5 THREATS
TO MISSISSIPPI'S TAX SYSTEM

MEPC

MEPC A Hope Initiative
MISSISSIPPI ECONOMIC POLICY CENTER

About the Mississippi Economic Policy Center

The Mississippi Economic Policy Center (MEPC) is a nonprofit, nonpartisan organization that conducts independent research on public policy issues affecting working Mississippians. Through public outreach efforts, policy making education and engaging the media, MEPC uses its analysis to ensure that the needs of low and moderate-income Mississippians, in particular, are considered in the development and implementation of public policy with the ultimate goal of improving access to economic opportunity.

MEPC is managed by the Hope Enterprise Corporation (HOPE), a regional financial institution and community development intermediary dedicated to strengthening communities, building assets and improving lives in economically distressed areas in the Mid South.

To read more about MEPC, go to *www.mepconline.org*
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FIVE THREATS TO MISSISSIPPI'S TAX SYSTEM

Mississippi lacks sufficient tax revenue to adequately fund our schools, roads, public health care system and other services that promote a strong economy and help working families build a secure future. Unless steps are taken to reverse current trends, the gap between the state's revenue stream and the services it provides will only widen, ultimately threatening the prosperity of all Mississippians.

State tax revenues support the foundations of the economy and affect the quality of life for all Mississippians. Families and businesses depend on public funding for services such as K-12 public education; community colleges and universities; public safety, health care, the judicial and correctional system, and more.

In recent years, policymakers have responded to the drop in revenue caused by the recent recession (2007-09) by making multiple rounds of cuts in key services rather than searching for less damaging ways to meet the state's challenges. Since the recession, tax revenues have not been restored to year 2000 levels (F:1). As a result, pressing needs remain unmet. For example, the Mississippi Adequate Education Program, the state plan for assuring a basic education for all children, has been underfunded by a staggering $1.5 billion since 2008, when state revenues were at their peak after Hurricane Katrina.

Mississippi's tax system contains five flaws that threaten our full recovery and future prosperity:

1. **Tax-exempt retirement state income.** All retirement income is exempt from taxation, even for the wealthiest residents. The exemption is not an effective means to attract more retirees to the state. Retirement income should be taxed according to the taxpayer's ability to pay.

2. **Uncollected sales tax for online purchases.** Mississippians are making more purchases online, but the sellers, unlike their competitors who sell in person, aren't required to collect the state sales taxes that buyers legally owe. We should join other states in fixing this problem.

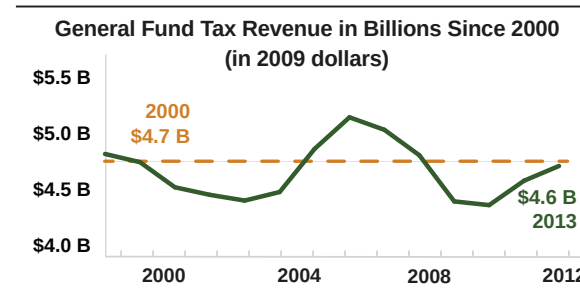
3. **Arbitrary sales tax on services.** From legal advice to lawn care, many services are tax exempt. In today's economy, people are spending more on services and less on goods, such as food and clothing, which are taxed. The state sales tax hasn't been adjusted to reflect these changes. Mississippi needs to bring its sales tax system up to date.

4. **Costly corporate tax loopholes.** Most corporations in Mississippi pay no state income taxes Many are able to take advantage of the state's various tax breaks and loopholes. Lawmakers should closely scrutinize these giveaways and end those that are wasteful and ineffective.

5. **Outdated, inequitable income tax.** The state's outdated income tax treats wealthy households the same as middle and low-income families. A tax system that ensures everyone pays their fair share would boost Mississippi's resources and combat growing economic inequality.

F:1 Current Mississippi Tax Revenue Lower Than Year 2000 Levels

In 2008, state revenue peaked due to a spike from hurricane recovery spending. This spike was followed by a recession causing revenues to decline. Revenues have not been restored to year 2000 levels, leaving state services struggling after multiple years of budget cuts.



Source: MEPC Analysis of State General Fund Revenue Estimate from the Revenue Esitimating Group 2006-2012

Aging Population, Diminishing Resources

The first threat to our tax revenue is the state's exemption of all retirement income from taxation. By 2030, one in five Mississippians will be over age 65 (F:2). This population shift, combined with the exemption for retirement income, will erode Mississippi's income tax revenue. The loss may be amplified by increases in the costs of providing services to an aging population.

> Mississippi is one of only five states that exempt all federal, state, and local pensions as well as most private retirement income.

The exemption was added to the tax code in 1994 and applies to all, regardless of the amount or type of income a retiree receives.

This exemption costs the state over $340 million annually; and the lost revenue has already increased by more than 50% in the last five years (F:2). If this trend remains unchecked, it could put a significant strain on the state's ability to support schools, health care and other necessities for years to come.

When the exemption was enacted, it was touted as a way to attract retirees to the state. However, income tax breaks are not effective at attracting seniors.[1]

Mississippi is one of only five states that exempt all federal, state, and local pensions as well as most private retirement income.[2] Many states provide exemptions that are less broad and based on income levels, phasing the exemptions out as incomes rise. This avoids putting a burden on low-income seniors. Alternatively, taxes could be raised elsewhere to make up for the lost revenue.

F:2 Retirement Exemption Cost The State More Than $340 Million In Lost Revenues

Mississippi's exemption of all retirement income (both public and private), regardless of income level, was enacted in 1994. This exemption cost the state more than $340 million in lost revenues and has increased over 50% in the last five years. This will likely increase as the population ages.

ESTIMATED RETIREMENT EXEMPTION TOTAL

YEAR	EXEMPTION
2012	$341,205,000
2011	$323,976,000
2010	$314,368,000
2009	$281,660,000
2008	$226,000,000

51% increase in last 5 years

SHARE OF MISSISSIPPIANS OVER 65

In 2030 one in five Mississippians

will be over 65

Up from 12.8% in 2010

Source: IHL University Research Center Mississippi Tax Expenditure Report 2007-2011, U.S. Administration on Aging analysis of U.S. Census interim population projections data

The state lost an estimated **$135 million** in online sales tax revenue in 2012.

Growing Online Sales Means Less Tax Revenue

The second threat to state revenue is the increase in Internet sales by retailers that do not collect state sales taxes on purchases by Mississippians. The value of E-commerce as a share of retail trade has increased fourfold in the past 10 years (F:3). The state lost an estimated $135 million in online sales tax revenue in 2012. This loophole also harms the competitiveness of local brick-and-mortar businesses that are required to collect sales tax, while their online out-of-state competitors are not.

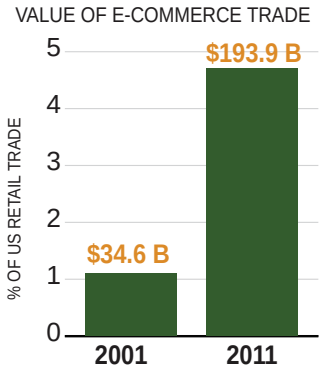
Federal tax law bars a state from requiring an out-of-state retailer (whether online or mail-order) to collect sales tax unless it has a physical presence in the state. This does not mean that taxes are not owed on the items purchased. The consumer still owes a "use tax" equal to what the sales tax would have been if the item were purchased at a physical store; however, most of this revenue will not be collected if the seller is not required to charge it.

Allowing states to require collection of taxes owed from online retail sales is currently being debated in Congress. Some states are fighting large online retailers through the courts to require them to collect sales taxes. Mississippi should work with other states to promote sales tax collection of Internet and catalog sales by enacting the "Amazon Law." Enacted in 15 states, the law requires Internet retailers with in-state affiliates to direct traffic to their affiliates for purchases made in order to collect sales tax.

F:3 Increase in E-commerce Means Lost Revenue for Mississippi

In the last ten years, E-commerce has increased dramatically. States that cannot collect sales tax from many of these purchases lose hundreds of millions of dollars in revenue, with greater losses anticipated in the future.

INCREASE IN E-COMMERCE



ESTIMATED LOSS OF REVENUE IN MISSISSIPPI

YEAR	ESTIMATED LOSS	% OF CURRENT SALES/USE TAX
2007	$85,800,000	4.0%
2008	$91,500,000	4.2%
2009	$82,300,000	3.9%
2010	$102,100,000	5.1%
2011	$120,000,000	6.0%
2012	$134,900,000	6.5%

Source: MEPC Analysis of data from the U.S. Census Bureau 2011 Estats and University of Tennessee Center for Business and Economic Research

Arbitrary Sales Tax on Services

The third threat to state revenue is the increase in purchases of services that are not subject to state sales tax. Mississippi relies heavily on the taxation of goods – items such as food, clothing, and motor vehicles – to pay for state services. Mississippi ranks among the top 10 states in the amount of sales tax revenue as a percentage of personal income. A sales tax of 7% is applied on the purchase of all goods unless they are specifically exempt in law.

In contrast to goods, services are only subject to sales tax if they are specifically listed in the sales tax law. Some taxed services in Mississippi include dry cleaning, vehicle and air conditioner repair, car washes, and amusements such as bowling.[3]

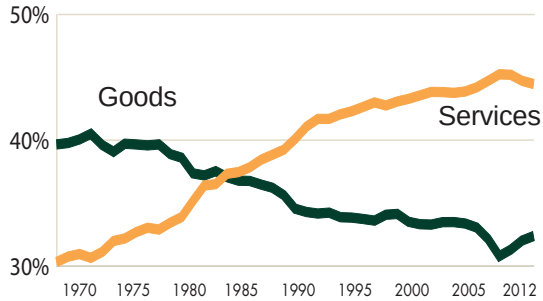
Services not taxed include salon, pool cleaning, dog grooming, interior design, travel, lawn care, legal and accounting, and more. The exclusion of certain services not only causes the state to lose untaxed revenue, it also creates a competitive advantage for businesses exempt from sales tax.

Over the past several decades the purchase of goods such as clothes and household items has decreased compared to the use of services (F:4).

F:4 Services are only taxed if they are named in the sales tax law.

The traditional sales tax base, made up of goods such as cars, clothing, furniture, and other items, is declining as a share of household expenditures. At the same time, the share of services is increasing. In Mississippi, goods are subject to the sales tax unless specifically named as exempt. Services are not subject to sales tax unless they are named in the sales tax law.

U.S. SHARE OF HOUSEHOLD CONSUMPTION



Source: MEPC and Center on Budget and Policy Priorities analysis of U.S. Perconal Consumption Expenditures data from the U.S. Bureau of Economic Analysis

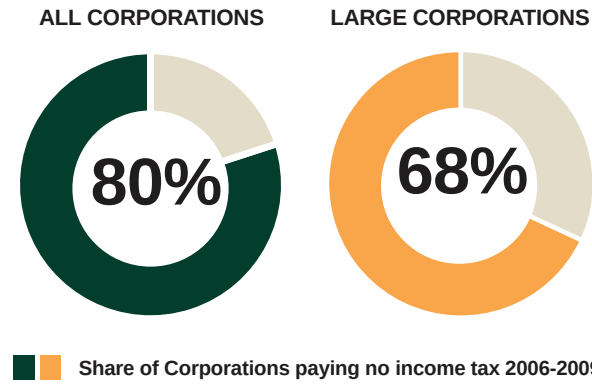
A comprehensive sales tax could be implemented on all services unless specifically exempt. This change would update the state's tax system to reflect changes in the economy and could raise as much as $300 million a year in revenue.

Costly Corporate Tax Loopholes

The fourth threat to state revenue is the erosion of state corporate income taxes through loopholes and tax giveaways. According to legislative research, most corporations operating in Mississippi do not pay state corporate income tax (F:5). This was the case even before the recession decreased corporate profits. Many corporations escape taxes by shifting profits to related corporations in other states with lower income taxes or none at all.

F:5 Most Corporations Pay No State Income Tax

From 2006-2009, most Mississippi corporations paid no state income taxes. Corporations may owe no income taxes because they did not earn a profit during the tax year. However, some may avoid taxation by taking advantage of tax loopholes and shifting profits to other states.



Source: MEPC Analysis of data from the Performance Evaluation and Expenditure Review Committee of the Mississippi Legislature

One way to end this practice is to require multi-state corporations to report their income from all subsidiaries together, a practice known as combined reporting.

This would mean more revenue for Mississippi, and would also level the playing field for local businesses that, for the most part, do not have the means to take advantage of transferring income out of state to avoid taxation.

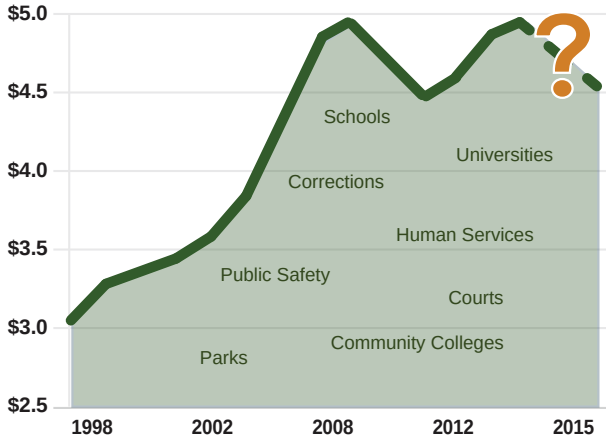
The majority of states with a corporate income tax (23 states) require combined reporting.

Tax breaks designed to benefit certain industries also contribute to the erosion of corporate income tax revenue for the state. These tax breaks are rarely reviewed to determine if they are meeting the intended goals, such as job creation. Data is often not even available on how much these tax breaks cost the state (F:6). More information is necessary in order to evaluate these expensive tax loopholes.

F:6 How Much Do Corporate Tax Giveaways Cost Us?

Corporate tax giveaways reduce general fund collections and affect the state's ability to invest in the basic foundations of the economy for schools, roads, safe communities, and more. Data on the outcomes of the tax breaks, including how much they cost and whether they are meeting their goals (i.e. number of jobs created, etc.) is sparse.

General Fund Tax Revenue in Billions



Source: MEPC Analysis of State General Fund Revenue Estimate from the Revenue Esitimating Group 2006-2012

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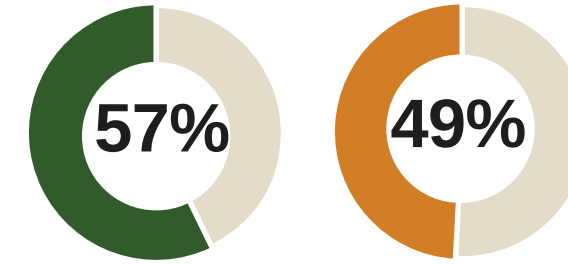
Outdated Income Tax Rate & Growing Inequality

The final threat to state revenue is Mississippi's essentially flat income tax brackets, which have not been updated in 25 years. The substantial disparity in the income of wealthy households compared to middle and low-income households should be reflected in the income tax rate. For example, a Mississippi family of four with $30,000 in annual taxable income pays the same 5% top tax rate as a family of four with $3,000,000 in annual taxable income.

F:7 Mississippi's Middle and Low-Income Families Pay More Than Half of the State's Taxes

The wealthiest 20% hold 57% of the state's total income. Mississippi families earning less than $70,000 pay more than half of the state's taxes through income tax and sales tax.

WEALTHIEST 20%



Source: MEPC Analysis of data from the Institute on Taxation and Economic Policy

Though the state's income tax brackets have remained unchanged, the wealthiest 20%, those earning more than $70,000 a year, have increased their income by more than twice the rate of growth compared to middle-income earners. Recently, while the wealthiest 20% gained income (F:7), the middle and low-income earners lost income.

Mississippi has the highest poverty rate in the nation at 22.4%, with more than one out of every five people living in poverty. Yet in Mississippi, even those living in poverty pay state income tax. In fact, the threshold for state income tax is lower than the federal poverty level (F:8).

Mississippi's heavy reliance on sales tax revenue inequitably burdens low and middle-income families (F:8), since a higher proportion of their incomes must be spent on taxed goods and services. An unbalanced tax system not only increases disparity, it threatens the overall tax system in the long term.

In general, income tax revenues are more effective for keeping pace with a state's financial needs than sales tax revenues.[4] Creating a new income tax bracket, with a 6% tax on income over $45,000 and a 7.5% tax bracket on income over $100,000, would raise approximately $109 million in additional annual revenue. It would also balance the income tax system more equitably among taxpayers.

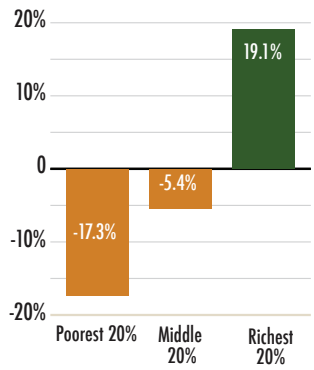
Throughout the state's history, lawmakers have adjusted the state's tax system to adapt to changing economic conditions and the needs of Mississippi families. Now is the time to address these threats before they thwart the state's economic stability.

An unbalanced tax system not only increases disparity, it threatens the overall tax system in the long term.

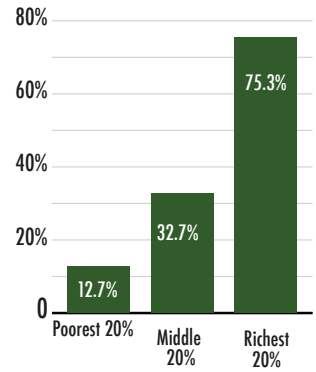
F:8 The substantial disparity in the income of wealthy households compared to middle and low-income households should be reflected in the income tax rate.

Mississippi's basically flat income tax has a top bracket that starts at only $10,000 of taxable income. It also fails to exempt income earned by families living below the poverty level. At the same time, the wealthiest Mississippians have seen dramatic increases in income while lower and middle income families have seen declines in their income.

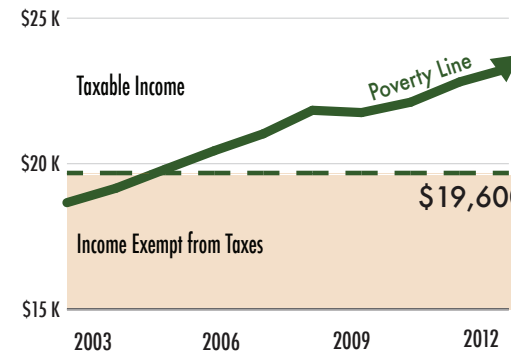
INCOME GROWTH: SHORT TERM
% change in income 1990s to 2000s



INCOME GROWTH: LONG TERM
% change in income late 1970s to 2000s



MISSISSIPPANS IN POVERTY PAY INCOME TAX
Income tax threshold and poverty line for family of four



Source: MEPC Analysis of data from the Center on Budget and Policy Priorities and Mississippi Code Section 27, Chapter 7.

References

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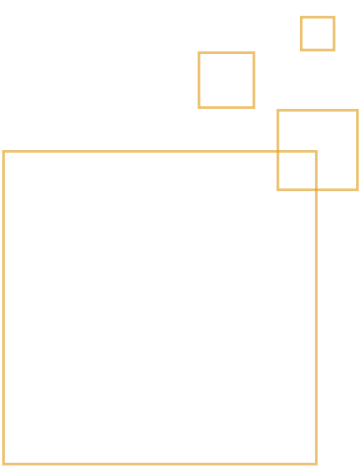
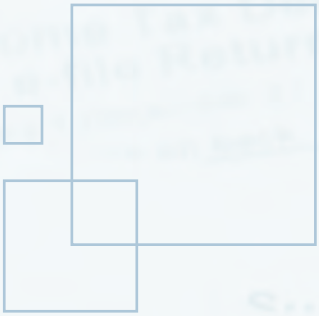
2. Snell, Ronald, National Council on State Legislatures, “State Personal Income Taxes on Pensions & Retirement Income : Tax Year 2010” available at http://www.ncsl.org/documents/fiscal/TaxonPensions2011.pdf.

3. Mississippi Code §27-65-23.

4. McNichol, Elizabeth, “Strategies to Address the State Tax Volatility Problem: Eliminating the State Income Tax Not a Solution,” Center on Budget and Policy Priorities, April 18, 2013.





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