 408.1	$0.89	27
U.S.	92,759.2	92,759.2	1.00	--
Alabama	1,493.9	1,187.3	0.79	35
Alaska	591.4	324.6	0.55	48
Arizona	973.7	1,048.2	1.08	16
Arkansas	937.7	658.6	0.70	41
California	9,686.3	11,149.7	1.15	10
Colorado	1,097.9	1,363.6	1.24	7
Connecticut	1,221.4	1,706.8	1.40	3
Delaware	298.5	269.0	0.90	25
Florida	2,779.4	4,202.0	1.51	2
Georgia	2,209.4	1,947.9	0.88	28
Idaho	393.0	296.8	0.76	36
Illinois	4,303.1	4,990.4	1.16	9
Indiana	1,759.5	1,957.2	1.11	12
Iowa	1,090.7	1,029.6	0.94	22
Kansas	802.8	1,001.8	1.25	6
Kentucky	1,577.2	1,113.1	0.71	40
Louisiana	1,770.8	1,586.2	0.90	26
Maine	590.3	361.8	0.61	45
Maryland	1,718.6	1,938.7	1.13	11
Massachusetts	2,634.0	2,606.5	0.99	20
Michigan	3,773.4	3,450.6	0.91	23
Minnesota	1,862.2	1,623.3	0.87	29
Mississippi	1,154.3	658.6	0.57	47
Missouri	1,771.7	1,845.9	1.04	17
Montana	486.1	278.3	0.57	46
Nebraska	636.2	575.1	0.90	24
Nevada	319.8	389.6	1.22	8
New Hampshire	367.0	398.9	1.09	13
New Jersey	2,871.0	3,877.3	1.35	5
New Mexico	664.0	454.5	0.68	43
New York	10,268.3	7,708.3	0.75	37
North Carolina	1,926.5	1,938.7	1.01	18
North Dakota	429.9	269.0	0.63	44
Ohio	4,043.8	4,053.6	1.00	19
Oklahoma	1,161.1	1,252.2	1.08	15
Oregon	1,122.4	936.9	0.83	32
Pennsylvania	4,665.6	4,591.6	0.98	21
Rhode Island	547.6	380.3	0.69	42
South Carolina	1,165.3	955.4	0.82	34
South Dakota	431.8	213.3	0.49	50
Tennessee	1,777.6	1,530.5	0.86	30
Texas	4,130.5	6,641.6	1.61	1
Utah	652.3	482.3	0.74	38
Vermont	330.8	167.0	0.50	49
Virginia	1,646.2	2,272.6	1.38	4
Washington	1,673.2	1,808.8	1.08	14
West Virginia	818.1	584.4	0.71	39
Wisconsin	2,062.8	1,725.3	0.84	31
Wyoming	270.5	222.6	0.82	33
Dist. of Columbia	1,340.8	333.9	0.25	51

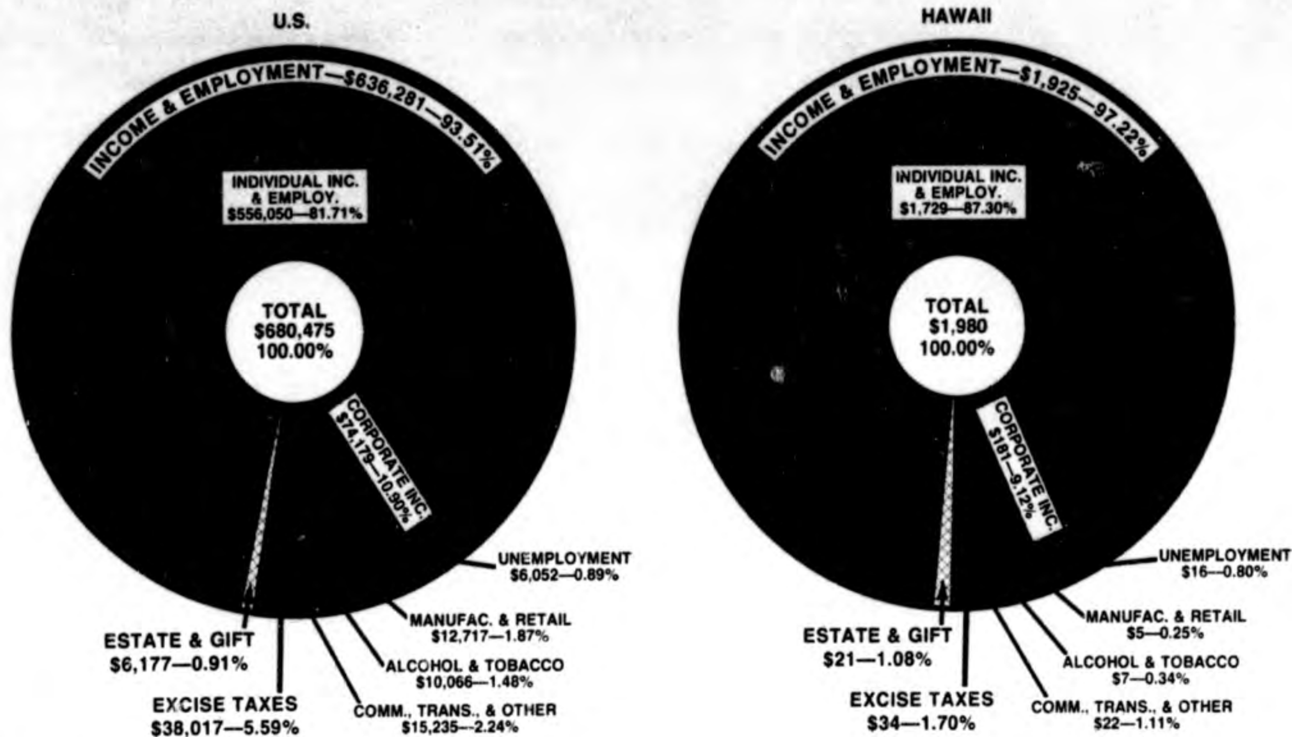
a. Excludes shared revenues and payments in lieu of taxes; includes general revenue sharing and trust fund aids.
b. Total tax burden for grants assumed to equal grant payments.

SOURCE: Tax Foundation, Inc. computations based on data from the U.S. Department of Commerce, Bureau of the Census and Office of Management & Budget.

CHART 7

FEDERAL TAX COLLECTIONS

Fiscal Year 1984
(In Millions of Dollars)



SOURCE: Tables 8 and 29.

TABLE 32
FEDERAL BUDGET RECEIPTS, EXPENDITURES, AND PUBLIC DEBT
Selected Fiscal Years
(Dollars in Millions)

	1984		1983		1982		1979		1974	
	Amount	$ of Total	Amount	$ of Total	Amount	$ of Total	Amount	$ of Total	Amount	$ of Total
BUDGET RECEIPTS[a]										
Individual Income Taxes	$ 296,206	44.4	$ 288,938	48.1	$ 297,744	48.2	$217,841	47.0	$118,952	45.2
Corporate Income Taxes	56,893	8.5	37,022	6.2	49,207	8.0	65,677	14.2	38,620	14.7
Employee Taxes & Contributions[b]	241,651	36.3	208,994	34.8	201,498	32.6	138,939	30.0	75,071	28.5
Excise Taxes										
Federal Funds	22,279	3.3	24,086	4.0	28,668	4.6	9,808	2.1	9,743	3.7
Trust Funds	15,082	2.3	11,214	1.9	7,642	1.2	8,937	1.9	7,100	2.7
Estate and Gift Taxes	6,010	0.9	6,053	1.0	7,991	1.3	5,411	1.2	5,035	1.9
Customs Duties	11,370	1.7	8,655	1.4	8,854	1.4	7,439	1.6	3,335	1.3
Miscellaneous Receipts	16,965	2.5	15,601	2.6	16,161	2.6	9,251	2.0	5,368	2.0
TOTAL RECEIPTS	$ 666,457	100.0	$ 600,562	100.0	$ 617,766	100.0	$463,302	100.0	$263,224	100.0
BUDGET EXPENDITURES[a]										
National Defense	$ 227,411	27.0	$ 209,902	26.4	$ 185,309	25.4	$116,342	23.7	$ 77,781	29.0
International Affairs	13,063	1.6	8,995	1.1	10,016	1.4	6,171	1.3	5,681	2.1
General Science, Space, & Tech.	8,310	1.0	7,745	1.0	7,080	1.0	5,051	1.0	3,977	1.5
Agriculture	12,203	1.4	22,206	2.8	14,889	2.0	6,191	1.3	2,227	0.8
Natural Resources & Energy	15,129	1.8	16,671	2.1	17,678	2.4	18,998	3.9	6,507	2.4
Transportation	24,587	2.9	21,385	2.7	20,570	2.8	17,468	3.6	9,172	3.4
Community Devel. & Housing	12,520	1.5	11,358	1.4	11,033	1.5	12,123	2.5	8,059	3.0
Education & Manpower	27,579	3.3	26,606	3.3	26,329	3.6	29,693	6.0	12,344	4.6
Health	30,432	3.6	28,655	3.6	27,435	3.8	20,477	4.2	20,364	7.6
Income Security	348,320	41.4	345,467	43.4	309,552	42.5	196,926	40.1	84,437	31.5
Veteran's Benefits & Svcs.	25,614	3.0	24,846	3.1	23,958	3.3	19,931	4.1	13,386	5.0
Law Enforcement & Justice	5,660	0.7	5,099	0.6	4,703	0.6	4,169	0.8	2,462	0.9
Net Interest	111,058	13.2	89,774	11.3	84,995	11.7	42,615	8.7	21,449	8.0
General Government	5,117	0.6	4,784	0.6	4,536	0.6	3,948	0.8	3,243	1.2
General Revenue Sharing	6,770	0.8	6,452	0.8	6,390	0.9	8,369	1.7	6,890	2.6
Less: Undistributed Offsetting Receipts	(31,957)	(3.8)	(33,976)	(4.3)	(26,099)	(3.6)	(17,476)	(3.6)	(10,068)	(3.8)
TOTAL EXPENDITURES	$ 841,815	100.0	$ 795,969	100.0	$ 728,375	100.0	$490,997	100.0	$267,912	100.0
Deficit or Surplus	$(175,359)	--	$(195,404)	--	$(110,609)	--	$(27,694)	--	$(4,688)	--
Gross Federal Debt[c]	$1,576,748	--	$1,381,886	--	$1,146,987	--	$780,425	--	$468,200	--

NOTE: Detail may not add to totals due to rounding; data for 1979-84 revised for comparative purposes to reflect establishment of a military retirement trust fund and on-budget outlays only.

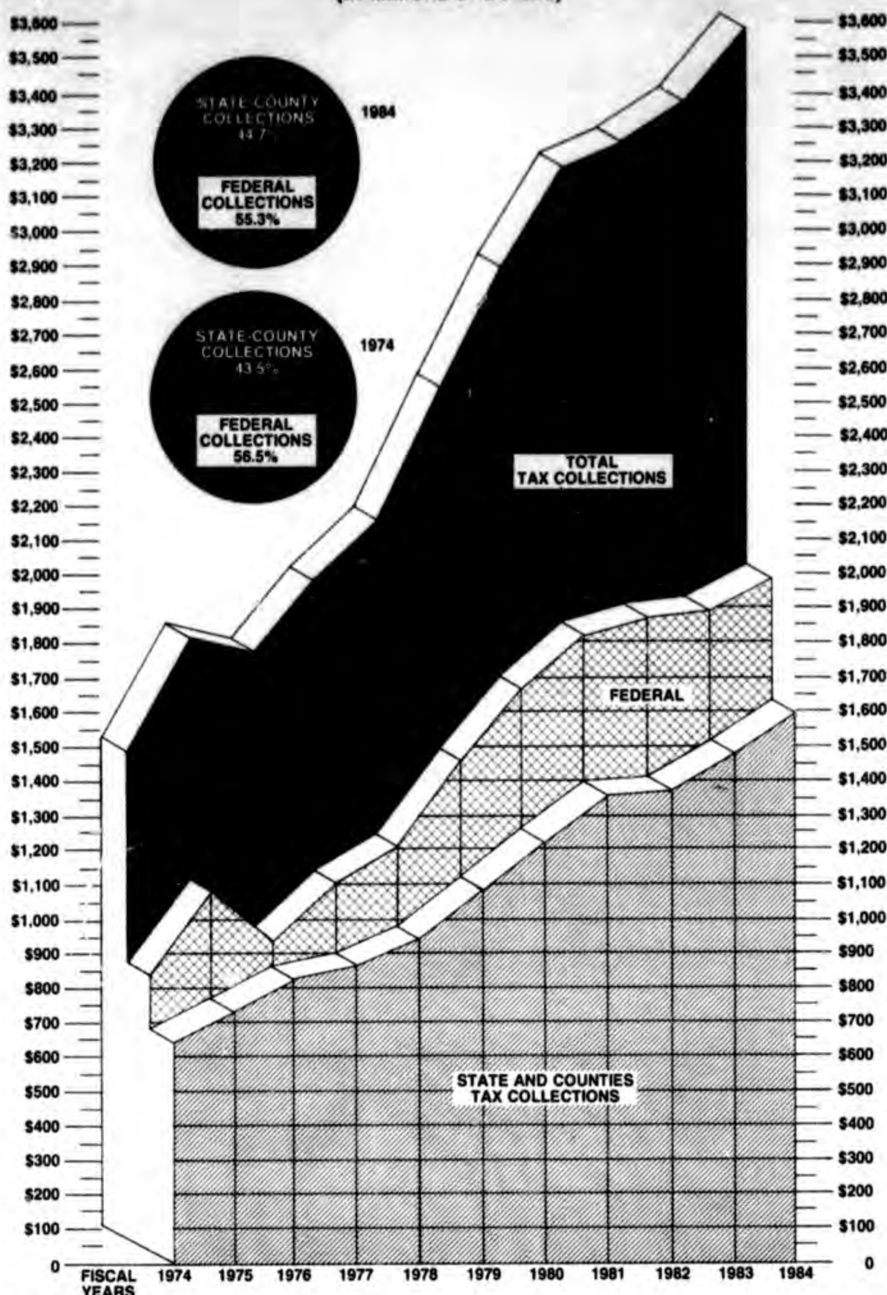
a. Includes both federal and trust funds.

b. Includes unemployment insurance and other insurance and retirement contributions.

c. At the end of the fiscal year.

SOURCE: "Budget of the United States Government," fiscal years 1986 and 1984, Executive Office of the President, Office of Management and Budget, Washington, D.C.

CHART 8
TAX COLLECTIONS IN HAWAII
Total, Federal, and State-Local
(In Millions of Dollars)



NOTE: Excludes Unemployment Compensation tax.

SOURCE: Compiled by the Tax Foundation of Hawaii from reports of the County Finance Directors and State Department of Taxation, State of Hawaii; and reports of the Internal Revenue Service, U.S. Department of the Treasury.

TABLE 33

HAWAII STATE GENERAL FUND FINANCES

Fiscal Years Ending June 30
(In Thousands)

Fiscal Year	Receipts	Expenditures	Excess or Deficiency	Cash Balance	Unexpended Appropriations	Unappropriated Surplus
1984	$1,354,631	$1,375,403	$(20,772)	$162,880	$ 56,667	$105,063
1983	1,252,536	1,344,676	(92,140)	183,652	54,135	129,517
1982	1,185,778	1,237,997	(52,219)	275,792	65,828	209,964
1981[a]	1,198,680	1,092,866	105,814	335,919	104,226	231,692
1980	1,084,860	963,323	121,537	230,105	51,073	179,032
1979	942,455	886,942	55,513	108,568	41,641	66,927
1978	816,104	835,608	(19,504)	53,054	50,699	2,355
1977[b]	737,398	785,159	(47,761)	72,559	37,353	35,205
1976	908,251	900,385	7,867	142,742	100,933	41,810
1975	823,749	760,326	63,423	134,875	51,409	83,467
1974	708,294	675,748	32,546	71,452	57,634	13,818

a. Adjustment of cash balance to reflect a restatement of continuing appropriations for fiscal 1981 in the amount of $7,908,000.

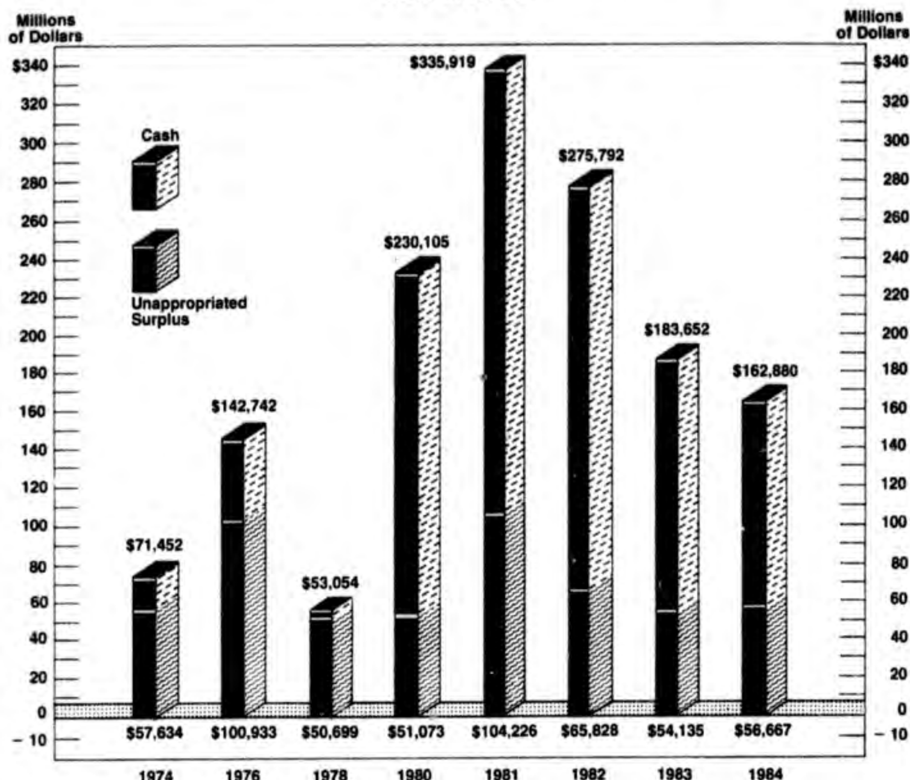
b. 1977 reflects a decrease due to a reclassification of funds; unexpended appropriations reduced by $22,242. Prior to 1977, federal funds earmarked for specific purposes were included.

SOURCE: Annual Financial Reports of the Comptroller, Department of Accounting and General Services, State of Hawaii.

CHART 9

GENERAL FUND FINANCIAL POSITION

State of Hawaii



SOURCE: Table 33.

HOW GOVERNMENT SPENDS ITS MONEY

During fiscal year 1984, state and local governments in Hawaii spent more than $2.6 billion in providing services for the people of the 50th State.

Unlike its counterparts on the mainland, Hawaii's state government provides many services which are traditionally delivered by cities, counties, municipalities, school districts and the like such as education, welfare administration, court functions, hospitals, and airport and harbor operations. Therefore it is not surprising that state government in Hawaii accounted for almost 80% of all state and local expenditures, reflecting the centralized system of government in the 50th state.

Education claimed the lion's share of state government expenditures in 1984, representing one-third of total operating costs, followed by public welfare programs at 16% of the total, debt service costs at 10%, public employee retirement at 6%, and hospitals at 5%. The total cost for state government operations actually declined in 1984 due to sharp cutbacks in urban redevelopment and housing grants and programs to protect natural resources.

Expenditures for airport, harbor, and highway operations, maintenance, and capital costs are classified as special fund expenditures which are funded from earmarked taxes, grants, and fees. Of the three program areas, highways accounted for the bulk of the spending with nearly $130 million in program expenditures, of which 63% was allocated for capital projects, followed by airports at $101 million, and harbors at $24 million.

County government expenditures topped $555 million in 1984, increasing 8.5% over the previous year. Of total county expenditures, the City and County of Honolulu accounted for 72%, Hawaii County for 12%, Maui County for 10%, and Kauai County for 6%. Major local government expenses in Hawaii are attributable to public safety, including police and fire, general government operations, public employee retirement system costs, and health and sanitation functions.

Per capita spending by state and county governments in Hawaii rose by 3.3% to $2,409 during 1983. Despite this modest growth in public expenditures, it was sufficient to boost the 50th State a notch in the U.S. ranking, making Hawaii the fifth biggest spender among the 50 states. Per capita expenditures for health and welfare services continue to outpace all other program areas, even education which came in a distant second.

TABLE 34

PER CAPITA DIRECT GENERAL EXPENDITURES

State and Local Government — Fiscal 1983[a]

State	Rank	Total	Public Educ.[b]	Higher Educ.	Hwys.	Health Welfare[c]	Police Fire	Control[d]	Int. on Debt	All Other[e]
HAWAII	5	$2,409	$ 439	$269	$151	$ 530	$116	$144	$ 170	$ 592
U.S. Av.	--	1,988	523	187	157	490	109	89	103	330
Ala.	41	1,668	440	216	162	407	73	68	78	225
Alaska	1	8,662	1,574	517	872	883	351	537	1,223	2,704
Ariz.	29	1,885	520	277	153	293	129	98	94	321
Ark.	51	1,372	404	142	145	336	53	57	65	170
Calif.	13	2,218	503	232	102	605	146	115	69	445
Colo.	23	2,024	592	243	183	415	112	109	94	276
Conn.	25	1,989	565	119	131	464	120	89	150	350
Del.	15	2,181	534	330	217	287	97	122	233	361
Fla.	42	1,645	447	128	129	356	124	84	64	313
Ga.	33	1,786	436	148	162	556	83	70	57	274
Idaho	43	1,600	424	181	192	317	77	80	59	270
Ill.	28	1,897	503	163	159	464	126	88	107	287
Ind.	44	1,591	474	190	114	397	75	66	57	217
Iowa	24	2,016	547	257	249	510	79	76	60	239
Kans.	26	1,961	520	234	216	412	82	91	138	270
Ky.	45	1,554	417	167	189	326	56	67	120	211
La.	19	2,119	505	186	247	496	103	88	144	349
Me.	34	1,770	472	143	198	429	73	89	101	265
Md.	14	2,215	568	21[illegible]	198	483	120	86	128	420
Mass.	20	2,107	518	101	116	610	133	88	121	419
Mich.	10	2,238	568	235	121	710	121	101	88	294
Minn.	6	2,404	616	207	241	623	94	104	154	366
Miss.	46	1,548	367	189	195	427	53	54	51	208
Mo.	49	1,479	412	141	138	358	90	65	59	217
Mont.	17	2,139	688	177	280	352	79	119	121	323
Neb.	27	1,899	540	224	244	407	78	82	63	262
Nev.	7	2,340	480	169	247	442	175	166	155	505
N. H.	39	1,721	450	145	215	358	92	72	153	235
N. J.	21	2,086	596	131	137	443	133	94	148	405
N. M.	8	2,295	653	262	284	398	107	113	150	328
N. Y.	4	2,790	685	157	162	787	156	112	200	531
N. C.	47	1,497	424	205	114	334	75	57	57	231
N. D.	12	2,234	566	301	267	358	63	95	86	498
Ohio	31	1,797	493	179	128	510	100	75	75	238
Okla.	36	1,754	523	232	177	396	85	72	35	234
Ore.	11	2,237	618	234	169	354	121	132	223	385
Pa.	35	1,761	500	97	144	461	80	78	109	292
R. I.	16	2,172	548	180	102	596	134	100	192	319
S. C.	50	1,448	437	174	79	387	61	56	54	200
S. D.	32	1,789	473	173	279	291	65	101	91	315
Tenn.	48	1,493	372	152	136	399	76	53	83	222
Texas	37	1,730	544	216	158	343	87	71	78	235
Utah	30	1,855	566	285	167	292	92	83	84	286
Vt.	22	2,081	534	261	239	422	72	102	122	329
Va.	40	1,710	504	181	159	368	93	85	76	244
Wash.	18	2,128	563	226	231	425	111	94	88	390
W. Va.	38	1,725	508	150	202	353	53	72	117	269
Wisc.	9	2,243	554	276	199	648	119	91	98	257
Wyo.	2	3,569	1,017	357	496	557	149	151	272	570
D. C.	3	3,560	589	120	110	1,076	338	206	2[illegible]3	904

NOTE: Detail may not add to total due to rounding.

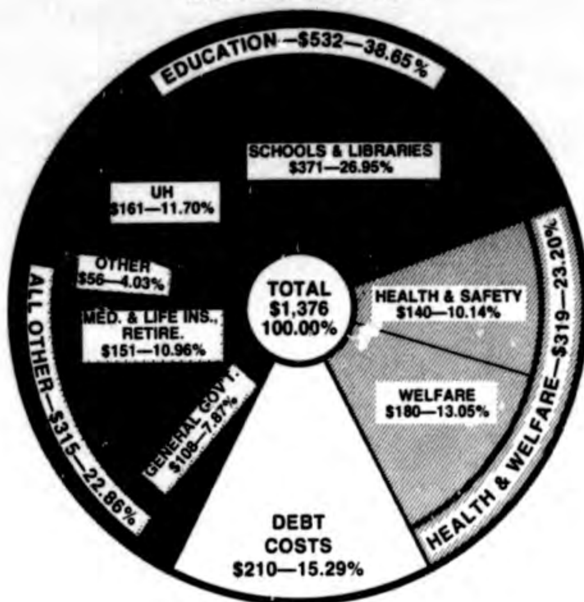
a. Includes capital outlay.
b. Includes libraries.
c. Includes vendor payments under welfare programs, institutional care of the needy, administration of welfare activities, and health, hospital, veterans services, sewerage, and other sanitation expenditures.
d. Includes financial administration.
e. Includes airports, corrections, housing and urban renewal, natural resources and parks, public buildings, water transport, air transportation, unemployment compensation, and all other unallocable expenditures.

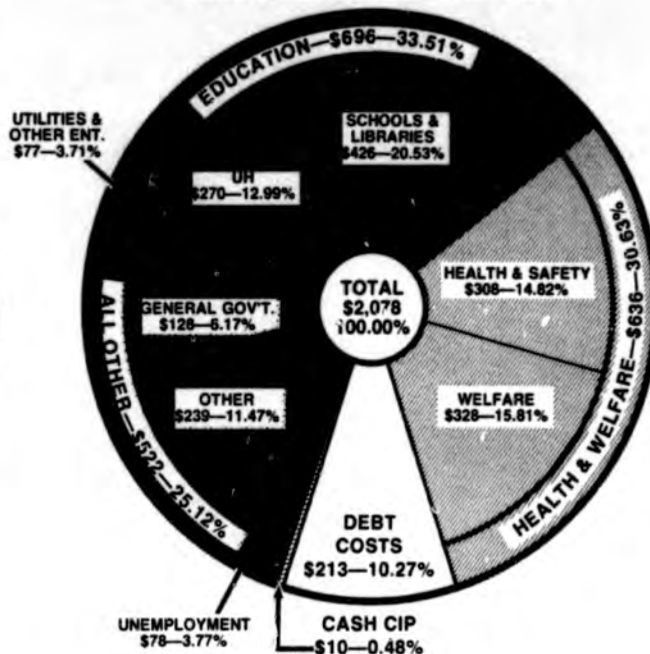
SOURCE: "Governmental Finances in 1982-1983," Series GF 83, No. 5, Bureau of the Census, U.S. Department of Commerce, Washington, D.C., October 1984.

CHART 10

HOW STATE GOVERNMENT DOLLARS ARE SPENT

Operating Expenditures — By Functions
State of Hawaii — Fiscal 1984
(Dollars in Millions)





NOTE: See Table 35 for further detail.
SOURCE: Compiled by the Tax Foundation of Hawaii from the 1984 Annual Report of the Comptroller, State of Hawaii.

TABLE 35

STATE OPERATING EXPENDITURES

State of Hawaii — Selected Fiscal Years[a]

Functions	1984	1983	1982	1979	1974
General Government - Control	$ 46,028,637	$ 42,160,372	$ 34,922,365	$ 27,608,676	$ 12,828,100
- Staff	82,[illegible]02,315	73,693,206	79,580,770	63,307,765	29,149,996
Public Safety - Police & Fire	1,682,278	2,340,081	2,037,809	2,690,607	218,700
- Other Protection	71,661,882	69,710,160	60,095,222	43,199,581	34,972,507
Highways	49,040,979	57,207,337	48,937,486	42,682,202	16,165,573
Natural Resources	17,172,230	28,403,965	19,094,014	15,863,975	10,564,297
Health & Sanitation	72,630,585	72,269,838	67,809,881	30,955,958	16,903,552
Hospitals & Institutions	114,557,165	96,335,498	84,152,155	78,755,102	42,130,802
Public Welfare	328,399,874	328,322,855	317,194,604	243,717,212	118,153,995
Education - Higher	269,796,046	261,096,594	240,226,613	173,868,613	115,539,404
- Public Education	405,228,441	406,369,727	370,356,199	282,119,762	182,470,087
- Libraries & Other	21,233,213	22,752,946	22,082,00[illegible]	15,508,124	8,366,011
Recreation	13,826,886	13,885,134	12,848,298	8,462,116	4,350,987
Utilities & Other Enterprises	76,989,615	76,855,869	59,289,660	51,608,597	39,240,241
Debt Service[b]	213,293,091	199,212,768	175,329,846	139,265,945	62,583,267
Retirement & Pension	126,006,369	123,442,993	94,877,813	62,261,333	47,095,905
Employees' Health & Hosp. Ins.	24,855,892	21,116,955	19,715,070	13,487,102	8,130,596
Unemployment Compensation	78,278,241	90,207,383	79,445,226	44,053,260	45,240,163
Grants-in-Aid to Counties	18,173,045	18,173,045	18,273,045	20,650,138	19,447,551
Urban Redevelop. & Housing	11,618,519	151,534,980	82,802,846	38,668,851	12,593,908
Miscellaneous	25,110,886	23,696,023	21,103,522	13,353,934	11,472,440
Cash Capital Improvements[c]	9,986,642	11,861,345	48,298,360	71,146,027	61,265,106
TOTAL	$2,077,672,831	$2,190,649,074	$1,958,472,808	$1,483,234,880	$898,883,986

NOTE: Due to reclassification of funds, 1974 data not exactly comparable to later years; all interfund transfers eliminated to avoid duplication.

a. Includes general, special, and proprietary fund expenditures; unemployment trust fund is treated as a special fund.

b. Debt service on revenue bonds reimbursable from highway funds are included under Highways; from airport and harbor funds under Utilities; from Sand Island receipts, land revolving trust, and Veterans' home loan funds under Miscellaneous.

c. Special funds account for $58,695,768 in 1974, $71,111,203 in 1979, $39,852,659 in 1982, $7,300,545 in 1983, and $8,939,166 in 1984.

SOURCE: Compiled by the Tax Foundation of Hawaii from the Annual Reports of the Comptroller, Department of Accounting and General Services, State of Hawaii.

TABLE 36

OPERATING EXPENDITURES[a] — CITY AND COUNTY OF HONOLULU

Selected Fiscal Years

Object of Expenditure	1984	1983	1982	1979	1974
General Government					
Control	$ 4,707,545	$ 4,735,039	$ 5,415,795	$ 3,828,404	$ 1,847,942
Staff	45,528,241	36,594,853	30,872,881	25,061,970	14,991,572
Public Safety					
Police & Fire	84,275,254	82,835,763	72,772,215	56,952,413	38,564,420
Other Protection	13,526,169	10,914,824	10,582,667	8,583,061	7,245,450
Highways	15,409,959	17,273,783	17,368,372	13,389,134	10,306,343
Health & Sanitation	37,350,900	35,530,903	34,902,402	21,914,397	14,735,450
Recreation	28,635,484	27,305,583	25,728,057	19,794,408	11,873,516
Interest	15,219,325	15,279,328	12,533,667	11,827,975	8,206,452
Bond Redemption	16,611,229	15,142,000	16,327,000	15,451,075	12,415,622
Pension & Retirement	33,241,499	32,658,679	22,498,832	18,456,222	10,744,301
Salary Adjustment	--	--	--	--	162,211
Econ. & Urban Dev.[b]	21,568,463	17,680,283	20,637,749	39,853,857	9,995,063
Mass Transit[c]	37,179,899	40,237,042	36,682,973	24,621,388	3,758,510
Miscellaneous	13,586,254	20,598,511	20,438,357	13,309,968	4,590,721
Cash Capital Improve.	35,578,869	16,888,567	41,148,033	20,141,051	20,825,177
TOTAL	$402,419,091	$373,675,159	$367,909,000	$293,185,323	$170,262,751

NOTE: Detail may not add to totals due to rounding.

a. All funds expended by the county with the exception of certain bond, revolving, loan, and enterprise funds. Excludes urban redevelopment land purchases.
b. Includes expenditures from redevelopment grants.
c. Includes transfers to the bus transportation fund which are not reported as part of operating expenditures.

SOURCE: Finance Director's Annual Report, City and County of Honolulu, State of Hawaii.

TABLE 37

OPERATING EXPENDITURES[a] — COUNTY OF MAUI

Selected Fiscal Years

Object of Expenditure	1984	1983	1982	1979	1974
General Goverment					
Control	$ 873,980	$ 771,329	$ 699,928	$ 523,153	$ 327,985
Staff	6,565,002	6,572,810	6,133,115	6,073,384	1,876,166
Public Safety					
Police & Fire	10,997,506	10,961,859	8,941,345	6,351,532	4,247,326
Other Protection	1,311,468	2,981,858	1,087,968	4,111,287	519,558
Highways	4,289,752	4,132,175	4,111,474	[illegible],008,373	1,802,179
Health & Sanitation	4,893,074	4,819,699	4,517,978	1,706,063	424,355
Hospitals & Institutions	92,553	85,603	200,506	39,229	5,356
Public Welfare	3,321,766	3,354,631	3,018,394	3,534,778	133,331
Public Schools	190,870	185,219	162,993	166,040	77,414
Recreation	3,277,611	3,591,840	3,385,721	2,214,836	1,145,028
Interest	1,098,093	1,122,[illegible]38	1,162,085	828,819	1,072,911
Bond Redemption	1,513,500	1,105,000	1,147,000	1,252,815	646,122
Pension & Retirement	3,038,521	2,915,319	2,272,123	1,954,952	1,619,447
Salary Adjustment	--	--	--	--	11,917
Miscellaneous	3,107,100	3,394,486	3,078,703	1,737,091	1,246,347
Cash Capital Improve.	12,156,715	5,512,965	2,184,408	3,436,173	1,214,527
TOTAL	$56,727,511	$51,506,831	$42,103,741	$36,938,526	$16,369,970

NOTE: Detail may not add to totals due to rounding.

a. All funds expended by the county with exception of certain revolving and bond fund expenditures, loan repayments, and Act 97, SLH 1965 expenditures; interfund transfers eliminated to avoid duplication.

SOURCE: Finance Director's Annual Financial Reports, County of Maui, State of Hawaii.

TABLE 38
OPERATING EXPENDITURES[a] — COUNTY OF HAWAII
Selected Fiscal Years

Object of Expenditure	1984	1983	1982	1979	1974
General Government					
Control	$ 1,504,479	$ 1,825,396	$ 2,002,767	$ 1,941,939	$ 758,858
Staff	6,652,777	5,666,114	5,496,619	5,186,899	2,144,346
Public Safety					
Police & Fire	18,733,850	17,134,725	15,176,742	9,775,655	6,387,077
Other Protection	3,967,403	3,687,568	3,547,676	2,168,856	1,582,301
Highways	5,213,811	4,998,907	4,692,389	3,177,249	2,560,483
Health & Sanitation	2,922,043	2,687,678	2,864,561	1,544,160	746,512
Public Welfare	2,405,548	1,642,971	1,477,625	944,492	163,851
Public Schools	281,466	267,423	236,939	234,427	215,131
Recreation	5,300,459	5,337,128	5,096,681	3,253,146	2,103,031
Interest	3,562,733	3,608,094	2,898,009	1,715,560	1,221,586
Bond Redemption	1,177,000	1,698,916	1,458,644	1,455,109	1,267,651
Pension & Retirement	7,485,471	7,421,098	5,574,336	4,777,652	2,193,155
Mass Transit	1,341,605	1,014,804	991,078	600,926	181,610
Miscellaneous	1,442,169	1,355,042	1,402,437	913,624	414,554
Cash Capital Improve.	2,891,056	655,289	1,104,149	1,531,540	1,576,344
TOTAL	$64,881,870	$59,001,153	$54,040,652	$39,221,234	$23,516,490

NOTE: Detail may not add to totals due to rounding.

a. All funds expended by county with the exception of certain revolving and bond fund expenditures, loan repayments, Act 97, SLH 1965 funds, and Hilo hospital special fund. Interfund transfers are eliminated to avoid duplication.

SOURCE: Finance Director's Annual Financial Reports, County of Hawaii, State of Hawaii.

TABLE 39
OPERATING EXPENDITURES[a] — COUNTY OF KAUAI
Selected Fiscal Years

Object of Expenditure	1984	1983	1982	1979	1974
General Government					
Control	$ 899,331	$ 830,251	$ 893,423	$ 618,146	$ 454,592
Staff	4,197,607	4,158,749	4,240,108	3,518,402	1,851,387
Public Safety					
Police & Fire	6,694,491	6,568,949	5,654,237	4,163,146	2,838,105
Other Protection	5,101,220	2,204,732	596,207	383,119	284,713
Highways	3,034,753	2,824,589	1,396,894	1,346,865	886,28.
Health & Sanitation	1,006,317	1,012,378	948,897	545,822	255,879
Public Welfare	968,523	682,219	2,009,260	573,047	68,336
Public Schools	124,686	122,128	130,537	117,483	71,726
Recreation	1,871,782	1,820,243	1,771,269	1,477,084	622,459
Interest	1,671,693	1,672,398	1,673,103	841,959	592,641
Bond Redemption	15,000	15,000	15,000	819,000	359,082
Pension & Retirement	3,004,770	2,548,888	1,889,803	1,663,208	795,589
Salary Adjustment[b]	12,768	13,366	12,333	7,997	80,878
Cash Capital Improve.	290,256	942,267	1,347,657	227,197	330,905
Miscellaneous	2,515,891	2,547,155	2,702,434	1,768,972	1,421,831
TOTAL	$31,409,089	$27,963,312	$25,281,160	$18,071,447	$10,914,411

NOTE: Detail may not add to totals due to rounding.

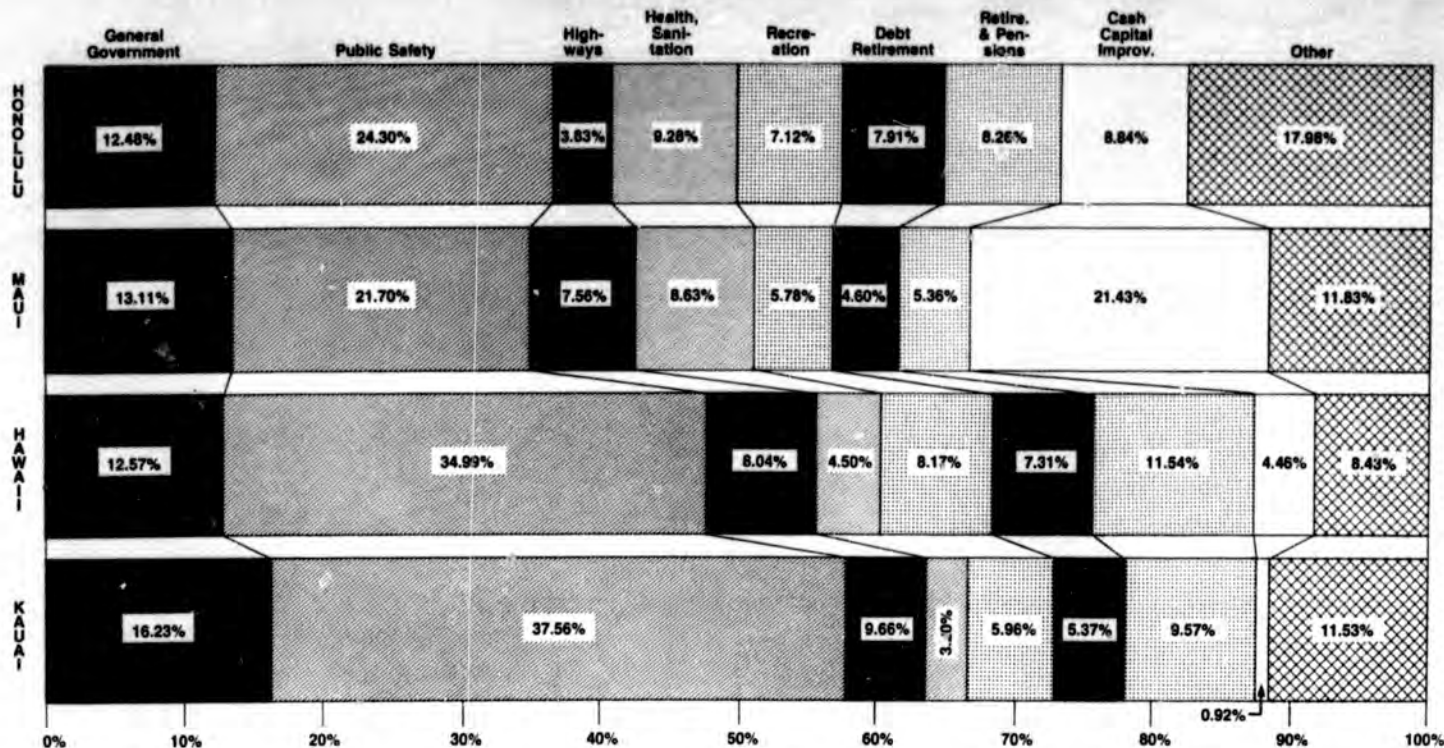
a. All funds expended by the county with the exception of certain revolving and bond fund expenditures, loan repayments, and Act 97, SLH 1965 expenditures; interfund transfers eliminated to avoid duplication.
b. Amount not allocated by function.

SOURCE: Finance Director's Annual Financial Reports, County of Kauai, State of Hawaii.

CHART 11

OBJECTS OF COUNTY GOVERNMENT EXPENDITURES

Percentage Distribution — By Counties
For Fiscal Year 1984



SOURCE: Tables 36-39.

TABLE 40

PUBLIC EMPLOYMENT

State and Local Government Full-Time Equivalent Employees Per 10,000 Population, by Function: October 1983

State	Rank	Total	Public Educ.[a]	Higher Educ.	Hwys.	Hlth. Hosp.	Police Fire	Parks Rec.[b]	Water	Con-trol[c]	All Other[d]
HAWAII	23	480	159	54	19	50	40	28	9	42	79
U.S. Av.	--	465	173	50	22	55	36	15	6	30	80
Ala.	17	484	167	54	27	87	31	13	6	25	75
Alaska	1	814	260	99	80	29	37	60	3	83	164
Ariz.	37	451	173	64	19	25	37	15	5	34	80
Ark.	39	445	183	48	29	53	26	15	6	25	59
Calif.	41	438	147	51	13	49	38	18	7	29	88
Colo.	25	477	180	62	23	51	35	17	8	34	66
Conn.	46	431	181	33	24	41	41	9	4	31	68
Del.	12	507	164	75	28	57	29	16	3	44	91
Fla.	40	438	153	38	18	58	40	18	6	30	78
Ga.	7	541	193	43	23	124	36	15	9	25	74
Idaho	32	456	180	59	30	48	29	21	3	35	51
Ill.	48	421	156	47	16	35	44	14	5	32	73
Ind.	42	435	179	54	19	53	30	10	4	26	61
Iowa	16	489	194	70	30	61	25	12	4	29	64
Kans.	8	523	206	75	34	52	33	17	7	38	61
Ky.	50	410	170	46	21	37	26	16	5	25	65
La.	9	518	192	54	30	73	35	21	6	32	76
Me.	35	451	204	41	35	27	29	15	7	28	64
Md.	15	498	171	63	23	55	42	18	5	30	91
Mass.	38	446	175	27	18	57	49	8	6	30	77
Mich.	44	431	169	61	15	48	30	11	5	28	64
Minn.	29	468	179	56	26	56	24	16	4	31	76
Miss.	13	500	183	59	31	85	27	24	4	23	64
Mo.	43	432	170	37	22	62	36	13	5	29	58
Mont.	10	518	206	53	38	35	29	36	4	43	75
Neb.	4	581	193	83	35	58	29	29	5	36	113
Nev.	28	473	150	35	22	62	50	18	5	40	92
N. H.	49	419	172	52	31	25	36	10	3	19	71
N. J.	24	478	198	35	25	46	46	10	4	35	80
N. M.	5	566	205	86	31	64	37	23	6	35	78
N. Y.	6	551	164	33	25	85	46	11	3	36	148
N. C.	26	476	183	60	22	64	29	15	5	23	73
N. D.	14	500	190	77	31	42	25	26	4	44	62
Ohio	47	429	169	46	19	46	32	11	6	28	72
Okla.	11	515	196	61	26	66	35	17	8	27	80
Ore.	18	483	185	60	24	40	34	21	5	35	80
Pa.	51	383	160	23	22	30	29	9	4	29	77
R. I.	30	465	155	49	18	45	46	12	5	31	105
S. C.	21	481	192	55	20	76	27	11	5	25	71
S. D.	19	483	207	56	37	38	26	19	5	39	55
Tenn.	33	454	164	48	25	58	35	12	9	22	82
Texas	27	474	203	59	20	56	33	13	9	25	57
Utah	45	431	168	83	18	33	27	15	5	27	56
Vt.	31	458	198	61	35	22	26	16	3	33	65
Va.	22	481	194	57	24	51	33	15	5	26	77
Wash.	36	451	154	62	23	39	32	19	5	30	87
W. Va.	20	482	213	48	33	57	22	16	4	29	60
Wisc.	34	451	160	75	23	38	33	13	4	29	77
Wyo.	3	661	257	77	48	88	43	28	7	48	66
D. C.	2	735	162	27	18	85	94	9	6	49	287

NOTE: Detail may not add to total due to rounding.

a. Includes local libraries.

b. Includes natural resources.

c. Includes financial, administration, and general control.

d. Includes employees in special schools, welfare, employment security administration, correction, sewerage and other sanitation, public service enterprises, state liquor stores, and all other general government functions.

SOURCE: "Public Employment in 1983," Series 83, No. 1, U.S. Department of Commerce, Bureau of the Census, Washington, D.C., June 1984.

TABLE 41

AVERAGE MONTHLY EARNINGS OF PUBLIC EMPLOYEES

State and Local Government Full-Time Equivalent Employees[a]

October 1983: By Function

State	Rank	State Av.	Public Educ.[b]	Higher Educ.[c]	Hwys.	Hlth. Hosp.	Police Fire	Parks Rec.[d]	Water	Control[e]	All Other[f]
HAWAII	20	$1,673	$1,639	$2,074	$1,585	$1,424	$1,942	$1,565	$1,653	$1,760	$1,499
U.S. Av.	--	1,674	1,665	1,891	1,539	1,459	1,940	1,544	1,606	1,649	1,663
Ala.	45	1,326	1,230	1,68[illegible]	1,205	1,192	1,473	1,373	1,329	1,531	1,345
Alaska	1	2,746	2,949	2,231	2,443	2,578	3,540	2,565	3,142	2,772	2,782
Ariz.	9	1,816	1,749	2,097	1,668	1,610	2,041	1,716	1,738	1,697	1,804
Ark.	50	1,221	1,137	1,589	1,205	1,145	1,315	1,220	1,123	1,135	1,258
Calif.	3	2,101	2,009	2,271	1,967	1,870	2,499	1,880	2,203	2,087	2,039
Colo.	15	1,757	1,632	2,072	1,749	1,602	1,959	1,812	1,934	1,727	1,795
Conn.	14	1,758	1,737	1,963	1,868	1,578	1,978	1,544	1,794	1,721	1,694
Del.	28	1,569	1,571	1,986	1,428	1,175	1,887	1,428	1,355	1,488	1,473
Fla.	26	1,570	1,486	1,839	1,314	1,556	1,772	1,411	1,430	1,626	1,595
Ga.	47	1,316	1,223	1,893	1,201	1,266	1,396	1,305	915	1,399	1,327
Idaho	38	1,418	1,342	1,551	1,523	1,347	1,562	1,504	1,373	1,312	1,496
Ill.	7	1,837	1,870	2,117	1,895	1,540	2,082	1,531	2,050	1,523	1,753
Ind.	31	1,497	1,530	2,084	1,254	1,385	1,481	1,235	1,259	1,189	1,248
Iowa	25	1,583	1,545	1,966	1,485	1,385	1,702	1,623	1,587	1,507	1,499
Kans.	36	1,421	1,414	1,547	1,358	1,25[illegible]	1,548	1,431	1,470	1,340	1,440
Ky.	39	1,401	1,385	1,706	1,466	1,119	1,519	1,157	1,316	1,401	1,388
La.	42	1,375	1,359	1,783	1,332	1,112	1,529	1,400	1,314	1,366	1,328
Me.	43	1,367	1,271	1,549	1,411	1,378	1,515	1,613	1,287	1,320	1,431
Md.	12	1,766	2,001	1,708	1,505	1,588	1,976	1,305	1,657	1,679	1,566
Mass.	19	1,698	1,755	1,766	1,584	1,387	1,952	1,421	1,516	1,603	1,723
Mich.	4	1,978	2,093	1,946	1,888	1,732	2,219	1,792	1,834	1,860	1,891
Minn.	10	1,815	1,726	2,130	1,983	1,516	2,151	1,830	1,880	1,933	1,794
Miss.	51	1,171	1,132	1,606	965	1,001	1,270	1,264	1,021	1,230	1,120
Mo.	35	1,432	1,450	1,699	1,381	1,185	1,707	1,32[illegible]	1,369	1,347	1,394
Mont.	23	1,621	1,731	1,829	1,746	1,374	1,618	1,268	1,474	1,499	1,474
Neb.	34	1,446	1,454	1,347	1,346	1,259	1,807	1,308	1,549	1,326	1,610
Nev.	8	1,830	1,745	1,930	1,845	1,791	2,062	1,687	1,951	1,838	1,847
N. H.	37	1,419	1,341	1,680	1,273	1,350	1,685	1,545	1,276	1,523	1,335
N. J.	13	1,763	1,929	2,106	1,663	1,399	1,913	1,453	1,445	1,629	1,460
N. M.	32	1,466	1,475	1,674	1,521	1,181	1,600	1,429	1,377	1,459	1,387
N. Y.	5	1,956	2,107	2,044	1,606	1,670	2,313	1,662	1,863	1,864	1,925
N. C.	41	1,382	1,362	1,610	1,271	1,326	1,488	1,347	1,229	1,521	1,259
N. D.	21	1,642	1,835	1,786	1,460	1,226	1,607	1,606	1,576	1,379	1,467
Ohio	27	1,569	1,648	1,621	1,519	1,344	1,807	1,498	1,596	1,440	1,457
Okla.	4[illegible]	1,383	1,330	1,700	1,248	1,244	1,472	1,372	1,170	1,498	1,375
Ore.	16	1,747	1,627	1,981	1,702	1,493	2,103	1,650	1,896	1,761	1,851
Pa.	22	1,625	1,650	1,904	1,462	1,456	1,865	1,613	1,607	1,459	1,575
R. I.	11	1,780	1,962	1,794	1,401	1,673	1,831	1,323	1,441	1,570	1,720
S. C.	49	1,305	1,211	1,777	1,084	1,261	1,329	1,238	1,232	1,343	1,299
S. D.	46	1,325	1,239	1,572	1,372	1,116	1,425	1,504	1,342	1,292	1,416
Tenn.	44	1,347	1,425	1,599	1,122	1,073	1,426	1,168	1,398	1,398	1,283
Texas	29	1,529	1,411	1,855	1,519	1,393	1,849	1,456	1,365	1,690	1,542
Utah	24	1,603	1,572	1,516	1,785	1,386	1,869	1,651	1,565	1,763	1,680
Vt.	33	1,454	1,297	1,798	1,442	1,450	1,658	1,519	1,577	1,477	1,498
Va.	30	1,515	1,492	1,889	1,286	1,378	1,675	1,383	1,466	1,583	1,398
Wash.	6	1,886	1,769	2,001	2,097	1,547	2,248	1,816	2,073	1,847	1,995
W. Va.	48	1,311	1,376	1,551	1,218	1,147	1,428	1,214	1,138	1,198	1,148
Wisc.	18	1,714	1,753	1,705	1,713	1,517	1,966	1,572	1,837	1,732	1,638
Wyo.	17	1,720	1,760	1,961	1,917	1,339	1,758	1,732	1,513	1,701	1,656
D. C.	2	2,263	2,336	2,159	1,959	2,163	2,566	2,020	2,4[illegible]2	2,347	2,169

a. Computed by the Tax Foundation of Hawaii from October 1983 payroll data.

b. Includes instructional and other local school staff and local library personnel.

c. Includes instruction and other personnel.

d. Includes natural resources.

e. Includes financial administration and other general control.

f. Includes special schools, welfare, employment security administration, correction, severage and other sanitation, other general government functions, and public service enterprises other than water supply.

SOURCE: "Public Employment in 1983," Series GE 83, No. 1, U.S. Department of Commerce, Bureau of the Census, Washington, D.C., June 1984.

TABLE 42

EMPLOYEES' RETIREMENT SYSTEM

Receipts, Expenditures, and Reserves
State of Hawaii — Selected Fiscal Years
(In Thousands)

	1984	1983	1982	1979	1974
		SOURCE OF RECEIPTS			
Retirement System Contributions					
State	$ 107,193	$ 107,175	$ 73,086	$ 52,153	$ 36,385
Counties	37,249	36,640	22,672	20,738	13,439
Employees	80,435	79,610	72,052	56,475	29,414
Social Security Contributions[a]					
State and Counties	59,843	55,276	49,634	33,498	18,718
Employees	58,664	55,276	49,634	33,498	18,718
Administration	1,868	1,215	1,145	823	488
Earnings from Investments	206,102	178,791	135,603	82,952	52,343
TOTAL	$ 551,354	$ 513,983	$ 403,826	$ 280,137	$169,505
		OBJECT OF EXPENDITURES			
Administration	$ 1,868	$ 1,215	$ 1,145	$ 823	$ 488
Benefits	106,131	95,807	84,658	61,292	29,321
Refunds and Withdrawals	29,450	28,924	24,899	16,257	8,467
Social Security	118,507	110,552	99,268	66,996	37,437
TOTAL	$ 255,956	$ 236,498	$ 209,970	$ 145,368	$ 75,713
		CASH AND INVESTMENT AS OF JUNE 30			
Cash	$ 14,709	$ 6,405	$ 5,380	$ 3,188	$ 2,305
Certificates of Deposit	24,027	33,275	25,524	210,931	122,036
Investments					
Bonds	1,177,591	1,013,292	898,987	389,327	109,851
Stocks	545,169	406,420	260,325	170,807	191,897
Mortgages	437,113	438,459	432,776	331,280	170,209
TOTAL	$2,198,654	$1,897,851	$1,622,992	$1,105,533	$596,298
MEMBERS IN SYSTEM	51.6	51.6	49.8	47.5	43.4
Earnings as % of Investments[b]	9.4	9.4	8.5	9.4	11.1

a. Calculated by dividing Social Security disbursements in half.
b. "Earnings from Investments" divided by total "Investments."

SOURCE: Compiled by the Department of Budget and Finance, Employees' Retirement System, State of Hawaii and "State Government Finances," 1974, U.S. Department of Commerce, Bureau of the Census, Washington, D.C.

TABLE 43

COMPENSATION RATES IN SELECTED POSITIONS

Private Industry and State-County Governments

Job Classification	Private Industry[a]		State-County Governments[a]		Private Industry		State-County Governments	
	Min.	Max.	Min.	Max.	Median	Mean	Median	Mean
Monthly Salary Rates								
Accountant (Entry)	$1,294	$1,910	$1,140	$1,868	$1,600	$1,483	$1,278	$1,298
Account Clerk (Sr.)	1,061	1,569	1,090	1,481	1,302	1,322	1,090	1,182
Cashier	981	1,362	1,090	1,481	1,193	1,148	1,159	1,209
Civil Eng. (Lic.)	2,184	3,182	1,868	2,817	2,574	2,787	2,343	2,241
Clerk	883	1,302	1,000	1,376	1,045	1,100	1,029	1,099
Clerk (Jr.)	766	1,123	915	1,193	898	949	915	933
Clerk (Personnel)	1,095	1,594	1,161	1,662	1,299	1,338	1,410	1,392
Clerk (Sr.)	1,032	1,558	1,090	1,481	1,250	1,332	1,244	1,248
Clerk (Steno.)	958	1,389	1,057	1,428	1,215	1,296	1,057	1,163
Cus. Serv. Clerk	908	1,414	1,128	1,538	1,328	1,400	1,217	1,299
Data Entry Oper.	848	1,286	1,029	1,376	1,078	1,134	1,029	1,101
Dietician	1,399	2,408	1,440	2,139	2,005	2,050	2,001	1,881
Engineering Aide	1,120	1,605	1,128	1,538	1,300	1,363	1,128	1,174
Engr. Draft Tech.	1,419	2,065	1,376	1,990	1,770	1,898	1,818	1,773
Hosp. Attendant	965	1,240	963	1,282	1,069	1,057	1,087	1,083
Hosp. Ward Clerk	1,104	1,224	971	1,481	1,213	1,210	1,029	1,116
Land Surveyor	1,376	2,019	1,419	1,845	1,597	1,731	1,762	1,731
Med. Technologist	1,779	2,106	1,440	2,139	2,004	2,019	1,750	1,783
Nurse (Practical)	1,186	1,451	1,158	1,616	1,449	1,426	1,300	1,380
Nurse (Staff)	1,793	2,005	1,652	2,151	2,019	1,978	1,785	1,860
Occup. Therapist	1,725	2,034	1,440	2,139	1,920	1,876	1,786	1,783
Physical Therapist	1,848	2,135	1,440	2,139	2,082	2,044	1,835	1,873
Secretary	1,095	1,627	1,164	1,737	1,300	1,341	1,489	1,469
Secretary (Private)	1,257	1,872	1,282	2,279	1,602	1,679	1,737	1,723
Switchboard Oper.	905	1,309	971	1,327	1,371	1,328	1,058	1,101
Hourly Wage Rates[b]								
Auto Mechanic	$ 6.37	$10.70	$ 8.08	$ 9.23	$ 9.22	$10.15	$ 8.08	$ 8.33
Auto Mech. Helper	4.23	6.04	6.72	7.38	7.76	7.69	6.72	6.86
Bldg. Maint. Repair.	6.15	9.08	7.89	8.76	9.09	9.05	7.89	8.01
Carpenter (Maint.)	7.93	10.62	7.89	8.76	9.36	9.77	7.89	8.05
Cook (Assistant)	4.78	6.85	6.72	7.38	6.85	6.46	6.72	6.90
Cook (General)	6.02	8.21	7.33	8.13	9.25	8.30	7.33	7.45
Electrician (Maint.)	7.80	9.55	8.08	8.98	9.93	11.24	8.08	8.17
Electronic Tech.	11.88	18.00	8.54	12.55	14.38	14.30	10.97	10.12
Groundskeeper	4.90	6.89	6.27	6.83	6.46	6.36	6.27	6.40
Janitor (Heavy)	4.48	6.58	6.27	6.83	6.28	6.28	6.27	6.42
Kitchen Helper	4.50	6.31	6.27	6.83	5.65	5.40	6.27	6.39
Laborer (Heavy)	8.30	11.03	6.31	6.89	7.32	7.38	6.31	6.43
Laborer (Light)	4.53	6.17	6.27	6.83	6.59	6.69	6.27	6.34
Painter (Maint.)	8.77	10.64	7.89	8.76	9.32	9.77	7.89	8.00
Plumber (Maint.)	9.53	10.51	8.08	8.98	9.60	10.13	8.08	8.17
Security Attend.	5.24	7.10	5.43	7.13	6.67	6.52	5.43	5.69
Trades Helper	6.70	7.53	6.72	7.38	7.79	7.74	6.72	6.92
Truck Driver A[c]	5.22	6.91	6.51	7.13	7.95	7.44	7.13	6.92
Truck Driver B[c]	5.60	9.95	6.91	7.63	7.79	8.58	6.91	7.21
Truck Driver C[c]	7.24	9.33	7.13	7.89	9.19	9.87	7.13	7.40
Warehouse Worker	5.87	9.07	6.51	7.13	8.50	8.55	6.51	6.57
Washer	5.24	6.51	6.31	6.89	6.16	6.05	6.89	6.70

NOTE: Results of sampling 487 establishments and 13 government agencies employing 50,853 persons. Wages and salaries in effect on June 1, 1984 or scheduled to go into effect by August 31, 1984. Caution must be exercised in making comparisons due to variations among jobs and fringe benefits.

a. Average of salary ranges.
b. Federal minimum wage set at $3.35 per hour.
c. A = capacity under 1.5 tons; B = 1.5 to 5 tons; C = 5 tons and over.

SOURCE: "Pay Rates in Hawaii, Private Employment, Government Employment," Hawaii Employers Council, Research Department, Special Publication No. 163, September 1984.

TABLE 44

CLASSROOM TEACHERS' SALARIES: 1983-1984

Estimated Average Annual Salaries[a]

State	Elementary	Secondary	All Teachers: Amount	All Teachers: Rank	All Teachers: $ Increase Over 1982-1983[b]
HAWAII	$25,300	$24,000	$24,357	9	(1.77)
U.S. Av.	21,465	22,570	21,935	--	5.89
Alabama	17,682	17,682	17,682	43	(0.94)
Alaska	37,580	38,000	37,807	1	11.25
Arizona	21,525	21,929	21,642	21	8.42
Arkansas	16,436	17,396	16,929	49	12.64
California	24,696	26,314	24,843	7	3.36
Colorado	23,100	23,835	23,276	13	8.41
Connecticut	22,385	23,036	22,627	19	9.15
Delaware	20,406	21,373	20,934	24	1.50
Florida	19,871	19,109	19,497	32	6.69
Georgia	18,300	19,070	18,631	37	7.00
Idaho	17,314	18,710	17,985	41	2.27
Illinois	23,183	26,069	24,191	11	8.41
Indiana	21,091	21,983	21,538	22	7.03
Iowa	19,375	20,819	20,149	28	4.63
Kansas	19,280	19,440	19,368	33	6.24
Kentucky	19,200	20,510	19,660	31	6.94
Louisiana	18,130	18,890	18,400	39	(0.11)
Maine	16,839	18,171	17,328	48	6.65
Maryland	23,052	24,471	24,095	12	5.74
Massachusetts	22,700	23,1[illegible]	22,964	16	7.11
Michigan	27,250	26,770	27,049	4	1.86
Minnesota	23,460	25,170	24,350	10	9.21
Mississippi	15,554	16,118	15,812	51	10.42
Missouri	18,748	19,870	19,310	34	10.21
Montana	20,126	21,764	20,690	25	6.17
Nebraska	17,976	19,598	18,785	36	7.89
Nevada	21,940	22,810	22,360	20	1.31
New Hampshire	17,357	17,394	17,376	47	5.00
New Jersey	22,774	23,826	23,264	14	8.02
New Mexico	19,900	21,227	20,571	26	0.49
New York	26,545	27,964	27,319	3	9.28
North Carolina	18,248	18,397	18,311	40	4.13
North Dakota	18,990	19,690	19,260	35	4.73
Ohio	20,879	21,290	21,290	23	6.43
Oklahoma	18,080	19,140	18,580	38	1.70
Oregon	22,769	23,897	23,155	15	6.48
Pennsylvania	22,567	22,820	22,703	18	7.20
Rhode Island	24,986	25,748	25,337	5	9.33
South Carolina	16,862	18,079	17,384	46	5.21
South Dakota	16,200	16,700	16,480	50	5.67
Tennessee	17,860	18,000	17,910	42	3.05
Texas	19,692	20,858	20,170	27	3.17
Utah	19,347	21,022	20,007	29	0.75
Vermont	17,166	17,970	17,606	44	8.20
Virginia	18,973	20,589	19,676	30	6.16
Washington	23,995	24,789	24,365	8	3.73
West Virginia	17,002	18,098	17,489	45	0.96
Wisconsin	22,400	23,323	22,811	17	6.12
Wyoming	24,691	26,242	25,197	6	6.36
Dist. of Columbia	27,659	27,659	27,659	2	8.00

a. Limited to classroom teachers excluding principals, supervisors, librarians, guidance and psychological personnel, and related instructional workers.

b. 1982-1983 revised data.

SOURCE: "Estimates of School Statistics, 1984-85," NEA Research, National Education Association, 1985 (copyright 1985).

TABLE 45

ESTIMATED PUPIL-TEACHER RATIOS AND PER CAPITA DIRECT SCHOOL EXPENDITURES

	Pupil-Teacher Ratios[a]			Per Capita Direct Expenditures - Local Schools[b]			
				Capital		Total Expenditures	
State	Elementary	Secondary	Total	Outlay	Other	Amount	Rank
HAWAII	19.3	20.4	20.1	$ 28.80	$ 383.42	$ 412.22	41
U.S. Av.	20.1	16.3	18.4	30.77	451.94	482.71	--
Ala.	20.8	19.4	20.1	41.00	326.24	367.24	48
Alaska	13.9	18.4	15.6	329.45	1,151.33	1,480.78	1
Ariz.	21.3	22.8	21.8	76.26	404.95	481.21	22
Ark.	20.1	16.5	18.2	9.87	348.34	358.21	49
Calif.	26.3	18.7	23.4	16.06	454.21	470.27	27
Colo.	20.5	17.3	19.1	70.20	491.24	561.44	9
Conn.	17.4	11.9	15.1	27.30	487.36	514.66	16
Del.	18.5	15.5	16.8	17.59	458.75	476.34	24
Fla.	16.8	19.6	18.1	44.85	376.27	421.12	39
Ga.	18.8	18.3	18.6	31.74	377.99	409.73	42
Idaho	22.6	19.5	21.1	32.66	364.84	397.50	44
Ill.	19.3	16.3	18.3	24.25	440.73	464.98	29
Ind.	20.3	18.7	19.5	35.20	391.81	427.01	37
Iowa	18.6	14.2	16.2	21.79	481.10	502.89	19
Kans.	17.2	13.5	15.6	34.93	463.01	497.94	20
Ky.	20.5	19.0	19.9	39.21	329.27	368.48	47
La.	21.2	14.8	19.0	31.00	414.89	445.89	34
Me.	18.8	14.2	17.1	25.51	406.93	432.44	36
Md.	19.2	17.0	18.0	26.30	478.02	504.32	18
Mass.	27.2	8.4	15.5	9.36	471.04	480.40	23
Mich.	26.6	16.1	21.7	14.99	518.39	533.38	11
Minn.	18.3	17.4	17.8	34.51	541.38	575.89	7
Miss.	18.9	17.9	18.5	13.36	319.66	333.02	50
Mo.	23.4	10.7	17.0	13.74	372.24	385.98	46
Mont.	17.2	14.9	16.4	58.98	575.26	634.24	3
Neb.	16.2	14.3	15.3	35.02	473.95	508.97	17
Nev.	19.3	21.7	20.4	27.33	420.80	448.13	32
N. H.	19.4	13.2	16.2	17.96	406.44	424.40	38
N. J.	17.2	13.5	15.6	22.73	530.37	553.10	10
N. M.	19.0	19.0	19.0	76.57	541.79	618.36	4
N. Y.	17.1	14.9	15.9	24.79	590.58	615.37	5
N. C.	24.0	14.3	20.0	13.35	381.27	394.62	45
N. D.	17.0	12.9	15.6	45.35	481.94	527.29	12
Ohio	21.8	15.5	18.9	16.91	453.08	469.99	28
Okla.	18.3	15.3	16.9	56.98	425.24	482.22	21
Ore.	18.8	16.3	17.8	26.39	561.72	588.11	6
Pa.	17.5	16.5	17.0	22.76	424.48	447.24	33
R. I.	18.4	17.2	17.8	6.05	457.20	463.25	31
S. C.	20.7	15.5	18.8	48.09	350.44	398.53	43
S. D.	16.3	14.0	15.5	27.36	414.46	441.82	35
Tenn.	23.7	16.0	20.9	15.00	309.92	324.92	51
Texas	17.6	17.8	17.7	68.17	456.35	524.52	13
Utah	23.3	25.4	24.1	59.50	464.55	524.05	14
Vt.	16.8	12.6	14.5	20.67	455.13	475.80	25
Va.	17.9	15.8	17.0	22.56	441.62	464.18	30
Wash.	20.2	22.0	21.1	53.41	461.29	514.70	15
W. Va.	17.7	15.0	16.5	29.42	441.72	471.14	26
Wisc.	17.8	16.2	17.1	13.02	400.68	413.70	40
Wyo.	12.2	19.0	14.4	188.03	788.93	976.96	2
D. C.	15.0	16.8	15.7	32.91	532.38	565.29	8

NOTE: Per capita expenditures do not correspond with Table 34 since expenditures for supervision of local schools, state schools for the handicapped, and other similar special educational programs have been eliminated.

a. Estimated for the 1983-1984 school year by dividing public school fall enrollment by the number of classroom teachers as reported by the National Education Association.

b. As reported by the U.S. Department of Commerce for fiscal 1983.

SOURCE: "Estimates of School Statistics, 1984-85," NEA Reseach, National Education Association, 1985 (copyright 1985); "Governmental Finances in 1982-83," Series GF 83, No. 5, U.S. Department of Commerce, Bureau of the Census, Washington, D.C., October 1984.

TABLE 46

HAWAII PUBLIC SCHOOL COSTS

Selected Fiscal Years[a]

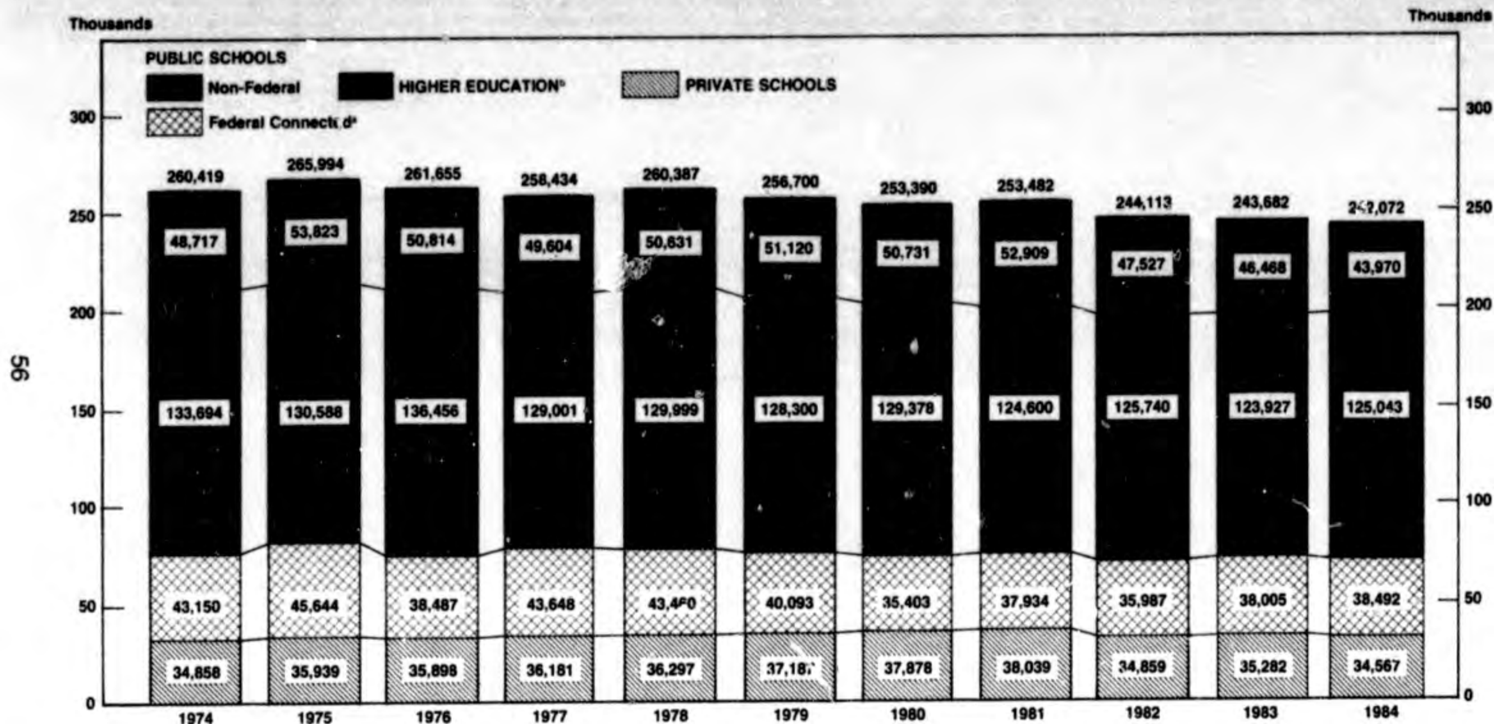
Object of Expenditure		1984	1983	1982	1979	1974
Administration		$ 30,843,588	$ 29,412,139	$ 28,131,860	$ 20,086,059	$ 11,784,366
Instruction:	Personal Services	250,174,735	249,025,383	226,836,099	180,111,478	118,710,391
	Supplies	26,298,925	24,731,865	23,346,220	19,594,150	10,116,144
Food Services:	Personal Services	15,399,843	16,326,378	13,846,412	11,208,249	6,839,796
	Supplies	17,604,476	16,644,917	16,772,944	13,093,332	10,666,468
Attendance & Health Services		16,688,129	16,636,062	14,832,100	11,112,320	6,380,852
Pupil Transportation Services		15,500,134	14,741,192	13,293,991	8,123,967	3,791,164
Operation of School Plant[b]		28,260,101	29,532,847	28,630,406	16,641,751	9,610,830
Maintenance of School Plant		11,036,857	14,209,642	13,000,623	8,963,612	5,783,982
Retire., S.S., Med. Ins. Contrib.		92,692,925	83,922,347	50,871,562	41,835,718	27,184,240
Workers' Compensation[c]		3,475,422	986,477	1,063,610	1,608,195	1,547,897
Debt Retirement:	Interest	121,874	160,812	207,876	408,459	1,004,806
	Principal	901,392	1,349,306	1,368,330	2,272,826	3,878,320
Sub-Total		$508,998,401	$497,679,367	$432,202,033	$335,060,116	$217,299,256
Capital Outlay[d]		11,941,000	23,304,890	17,237,000	21,628,000	33,618,196
Adult Education		2,858,035	2,882,074	2,920,821	2,508,417	10,057,762
Public Libraries		12,483,771	12,365,610	12,160,848	8,147,228	5,181,944
Summer School		1,012,194	849,705	848,660	549,651	474,592
Athletic Funds		723,177	744,997	753,915	839,644	617,695
Total		$538,016,578	$537,826,643	$466,123,277	$368,733,056	$267,249,445
Average Daily Enrollment		160,528	160,661	160,042	168,453	176,494
Average Daily Attendance		150,137	149,696	148,636	154,263	160,892

NOTE: Data not strictly comparable due to revised reporting method.

a. Includes expenditures from federal, state, and county funds; does not include all costs attributable to operation of the department of education.
b. Includes appropriation for safety and security systems for 1982, 1983, and 1984.
c. Includes unemployment compensation.
d. Bond fund expenditures not included.

SOURCE: Annual Financial Reports, Office of Business Services, Department of Education, State of Hawaii.

CHART 12
TRENDS IN HAWAII SCHOOL ENROLLMENT
Fall 1974-1984



[a]Includes enrollment for partial as well as full federal impact-area aid, 1984 estimated.

[b]Fall full- and part-time enrollment in day time credit courses. Includes University of Hawaii system and enrollment in technical schools.

SOURCE: Student Information Services, Department of Education, State of Hawaii; University Relations, University of Hawaii.

TABLE 47
UNIVERSITY OF HAWAII
Current Income and Expenditures — Selected Fiscal Years[a]

	1984	1983	1982	1979	1974
		REVENUES			
For Educational Purposes	$(271,113,339)	$(258,345,310)	$(239,141,018)	$(175,323,892)	$(108,501,107)
Federal Funds	54,953,017	49,416,304	52,713,057	38,597,114	35,044,413
State Appropriations	196,862,600	192,178,378	171,342,782	125,675,089	66,016,095
University Funds	(19,297,722)	(16,750,628)	(15,085,179)	(11,051,689)	(7,440,599)
Student Fees[b]	6,676,790	6,246,644	5,793,798	3,787,563	3,325,707
Departmental Earnings	4,247,977	3,405,664	3,410,900	3,003,354	1,452,899
Gifts and Grants	7,153,322	6,517,692	5,181,526	3,664,955	2,209,919
All Other	1,219,633	580,628	698,955	595,817	452,074
For Non-Educational Programs	(25,967,358)	(25,591,274)	(23,159,975)	(16,459,562)	(11,022,346)
Auxiliary Enterprises	25,967,358	25,591,274	23,159,975	16,459,562	9,461,587
Other Sources	--	--	--	--	1,560,759
TOTAL REVENUES	$ 297,080,697	$ 283,936,584	$ 262,300,993	$ 191,783,454	$ 119,523,453
		EXPENDITURES			
For Educational Purposes	$(267,960,321)	$(259,236,133)	$(234,793,488)	$(172,921,723)	$(110,027,334)
Instruction & Rel. Act	79,581,807	79,783,603	70,695,236	57,287,627	35,382,654
Community Colleges	47,830,039	47,754,297	41,323,184	30,031,451	14,064,871
Organized Research	58,328,513	52,803,868	49,978,396	35,293,343	25,422,075
Extension Services	6,164,907	5,881,688	4,605,831	3,378,897	2,186,274
Libraries	9,186,835	9,200,925	7,864,101	5,511,333	2,746,657
Plant Oper. & Maint.	17,322,175	16,642,360	15,040,034	8,638,461	3,755,864
Public Services	8,848,954	8,880,897	9,490,330	6,379,281	15,802,629
Admin. & Gen. Expenses	40,697,091	38,288,495	35,796,376	26,401,330	10,666,310
For Non-Educational Purposes	(23,803,184)	(24,209,257)	(21,992,491)	(14,444,382)	(8,930,509)
Auxiliary Enterprises	19,523,264	20,303,506	17,917,083	12,464,504	7,424,420
Other	4,279,920	3,905,751	4,075,408	1,979,878	1,506,089
TOTAL EXPENDITURES	$ 291,763,505	$ 283,445,390	$ 256,785,979	$ 187,366,105	$ 118,957,843

NOTE: After 1977, auditors have included non-imposed fringe benefit costs, attributable to University employees but actually funded through other state agencies (primarily Department of Budget and Finance), as part of the University's expenditures.

a. Encumbrances of funds not included in expenditure data; revenues may include advances by federal agencies. Detail not absolutely comparable between years because of changes in reporting.

b. Fees from special programs only; tuition and fees for regular academic semesters are state general fund realizations and are not reflected in University data.

SOURCE: Central Accounting Office, and Financial Reports, University of Hawaii.

TABLE 48

DIVISION OF AIRPORTS

Department of Transportation — State of Hawaii

Revenues and Expenditures — Selected Fiscal Years

	1984	1983	1982	1979	1974
			REVENUES[a]		
Fuel Tax[b]	$ 4,932,977	$ 4,879,845	$ 4,889,071	$ 4,861,054	$ 4,790,433
Revenue From Operations	83,268,824	80,719,376	65,013,562	53,593,388	25,551,919
Bond Funds	--	--	--	7,794,233	8,212,266
Federal Grants	6,045,928	6,016,004	12,797,184	--	--
All Other Revenues	19,232,891	17,537,035	23,555,432	17,703,770	5,074,462
TOTAL	$113,480,620	$109,152,260	$106,255,249	$83,952,445	$43,629,080
			EXPENDITURES[c]		
Personnel Services	$ 17,104,443	$ 16,215,187	$ 13,568,798	$ 9,334,791	$ 4,897,592
Other Operating Expenses	27,347,068	26,563,310	26,350,431	11,581,443	6,055,200
Capital Outlay	43,709,471	30,440,795	21,056,449	27,648,301	26,696,931
Bond Interest	26,604,588	26,298,511	24,265,613	19,487,180	14,068,051
All Other Expenditures	1,628,393	1,774,399	15,992,141	6,082,987	1,481,566
TOTAL	$116,393,963	$101,292,202	$101,233,432	$74,134,702	$53,199,340

NOTE: Detail may not add to total due to rounding.

a. Excludes advances from Treasurer and investments redeemed; includes general fund appropriations.

b. Rate at 1 cent per gallon.

c. Excludes bond principal payments since expenditures from bond funds included; also, excludes investments purchased and transfers.

SOURCE: Airports Division, Department of Transportation, and Auditor's Report for the fiscal year, and Consolidated Statement of Receipts and Expenditures, Airports Division, Department of Transportation, State of Hawaii.

TABLE 49
DIVISION OF HARBORS
Department of Transportation — State of Hawaii
Revenues and Expenditures — Selected Fiscal Years[a]

	1984	1983	1982	1979	1974
		REVENUES			
Wharfage	$ 8,965,619	$ 8,057,975	$ 7,540,070	$ 6,849,545	$ 4,705,670
Pilotage Fees	--	--	--	382,147	649,011
Docking & Mooring Fees	1,702,905	1,739,876	1,610,145	1,192,693	858,273
Rentals	9,447,769	9,303,944	9,082,608	5,485,553	3,573,523
Sales of Services & Materials	388,680	364,680	429,624	355,728	282,541
Income on Investments	3,248,655	3,833,794	3,768,105	2,498,219	460,737
Miscellaneous[b]	1,333,966	861,792	642,484	493,323	311,523
TOTAL REVENUES	$25,087,594	$24,162,061	$23,073,036	$17,257,208	$10,841,278
		EXPENDITURES			
Administration	$ 1,350,075	$ 1,267,194	$ 995,868	$ 1,060,978	$ 1,140,255
Harbor Operations	1,211,140	1,242,239	1,290,539	789,096	1,627,903
General Maintenance	2,854,827	2,216,294	1,429,012	1,297,000	1,129,090
Engineering Svcs. & Overhead[c]	--	--	--	--	117,356
Salaries & Wages[d]	4,558,591	4,429,048	3,786,739	3,213,201	(e)
5% Surcharge on Gross Receipts	660,646	595,935	655,596	527,349	339,145
Interest on Bonded Debt	6,660,609	7,103,211	6,226,386	3,766,615	2,048,618
Principal on Bonded Debt	3,446,705	3,301,705	3,162,451	2,140,421	1,882,024
City & County Fireboat	786,910	875,712	692,778	591,018	469,748
Depreciation	2,592,696	2,537,747	2,084,642	1,798,375	1,406,425
Miscellaneous	98,692	179,076	461,747	20,150	125,852
TOTAL EXPENDITURES	$24,220,891	$23,748,161	$20,785,758	$15,205,003	$10,286,416

a. Report on the "public undertaking," as defined in the resolution authorizing issuance of harbor revenue bonds as all harbors and waterfront improvements and other properties under the Harbors Division, except those principally used for recreation and landing of fish.
b. Includes permits to operate small power boats, recoveries for damage to property, sale of utilities, etc.
c. After 1977, category allocated to "Salary and Wages" and "Administration".
d. Retirement contributions were $936,000 (1984), $841,000 (1983), $417,000 (1982), and $357,000 (1979).
e. "Salaries and Wages" and retirement assigned to appropriate function before 1977; retirement contributions were $414,954 in 1974.

SOURCE: Financial Statement and Report of Certified Public Accountants, Harbors Division, Department of Transportation, State of Hawaii.

TABLE 50

DIVISION OF HIGHWAYS

Department of Transportation — State of Hawaii

Revenues and Expenditures — Selected Fiscal Years

	1984	1983	1982	1979	1974
			REVENUES		
Fuel Tax	$ 29,091,832	$ 28,432,421	$ 27,911,737	$ 30,032,484	$14,804,227
Weight Tax	8,417,107	8,096,584	7,776,343	7,431,306	--
Federal Aid	65,466,938	52,874,624	48,526,918	51,361,136	40,091,128
Land Sales	120,359	113,768	34,362	179,733	56,242
Rentals	130,292	95,716	94,371	68,550	191,675
Permit Fees	62,226	62,209	64,292	29,063	22,531
General Funds	--	--	--	--	204,915
Bond Funds	12,688,000	16,639,675	14,216,941	16,303,654	17,242,004
Vehicle Registration Fees	636,118	614,418	588,410	570,918	--
Gross Weight Fees	--	--	266	(42,138)	--
Other[a]	15,710,372	16,360,372	18,569,943	480,398	608,941
TOTAL REVENUES	$132,323,244	$123,289,787	$117,783,583	$106,415,104	$73,221,663
			EXPENDITURES		
Administration	$ 4,447,507	$ 4,264,923	$ 3,700,382	$ 2,806,984	$ 1,319,422
5% Surcharge	1,673,657	1,701,845	1,858,417	1,223,334	331,659
Maintenance	20,492,303	24,174,459	22,880,782	17,019,584	6,132,124
Planning & Research	--	--	--	285,949	1,122,050
Debt Service	20,560,263	19,652,581	16,919,634	14,197,510	8,453,915
Capital Projects	83,158,826	81,219,510	63,097,640	70,483,265	57,441,183
TOTAL EXPENDITURES	$130,332,556	$131,013,318	$108,456,855	$106,016,626	$74,800,353

NOTE: Includes expenditures from highway, general, and general obligation bond funds; interfund transfers are eliminated to avoid duplication.

a. Includes general excise tax collections of $16,511,734 in 1982, $15,538,477 in 1983, and $15,122,115 in 1984 derived from the sale of gasoline under Act 159, SLH 1981.

SOURCE: Annual Report to the Governor, and Highways Division, Department of Transportation, State of Hawaii.

THE LONG TERM PUBLIC BONDED DEBT

Debt financing provides the wherewithal to fund long-lived public facilities while providing an even repayment schedule over the economic life of the project. Governments issue long term bonds to secure the money to plan, design, and construct capital projects such as schools, parks, and roads.

Hawaii's governments issue three types of bonds: 1) nonreimbursable general obligation (G.O.) bonds; 2) reimbursable G.O. bonds; and 3) revenue bonds. Nonreimbursable G.O. bonds are used to build public facilities and projects which are not backed by user taxes or fees. Debt services costs, i.e., principal and interest payments, are paid from general fund resources, including taxes as well as departmental earnings. The full faith and credit of the state or county pledged for repayment of these obligations.

Reimbursable bonds are similar to nonreimbursable G.O.'s in that the full faith and credit of the issuer is pledged to insure repayment; however, this type of debt is issued when earmarked revenues or user charges accrue to a special fund, which reimburses the general fund for the debt repayment costs. Examples of reimbursable G.O.'s issued by the state of Hawaii and the earmarked taxes or fees include: highway reimbursable G.O.'s and gasoline and diesel fuel taxes, and airport reimbursable G.O.'s and aviation fuel taxes.

Revenue bonds are issued when fees or charges stemming from a capital project are the resources which are to support the debt repayments. Unlike G.O.'s, the full faith and credit of the issuer is not pledged to repay debt costs in case the project does not realize sufficient revenues to cover the debt costs. Revenue bonds are issued when a steady revenue inflow is assured, such as parking facilities for government employees

State government G.O. bond debt is limited by the state Constitution with a ceiling placed on debt service. Debt service in the year in which it is highest cannot exceed 18.5% of the average general fund revenues collected during the past three fiscal years. The limit includes only debt repayments which are charged directly to the general fund, thus reimbursable G.O.'s which are repaid from special fund revenues are excluded. In 1984, the debt limit was $227.7 million while debt service charged to the limit totaled $194.5 million leaving a $33.2 million debt margin.

County G.O. debt is limited to 15% of the net assessed value of real property within the county. At the end of 1984, debt charged to the limit reached $297 million, leaving a debt margin of $5.9 billion.

TABLE 51

STATE AND LOCAL LONG-TERM DEBT

Related to Population, Personal Income, and Tax Collections
Debt Outstanding at June 30, 1983

	Per Capita Debt		Per Cap. Debt as a % of Per Cap.			
			Personal Income[a]		Tax Collections[b]	
State	Amount	Rank	Percent	Rank	Percent	Rank
HAWAII	$ 2,541.17	13	20.98	17	174.41	26
U.S. Average	1,863.17	--	15.98	--	153.27	--
Alabama	1,477.01	37	15.98	28	183.16	20
Alaska	17,090.77	1	99.40	1	348.24	1
Arizona	2,489.67	15	23.36	13	233.93	10
Arkansas	1,349.50	42	15.05	33	175.11	25
California	1,329.01	43	10.02	48	99.41	49
Colorado	2,121.04	21	16.61	25	181.86	22
Connecticut	2,204.12	20	14.80	35	153.75	28
Delaware	3,695.83	4	29.18	7	290.37	4
Florida	1,371.84	41	11.83	44	141.77	36
Georgia	1,419.98	39	13.68	37	145.92	32
Idaho	924.92	50	9.68	49	105.73	47
Illinois	1,522.87	34	12.28	42	121.32	42
Indiana	912.42	51	8.71	51	100.79	48
Iowa	1,009.30	48	9.43	50	86.18	51
Kansas	2,273.11	18	18.56	20	201.38	15
Kentucky	2,520.13	14	26.82	9	283.73	6
Louisiana	2,626.58	12	25.58	11	249.97	8
Maine	1,498.68	35	15.22	30	138.51	38
Maryland	2,397.06	17	18.45	21	177.58	24
Massachusetts	2,070.53	23	15.61	29	145.35	33
Michigan	1,489.87	36	12.99	39	108.72	45
Minnesota	2,719.07	11	22.82	14	184.54	19
Mississippi	1,009.22	49	12.46	41	131.16	41
Missouri	1,120.82	47	10.22	47	120.40	43
Montana	1,794.72	29	18.04	23	152.24	29
Nebraska	3,256.70	7	29.05	8	284.08	5
Nevada	2,265.37	19	18.19	22	186.60	17
New Hampshire	1,983.21	24	16.50	26	208.64	13
New Jersey	2,113.88	22	14.97	34	145.11	34
New Mexico	2,488.55	16	25.81	10	239.05	9
New York	2,814.87	10	21.67	15	149.00	30
North Carolina	1,226.91	45	12.54	40	134.63	40
North Dakota	1,527.73	33	13.10	38	138.84	37
Ohio	1,173.98	46	10.47	46	106.72	46
Oklahoma	1,541.57	32	14.06	36	137.25	39
Oregon	3,480.80	5	32.41	3	283.33	7
Pennsylvania	1,735.04	30	15.16	31	148.40	31
Rhode Island	2,818.91	9	24.16	12	217.69	12
South Carolina	1,605.16	31	17.47	24	182.73	21
South Dakota	1,899.25	28	19.29	19	207.88	14
Tennessee	1,446.44	38	15.15	32	179.93	23
Texas	1,906.38	27	16.31	27	184.64	18
Utah	3,188.68	8	35.46	2	331.26	2
Vermont	1,944.36	26	19.48	18	170.84	27
Virginia	1,279.37	44	10.56	45	116.90	44
Washington	3,894.50	3	31.98	4	298.24	3
West Virginia	1,954.15	25	21.34	16	201.11	16
Wisconsin	1,393.19	40	12.27	43	97.80	50
Wyoming	3,477.83	6	29.20	6	142.33	35
Dist. of Columbia	4,735.49	2	30.08	5	222.07	11

a. Calendar 1983.
b. Fiscal 1983.
SOURCE: "Governmental Finances in 1982-83," GF 83, No. 5, U.S. Department of Commerce, Bureau of the Census, October 1984; "Survey of Current Business," Vol. 64, No. 8, U.S. Department of Commerce, Bureau of Economic Analysis, August 1984, Washington, D.C.

TABLE 52
PUBLIC BONDED DEBT IN HAWAII
Bonds Outstanding by Agencies and Funds At December 31, 1984 and June 30, 1985[a]

Governmental Unit and Funds Charged with Debt Service Costs:	Principal Outstanding at: Actual 12/31/84	Estimated 6/30/85
STATE: Subtotal	$(2,391,453,000)	$(2,402,788,300)
General Fund	1,363,440,431	1,381,795,175
Highway Fund	151,135,488	149,724,076
Airport Fund	42,740,056	41,530,882
Harbor Fund	24,025,666	22,732,345
Land Revolving Fund	2,121,212	1,770,285
Sand Island Receipts	50,101	22,604
Veterans' Loan Fund	16,027	--
Univ. of Hawaii Fund	28,605,000	28,430,000
Economic Development Fund	180,000	180,000
Dwelling Unit Rev. Fund	54,157,000	51,658,000
Parking Facilities	4,029,019	3,991,933
Airport Revenues[b]	336,165,000	336,165,000
Univ. of Hawaii Revenues[b]	6,543,000	6,543,000
Harbor Revenues[b]	61,305,000	61,305,000
Hawaii Housing Authority[b]	316,940,000	316,940,000
HONOLULU: Subtotal	$(221,004,000)	$(215,503,000)
General Fund	153,008,509	149,392,484
Highway Fund	22,512,030	21,761,555
Off-Street Parking Fund	2,034,717	2,034,717
Special Assessment Fund	6,417,745	6,223,245
Water Fund	30,651,000	29,791,000
Water Revenues[b]	6,380,000	6,300,000
MAUI: Subtotal	$(33,516,500)	$(31,866,500)
General Fund	25,386,500	24,356,500
Water Fund	7,810,000	7,345,000
Water Revenues[b]	320,000	165,000
HAWAII: Subtotal	$(50,887,000)	$(50,097,000)
General Fund	50,887,000	50,097,000
KAUAI: Subtotal	$(18,847,000)	$(18,020,000)
General Fund	18,323,000	17,500,000
Water Fund	524,000	520,000
TOTAL	$ 2,715,707,500	$ 2,718,274,800

NOTE: Outstanding debt based on date upon which principal payments are made to the bearers of the bonds.

a. Gross debt exclusive of cash reserves. Excludes bonds not chargeable to public funds and short-term bond anticipation notes. June 30 estimate does not include anticipated issues.

b. Revenue bonds balance as of July 1, 1984.

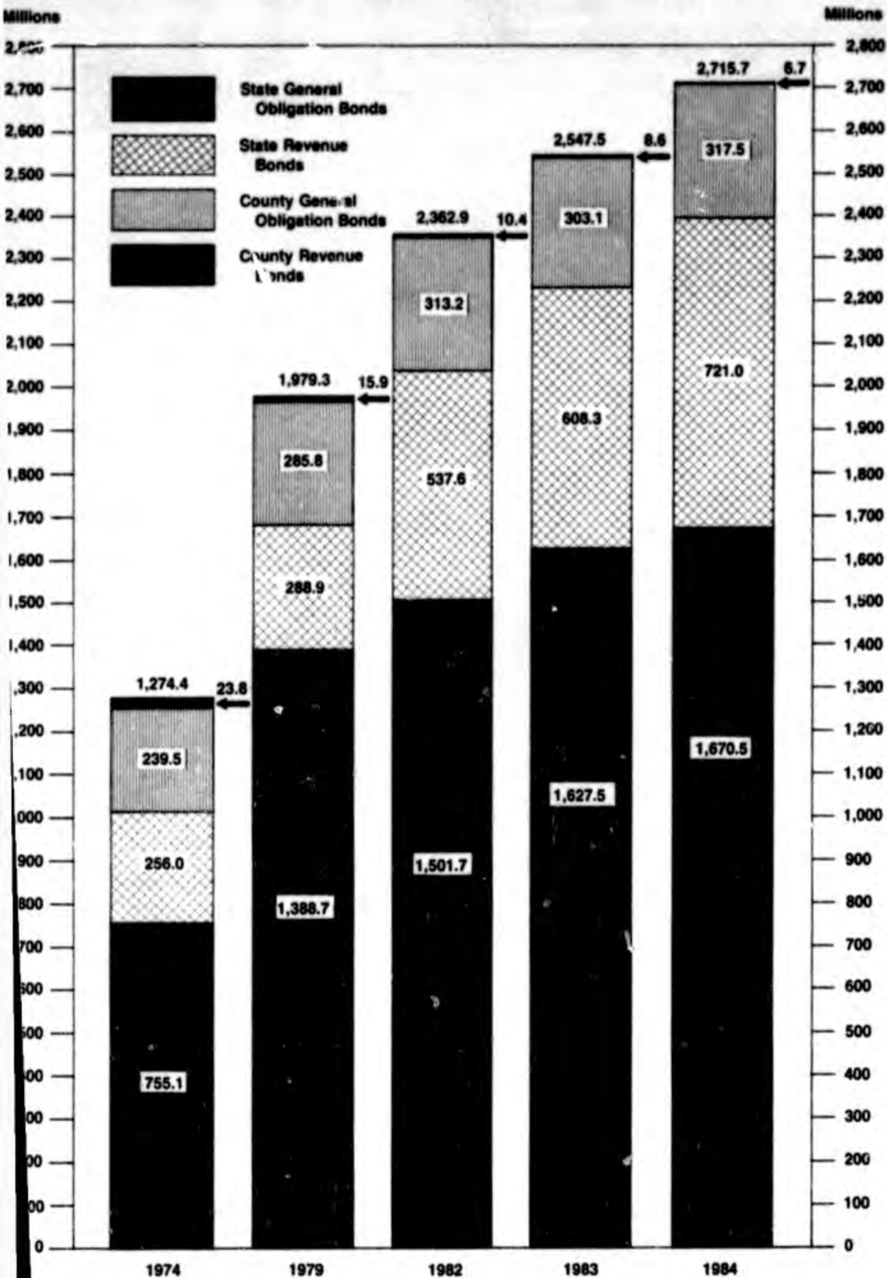
SOURCE: Prepared by the Tax Foundation of Hawaii from data received from the State Department of Budget and Finance and the County Finance Departments.

CHART 13

PUBLIC BONDED DEBT IN HAWAII

Bonds Outatanding By Agencies and Funds*

At December 31



*See Table 52 for detail.

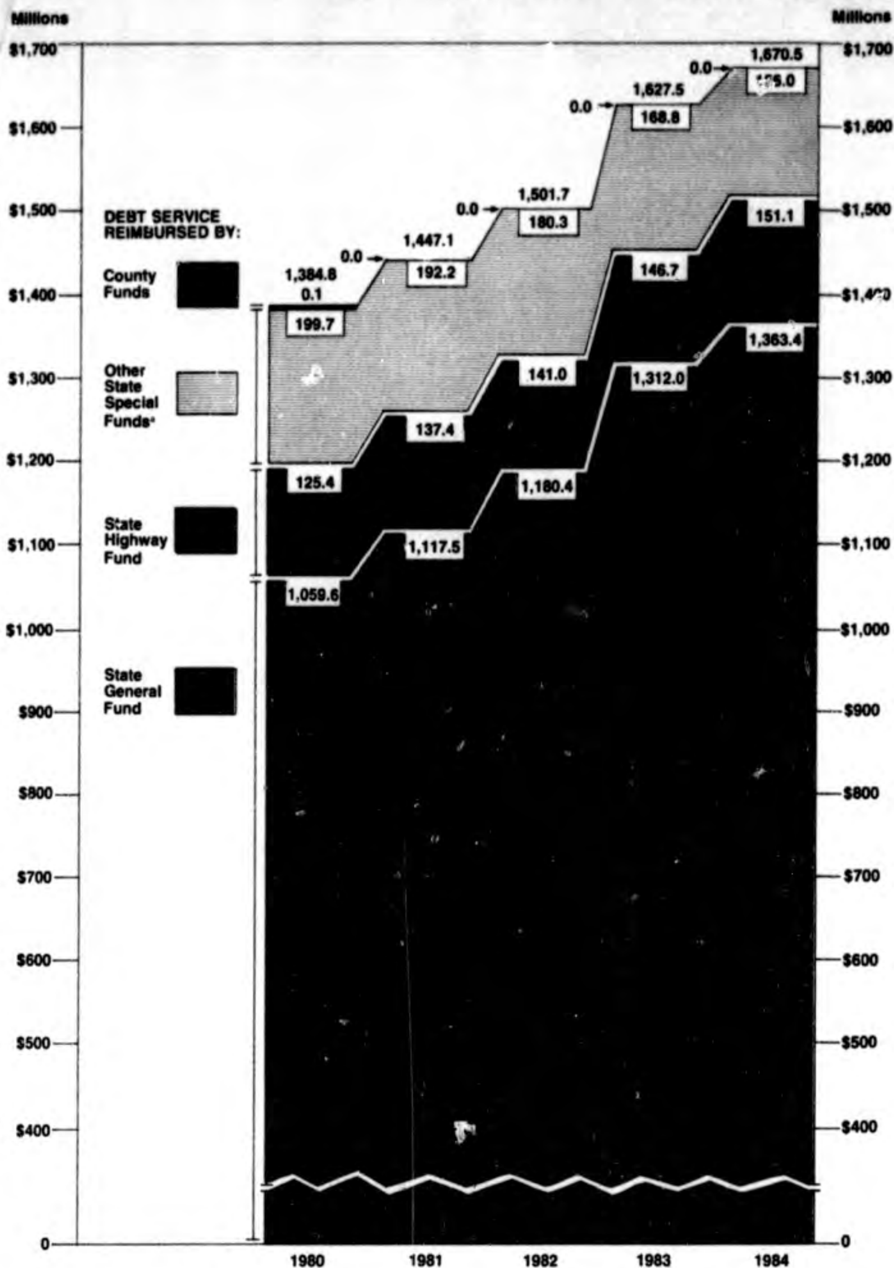
SOURCE: Prepared by the Tax Foundation of Hawaii from data provided by the Department of Budget and Finance, State of Hawaii and the County Departments of Finance.

CHART 14

OUTSTANDING GENERAL OBLIGATION BONDS

State of Hawaii — By Fund*

At December 31



*See Table 54 for detail.

SOURCE: Prepared by the Tax Foundation of Hawaii from data provided by the Department of Budget and Finance, State of Hawaii.

TABLE 53
COUNTY DEBT MARGIN
At June 30, 1984 — Dollars in Thousands

Funds Charged with Debt Service	Honolulu	Maui	Hawaii	Kauai	Total
General Obligation Bonds:					
General Fund	$ 161,639	$ 25,387	$ 74,992	$ 18,726	$ 280,744
Highway Fund	24,038	--	--	--	24,038
Water Fund	31,553	8,130	--	292	39,975
Off-Street Parking	2,369	--	--	--	2,369
Special Assessment	6,928	--	1,073	--	8,001
Other Debt[a]	11,583	10,051	1,276	4,640	27,550
Gross County Debt	$ 238,110	$ 43,567	$ 77,341	$ 23,658	$ 382,677
Less: Special Assessment	$(6,926)	$ --	$(1,073)	$ --	$(7,999)
Water G.O.	(31,553)	(8,130)	--	(292)	(39,975)
Cash Reserves	(14,075)	--	(22,685)	--	(36,760)
DEBT CHARGED TO LIMIT	$ 185,556	$ 35,437	$ 53,583	$ 23,366	$ 297,943
		DEBT LIMIT AND MARGIN			
Fiscal 1984 Property Values[b]	$28,004,555	$5,565,837	$4,020,329	$2,089,933	$39,680,655
Debt Limit[c]	4,200,683	834,876	603,049	313,490	5,952,098
Debt Charged to Limit[d]	185,556	35,437	53,583	23,366	297,943
Debt Margin	4,015,127	799,438	549,466	290,124	5,654,156
		AS A % OF NET ASSESSED VALUES			
Gross County Debt	0.85	0.78	1.92	1.13	0.96
Debt Charged to Limit	0.66	0.64	1.33	1.12	0.75
Debt Margin	14.34	14.36	13.67	13.88	14.25

a. Includes lease-purchase agreements, long-term notes payable, agreements of sale, etc.
b. Gross valuation of real property less exemptions and 50% of valuations on appeal.
c. 15% of real property net assessed values.
d. Does not include principal repayment for current fiscal year which are excludable from debt charged against the limit.

SOURCE: County Finance Directors' Annual Financial Reports.

TABLE 54

STATE GENERAL OBLIGATION BONDS

State of Hawaii — December 31, 1984

Principal and Interest Payments Chargeable to:[a]	Total
General Fund	$1,363,440,431
Highway Special Fund	151,135,488
Airport Special Fund	42,740,056
Harbor Special Fund	24,025,666
Land Revolving Fund	2,121,212
Sand Island Receipts	50,101
Veteran's Loan Fund	16,027
Dwelling Unit Revolving Fund	54,157,000
University of Hawaii	28,605,000
Parking Facilities	4,029,019
Economic Development	180,[illegible]00
TOTAL	$1,670,5[illegible]0,000

a. Debt service on State issued general obligation bonds is a charge against the State's general revenues. However, special fund agencies (by law) are required to reimburse the State general fund for debt service charges on certain bonds issued for them by the State.

SOURCE: Compiled by the Tax Foundation of Hawaii from data provided by the Department of Budget and Finance, State of Hawaii.

TABLE 55

STATE DEBT SERVICE CHARGED TO DEBT LIMIT

State of Hawaii — July 1, 1984

Type of Debt Service	Excludable Debt Service	Charged to Debt Limit
Total General Obligation Bonds		$229,121,030
Reimbursed by:		
Airports	$ 6,355,942	
Highways	22,285,627	
Harbors	3,208,745	
University of Hawaii	2,089,591	
Parking Control[a]	642,153	(34,582,058)
Total[b]	$34,582,058	$194,538,972
Debt Limit[c]		$227,779,482
Debt Margin		$ 33,240,310

a. Formerly "Multideck Parking."
b. Total net amount of principal and interest payable on outstanding general obligation bonds in highest debt service year (1986).
c. Limit is computed by multiplying the average general fund revenues for 1982, 1983, and 1984 ($1,231,240,445) by 18.5%.

SOURCE: "State of the Debt Limit of the State of Hawaii as of July 1, 1984," Department of Budget and Finance, State of Hawaii.

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The Tax Reform Act

Analysis and planning opportunities

Arthur Young

A MEMBER OF ARTHUR YOUNG INTERNATIONAL

The Tax Reform Act of 1986 contains the most sweeping changes to our nation's tax laws since the original enactment of the Internal Revenue Code in 1913.

Since the changes will have a significant impact on most taxpayers, the time to start tax planning is now. We have prepared this booklet to give you an overview of some of the major provisions affecting both individuals and business. In addition, to help you with your initial tax planning, we have included a number of planning tips for you to think about, as well as responses to some of the typical questions our clients have been asking us.

Of course, each taxpayer's situation is different, and no booklet can answer all of the questions you may have about such a massive legislative effort. Our tax professionals have therefore developed the Arthur Young Tax Reform Analyzer[SM]—a comprehensive service designed to help you determine how you or your business will be affected by the new law, and to provide you with a valuable "action plan" to help you implement tax planning ideas appropriate to your special circumstances.

For more information about the Tax Reform Analyzer, or about the material in this booklet, please contact your local Arthur Young office (a list is provided on the inside back cover). We will also be conducting seminars on the new bill, and will have available publications on how the new law will affect a number of industries, including banking, thrift, construction, oil and gas, health care, aerospace and defense, high technology, insurance, law firms, real estate, retail, entertainment, and securities.

Arthur Young
August 1986

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Overview of the Provisions Affecting Individuals

Provision	New Bill	Planning Opportunities
Individual tax rates	In 1987, five rates ranging from 11% to 38½% apply. In 1988, there will be three rates, 15%, 28%, and 33%.	For 1986 and 1987, consider deferring income and accelerating deductions. (This strategy may not be appropriate for those subject to the alternative minimum tax.)
Deduction for taxes	Sales taxes will no longer be deductible.	If contemplating the purchase of a major item, such as a car or boat, consider buying it in 1986.
Consumer interest deductions	No longer deductible after phase-in period.	Consider financing college, medical, or other major expenditures by taking out a mortgage on your residence.
Miscellaneous itemized deductions	Most may be claimed only to the extent they exceed 2% of adjusted gross income.	Consider paying for as many of these expenses as possible during 1986. In future years, consider "bunching" deductions.
Individual capital gains	Taxed at same rate as ordinary income.	To the extent advisable, long-term gains should be realized in 1986; short-term gains should be deferred. Long-term losses should be deferred, unless they will be offset in 1986 by short-term gains.
Losses from passive investments	Losses and credits from passive investments may not offset other income, such as salary, interest, dividends, and active business income.	Consider ways of generating additional passive income. Alternatively, consider becoming a material participant in a passive activity.

Provision	New Bill	Planning Opportunities
Individual alternative minimum tax	Existing alternative minimum tax expanded.	Consider deferring expenses to a year when you will be subject to the regular tax.
IRAs	Deduction will only be available to those not covered by qualified plans or with income below certain levels.	Employees covered by a qualified plan should consider making deferrals under a 401(k) plan when available.
401(k) plans	Contributions to these plans now limited to $7,000 annually.	Consider using nonqualified deferred compensation plans to defer more than $7,000.
Distributions	Imposes excise taxes and reduces ten-year averaging to five-year averaging.	Individuals should reexamine their retirement, investment, and savings strategies.
Income shifting	Certain investment income from property owned by a child under age 14 will be taxed at the parents' marginal rate. Income from Clifford and spousal remainder trusts will be taxed to the grantor.	Consider making annual gifts to your children—you will be no worse off paying tax on money in a child's possession than if you had never given it. When the child reaches age 14, there will be a substantial amount invested, and the income will be taxed at lower rates. Also consider paying your children for any services rendered to the family business. Earned income can still be offset by the standard deduction.

Individual Tax Rates

Beginning in 1988, the taxation of individuals will be reduced to a three-step process. Depending on your filing status (see the table below; note, we have not included the rate tables for head of household and married filing separately), a certain portion of your taxable income will be subject to a 15 percent rate, and any amount over that will be taxed at 28 percent. There will also be a 5 percent surcharge on higher levels of taxable income (in effect, imposing a third marginal rate of 33 percent). This will result in a phasing out of the benefit of the 15 percent rate and the personal exemption.

In addition, both the standard deduction (see table) and the personal exemption ($1,900 in 1987; $1,950 in 1988; $2,000 in 1989) have been increased. The personal exemption may no longer be taken by anyone who is eligible to be claimed as a dependent by another taxpayer, such as a dependent child.

In 1987, there will be five rates, but no phase-out of the benefit of the lower rates or the personal exemption.

1987

	Taxable Income	*Rate*	*Standard Deduction**
Married filing jointly	$0–$3,000	11%	$3,800
	$3,000–$28,000	15%	
	$28,000–$45,000	28%	
	$45,000–$90,000	35%	
	Over $90,000	38.5%	
Single	$0–$1,800	11%	$2,570
	$1,800–$16,800	15%	
	$16,800–$27,000	28%	
	$27,000–$54,000	35%	
	Over $54,000	38.5%	

1988

	Taxable Income	*Rate*	*Standard Deduction**
Married filing jointly	$0–$29,750	15%	$5,000
	$29,750–$71,900	28%	
	$71,900–$149,250	33%**	
	Over $149,250	28%	
Single	$0–$17,850	15%	$3,000
	$17,850–$43,150	28%	
	$43,150–$89,560	33%**	
	Over $89,560	28%	

*Taxpayers over 65 or blind will be able to claim an additional standard deduction of $600 if married ($750 for single individuals). This replaces the additional personal exemptions previously allowed. Taxpayers who may be claimed on another's return may use only $500 of the standard deduction against investment income.

**The 33 percent bracket will be broader than indicated depending on the number of exemptions claimed. For each exemption claimed, the 33 percent bracket will be increased by $10,920 in 1988 and $11,200 in 1989. Thus, for example, for a married couple with no children, the 33 percent bracket will end at $171,090 of taxable income in 1988.

Individual Deductions, Credits, and Exclusions

Certain deductions, credits, and exclusions that were available to individual taxpayers in the past have been modified as follows:

State and local taxes Sales taxes will no longer be deductible beginning January 1, 1987. Income and property taxes remain fully deductible.

Interest Mortgage interest on up to two homes will be deductible to the extent loans do not exceed the purchase price plus the cost of any improvements. Interest on loans in excess of this amount will be deductible only if incurred for educational or medical purposes. Investment interest will now be deductible only to the extent of investment income. (However, the definitions of both of these terms have been broadened.) Consumer and other nonbusiness interest will not be deductible. These limitations will be phased in over four years, with 65 percent still allowed in 1987, 40 percent in 1988, 20 percent in 1989, 10 percent in 1990, and none thereafter.

Example:

Assume a taxpayer filing a joint return has $3,000 of investment income and $26,000 of interest expense:

Medical expenses Medical expenses will be deductible only to the extent they exceed 7.5 percent of adjusted gross income.

Employee business and other miscellaneous itemized deductions These expenses—such as travel and transportation, tax return preparation, and investment expenses—will generally be deductible only to the extent they exceed 2 percent of adjusted gross income.

Hobby losses An activity will be presumed *not* to be a hobby (and therefore not subject to limitation) if it is profitable in three out of five consecutive years (two out of seven for horse breeding or horse racing).

Two-earner deduction This deduction will be repealed.

Political contributions credit This credit will be repealed.

Foreign earned income exclusion The amount of income earned abroad that may be excluded by American citizens from their U.S. taxable income will be decreased from $80,000 to $70,000 a year.

These changes will generally be effective for taxable years beginning after 1986.

	Current Law	*New Law*	
Interest incurred on:		1987	1991
Mortgage on purchase of home	$15,000	$15,000	$15,000
Consumer purchases	4,000	2,600	0
Margin account used to acquire stock	7,000	5,600	3,000
	$26,000	$23,200	$18,000

Question:

Should I accelerate my charitable contributions into 1986?

Answer:

To the extent feasible, taxpayers should consider making charitable contributions in 1986 that they would otherwise make in 1987. For itemizers, the higher marginal rates of current law generally yield a greater tax benefit for contributions than will the new rates. Also, although contributions of appreciated property will continue to be fully deductible next year, the untaxed appreciation will be subject to the alternative minimum tax. For nonitemizers, such contributions are fully deductible in 1986, but no deduction will be allowed in 1987.

Income Averaging

Income averaging has been repealed for taxable years beginning after 1986.

Individual Capital Gains

Beginning January 1, 1987, net capital gains for individuals will be taxed as ordinary income subject to a taxpayer's top marginal rate (33 percent in the phase-out range after 1987). For 1987, however, the top rate for capital gains cannot exceed 28 percent. Net capital losses will continue to be deductible up to a maximum of $3,000 per year. No distinction will be made between short- and long-term gains or losses.

Question:

In light of the changes made by the new law, what should I consider in reexamining my investment strategy?

Answer:

Everyone's situation must be considered separately. However, there are some general ideas to keep in mind.

To the extent advisable, long-term capital gains which you plan to recognize in the near future should be realized in 1986. For 1987 and beyond, you should consider timing your capital gains to offset capital losses to the greatest extent possible. This strategy maximizes the amount of deductible capital losses.

Tax Shelters

Losses from Passive Investments

Taxpayers may no longer use losses (or credits) from passive investments to offset income from salaries, active business income, or portfolio income (interest, dividends, and royalties). Instead, losses from passive investments may only be deducted against income from such investments (with a limited exception for certain active rental real estate activities, described below). Passive investments will include all rental activities, all limited partnership interests, and those other businesses in which the taxpayer is not involved in the operations on a regular, continuous, and substantial basis. Working interests in oil and gas properties will not, however, be considered passive investments.

Losses up to $25,000 (or equivalent credits) from real estate rental activities in which the taxpayer actively participates may be used to

offset other types of income. This $25,000 amount, however, is phased down to zero for those taxpayers with incomes of between $100,000 and $150,000. (A higher phase-out level is provided for rehabilitation and low-income housing credits.) Real estate losses in excess of these amounts will be treated as passive investment losses.

Losses disallowed under these rules will be deferred until there is income from passive investments to offset them, or until the investment generating the losses has been disposed of.

These limitations apply to passive investment losses incurred in taxable years beginning after December 31, 1986. However, losses attributable to investments made prior to the date the bill is signed by the President are deductible to the extent of: 65 percent in 1987, 40 percent in 1988, 20 percent in 1989, 10 percent in 1990, and none thereafter.

At-Risk Rules

The at-risk rules of prior law will now apply to real estate activities with an exception for third-party loans from commercial lenders.

Example:

Assume the following income (loss) from a taxpayer's investments (purchased prior to date of enactment):

Limited real estate partnerships	$(20,000)
Limited cattle feeding partnerships	12,000
Actively managed real estate	(30,000)
	$(38,000)

In addition, the taxpayer has $100,000 in income ($97,000 in salary income; $3,000 in dividend income).

	Current Law	*New Law*	
		1987	*1991*
Losses from "passive" activities subject to disallowance:			
Limited real estate partnership	$ (20,000)	$ (20,000)	$ (20,000)
Actively managed real estate	(30,000)	(5,000)*	(5,000)*
Income from passive activities:			
Limited cattle feeding partnership	12,000	12,000	12,000
Net loss subject to limitation	(38,000)	(13,000)	(13,000)
Percentage of loss allowed	100%	65%	0%
Allowable loss	$ (38,000)	$ (8,450)	0
Disallowed loss carried forward	$ 0	$ (4,550)	$ (13,000)
Adjusted gross income:			
Salary and dividends	$ 100,000	$ 100,000	$ 100,000
Allowable loss	(38,000)	(33,450)*	(25,000)*
AGI	$ 62,000	$ 66,550	$ 75,000

*$25,000 of the $30,000 loss from actively managed real estate is not subject to disallowance.

Retirement Savings

Individual Retirement Accounts (IRAs)

One of the most significant and debated changes of the new bill results in many individuals being no longer able to fund and deduct a contribution to an IRA. These plans will only be available to the extent of earned income (see the table below).

Individuals not eligible to make deductible contributions may now make nondeductible contributions of up to $2,000, the earnings on which would be tax-deferred. Spousal IRAs will continue to be available.

401(k) Plans

Voluntary salary deferrals will now be limited to $7,000 a year. Highly compensated employees are further limited by reducing the multiple by which their deferrals may exceed those of lower-paid employees.

Contribution Limits

While the limit for contributions to a defined contribution plan remains substantially intact at $30,000, the benefit that may be provided by a defined benefit pension plan has been sharply reduced in certain situations. For example, defined benefit plans may continue to provide a $90,000 benefit at retirement, but retirement age has been redefined as age 65. For anyone retiring before this age, the $90,000 benefit must be actuarially reduced.

Distributions

For lump-sum distributions, ten-year averaging is replaced with five-year averaging. In addition, the bill encourages employees to take distributions as annuities at retirement, and imposes excise taxes in many cases where the distribution departs from the annuity form or begins prior to retirement or age 59½.

IRA Limitation

Adjusted Gross Income		*Allowable Deduction*	
Married Filing Jointly	*Single*	*Not an Active Participant in a Qualified Plan*	*Active Participant in a Qualified Plan*
$0-$40,000	$0-$25,000	$2,000	$2,000
$40,000-$50,000	$25,000-$35,000	$2,000	$0-$2,000*
Over $50,000	Over $35,000	$2,000	$0

*The $2,000 amount is reduced by 20 percent of the income in the indicated range, e.g., if the adjusted gross income of a single individual were $30,000, the allowable deduction would be $1,000.

Individual Alternative Minimum Tax (AMT)

The alternative minimum tax will be modified and expanded. Its structure will be the same as in the past, but the rate will be raised to 21 percent. In addition, the $40,000 exemption will be reduced by 25 cents for each dollar that minimum taxable income exceeds $150,000 (for married couples) or $112,500 (for single individuals).

The new tax preferences will include tax-exempt interest on certain "nongovernmental bonds" issued after August 7, 1986; untaxed appreciation of charitable contributions of property; excess depreciation on both real and personal property placed in service after 1986; and net losses from passive investment activities that have not been disallowed under the passive loss provision described earlier.

Minimum tax liability relating to certain preferences may be used to offset future years' regular tax liability.

Income Shifting

For children under age 14, the first $500 of investment income may be offset by the child's standard deduction. The next $500 is taxed at the child's tax rate, and any investment income over $1,000 is taxed at the parents' marginal rate.

In addition, the income-shifting techniques of Clifford and spousal remainder trusts have been eliminated for trusts created, or additions to corpus made, after March 1, 1986 by taxing the income of such a trust to the person creating it. Such trusts created before March 1 may be subject to the rules described in the preceding paragraph if the beneficiary is a child under age 14.

Overview of the Provisions Affecting Business

Provision	New Bill	Planning Opportunities
ACRS depreciation	Additional class lives added. In some cases, provides for more rapid depreciation than in the past; in other cases, slower.	Consider revising the timing of capital investments to gain maximum tax advantages, e.g., placing real property in service in 1986 rather than 1987.
Expensing business property	Maximum limit raised to $10,000, subject to a phase-out at $200,000.	Taxpayers nearing $200,000 in capital investments in any year after 1986 should consider delaying additional investments.
Cash method of accounting	Denied to most corporations.	Consider changing year-end to defer applicability of the change.
Taxable year-end	Certain entities required to adopt a calendar year-end.	Consider timing of income and deductions for the year of change (i.e., the short period).
Installment sales	Use limited for business taxpayers, based on the ratio of debt to total assets.	Consider minimizing the level of debt outstanding on measurement dates.
Capitalization of costs	Certain production, acquisition, inventory, and interest costs will be required to be capitalized.	Consider changing year-end to defer applicability of the change.
Reserve for bad debts	Eliminated except for certain financial institutions.	Consider maximizing reserves for 1986.
Employee Stock Ownership Plans	Current rules for ESOPs expanded and made more liberal.	Consider establishing an ESOP to take advantage of numerous new incentives.
Deferred annuity contracts	Nonindividual owners—e.g., corporations, partnerships, trusts, etc.—of annuity contracts to be taxed currently on inside build-up.	Corporations should explore alternative tax-exempt investments to fund executives' nonqualified compensation.
Fringe benefits	All fringe benefit plans subject to new, complex nondiscriminatory tests.	Perform a comprehensive review of all fringe benefit plans to determine compliance with the new bill.

Provision	New Bill	Planning Opportunities
Corporate rates	Top rate reduced from 46% to 34%.	Consider deferring income and accelerating deductions whenever possible.
Dividends received deduction	Reduced from 85% to 80%.	Despite the reduction, consider deferring the payment of dividends to 1987 to take advantage of the lower tax rate.
Corporate capital gains	28% rate repealed.	To the extent advisable, consider recognizing gains in 1986.
Gain or loss recognition upon liquidation	Corporations must recognize gain or loss on distributions of property in complete liquidation as if they had sold the property at fair market value.	Carefully examine numerous transition rules.
Corporate alternative minimum tax	20% rate will be applied to a base of regular taxable income plus preferences.	Planning strategies will vary, depending on the particular situation, e.g., it may be advantageous to accelerate income and defer expenses. S corporations and partnerships should be considered as alternative forms of doing business.
Foreign tax credit limitation	Separate limitations for different types of income.	Try to minimize actual foreign taxes paid through local country tax planning. Also consider intercompany debt, royalties, and special-purpose corporations planning.
Tax haven income—Subpart F rules	Subpart F income expanded to include commodity transactions, foreign currency gains, certain related party payments, and gains from property which do not produce active income. The exception for banking and shipping income will be repealed.	Review foreign subsidiaries and consider restructuring operations.
Foreign currency exchange gain or loss	Now determined by the currency utilized in the country of residence of the corporation.	Consider recognizing unrealized capital gain from foreign currency in 1986 and defer recognition of capital losses until 1987 (when they will be treated as ordinary).

Depreciation

The law governing depreciation of business property will be substantially revised by the new bill. The rules are summarized in the following table:

Class Life	*Depreciation Rate**	*Examples of Property*
3 year	200% declining balance, switching to straight line	Same as present law, but excluding cars and light trucks, which now have a five-year class life
5 year	200% declining balance, switching to straight line	Generally, property with asset depreciation range (ADR) midpoints between four and ten years
7 year	200% declining balance, switching to straight line	Generally, property with ADR midpoints of 10 to 16 years
10 year	200% declining balance, switching to straight line	Generally, property with ADR midpoints of 16 to 20 years
15 year	150% declining balance, switching to straight line	Generally, property with ADR midpoints of 20 to 25 years
20 year	150% declining balance, switching to straight line	Generally, property with ADR midpoints of 25 years or more, except real property with an ADR of 27.5 years or more
27½ year	Straight line	Residential rental property
31½ year	Straight line	All real estate other than residential

*Taxpayers may elect straight line depreciation, using specified depreciation lives.

Question:

Would it be advisable to place depreciable property in service this year rather than next year?

Answer:

Generally, it is more advantageous from a tax viewpoint to place depreciable property in service in 1986 versus 1987 even though the bill provides a more accelerated method of depreciation. This is due to the higher 1986 tax rates and the present value of the tax benefits of future depreciation deductions. For example, five-year property with a cost of $100,000, placed in service in October 1986, will yield tax benefits (after financing costs) with a present value approximately $3,000 greater than if placed in service in January 1987. This benefit will be even greater if the asset's class life has lengthened under the new law. Taxpayers subject to the alternative minimum tax in 1986 may be better off placing the property in service in 1987.

Expensing in Lieu of Depreciation ("Bonus" Depreciation)

Small businesses will be able to expense annually up to $10,000 of the cost of business property. The $10,000 deduction will be reduced dollar-for-dollar for amounts invested in business property in excess of $200,000 during the year.

Investment Tax Credit (ITC)

The investment tax credit will be repealed retroactively for property placed in service after December 31, 1985. Transitional rules have been provided to protect taxpayers who made certain investment commitments before this date. ITC carried forward into 1987 and beyond will be reduced by as much as 35 percent of the amounts carried forward.

Accounting Provisions

Cash Method of Accounting

Except in the case of certain personal service corporations, corporations with average annual gross receipts of $5 million or less, and S corporations, all corporate taxpayers will now be required to use the accrual, rather than the cash, method of accounting. In addition, tax shelters may not use the cash method.

Installment Sales

In general, business taxpayers will not be able to use the installment method of reporting for a portion of their sales based on the ratio of their total debt to total assets. The method is also not permitted for sales under a revolving credit plan and for sales of publicly traded property. Several exceptions are provided.

Capitalization of Interest, Inventory, and Production Costs

New, more comprehensive cost capitalization rules provide that interest and certain costs of production—which in the past were deductible as incurred— must now be capitalized as part of the cost of the property produced. Similar rules apply to most wholesalers and retailers with average annual gross receipts of more than $10 million, with respect to the acquisition and carrying of inventory.

Long-Term Contracts

Taxpayers using the completed contract method of accounting will be required to capitalize additional costs. The method will be adjusted so that the benefits of using it will be substantially curtailed.

Bad Debt Reserves

The reserve method of calculating the deduction for bad debts will no longer be allowed, except in the case of certain financial institutions.

Taxable Years

In general, partnerships, personal service firms, and S corporations will be required to use the calendar year as their taxable year, unless they can demonstrate to the IRS an adequate business purpose for doing otherwise.

Question:

How will the bill affect business recordkeeping requirements?

Answer:

Taxpayers will need to adopt new accounting procedures to gather additional information needed for tax purposes, e.g., many will be required to adopt a new method of accounting altogether; certain wholesalers and retailers will have to allocate a certain portion of their interest expense to inventory; manufacturers will have to allocate certain general, administrative, and other indirect costs to inventory; additional records will be required to substantiate business meals and entertainment; and the new corporate alternative minimum tax will virtually require a separate set of accounting records.

Entertainment and Business Meals

The new bill mandates that, in general, only 80 percent of the amount spent for business meals (including meals away from home on overnight business) and entertainment will be deductible. Substantiation requirements will also be tightened.

Corporate Provisions

Rates

The new corporate tax rate schedule will be as follows:

Taxable Income	*Rate*
$0-$50,000	15%
$50,000-$75,000	25%
$75,000-$100,000	34%
$100,000-$335,000	39%
Over $335,000	34%

These rates will be effective July 1, 1987. Companies with a taxable year that includes this date will be subject to a blended rate.

Question:

Will one form of conducting business be more advantageous than others from a tax point of view?

Answer:

Regular corporations will pay a higher maximum rate than individuals. In addition, corporations will be subject to the corporate alternative minimum tax. Income earned by a regular corporation is also taxed twice, once when earned by the corporation and again when distributed to the shareholder. Taxpayers should consider whether to conduct business in regular corporate form or in a form that taxes business earnings directly to the owner of the business, e.g., partnerships or S corporations.

Dividends-Received Deduction

The corporate dividends-received deduction will be reduced from 85 percent to 80 percent for dividends received or accrued after December 31, 1986.

Capital Gains

The preferential corporate capital gains rate of 28 percent will be repealed. Capital gains will now be taxed at the same rate as ordinary income.

Net Operating Loss (NOL) Limitations

The bill limits the rate at which new owners of a loss corporation may use its net operating loss. In general, the amount allowed each year will be calculated by multiplying the value of the loss corporation by a specified tax-exempt rate. These limitations will apply generally to changes in ownership and reorganizations occurring after December 31, 1986.

Recognition of Gain or Loss in Liquidations (Repeal of *General Utilities*)

The bill will require gain or loss to be recognized by a corporation on a distribution or deemed distribution of its property in complete liquidation as if it had sold the property at fair market value. An exception will be provided for small closely held companies. This new rule generally applies to liquidations completed after 1986, with numerous transition rules.

Corporate Alternative Minimum Tax (AMT)

The add-on minimum tax will be replaced by a corporate alternative minimum tax that is calculated on a basis similar to the individual AMT. The rate is 20 percent. The exemption amount of $40,000 is reduced by 25 cents for each dollar that minimum taxable income exceeds $150,000.

Among the most important tax preferences are the following:

- One-half of the amount by which the company's financial statement income (with certain adjustments) exceeds its regular taxable income increased by all other preferences;
- Untaxed appreciation of charitable contributions of property;

- Certain "excess" accelerated depreciation on both real and personal property placed in service after 1986;
- Tax-exempt interest on certain "nongovernmental-purpose" bonds; and
- Completed contract method of accounting (the percentage-of-completion method must be used for minimum tax purposes).

Up to 25 percent of a company's minimum tax liability may be offset by available investment tax credits. Minimum tax liability relating to deferral preferences may be used to offset future years' regular tax liability.

Personal Holding Companies

Corporations actively engaged in the development of computer software may generally exclude royalties from such software from the computation of their personal holding company income. This provision will apply retroactively to any open tax years.

Compensation

Qualified Deferred Compensation Plans

The group in whose favor qualified deferred compensation plans (including 401(k) plans) and fringe benefit programs may not discriminate is now specifically set forth in statutory language.

Employer-matching and nondeductible employee contributions are now subject to new nondiscrimination tests similar to those for 401(k) plans. This will affect qualified thrift or savings plans.

Under the bill, a plan must satisfy three alternative coverage tests. Each plan must also cover a minimum of 40 percent of a business' employees. Stricter vesting rules will also apply.

An annual limit of $7,000 has been imposed on each employee's elective 401(k) deferrals. Section 401(k) plans may not have an eligibility requirement of more than one year.

A nondeductible 10 percent excise tax has been imposed on most reversions received by an employer from a defined benefit plan.

The rules governing the integration of a qualified plan with the social security system have also been substantially modified.

Employee Stock Ownership Plans

The payroll-based ESOP tax credit will be repealed for compensation paid or accrued after December 31, 1986. The bill also makes a number of changes to the ESOP rules, expanding the class of loans eligible for the 50 percent interest exclusion and allowing distributions upon termination of an ESOP.

Deferred Annuity and Insurance Contracts

A nonindividual owner—e.g., corporation, partnership, trust, etc.—of a deferred annuity contract must include in income any increase in the cash surrender value of the deferred annuity contract over its basis during the taxable year.

An employer may not deduct interest paid on loans from insurance contracts in excess of $50,000 per officer, employee, or certain owners of the company.

Fringe Benefits

The new bill provides that, if any fringe benefit plan discriminates in favor of highly compensated employees in either eligibility or benefits, it will result in income for these employees.

Question:

What needs to be done with existing qualified plans and fringe benefit packages?

Answer:

Most employers will need to reexamine their qualified plans and fringe benefit packages in light of the new coverage and nondiscrimination tests and make necessary amendments. Employers who will be hardest hit by these provisions are those whose plans cover only certain groups of employees.

Research and Development

The R&D credit has been extended for three years, to the end of 1988 The rate has been reduced to 20 percent, and the definition of qualifying expenditures has been narrowed considerably. In addition, in allocating expenses between U.S. and foreign income, 50 percent of domestic R&D may be allocated against U.S. income and the remainder apportioned in accordance with gross sales.

Provisions Affecting U.S. Multinational Companies

Foreign Tax Credit Limitation

The bill significantly changes the foreign tax credit limitation by establishing a new, separate limitation for passive income, as well as for banking and shipping income. As a result, income in a certain limitation will not be available to absorb excess foreign tax credits relating to other foreign source business income.

Foreign Source Income

The bill makes broad modifications to the rules for determining the source (foreign or domestic) of income earned by a U.S. taxpayer. Generally, for inventory sales of a foreign person, the source will now be determined by the "residence" of the taxpayer that earned it. However, U.S. exporters will retain their ability to treat a portion of export sales as foreign source income.

Expenses, principally interest, must now be allocated between foreign and domestic sources on a consolidated group basis, as if the affiliated members were a single corporation. In most cases, this change will result in more expenses being allocated against foreign source income than was done in the past.

Foreign Currency Exchange Gain or Loss

The bill clarifies prior law by mandating that generally (1) foreign currency gains and losses will be recognized when the transaction is completed, (2) their character will be ordinary income, and (3) their source will be deter-

mined by the residence of the corporate taxpayer or branch. The bill also requires that a foreign branch or subsidiary use the profit and loss method whenever translating foreign earnings into U.S. dollars.

Tax Haven Income: Subpart F Rules

The definition of Subpart F income has been expanded to include income from commodity transactions, foreign currency gains, certain related-party payments that reduce the Subpart F income of the payor, and gains from any asset that does not produce active income. In addition, the Subpart F income exceptions for banking and the reinvestment for shipping income will be repealed. Finally, the Subpart F de minimis test will now apply only if gross foreign base company income is lower than 5 percent of gross income or $1 million, whichever is less.

Provisions Affecting Foreign Multinational Companies

Branch Level Tax

A new tax will be imposed on the earnings of a U.S. branch to the extent those earnings are remitted to the foreign head office. To the extent that the branch profits are reinvested in additional U.S. branch property, the imposition of the branch level tax will be deferred. The rules for applying the second-level withholding tax have also been modified.

Transfer Prices for Imports

A new rule requires that the transfer price between related parties may be no higher than the value used for customs purposes.

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