FISCAL RESEARCH CENTER

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SUBJECT: Sales Tax Rate Required to Replace the Income Tax

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Over the past few years the idea of eliminating the state income tax has been advanced. This memorandum considers the sales tax rate that would be necessary to replace the lost income tax revenue.

The table below lists the tax receipts for the individual income tax, the corporate income tax and the state sales and use tax.

Source	FY 2006 Preliminary Revenues ($ Millions)
Individual Income Tax	8,040.6
Corporate Income Tax	890.7
Sales and Use Tax	5,745.4
Total	14,676.7

Assuming no behavioral response to an increase in the sales tax rate, the required sales tax rate to generate $14,676.7 million in revenue would be 10.2 percent. But an increase in the sales tax rate will cause an increase in on-line shopping, in cross border shopping, and a shift from purchases of taxable to non-taxable items. The only estimate of this behavioral response that we have found suggests that a 10 percent increase in the sales tax rate will increase sales tax revenue by 9.3 percent. On the other hand, the elimination of the personal income tax will allow consumers to purchase more; we estimate that about 1/3 of the reduction in personal income taxes will be spent on sales taxable items. Thus, we estimate that the required sales tax rate to replace the income tax will be about 10.6 percent.

The revenue from the income tax has increased faster than the revenue from the sales tax. Assume that the growth in these revenue sources for the next 10 years matches the growth over the past 10 years. Thus in order to replace fiscal year 2016 expected income tax revenue, the required sales tax rate would be 11.9 percent.