THE FAIR SHARE TAX

IN BRIEF

- The “uniformity clause” of the Pennsylvania Constitution, which requires that any class be taxed at only one rate, prohibits a graduated income tax which leaves our tax system upside down as a whole. Those at the bottom and middle of the income distribution pay at far higher rates than those at the top.
- The Fair Share Tax replaces our personal income tax (PIT) with two separate taxes, a tax on wages and interest set at 2.8%, a tax on what we call income from wealth—dividends, capital gains, business profits, estates, royalties, and gambling winnings—which would be set at 6.5%.
- The Fair Share Tax would raise **$2.22 billion in new revenue** in the 2019-20 fiscal year and $2.63 billion in 2021-22. **Most of the new tax revenues will come from those at or close to the top of the income distribution with nearly 60% of the new revenue coming from the top 1%.**
- The Fair Share Tax reduces taxes for 60% of Pennsylvanians, including small businesses, while not raising taxes on seniors whose retirement income will continue to be exempt from personal income tax.

THE PROBLEM

As we point out in the introduction to our proposals for fair taxes, Pennsylvania’s tax system is upside down—those at the bottom and middle of the income distribution pay at far higher rates than those at the top. This is both unfair and a major barrier to raising the revenues the state needs to close the public investment deficit.

The primary reason that our tax system is so unfair is the “uniformity clause” of the Pennsylvania Constitution which requires that any class be taxed at only one rate which, among other things, prohibits a graduated income tax.

THE SOLUTION

The Fair Share Tax is a way to bring more fairness to Pennsylvania’s tax system by replacing our personal income tax (PIT) with two separate taxes. The first would be a tax on wages and interest set at 2.8%, set below the current personal income tax (PIT) rate of 3.07%. The second would be a tax on what we call income from wealth—dividends, capital gains, business profits, estates, royalties, and gambling winnings—which would be set at 6.5%.

The Fair Share Tax plan meets the requirements of the uniformity clause of Pennsylvania Constitution because each of the classes of income—classes that are well-defined in both federal and state law—would be taxed at a single rate. Wages and interest—that is income from labor and from the bank accounts in which people save their wage income—are received by almost everyone. Iincome from wealth is received mainly by a much smaller group with higher incomes. Thus the Fair Share Tax would begin to turn the Pennsylvania tax system right-side up, generating substantial new revenues mainly from those with the highest incomes in the state while reducing taxes for Pennsylvanians with low and moderate incomes.

- The Fair Share Tax would raise **$2.22 billion in new revenue** in the 2019-20 fiscal year and $2.63 billion in 2021-22.
- **Most of the new tax revenues will come from those at or close to the top of the income distribution with nearly 60% of the new revenue coming from the top 1%.**
  - Fifty-nine percent comes from Pennsylvania households in the top 1% of incomes who have an income above $569,000 and average income of $1.5 million. Their taxes increase by an average of $24,119, only 1.6% of their average income.
  - Another 25% comes from Pennsylvania households with income in the 95th through 99th percentile with incomes between $242,000 and $669,000 and an average income of $351,000. Their taxes increase by an average of $2,571 or 0.7% of their average income.
  - Another 12% comes from Pennsylvania households with incomes in the 80th through 94th percentile with incomes in the range of $109,000 to $242,000 and an average income of $152,000. Their taxes increase by an average of only $330 or 0.2% of their average income.
  - Overall, 95% of the increased revenue paid under the Fair Share Tax comes from families in the top 20% of all incomes.
- **Almost 60% of taxpayers would see their taxes go down** (59.3% to be exact); 25.7% will see no change in their taxes and 14.9% would see their taxes go up.
- **Out-of-state taxpayers will pay 16.1% of the $2.22 billion increase in revenues**.
- **There is little variation in the impact of the Fair Tax from one county to another or one legislative district to another**. The percentage of taxpayers in a county that sees a decrease or no change in their taxes ranges from 71% to 93%, with all but six counties in the 80% to 89% range. Rural and urban counties benefit similarly. Much the same is true in state legislative districts.
- **Because most small businesses can pay their owners in the form of wage income, the Fair Share Tax will reduce their taxes.**

BACKGROUND

Three criticisms of the Fair Share Tax are often put forward. Here, we explain why they are mistaken.

Criticism: Increasing taxes on the 1% will lead the wealthiest Pennsylvanians to leave the state.

> **Response:** There is nowhere for them to go. Based on an analysis we did using tax data from last year, even after implementation of the Fair Share Tax, the effective rate on the top 1%

of Pennsylvania taxpayers would be only 3.6%, less than that of any neighboring state and far below that of New York and New Jersey where the tax rate on the top 1% is 6.3%.

Criticism: The Fair Share Tax plan places an undue burden on retired seniors who only have income from wealth.

Response: Pennsylvania is already one of the most attractive places for seniors to retire because the state does not tax social security, pensions, or 401(k) withdrawals. This will not change under the Fair Share Tax plan. The only seniors who are likely to pay more are those who have substantial wealth far beyond the pensions and 401(k) plans held by most Pennsylvania seniors. They can afford to pay at a higher rate on their wealth.

Criticism: The Fair Share Tax plan will increase taxes on small business profits.

Response: The Fair Share Plan will actually reduce the taxes for most small businesses. The owners of small family businesses can receive income from them in two ways: as wages or as profits. Once the Fair Share Plan is instituted, small business owners will likely choose to receive most of their income in wages, which will lower their taxes from 3.07% to 2.8%. Larger businesses, which must secure profits to distribute to shareholders and drive up stock prices or to borrow from banks, will not have this option.

FOR MORE INFORMATION

Marc Stier, A Fair Share Tax to Support Public Investment in Pennsylvania, Pennsylvania Budget and Policy Center, March 21, 2017

PA Senate District Fact Sheets on the impact of a Fair Share Tax

PA House District Fact Sheets on the Impact of a Fair Share Tax

Senate Bill 555 Text