

Not All Income Tax-Free States Are Alike

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All but nine states have no general state income tax: Alaska, Florida, Nevada, Washington, South Dakota, Texas and Wyoming, Tennessee and New Hampshire. (Tennessee and New Hampshire have no general state income tax but do tax dividends and interest income.) These states are typically thought of as having a tax advantage over states with an income tax.



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But how do they fare in relation to each other? The NCPA's State Tax Calculator shows there are some significant differences in tax burdens among income tax-free states.

Sales Taxes. When states do not have a state income tax, they may compensate by having higher sales taxes. But rates vary. For instance [see Figure I]:

- Alaska and New Hampshire have no state sales tax.
- South Dakota and Wyoming state sales taxes are 4 percent.
- Florida's state sales tax rate is 6 percent — exceeded only by Texas (6.25 percent) Washington (6.5 percent), Nevada (6.85 percent) and Tennessee (7.0 percent)

Additionally, municipalities usually impose local sales taxes. According to the Tax Foundation, the average local sales tax rate in each state ranges from zero in New Hampshire to 2.44 percent in Tennessee.

Property Taxes. All states assess city and county property taxes, and some also have state property taxes. But rates vary widely. Of the no-income-tax states, Wyoming has the lowest median property tax rate (0.58 percent), compared to Tennessee (0.68 percent), Nevada (0.84 percent), Washington (0.92 percent), Florida (0.97 percent), Alaska (1.04 percent), South Dakota (1.28

percent), Texas (1.81 percent) and New Hampshire (1.86 percent). In fact, of all 50 states, New Hampshire and Texas rank second and third (behind New Jersey) with the highest property tax rates [see Figure II].

How do property and sales tax burdens differ among the seven no-income-tax states? They can be compared using the NCPA's State Tax Calculator. It is a first-of-its-kind tool to help people determine how moving from one state to another would affect their tax burden. The State Tax Calculator (www.whynotmove.org) is not a cost-of-living calculator. The software is based on a proprietary financial planning model developed by Laurence Kotlikoff, economics professor at Boston University.

The State Tax Calculator assumes households manage their finances to smooth their discretionary spending over their lifetimes. There are also built-in assumptions about wages and investments:

- Wage/business income is the same in both states.
- Earnings during working years will increase each year at an assumed 3 percent inflation rate.
- Any money invested in retirement accounts or regular savings accounts will grow 4 percent per year.

Also, annual and lifetime results assume the individual or couple live to age 100 and spend down their assets, leaving nothing to heirs.

Property Tax Comparison of Texas and Florida. Texas and Florida have

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nearly the same state/local combined average sales tax rates. But Texas has nearly twice the median property tax rate of Florida — a significant difference for homeowners considering a move. Thus:

- A 40-year-old Florida couple earning a combined income of \$150,000 a year, with a home value of \$200,000 (and purchasing the same value home in Texas), would lose more than \$2,000 annually in discretionary income by moving to Texas, for a total lifetime loss of \$181,000.
- However, if the same couple paid \$1,200 a month to rent in either state, they would lose only \$472 in discretionary income by moving to Texas (though property taxes are an implicit part of their rent).

The couple would also lose a small amount of discretionary income due to Texas' slightly higher sales taxes.

Property Tax Comparison of Alaska and New Hampshire. Consider Alaska and New Hampshire, neither of which has a state income or sales tax (though both have various local sales taxes). Suppose a 30-year-old single individual earning \$75,000 moves from New Hampshire to Alaska:

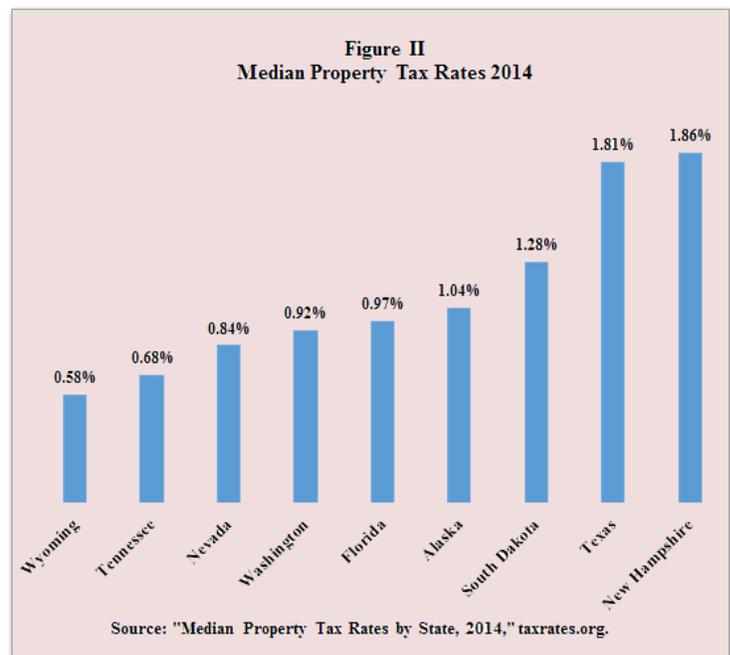
- If the individual were paying rent of \$1,200 a month, moving to Alaska would have a slight

advantage — a gain of \$142 in annual discretionary income and \$14,418 over a lifetime.

- If the individual owned a \$150,000 home in New Hampshire and purchased the same value home in Alaska, he would gain a much greater tax advantage, with an additional \$1,233 a year in discretionary income and a lifetime gain of \$125,226.

Much like the Florida and Texas comparison, this is due to the fact that New Hampshire has a significantly higher median property tax rate than Alaska, and an interest/dividends tax for accumulated savings.

Sales Tax Comparison of Florida and Nevada. Nevada and Florida have very similar median property tax rates — 0.84 percent and 0.97 percent, respectively.



a year moving from Florida to Nevada would lose \$182 a year in discretionary income, for a lifetime loss of \$18,573.

Thus, both households would lose discretionary income moving to Nevada. For the homeowners, the higher sales tax in Nevada reduces the savings from lower property taxes. The 30-year-old renter would be affected by Nevada's higher sales taxes, but its lower property taxes would have no effect. Nevada has a state and average local combined sales tax of 7.94 percent, compared to Florida's 6.63 percent.

Conclusion. If no-income-tax states spend about the same amount per resident on goods and services as income tax states, they will compensate by imposing higher taxes and additional fees.

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- The 40-year-old Florida home-owning couple earning a combined income of \$150,000 a year would lose about \$235 annually in discretionary income from moving to Nevada, for a lifetime loss of \$19,438.

- A 30-year-old single renter earning \$75,000

