Good afternoon and thank you for this opportunity to testify. My name is Kamolika Das and I'm the Local Tax Policy Director at the Institute on Taxation and Economic Policy or ITEP. ITEP is a non-profit, non-partisan tax policy organization. We conduct rigorous analyses of tax and economic proposals and provide data-driven recommendations to shape equitable and sustainable tax systems.

ITEP recently updated our flagship report, *Who Pays?*, which analyzes the distribution of state and local taxes across the income scale in all 50 states and D.C.[1] This is the 7th edition of the study; the first was published in 1996. This edition is the most comprehensive and thorough version yet. It covers 99.7% of all state and local taxes, including the most minute taxes like Pennsylvania's fireworks tax and dry-cleaning tax.

Our research finds that across the US, state and local tax systems are regressive – meaning that low- and middle-income families pay higher tax rates than the wealthy. Nationwide the lowest 20 percent of earners, households making under $24,000 a year, pay 11 percent of their income on state and local taxes while the top 1%, households making over $730,000 a year, pay 7 percent of their income on state and local taxes. It's clear that states are falling very short of what the public considers to be a fair tax code. Definitions of what constitutes tax equity or tax justice differ. Some people argue for flat taxes, where everyone pays the same portion of their income on taxes. Of course, this leaves lower-income people with far less income after paying for basic necessities. Others believe that a fair tax system is progressive, where the rich pay more because they can afford to pay, and because they owe some of their good fortune to the public services and social stability that government provides. Regardless of your definition, when looking at most state and local tax systems, including Pennsylvania's, state lawmakers are not delivering on fair and equitable taxes. In fact, the regressive nature of Pennsylvania's tax system far exceeds that of the national average. In Pennsylvania, the lowest 20 percent of earners pay an effective tax rate **2.5x** higher as a share of income than the top 1 percent. In fact, the more one earns, the *less* they pay in state and local taxes – to such an extent that Pennsylvania ranks the 4th most regressive tax system in the nation according to ITEP''s Tax Inequality Index.

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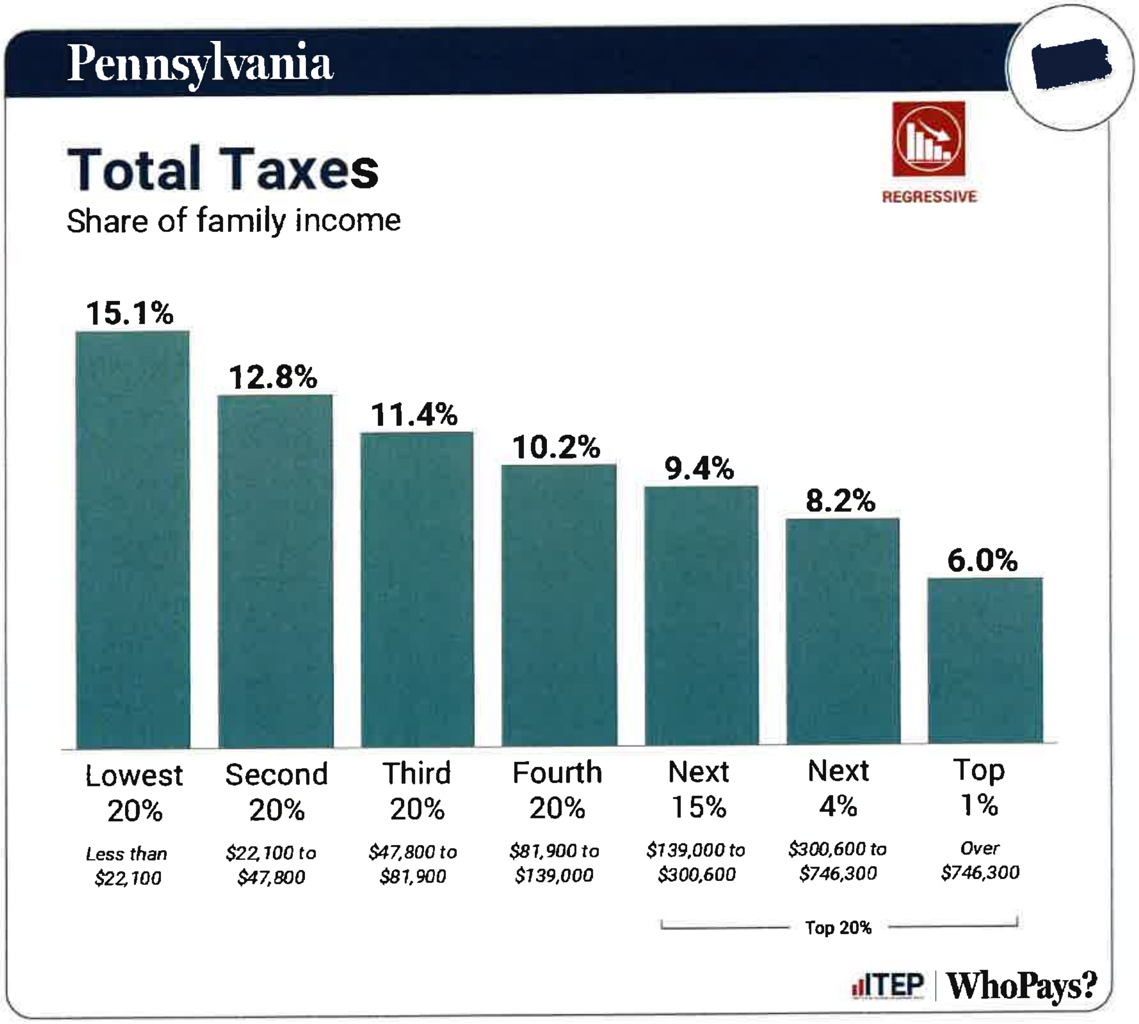
[1] Who Pays? 7th Edition, Institute on Taxation and Economic Policy, January 2024 https://itep.org/whopays-7th-edition/



A common thread that we've identified in regressive tax systems is that state and local governments are heavily reliant upon regressive taxes on what people buy, or on their homes that they own or rent. Sales taxes inevitably require a larger share of income from low- and middle-income families than from wealthier families because sales taxes are levied at a flat rate and spending as a share of income falls as income rises. A flat rate general sales tax may appear on its face to be neither progressive nor regressive, but that is not its practical impact. Since high earners can save a much larger share of their incomes than middle-income families—and since the poor can rarely save at all—the tax is inherently regressive. Similarly, taxes levied on housing will inevitably swallow up a larger share of income for lower-income families than it will for the wealthy since home values as a share of income tend to decline at higher incomes.

Often, when people think about state and local taxes, they solely focus on income taxes, but income taxes do not exist in isolation. This also leads to the deep misconception that flat income taxes result in an overall flat tax structure. But in reality, given the fact that sales taxes and property taxes are both regressive, states need offsetting structures like graduated income tax rates to create an overall flat structure and satisfy the minimum standard of tax fairness. A graduated tax that is based on one's ability to pay, or that is structured with rates that rise as income rises is the single biggest progressive tax that a state can levy. If you look at the jurisdictions that get closest to an overall flat structure, they rely heavily on graduated personal income tax rates.

Many states that are commonly perceived as "low tax" are often high tax for low-income families. This is especially stark in states without income taxes such as Florida, Tennessee, and Texas, but it's also true of many states with flat income tax rates. ITEP analyzed flat tax states and graduated income tax states empirically and on average, low- and middle-income households pay lower rates in graduated income tax states. This is commonsense since flat tax states are not raising as much from the wealthy so they must rely more heavily on everyone else. For example, households making $30,000 to $80,000 actually pay higher effective tax rates on all state and local taxes in Pennsylvania than they do in New Jersey.

Pennsylvania's overreliance on regressive taxes makes it more difficult to invest in the priorities that will bolster the prospects of low- and middle-income residents: education, workforce development, infrastructure improvements, and adequate healthcare. Progressive taxation is positively correlated with higher overall tax revenue levels relative to the size of each state's economy; choosing to tax high-income families who receive a large share of overall income at lower rates will inevitably constrain revenue collections. While Pennsylvania's wealthiest residents grew their collective wealth during the COVID-19 pandemic, the percent of families who are unable to afford the basics of housing, childcare, food, transportation, health care, and technology grew by 2 percentage points.[2] The existing flat income tax structure concentrates wealth and prevents Pennsylvanians from benefiting from these windfalls to address longstanding issues, such as the state's inexcusable educational opportunity gaps based on race and income levels.

Tax policy is one tool to help reduce this inequality. If you look at the jurisdictions with the least regressive state and local tax systems – the District of Columbia, Minnesota, Vermont, New York, New Jersey, Maine, and California – there are several common factors: graduated marginal income tax rates; targeted, refundable low-income credits; broad-based income taxes with limits on tax preferences for upper-income taxpayers; a higher reliance on taxes that take ability to pay into account; and a lower reliance on taxes on consumption. Several states have made strides in lessening tax regressivity in the past few years. New Mexico advanced 18 spots in our latest edition of *Who Pays?* by enacting a new state Child Tax Credit, a larger Earned Income Tax Credit for low-wage workers, a cut to the Gross Receipts Tax rate charged on the things New Mexicans buy every day, and a higher top income tax rate on the state's wealthiest families.[3] Washington state is no longer the single most regressive tax jurisdiction due to their recent enactment of a new tax on capital gains and the creation of a tax credit, similar to an EITC, for low- and moderate-income families. And Massachusetts voters dismantled their flat tax in November 2022 by adopting a constitutional amendment to impose a surtax on millionaires.

Flat rate tax structures are enshrined in the state constitutions of Pennsylvania, Colorado, Illinois, and Michigan, therefore limiting the shovel-ready policy options available to this set of states. However, even within those limitations, lawmakers can take immediate steps to reduce the regressivity of

[2] United for ALICE Research Center https://unitedforalice.org/state-overview/Pennsylvania

[3] Carl Davis, "New Mexico Making Tremendous Progress Making Taxes Less Regressive," Institute on Taxation and Economic Policy, January 2024 https://itep.org/new-mexico-making-tremendous-progress-making-taxes-less-regressive/

Pennsylvania's state and local tax system. Pennsylvania can choose to adopt state child tax credits like fourteen other states or join the nearly two-thirds of states (plus the District of Columbia and Puerto Rico) that have state earned income tax credits. Pennsylvania can also choose to tax income from wealth at higher rates than income from wages. Asking more of high-income and high-wealth households is an effective way to directly combat existing inequities in income and wealth and to raise sustainable revenues to support meaningful public investments.