Show-Me Institute
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Taxes Matter and They're Too High for Missouri

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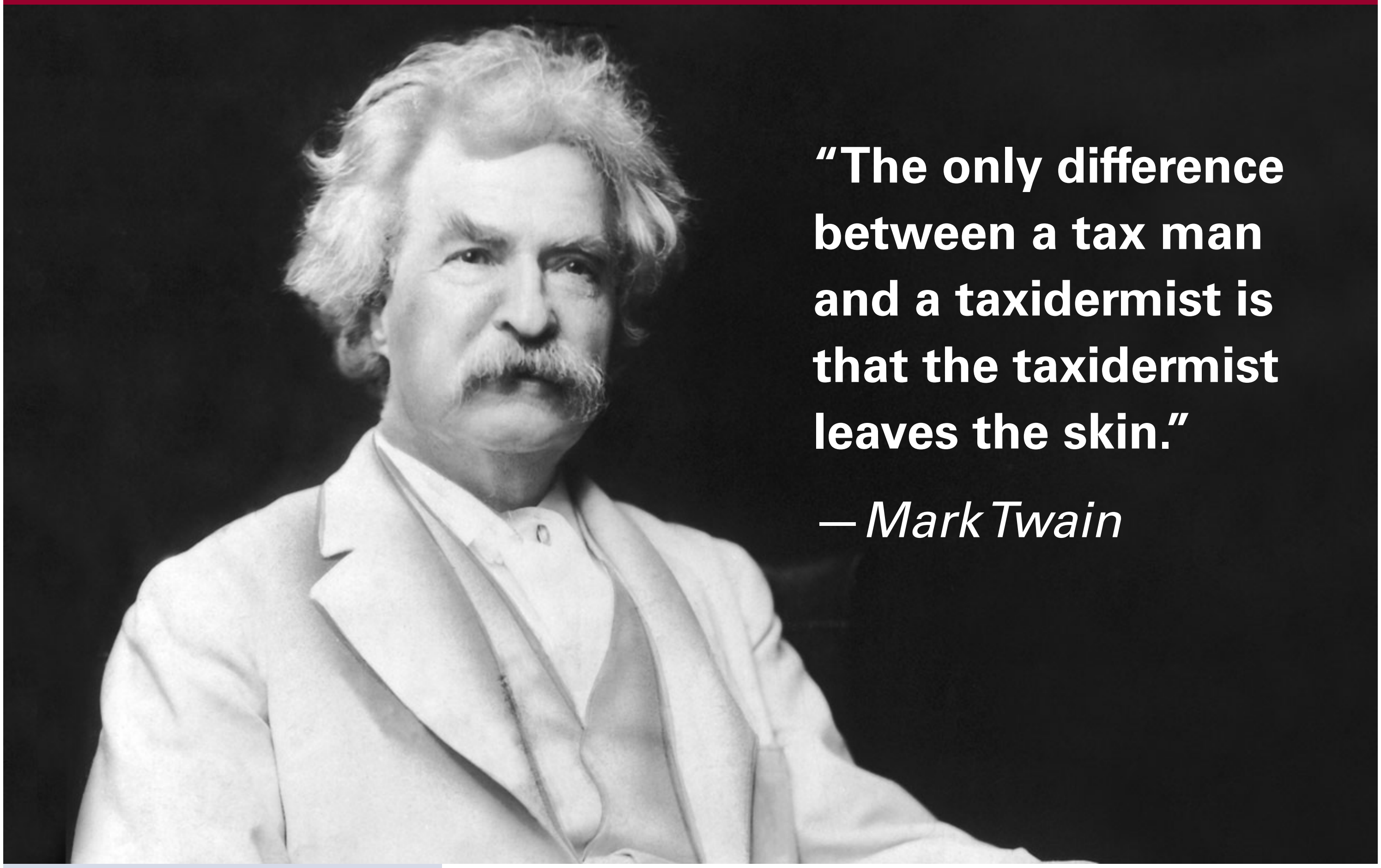
ABSTRACT

In 2014, Missouri passed its first individual income tax cut in a generation, but it appears this legislative success also presents a threat—legislative complacency on tax issues going forward. The 2014 tax cut was not only modest, but it also requires many years to take full effect. This time could be costly to Missourians if the state does not enhance its tax-cutting trajectory. Missouri was already behind in the tax competitiveness race when it passed the tax cut; it risks being left further behind by its regional peers if the legislature chooses to do no more.

INTRODUCTION

Humorist and Missouri native Mark Twain was not exactly a fan of taxes, and one of Twain's lesser-known books offers an educational parable for the effect that taxes can have on the average citizen. It's a story worth relating here, if only briefly.

Tom Sawyer Abroad (1894)[1] follows the travels of Tom, Huckleberry Finn, and Jim as they explore the world in a hot air balloon. When Sawyer's expedition reaches North Africa, he and his friends are caught in a sandstorm that fills their balloon with 20 tons of sand—sand that the traveling Missourians think will make



them rich if they can get it back to America.

"Look here, this sand's worth—worth—why, it's worth no end of money," Tom proclaims. "[T]he minute people knows it's genuwyne sand from the genuwyne Desert of Sahara, they'll just be in a perfect state of mind to git hold of some of it to keep on the what-not in a vial with a label on it for a curiosity."

Their new sand business, they thought, would bring them a fortune, and the three entrepreneurial Show-Me Staters were excited . . . but not for long. They hadn't yet considered the taxes they'd have to pay on their new enterprise.

Sawyer broke the bad news.

"Boys, it won't work; we got to give it up." "Why, Tom?" "On account of the duties."

"Whenever you strike a frontier," Tom grouses, "you find a custom-house there, and the gov'ment officers comes and rummages among your things and charges a big tax, which they call a duty because it's their duty to bust you if they can, and if you don't pay the duty they'll hog your sand. They call it confiscating, but that don't deceive nobody, it's just hogging, and that's all it is."

Instead of getting rich by selling Saharan sand by the vial, Tom, Huck, and Jim found themselves shoveling their sand back into the desert. Without selling a pebble, their business had been killed by bad tax policies.

TAX POLICY MATTERS

Tax policy matters not only to potential businesses and job seekers, but also to existing businesses and residents. Tax policy isn't the only factor that matters in business decisions; the regulatory environment, the quality of educational systems and infrastructure, and much more also affect where people and businesses decide to locate themselves.

Yet there is no doubt that poorly designed tax policy can deter entrepreneurs from starting or growing their businesses, whether these businesses sell Saharan sand, build aircraft, or cook food.[2] Missourians not only need to recognize that other states know that tax policy matters for promoting their own economic growth,[3] but more importantly many of our neighboring states are actively using tax policy to promote their economic interests, sometimes at Missouri's expense.

Only weeks into 2015, tax cut pushes were underway in at least five of Missouri's neighboring states. Lawmakers in Iowa were looking to make the state's income tax "flatter and simpler" only two years after legislators cut the state's property taxes.[4] In Nebraska, legislators were pursuing a package of property and income tax reforms that would send their income tax rates below those of Missouri.[5] Arkansas was pushing to cut its income taxes as well, in part by moving away from special tax carve outs.[6] Oklahoma was already on course to see rates drop in 2016 because of previous tax cut legislation,[7] but that didn't keep legislators from insisting that the state needed to expand that tax cut even further this year. Tennessee is looking to put the kibosh on taxes on dividend income, one of the few remaining taxes on income the state still has in place.[8]

Missouri's competition isn't standing still on tax policy, and that should worry us.

Missouri did itself a small favor by passing a gradual individual income tax cut in 2014 that, if revenue targets are met, would first go into effect in 2017.[9] Yet there is light years of difference between a tax cut that shaves a half percent from the individual income tax, bringing the rate to 5.5 percent no sooner than 2022, and tax cuts that clearly signal Missouri is open for business and tax competitive for the long haul.

PUTTING THE "LOW TAX STATE" TALKING POINT TO THE TEST

If tax policy and tax burdens matter, then how heavily a state's taxes fall upon its taxpayers should tell us something about the state's economic prospects. Are the state's taxes high? Are they low? Are they average? How would we assess this?

To the extent our friends on the Left would concede tax policy does actually matter, they usually do so with the proviso that Missouri is "already a low tax state"—a claim that has been repeated early and often over the last decade.[10] In 2007, the Missouri Budget Project cautioned lawmakers "to keep in mind that Missouri already is a low tax state" as

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legislators were considering tax cuts at that time.[11] Indeed, the "Missouri is a low tax state" verbiage has become an article of faith repeated by newspapers,[12] legislators,[13] lobbyists, and activists[14] year after year.

How does the Left reach that conclusion? For one, they often focus on taxes that constitute a relatively small part of the state budget. For instance, Missouri's gas taxes are low relative to the rest of the country, as are its cigarette taxes. Moreover, many of the Left's favorite studies focus on state taxes paid but omit local tax burdens[15]—burdens that state taxpayers pay, but not directly to the state.

The objections to these arguments are straightforward enough. First, Missouri cannot reasonably be termed "low tax" overall, simply because our QuikTrip unleaded and Marlboro Lights are cheap. Second, in our attempts at making holistic declarations about state taxation, we should not ignore the impact of taxes state law empowers its local governments to institute. Unfortunately, the Left alternately overemphasizes the impact of gas and cigarette taxes, or neglects billions of dollars in taxes Missouri state taxpayers already pay every year.

Income taxes, sales taxes, and property taxes, both state and local, do the heavy lifting to fund state and local services. If Missouri was, overall, average or above average in these taxes compared to the rest of the country, the state could not really, by definition, be a "low tax state" in any serious way. A Kansas Citian cannot choose to pay only her state taxes and ignore her local income, sales, and property taxes; to bifurcate the tax burden question in this way is to conceal the full effect of Missouri's tax policies.

WHAT DO WE FIND WHEN WE COMPARE MISSOURI'S TAX BURDENS TO OTHER STATES?

On income taxes, Missouri is average—at best.

In 2014, the Tax Foundation looked at state and local income tax collections per capita and found that Missouri ranked 29th overall.[16] On combined state and federal dividend taxes, Missouri ranked 20th overall.[17] Importantly, most American cities don't have an earnings tax; because of this, Kansas City's and Saint Louis' earnings taxes put those cities above average in that category.

It remains to be seen whether the state's 2014 income tax cuts will meaningfully improve the income tax picture, as states across the country and around Missouri that are competing with us for economic growth will likely be cutting taxes in the intervening years. In 2014, Missouri shared the same top tax rate as two bordering states,[18] had a higher rate than three bordering states, and had a lower rate than three other bordering states.[19] In other words, Missouri is in the middle on income taxes. But importantly, all three border states with higher income tax rates are looking at lowering their taxes this year. Missouri needs to keep driving toward lower tax rates, but it needs to start checking its rearview mirror—and often.

On sales taxes, Missouri is above average.

In 2015, the Tax Foundation found that Missouri had the 14th highest combined state and local sales tax in the country, placing it in terms of rates above even Florida, which has no income tax at all.[20] And as local taxing districts proliferate, sales taxes in excess of 10 percent in local jurisdictions will likely become more common, barring some legislated obstacle to rising local sales tax burdens.

On property taxes, Missouri is about average.

In 2009, the state ranked 24th in taxes paid as a percentage of home value,[21] meaning that although the cost of living here is lower the amount of money paid to the government on property tends to be a bit higher. Two years before in 2007, Missouri was actually above the national average on property tax rates.[22] Apples-to-apples property tax comparisons across the country are notoriously difficult in part because of differing assessment practices, but to the extent they can be compared, Missouri does not fare much better or worse than average. This is to say Missouri property taxes may not be "high," but they aren't "low."

Taken together, the findings for these three major types of taxes would *not* suggest Missouri is below the average when it comes to income, sales, and property tax rates. As such, it would not be reasonable to consider Missouri a "low tax state" for the taxes that really matter to fund state and local government.

It may sound good politically to claim Missouri's taxes are comparatively lower on average than other states. Unfortunately, it isn't really true.

CONCLUSION

The Missouri Legislature's passage of a modest tax cut in 2014 was certainly welcome, but this first, small step can in no way be the final step if Missouri is to become the "low tax state" it's long been claimed to be. Missouri's policymakers have significant work ahead of them if they want to keep the Show-Me State tax competitive, and our neighboring states aren't going to wait for us to engage this great task. Small tax reforms are nice but insufficient. There is still great, and important, work yet to be done.

Missouri can be a low tax state. We're simply not there yet.

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NOTES

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