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ARKANSAS ADVOCATES FOR CHILDREN & FAMILIES

PAYCHECK$ and POLITICS

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Don't All Families Deserve Fair Taxes?

Basic Facts About the Fairness of the Arkansas Tax System

As Governor Huckabee and the Arkansas General Assembly grapple with how to reform the public education system, they will eventually have to make major decisions about how to pay for these reforms. Paying for education reform will require large tax increases that could have major implications for the economic well-being of the state's working families with children, many of whom are struggling to get by and meet their basic needs.

A major issue that policymakers must consider is how to raise the needed revenue while minimizing any negative impacts these tax increases could have on the state's families. This is the first in a series of short issue briefs designed to present basic, but critical facts about the Arkansas tax system.

Arkansas' current tax system favors the wealthy at the expense of low- and middle-income families. Low-income families pay nearly twice as much (as a percent of their income) in state and local taxes than do the state's wealthiest families. Low-income families pay about 11 cents in state and local taxes on every $1.00 they earn, while the wealthiest pay less than 6 cents on every dollar.

Middle-income families also bear the brunt of an unfair tax system. Middle-income taxpayers (those making between $20,000 and $33,000 per year) pay almost 11 percent of their income in state & local taxes, compared to less than 6 percent for top 1 percent of families (those earning more than $242,000).

Arkansas State and Local Taxes in 2002

As Shares of Family Income for Non-elderly Taxpayers

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	Top 1%
Income Range	Less than $12,000	$12,000-$20,000	$20,000-$33,000	$33,000-$55,000	$55,000-$100,000	$100,000-$242,000	$242,000 or more
Average Income in Group	$7000	$16,200	$26,800	$43,400	$71,700	$137,900	$498,100
Sales & Excise Taxes	9.2%	8.1%	7.1%	5.4%	4.2%	2.7%	1.4%
Property Taxes	1.9%	1.6%	1.2%	1.5%	1.4%	1.5%	1.1%
Income Taxes	0.2%	1.4%	2.4%	2.8%	3.9%	4.6%	5.3%
Total Taxes	11.3%	11.2%	10.7%	9.7%	9.5%	8.8%	7.8%
Federal Deduction Offset	–	-0.1%	-0.0%	-0.2%	-0.7%	-1.4%	-2.0%
TOTAL AFTER OFFSET	11.3%	11.1%	10.7%	9.5%	8.8%	7.4%	5.8%

Source: Institute on Taxation and Economic Policy, July 2003

Note: All taxes include those levied on business and passed through to individuals

Over-reliance on the sales tax is the number one reason why the current tax system punishes the state's working families. Arkansas' sales taxes are among the highest in the nation (8th as a percent of personal income and 11th as a percent of total state & local revenue).

Sales taxes punish low and middle-income families the most. Consider that 9 cents out of every dollar earned by low-income families (and 7 cents of every dollar for middle-income families) go to sales taxes. In contrast, less than 1 ½ cents out of every dollar earned by upper-income families goes to sales taxes.

Many working families are struggling to meet their basic needs. Every family with children has to pay for things such as food, clothing, utilities, etc., all of which are subject to sales taxes. According to a recent study by Arkansas Advocates for Children & Families, a 2-parent, 2-child family has to earn nearly $36,000 annually to meet all of their basic daily living expenses without government assistance (known as the Arkansas Family Income Standard). According to a 2000 study by AACF (conducted prior to the latest recession), 36% of all Arkansas families with children don't earn the level of income needed to meet the family income standard for their family size.

Contrary to popular belief, working families really don't have control over how much of their income they spend on items subject to sales taxes. The money a low or middle-income family has to spend on bread and milk (and thus sales taxes) consumes much more of their income than that of an upper-income family. According to one study, low-income families spend 75 percent of their income on purchases subject to sales taxes, as compared to 50 percent for middle-income families. Upper-income families only spend 15 percent of their income on items subject to sales taxes. Purchases of the basic necessities of life, such as bread and milk, consume more of the incomes of low and middle-income families than that of upper-income families.

What is a fair tax system? Historically, "progressive" tax systems have been regarded as the fairest type of tax system. Under a progressive tax system, the percent of the income you pay in taxes increases as your income increases. A progressive tax system is based on the idea that those with a greater ability to pay contribute a larger share of their income in taxes. In contrast, a regressive system is generally regarded as the least fair. Under a regressive system, low-income families pay a greater percent of their income in taxes than do upper-income taxpayers.

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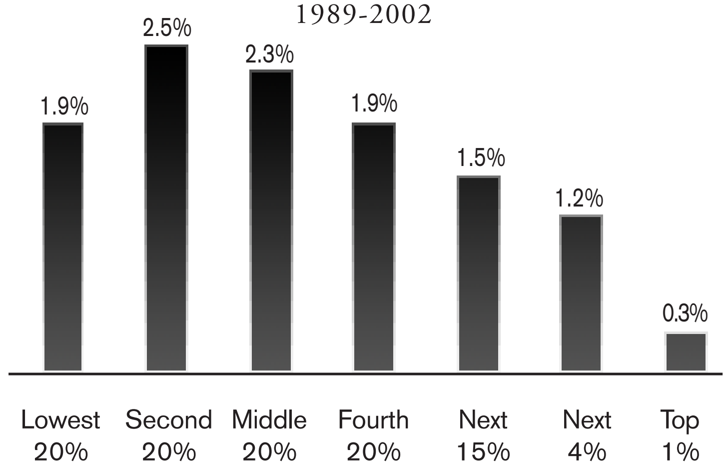
Changes in Taxes as Shares of Income

1989-2002



Source: Institute on Taxation and Economic Policy, January 2003

The Arkansas' tax system has become less fair to lower- and middle-income families over the past decade. From 1989 to 1992, the share of income (e.g., the percent of income) that middle-income families now pay in state and local taxes increased by 2.3 percent, compared to just 0.3 percent for the top one percent of Arkansas taxpayers. The reason? General sales taxes have increased by 1.125% since 1989.

The wealthy have benefited more from income tax changes in the Arkansas tax system than have other families during the past decade. Sales tax increases have hurt low and middle-income families during the past decade. However, other changes, such as exempting 30 percent of capital gains income from the state income tax (capital gains are increases in non-earned income, such as increases in stocks) and recent cuts in the estate tax (taxes on large estates inherited at the time of death) have disproportionately benefited the wealthy.

Corporations no longer pay their fair share of taxes. The Arkansas corporate income tax has declined in recent decades. Arkansas corporate income taxes have fallen from 0.52 percent of Gross State Product in 1978 to only 0.34 percent in 2002. It plays a smaller role in generating Arkansas tax revenues. In 1972, the corporate income tax generated nearly one-third (31 percent) of all Arkansas tax revenue, compared to 69 percent for the personal income tax. By 2000, the corporate share of income tax revenue was only 14 percent of income tax, while individuals paid 86 percent of all income tax revenue.

Corporate tax avoidance has come at the expense of low- and middle-income families. Corporate taxes make state tax systems fairer because they reduce the burden on the taxes paid by low and middle-income families. As corporations have been able to take advantage of various tax loopholes to cut their tax burden, this has driven up the amount of tax revenue that must be raised through other sources—such as the sales tax—that hurt low- and middle-income families.