Allocating State and Local Taxes to U.S. Households

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As developmental work for analysis for the Congress, the information in this presentation is preliminary and is being circulated to stimulate discussion and critical comment.
Why is CBO interested in allocating state and local taxes to U.S. households?
Two Reasons

First, CBO seeks to allocate state and local taxes to households for the sake of balance and completeness, because the agency already allocates spending for some jointly administered state and federal programs to households, namely:

- Medicaid
- Unemployment insurance

Second, CBO seeks to allocate state and local taxes because they are sizable and can significantly affect the distribution of income after transfers and taxes.

Source: Bureau of Economic Analysis, National Income and Product Accounts, Tables 3.2 and 3.3.
What components of state and local taxes does CBO intend to allocate to U.S. households?
CBO’s Goal Is Not to Do State-Level Tax Analyses
CBO Currently Presents National Distributions . . .

Income After Means-Tested Transfers and Federal Taxes
... and Plans to Continue

Income After Means-Tested Transfers and Taxes
State and Local Revenues, by Source, 2014

Source: U.S. Census Bureau, Annual Survey of State and Local Government Finances.
How will CBO allocate those components of state and local taxes to U.S. households?
## 1. Property Taxes: Three Competing Theories

### Traditional View

<table>
<thead>
<tr>
<th>Component</th>
<th>Incidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>Landowners</td>
</tr>
<tr>
<td>Improvements</td>
<td>Uncertain</td>
</tr>
</tbody>
</table>

### Capital View

<table>
<thead>
<tr>
<th>Component</th>
<th>Incidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>National average</td>
<td>Capital owners</td>
</tr>
<tr>
<td>Local variations</td>
<td>Excise tax effects</td>
</tr>
</tbody>
</table>

### Benefit View

<table>
<thead>
<tr>
<th>Component</th>
<th>Incidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>User fee for local government services</td>
<td>None</td>
</tr>
</tbody>
</table>
## 1. Property Taxes: CBO’s Approach

### Capital View Variant

Divide property into three components:

<table>
<thead>
<tr>
<th>Component</th>
<th>Incidence</th>
<th>Allocator</th>
</tr>
</thead>
</table>
| Owner-occupied residential property | Taxpayer   | **Itemizers**: SOI  
**Nonitemizers, nonfilers**: CPS |
| Personal property    | Taxpayer   | Household share of income      |
| Business property    | Capital owners | Household share of capital income |

Assume local variations cancel out at the national level.
2. Individual Income Tax

**Fairly Straightforward**

**Itemizers:** Use reported state and local income tax deduction from SOI.

**Nonitemizers:** Use estimated state income tax based on Bakija state income tax calculator.
3. Consumption Taxes (General and Selective Sales Taxes): Two Competing Methodologies

Sources Method
\[
\text{Income} + \text{Transfers} - \text{Taxes} - \text{Savings} = \text{Consumption}
\]
Allocate tax on the basis of this measure.

Uses Method
\[
\text{Income} + \text{Transfers} - \text{Taxes} - \text{Savings} = \text{Consumption}
\]
Allocate tax on the basis of this measure.
What are some (very) preliminary results?
Average State and Local Property Tax Rates, by Income Group and Research Organization

CBO, Tax Foundation, ITEP data shown for various income quintiles and percentiles.
Average State and Local Individual Income Tax Rates, by Income Group and Research Organization

ITEP = Institute on Taxation and Economic Policy; TPC = Tax Policy Center.
Average State and Local Consumption Tax Rates, by Income Group and Research Organization

CBO’s current state and local consumption tax methodology produces unrealistic results.