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Governmental accounting research: An analysis of state performance

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Governmental accounting research: An analysis of state performance

Abstract

Every state throughout the United States of America incurs significant expenses each year. Unlike a for-profit business, states cannot attempt to cover these expenses by selling a product to generate revenues. Instead, revenues are acquired through four main sources: charges for services, operating grants and contributions, capital grants and contributions, and taxes.

Even though every state relies heavily on the generation of revenues from taxes, certain states choose not to put in place one of the two most significant tax revenue sources: the personal income tax and the sales tax; one state—Alaska—has chosen to circumvent both. Understanding how large an impact the abovementioned tax sources had on a state's overall ability to generate revenues, and thus cover their expenses, it would be reasonable to assume the states that have chosen not to implement either the personal income tax or sales tax, or both, would be in a worse financial situation than the states that put both into practice. Through an analysis of the change in net assets as a percentage of total revenues, and the fund profit margin, for a total of twenty states— those that do not implement an income tax, a sales tax, or both, and those possessing the highest income tax rates and sales tax rates—it can be concluded that the aforementioned assumption is false.

Not having a personal income tax or a sales tax has little effect on the results of a state's change in net assets as a percentage of total revenues and fund profit margin. The results of the analysis produced too great an assortment of positive and negative state financial positions to result in any real correlation. States with both an income tax and sales tax were just as likely to be in a negative financial situation as those states that did not possess an income tax or sales tax, and vice versa. It really boils down to how efficiently and effectively a governmental entity spends, having an approximate idea of how much revenue they will generate with or without an income tax or sales tax. Total expenditures on a per capita level may suffer a bit in states that do not have an income tax or sales tax, but there is no evidence to suggest that not having one or both of these taxes has an effect on a state's "profit margin" figures. The tables that follow provide evidence supporting the conclusion of the conducted analysis.

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Honors Thesis in Governmental Accounting
Research—An Analysis of State Performance

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Even though every state relies heavily on the generation of revenues from taxes, certain states choose not to put in place one of the two most significant tax revenue sources: the personal income tax and the sales tax; one state—Alaska—has chosen to circumvent both. Understanding how large an impact the abovementioned tax sources had on a state's overall ability to generate revenues, and thus cover their expenses, it would be reasonable to assume the states that have chosen not to implement either the personal income tax or sales tax, or both, would be in a worse financial situation than the states that put both into practice. Through an analysis of the change in net assets as a percentage of total revenues, and the fund profit margin, for a total of twenty states—those that do not implement an income tax, a sales tax, or both, and those possessing the highest income tax rates and sales tax rates—it can be concluded that the aforementioned assumption is false.

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The accompanying tables and notes represent the details of my research pertaining to state income and sales tax rates:

Brief Summary of General Findings:

States with no income tax:

Alaska
Florida
Nevada
South Dakota
Texas
Washington
Wyoming

States with highest variable income tax rates:

Montana (11%)
Vermont (9.5%)
California (9.3%)
Washington D.C. (9.3%)
Oregon (9%)
Iowa (8.98%)
Maine (8.5%)

States with no sales tax:

Alaska
Delaware
Montana
New Hampshire
Oregon
Hawaii (See Below)
New Mexico (See Below)

States with highest state sales tax rate:

Tennessee (7%)
Rhode Island (7%)
Mississippi (7%)
Minnesota (6.5%)
Nevada (6.5%)
Washington (6.5%)

Only state with no income or sales tax:

Alaska

States with a flat income tax rate:

Colorado
Illinois
Indiana
Massachusetts
Michigan

Pennsylvania
Rhode Island

States taxing income only in the form of interest and dividends:

New Hampshire
Tennessee

Individual state analysis results:

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Alabama	2%	5%	4%

- Over 200 additional city and county sales taxes exist in the state of Alabama, which could substantially increase the sales tax rate at the time of purchase.
 - The state itself retains only 4% of the total sales tax applied to each purchase, however.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Alaska	None	None	None

- Alaska is the only state that does not enforce a state income tax or sales tax.
- Eighty nine Alaska municipalities enforce local sales taxes, which range from 1% to 7%.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Arizona	2.87%	5.04%	5.6%

- All fifteen Arizona counties levy a local tax.
- Incorporated Arizona municipalities also enforce transaction privilege taxes.
- The combined sales tax rate—the state enforced 5.6% sales tax rate combined with any local sales tax rates that may apply—can reach as high as 10.1% in Arizona.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Arkansas	1%	6.5%	5.125%

- There exist over 300 local sales taxes in the state of Arkansas.
- Taxpayers with a total annual household income of less than \$12,000 are permitted a sales tax exemption for electricity usage.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
California	1%	9.3%	6%

- Certain local taxes apply throughout the state of California that could drive the combined sales tax rate to as high as 8.5% (San Francisco County).

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Colorado	4.63% Flat Rate		2.9%

- Most services are not subject to Colorado sales tax.
- Additional county, city, and common special district taxes exist in the state of Colorado.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Connecticut	3%	5%	6%

- Most services are not subject to sales taxes in the state of Connecticut.
- There are a number of items that are exempt from sales taxes in the state of Connecticut. Some commonly purchased exempt items include:
 - Bicycle Helmets
 - Articles of clothing or footwear costing under \$50.
 - College Textbooks.
 - Internet Access Services.
 - Magazines sold by subscription and newspapers.
 - Medical goods and equipment.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Delaware	2.2%	5.95%	None

- The state of Delaware is one of five states that do not assess a sales tax upon consumers.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Wash. D.C.	5%	9.3%	5.75%

- The above stated sales tax rate is that which applies to tangible personal property. The District of Columbia actually levies sales taxes at five different rates in an

attempt to take advantage of its status as a tourist center. The following sales tax rates also apply:

- 9% for alcohol sold for off-premises consumption.
- 10% for restaurant meals, take-out food, rental cars and telephone calling cards.
- 12% for commercial parking.
- 14.5% for hotel and motel rooms.
- Certain items are exempt from the District of Columbia sales tax. Exempt items include groceries and prescription drugs.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Florida	None		6%

- The state of Florida is one of seven states that do not assess a personal income tax upon citizens.
- Additional county sales taxes may apply, which could make the combined sales tax rate as high as 9.5%.
- U.S. and Florida state flags are exempt from state and local taxes.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Georgia	1%	6%	4%

- Certain additional local sales taxes may apply.
- Prescription drugs, certain medical devices, and groceries are exempt from sales taxes.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Hawaii	1.4%	8.25%	4%*

- Although the above table lists Hawaii's sales tax rate as 4%, Hawaii does not actually have a sales tax. Instead they impose a 4% general excise tax, which is assessed on all business activities, including retail sales. Although termed by the state of Hawaii as an excise tax, this is in essence a sales tax.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Idaho	1.6%	7.8%	6%

- Certain local sales taxes may apply to sales in the state of Idaho.
- Sales taxes are not applicable to some services.

- Prescription drugs are not subject to sales taxes.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Illinois	3% Flat Rate		6.25%

- Certain local sales taxes may apply.
- Qualifying food, drugs, and medical appliances are not subject to the 6.25% sales tax listed above, but instead are taxed at a rate of 1%.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Indiana	3.4% Flat Rate		6%

- The state of Indiana has no local sales taxes.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Iowa	0.36%	8.98%	5%

- Certainly local sales taxes may apply to sales in the state of Iowa. Combined sales tax rates could reach as high as 7%.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Kansas	3.5%	6.45%	5.3%

- Additional city and county sales tax rates could create a combined sales tax rate as high as 8.3%.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Kentucky	2%	6%	6%

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Louisiana	2%	6%	4%

- Political subdivision local sales taxes may also apply to the 6% sales tax stated above.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Maine	2%	8.5%	5%

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Maryland	2%	4.75%	5%

- Local “piggyback income taxes” are applied by all twenty-three Maryland counties, as well as by the city of Baltimore, which range between 1.25% and 3.15%.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Massachusetts	5.3% Flat Rate		5%

- The 5% sales tax rate is applied to all tangible personal property.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Michigan	4% Flat Rate		6%

- The 4% income tax rate stated above is scheduled to decrease to 3.9% on 7/1/04.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Minnesota	5.35%	7.85%	6.5%

- Certain local sales taxes may apply that can drive the combined sales tax rate as high as 7.5%.
- Sales of liquor and beer are taxed at 9%.
- Motor vehicle rentals are taxed at 12.7%.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Mississippi	3%	5%	7%

- A number of additional local county sales taxes apply in the state of Mississippi.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Missouri	1.5%	6%	4.225%

- A number of additional local sales taxes apply in the state of Missouri.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Montana	2%	11%	None

- Montana is one of five states that do not assess a sales tax upon consumers.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Nebraska	2.56%	6.84%	5.5%

- Some Nebraska cities can assess an additional local sales tax in the amount of up to 1.5%, making the highest possible combined sales tax rate 7%.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Nevada	None		6.5%

- The state of Nevada is one of seven states that do not assess a personal income tax upon citizens.
- Certain local sales tax levies may bring the combined sales tax rate up to 7.5%.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
New Hampshire	5% on Dividend and Interest Income Only		None

- The state of New Hampshire is one of only two states that charge income tax in the form of dividend and interest income only.
- The state of New Hampshire is one of only five states that do not assess a sales tax upon consumers.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
New Jersey	1.4%	6.37%	6%

- The state of New Jersey offers sales tax exemptions to many items. Some of the exempt items include:
 - Most food items for at home preparation
 - Medicines
 - Clothing and footwear
 - Disposable paper products for in home use
 - Others.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
New Mexico	1.7%	8.2%	5%*

- The state of New Mexico has certain local sales taxes that could bring the combined sales tax rate to as high as 7.1875%.
- In all actuality, the state of New Mexico does not have a sales tax; instead it imposes what is called a gross receipts tax, which works in generally the same fashion as a sales tax.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
New York	4%	6.85%	4.25%

- Certain local levies can drive the combined state sales tax rate to just over 8% in the state of New York.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
North Carolina	6%	8.25%	4.5%

- Certain local sales taxes can drive the combined state sales tax rate to as high as 7.5% in the state of North Carolina.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
North Dakota	2.1%	5.54%	5%

- Certain local sales taxes can drive the combined sales tax rate to as high as 8% in the state of North Dakota.
- Electricity, water, and interstate communications are exempt from the state sales tax.
- Sales tax on natural gas is only 2%.
- Sales tax on retail sales of new farm machinery and irrigation equipment is only 3%.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Ohio	0.743%	7.5%	6%

- Ohio's state sales tax rate was increased from 5% to 6% on July 1, 2003, but is scheduled to fall back to 5% on July 1, 2005.
- Additional local sales taxes can drive the combined sales tax rate to as high as 8% in the state of Ohio.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Oklahoma	0.5%	7%	4.5%

- Certain local sales taxes may apply throughout the state of Oklahoma.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Oregon	5%	9%	None

- The state of Oregon is one of only five states that do not assess a sales tax upon consumers.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Pennsylvania	2.8% Flat Rate		6%

- A local sales tax of 1% is collected on the sales of taxable goods and services initiated from a location in the counties of Philadelphia and Allegheny.
- Major items exempt from the sales tax of Pennsylvania: food (not ready to eat), most wearing apparel, drugs, textbooks, sales for resale, and residential heating fuels.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Rhode Island	25% of Federal Taxable Income		7%

- Forty nine items are exempt from sales taxes in the state of Rhode Island. Some of those items include:
 - Prescriptions
 - Food
 - Some clothing
 - Precious metal bullion
 - Others.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
South Carolina	2.5%	7%	5%

- South Carolina counties have the option to impose an additional 1% local option sales tax on top of the 5% sales tax.
- Citizens of South Carolina, age 85 and older, get a 1% exclusion from the state 5% sales tax rate with a valid ID shown at the time of purchase.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
South Dakota	None		4%

- The state of South Dakota is one of seven states that do not assess a personal income tax upon citizens.
- Eligible senior citizens and disabled individuals may be able to get a once-a-year refund of sales taxes. Eligible individuals must:
 - Be 66 years old before January 1st of the current year or disabled during any part of the year,
 - Have been a South Dakota resident for the entire previous year, and
 - Must meet annual income requirements.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Tennessee	6% on Dividend and Interest Income Only		7%

- The state of Tennessee is one of only two states that charge income tax in the form of dividend and interest income only.
- Certain local sales taxes—ranging from 1.5% to 2.75%—may apply in the state of Tennessee.
- Food is taxed at 6% in the state of Tennessee, rather than the above stated sales tax rate.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Texas	None		6.25%

- The state of Texas is one of seven states that do not assess a personal income tax upon citizens.
- Certain local sales taxes can add as much as 2% to the set sales tax rate of 6.25%, bring the highest possible combined sales tax rate to 8.25%.
- Texas institutes an additional 2% sales tax on fireworks that benefits rural fire departments.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Utah	2.3%	7%	4.75%

- The state of Utah has a number of local sales taxes that may apply throughout the state.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Vermont	3.6%	9.5%	6%

- The state of Vermont has exempted 46 items from their state sales tax. Some of these exempt items include:
 - Medical items
 - Food
 - Clothing and shoes with a purchase price under \$110
 - Others.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Virginia	2%	5.75%	3.5%

- Certain municipalities charge additional local sales taxes on top of the state sales tax rate of 3.5%. The highest possible combined sales tax rate is 4.5%.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Washington	None		6.5%

- The state of Washington is one of seven states that do not assess a personal income tax upon citizens.
- The state of Washington allows for certain local sales taxes.
- The state of Washington has exempted food, aside from prepared foods, dietary supplements, and soft drinks, from the state sales tax.
- There is no sales tax imposed on most performed professional services and real estate services in the state of Washington.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
West Virginia	3%	6.5%	Tiered Sales Tax System - See Below

- See the following table for the West Virginia sales tax rates:

<u>West Virginia Tiered Sales Tax System:</u>	
<u>Sales Price</u>	<u>Tax</u>
\$.06 - \$.16	\$0.01
.17 - .33	0.02
.34 - .5	0.03
.51 - .67	0.04
.68 - .84	0.05
.85 - 1.00	0.06
1.01 - 1.16	0.07

And So On.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax Rate</u>
	<u>Low</u>	<u>High</u>	
Wisconsin	4.6%	6.75%	5%

- 55 Wisconsin counties impose an additional local sales tax of .5%.
- U.S. and Wisconsin state flags are exempt from Wisconsin state sales taxes.

<u>State/District</u>	<u>Income Tax Rates</u>		<u>State Sales Tax</u>
	<u>Low</u>	<u>High</u>	<u>Rate</u>
Wyoming	None		4%

- The state of Wyoming is one of seven states that do not assess a personal income tax upon citizens.
- Certain local sales taxes may apply throughout the state of Wyoming.

Summary of CAFR Findings:					
States with no income or sales tax:					
	Change in Net Assets		Fund Profit Margin		
	2003	2002	2003	2002	
Alaska	10.08%	-45.65%	-0.05%	-56.28%	
States with no income tax:					
	Change in Net Assets		Fund Profit Margin		
	2003	2002	2003	2002	
Florida	5.31%	4.44%	-3.95%	-5.38%	
Nevada	-1.02%	-2.38%	-5.44%	2.97%	<-----Note: Has second highest sales tax rate (tie).
South Dakota	7.55%	3.84%	-1.01%	-4.42%	
Texas	2.56%	-6.53%	5.66%	-1.30%	
Washington	-0.75%	-4.88%	-6.68%	-6.62%	<-----Note: Has second highest sales tax rate (tie).
Wyoming	19.36%	5.25%	20.94%	9.32%	
States with highest income tax rates:					
	Change in Net Assets		Fund Profit Margin		
	2003	2002	2003	2002	
Montana	9.40%	10.67%	2.43%	-0.97%	<-----Note: Does not have a sales tax.
Vermont	N/A	0.69%	N/A	-3.22%	
California	-13.94%	-9.77%	-16.02%	-13.07%	
Washington D.C.	-1.12%	0.36%	-11.79%	-8.95%	
Oregon	-2.11%	-6.88%	-2.07%	-7.48%	<-----Note: Does not have a sales tax.
Iowa	1.96%	2.38%	-2.71%	-2.37%	
Maine	N/A	0.18%	N/A	-8.65%	
States with no sales tax:					
	Change in Net Assets		Fund Profit Margin		
	2003	2002	2003	2002	
Delaware	1.03%	2.44%	-11.72%	-13.33%	
Montana	9.40%	10.67%	2.43%	-0.97%	<-----Note: Has highest state income tax rate.
New Hampshire	-4.21%	0.82%	-7.10%	-6.11%	
Oregon	-2.11%	-6.88%	-2.07%	-7.48%	<-----Note: Has fifth highest state income tax rate.
States with highest sales tax rate:					
	Change in Net Assets		Fund Profit Margin		
	2003	2002	2003	2002	
Tennessee	4.21%	4.11%	0.22%	-3.29%	
Rhode Island	N/A	7.36%	N/A	-8.64%	
Mississippi	2.56%	2.07%	-5.41%	-6.10%	
Minnesota	-6.97%	-2.57%	-9.75%	-2.99%	
Nevada	-1.02%	-2.38%	-5.44%	2.97%	<-----Note: Has no income tax.
Washington	-0.75%	-4.88%	-6.68%	-6.62%	<-----Note: Has no income tax.