How Can a Fair Share Tax Support Public Investment in Pennsylvania?

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By Marc Stier and Diana Polson[1] March 21, 2023

Executive Summary

Pennsylvania has long suffered from a tax system that is both highly regressive, taking a larger share of income from low-income and moderate-income families than high-income families, and that does not raise sufficient revenue to meet the needs of Pennsylvanians. In the recent past, inadequate revenues have led to a structural budget deficit and will continue to do so in the near future. In turn, this has led to what we call a public investment deficit: a lack of funding for critical needs that undermines both opportunity and economic growth. Just one example of the public investment deficit in Pennsylvania is the recent decision by Commonwealth Court President Judge Jubelirer saying the state fails to meet its constitutional obligation to provide a "thorough and efficient" education to all K-12 school children.

This paper puts forward the Fair Share Tax proposal, a major step toward fixing Pennsylvania's broken state and local tax system. It divides the state's Personal Income Tax into two new taxes: 1) a tax on wages and interest and 2) a tax on income from wealth which includes dividends; net income from a business, profession, or farm; capital gains; net income from rents, royalties, patents, and copyrights; gambling and lottery winnings; and income from estates or trusts.

The Fair Share Tax would raise the revenues we need to provide the public goods that are critical to creating thriving communities: education at all levels, infrastructure repair and improvement, protection for our air and water, and human services. It would set the tax rate on income from wealth higher than the current Personal Income Tax rate and set the tax on wages and interest lower than that rate.

In this paper, we present our standard Fair Share Tax plan. In the first appendix, we include another option that would raise even more money for Pennsylvania.

- Standard Fair Share Tax plan: Tax income from wealth at 6.5% and tax wages and interest at 2.8%.
    - This would raise $2.68 billion in new revenue each year, the vast majority of which would come from Pennsylvania's top 5% of income earners. Approximately fifteen percent would come from out-of-state taxpayers.
    - Under the Fair Share Tax, 57% of taxpayers would see their taxes go down, 26% would see no change in their taxes, and only 17% would see their taxes go up.
    - Considering only Pennsylvania taxpayers who see their taxes increase (i.e., excluding non-residents who pay taxes to Pennsylvania), 52% of the new revenues would come from the top 1% of families, 75% would come from the top 5% of families, and 87% would come from the top 20% of families. That means only 13% of revenue raised under the Fair Share Tax would come from the bottom 80% of income earners.

[1] While Marc Stier and Diana Polson wrote the text, Stephen Herzenberg contributed to the line of analysis that led to this paper. We are also very much indebted to Kamolika Das of the Institute for Tax and Economic Policy for her work in analyzing the impact of the Fair Share Tax.

    - There is little variation in the impact of tax from one county to another or one legislative district to another. The shares of taxpayers in a county that sees a decrease or no change in their tax ranges from 71% to 90%, with all but four counties under 80%.

- Option 2: Raise the tax rate on income from wealth to 12% and decrease the tax rate on income from wages and interest to 1.9%.
    - This option would increase Pennsylvania's revenue each year by $6.22 billion.
    - Eighty-five percent of taxpayers would see their taxes decrease (59%) or stay the same (26%). Only 15% of taxpayers would pay more under this option.
    - Fifty-two percent of the money raised by Option 2 comes from taxpayers in the top 1% and would earn, on average, $1.6 million per year. Three-quarters of the money raised would come from the top 5% of income earners.

These two options show the flexibility of the Fair Share Tax. While we present two options, legislators can choose to enact an almost infinite variation of combinations of two tax rates, one on the wages and interest, the other on income from wealth. And combining those tax rates in different ways can raise a range of new revenue. The two options we examine bring in an additional $2.9 billion or $6.22 billion annually, dramatically increasing state revenues. Other options could bring in lower or higher levels of income and contribute to making the overall state and local tax system in Pennsylvania more or less regressive.

New funding would allow the state to meet its constitutional responsibility, as recently determined by Commonwealth Court President Judge Jubelirer, to provide a "thorough and efficient" education to all school children. It would provide the pre-K education that every child needs to get their lives off to a good start. It would allow us to provide critical health care and other human services to vulnerable Pennsylvanians that were revealed by the pandemic to be inadequate. It would allow us to fix our crumbling infrastructure. And it would allow us to protect our water and air and do our part to limit climate change.

Meeting these important goals will be impossible if Pennsylvania does not figure out how to raise new revenues to meet these needs as well as close the structural budget deficit that will soon make it difficult to do what the people of Pennsylvania already expect our state government to do.[2]

[2] Marc Stier and Diana Polson, *Pennsylvania Budget Outlook: Short-Term and Long-Term*, Pennsylvania Budget and Policy Center, February 15, 2023, https://krc-pbpc.org/research_publication/pennsylvania-budget-outlook-short-term-and-long-term/.

Introduction

This paper puts forward a proposal we call the Fair Share Tax. Adopting it would be a major step toward fixing Pennsylvania's broken tax system and raising the revenues Pennsylvania needs to invest in the public goods that are critical to creating thriving communities and individual opportunity in our state: education, infrastructure, protection of our air and water, and human services.

The Need for Revenues in the Commonwealth Budget: Structural Deficits and Unmet Needs

Before the COVID-19 pandemic hit Pennsylvania, our need for new, recurring revenues was clear to all who followed Pennsylvania's budget politics. For a decade up until the start of the pandemic, the state government started each budget year with a structural deficit: the projected revenues for each year were less than the projected expenditures needed just to maintain the current level of state services adjusted for inflation and the need to meet contractual and constitutional obligations to state workers, debt service, and actuarially required pension contributions. Year afar year, structural deficits were met with short-term revenues such as selling licenses to new forms of gaming and budget gimmicks that included shifting revenues forward from future years to the current year, shifting expenditures back from the current year to future years, and borrowing from special funds. One last gimmick was underestimating Medical Assistance caseloads, which practically became an art form and at one point had created a $600 million and growing long-term deficit which was rolled over from year to year. And one year, the failure of the General Assembly to enact legislation for revenues to meet the expenditures it had already approved was met by floating a $1.3 billion bond secured by yearly tobacco settlement revenues.

The pandemic drastically reduced our state's revenues as much of the state shut down to mitigate the pandemic. But as the economy recovered, revenues picked up strongly, in no small part because the federal government provided huge sums to Pennsylvanians for unemployment insurance and relief checks. In addition, there has been significant federal funding flowing into Pennsylvania's state and local governments, including the American Rescue Plan (ARP), passed in March 2021, as well as other federal infrastructure and clean energy funding packages. These programs spurred the economic recovery and brought much-needed budgetary relief to the state. As we showed in a recent paper, these federal investments have led to large budget surpluses that have created a surplus we project to be $13 billion by the end of the fiscal year on June 30, 2023.[3]

However, as our recent paper also shows, projections by the Independent Fiscal Office (IFO) indicate that future revenues will not allow the state to continue to provide the current level of services it provides.[4] And, to be clear, these projected budget deficits are not a product of the pandemic. Rather, they were created by the same decisions that made it so difficult to balance state budgets in the decade before the pandemic: deep corporate tax cuts made in the last three decades, which reduced recurring revenues as well as the failure to find alternative sources of recurring revenues.[5] And, the corporate tax cuts enacted in June 2022 made the problem even worse. These projected deficits make it important to establish consistent and reliable funding sources for the state.

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[3] Ibid.

[4] Ibid.

[5] Marc Stier, *How Will Pennsylvania Use Its ARP Funds?* Pennsylvania Budget and Policy Center, April 29, 2021, https://krc-pbpc.org/research_publication/how-will-pa-use-arp-funds/.

New revenues are needed not just to secure fiscal stability but to create the commonwealth that meets our long-term need for public investment and especially to meet the moral and constitutional requirement to fund K-12 education adequately and equitably.

The Public Investment Deficit

Our state government has a responsibility to its residents to provide quality public education at all levels; services for those who need help dealing with poverty, poor health, and disability; infrastructure investments; and environmental protection among other things. When the state prioritizes these investments, our communities can thrive—our kids can get a good start in life through quality education, individuals and families can access critical human services, families can live in healthy and safe environments, goods can easily be moved from place to place, and people can travel to access good jobs in a thriving economy. However, when a public investment deficit becomes the norm, low- and middle-income families struggle and even the rich see their incomes grow more slowly. We fail to educate and train too many of our children for the jobs of the future, access to work and markets becomes harder for families and individuals, and our health, as well as the natural beauty of the state, is compromised by environmental degradation. Prosperity for all is stunted. In Pennsylvania, the public investment deficit takes on different shapes depending on the funding arena. But a common theme is that Pennsylvanians are losing out.

With regard to our state's public education system, a public investment deficit concretely means that too many children do not get the quality education they deserve, and our economy suffers as a result. Pennsylvania is ranked 44th in terms of the percentage of K-12 funding that comes from the state—in Pennsylvania, the state provides 38% compared to the national average of 48%. As a result, local governments must come up with more money for schools, primarily through property taxes, which are far harder to raise in low-income communities even when they are taxed at higher rates than high-income communities.[6] This has led to Pennsylvania having some of the most unequally funded K-12 schools in the country. In Pennsylvania, more than in any other state in the country, the zip codes and neighborhoods in which children grow up often determine the quality of their schools and strongly influence their future economic success.[7]

These are the problems that led President Judge Jubelirer to declare our system of funding K-12 education unconstitutional.

While funding K-12 education is the most prominent example of our public investment deficit, it is not the only one.

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[6] In Census link below, click on Summary Tables. Data is in table 5: "Percentage Distribution of Public Elementary Secondary School System Revenue by Source and State," US Census Bureau, https://www.census.gov/data/tables/2017/econ/school-finances/secondary-education-finance.html.

[7] Financial Information on Public Elementary/Secondary Education, Education Finance Statistics Center (EDFIN), National Center for Education Statistics, https://nces.ed.gov/edfin/Fy11_12_tables.asp. Also see: Emma Brown, "In 23 states, richer school districts get more local funding than poorer districts," *Washington Post,* March 12, 2015, https://www.washingtonpost.com/news/local/wp/2015/03/12/in-23-states-richer-school-districts-get-more-local-funding-than-poorer-districts/?utm_term=.1cefcd6cf8c4.

With regard to higher education, our state ranks 47th in the nation in terms of our public investment per capita,[8] and students are graduating with some of the highest debt in the country. Pennsylvania ranks fourth highest for in-state tuition and fees for public four-year colleges and universities.[9] This means that fewer low- and middle-income students can afford to attend college, which affects their future earnings and career options. Those who fund higher education through debt find their legs are kicked out from under them before they even begin their careers. In 2020, Pennsylvania graduates had the third-largest student loan debt in the country.[10]

Given the strong relationship between educational attainment in a community and economic and wage growth, the public investment deficit harms everyone in the state.[11] We underserve those who are intellectually and physically disabled, those who suffer from mental illness, adults and children who need protection from abuse, and those who, through no fault of their own, cannot find steady work or cannot afford child care so that they can work. With overdose deaths in our state nearly twice the national average, the opioid crisis is partly a sign of our failure to adequately fund human services.[12]

And at a time of increased global warming and weakening environmental protections at the national level, we still suffer from the deep cuts made a decade ago to Pennsylvania's Department of Environmental Protection (DEP). Public investment in the DEP dropped 39% between 2007–2008 and 2019–20.[13]

Our failure to invest in the public goods has created a state where communities are struggling and opportunity is limited.

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[8] College of Education, Grapevine database Table 4, Illinois State University, https://education.illinoisstate.edu/grapevine/tables/.

[9] Data downloaded from https://research.collegeboard.org/media/pdf/trends-in-college-pricing-student-aid-2022.pdf.

[10] Diana Polson, *Why Pennsylvania Needs Student Debt Relief: A Look at Our State's Student Debt Crisis*, Pennsylvania Budget and Policy Center, September 2022, https://krc-pbpc.org/wp-content/uploads/2022_PA-Student-Debt-Report-1.pdf.

[11] An increase of one year in the average number of years of schooling in an area is associated with increases of 17.4% in GDP per capita and 17.8% in wages per worker. See Noah Berger and Peter Fisher, *A Well-Educated Workforce Is Key to State Prosperity*, Economic Analysis Research Network (EARN), August 22, 2013, http://www.epi.org/publication/states-education-productivity-growth-foundations/.

[12] For more information on the opioid crisis in Pennsylvania, see http://6abc.com/health/gov-wolf-declares-a-disaster-emergency-over-opioid-crisis/2924563/ and https://www.haponline.org/Newsroom/News/ID/2558/PA-Drug-Overdose-Deaths-Up-37-during-2016-On-Average-13-Died-Daily.

[13] Diana Polson and Marc Stier, *Some Steps Forward Amid Major Disappointments: Pennsylvania's Enacted Budget 2019-2020*, Pennsylvania Budget and Policy Center, August 2019, https://www.krc-pbpc.org/research_publication/some-steps-forward-amid-major-disappointments-pennsylvanias-enacted-budget-2019-2020/.

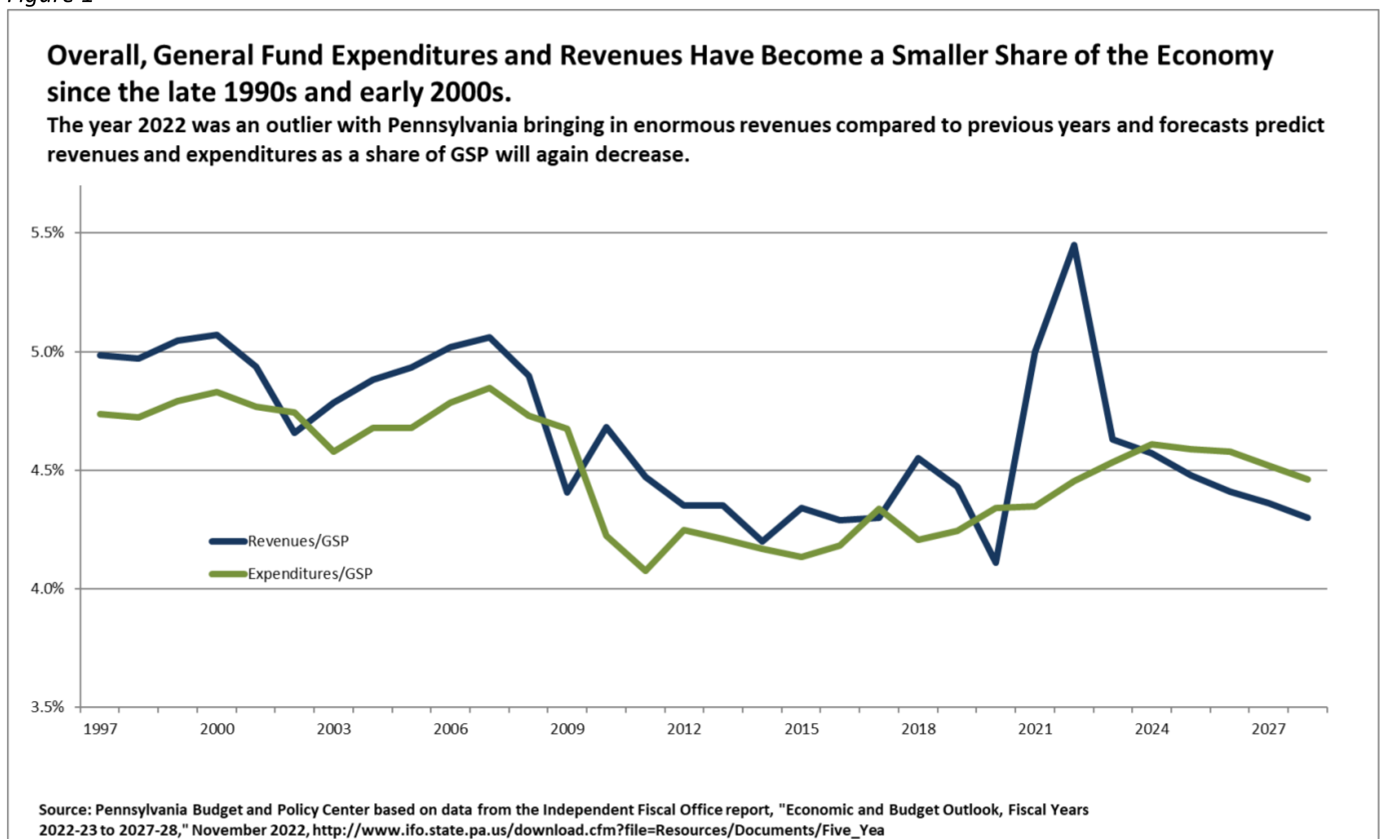
Enacting the Fair Share Tax proposal would be a big step toward resolving the structural deficit while closing our public investment deficit. And it would do so by asking the Pennsylvanians with the greatest incomes and wealth to pay their fair share of the tax burden.

The Source of our Public Investment Deficit

The Trend Is Towards A Shrinking Government in Pennsylvania

Our public investment deficit did not just happen naturally. And it is certainly not the result of a government that is growing in Pennsylvania. Just the opposite is true. Overall, our state government has been slowly shrinking. As figure 1 and table 1 show, state government spending in Pennsylvania has been falling as a share of the state's economy since 1996. Fiscal year 2021-22 is an outlier because of the enormous revenues generated that year by the quick recovery from the pandemic recession and because of the significant federal transfer of funds to the state. Predictions show that, as a share of Gross State Product (GSP), revenues and expenditures will begin to decrease again starting in 2023 and 2024.

Figure 1



A large part of this decrease took place under the administration of Governor Corbett (2011–2014 on table 1) during which expenditures as a percent of Gross State Product (GSP) decreased to 4.18%, substantially below the 4.70% average, between 1997 and 2010. This trend continued under Governor Wolf, although less so with spending between 2015 and 2023 at 4.31% or 8.3% below the 1997–2010 average. Projections show expenditures are likely to increase, although they still remain less than the 1997–2010 average.

Table 1

Pennsylvania General Fund Expenditures and Revenues as a Percent of Gross State Product (GSP)

Fiscal year ending	Expenditures / GSP	Revenues / GSP	Reduction in Spending Compared to 1997-2011
Average 1997 to 2010	4.70%	4.88%	
Average 2011 to 2014	4.18%	4.34%	-11.2%
Average 2015 to 2023	4.31%	4.57%	-8.3%
IFO Projections 2024 to 2028	4.55%	4.42%	-3.2%

Source: Pennsylvania Budget and Policy Center based on Independent Fiscal Office, "Economic and Budget Outlook, Fiscal Years 2022-23 to 2027-28," November 2022.

Of course, while state spending as a percent of GSP has declined, it has grown in absolute terms. But an increase in spending is necessary to maintain the same level of government services. The population of the state grows in most years, and inflation requires higher levels of spending to maintain the same level of services. And that is especially true in government because inflation in services—which is mainly what government provides, especially in health care services—tends to be higher than inflation in goods. Technological innovation makes it possible to produce goods such as computers and cars that are both cheaper and/or much more capable than they were in the past. But services are far more likely to be labor-intensive. That is why we pay relatively more for haircuts and concert tickets today than 20 or 40 years ago, while our computers become cheaper and more capable. To maintain the same level of service, government has to slowly grow as a share of GSP over time. Instead, it has shrunk in Pennsylvania.

The Problem Is Revenues, but the Solution Is Not Tax Increases on Everyone

As expenditures shrink in Pennsylvania our investment deficit grows. But the state cannot spend more than it brings in—so the ultimate source of our investment deficit is a reduction in revenues. Look again at figure 1 and table 1. Not only our expenditures but our revenues have dropped substantially as a share of the GSP since the period 1997 to 2011.[14]

While our investment deficit is the result of the state bringing in less revenue than it needs, the solution to this problem is not to raise taxes on everyone. As figure 2 shows, incomes for most Pennsylvanians have been flat for the last 30 years. But incomes for the top 1% have grown fast—and even more, for those with income/wealth in the stratospheric heights. Figure 2 shows just how much the 1% has captured in overall income growth. During the period 1945–1973, just 3.4% of overall income growth went to the top 1%. However, this changed drastically during the period 1973–2015 in which 46% of income growth when to the top 1%. The burden for new revenues should fall on those who have been doing well in the economy—not those who are just scraping by.

But that is exactly the opposite of the way Pennsylvania has been securing tax revenue.

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[14] Careful readers will note that in all three periods under consideration, revenues exceed expenditures as a percent of GDP. So why hasn't the state been accumulating surpluses? The answer is that each year revenues must exceed expenditures to provide a reserve for tax refunds to those whose withheld tax payments exceed their tax obligation. The refund reserve is, on average, 4% of expenditures or 0.18% of state GDP.

Figure 2

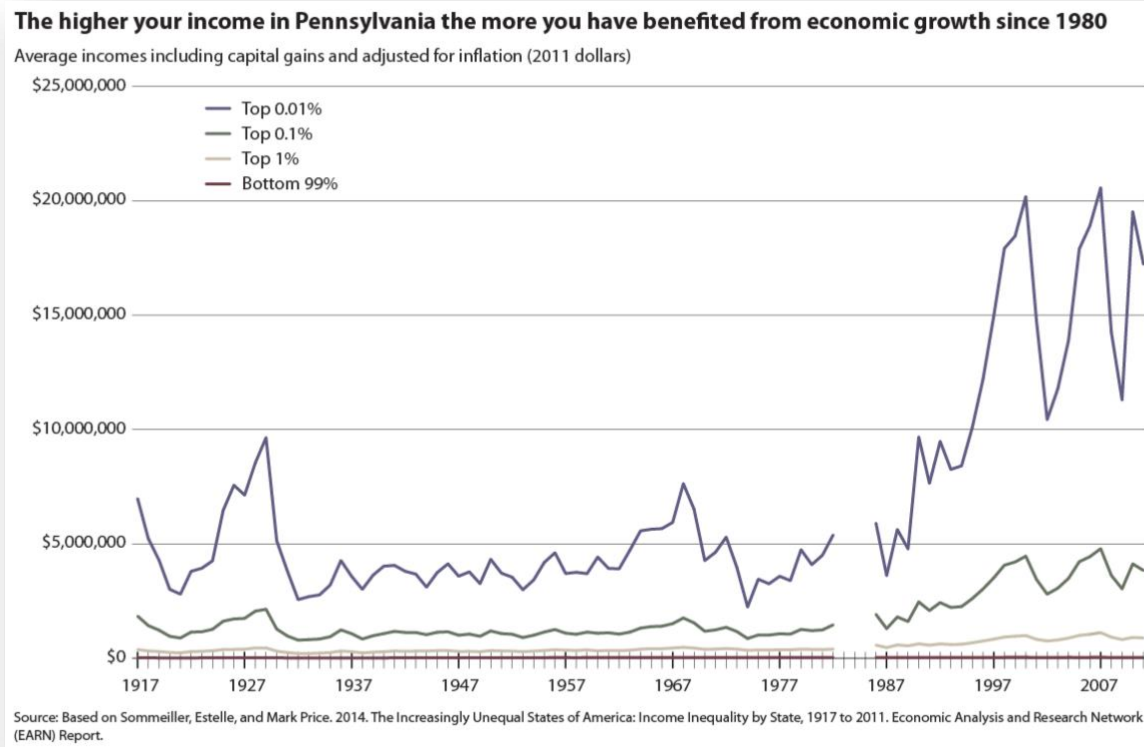
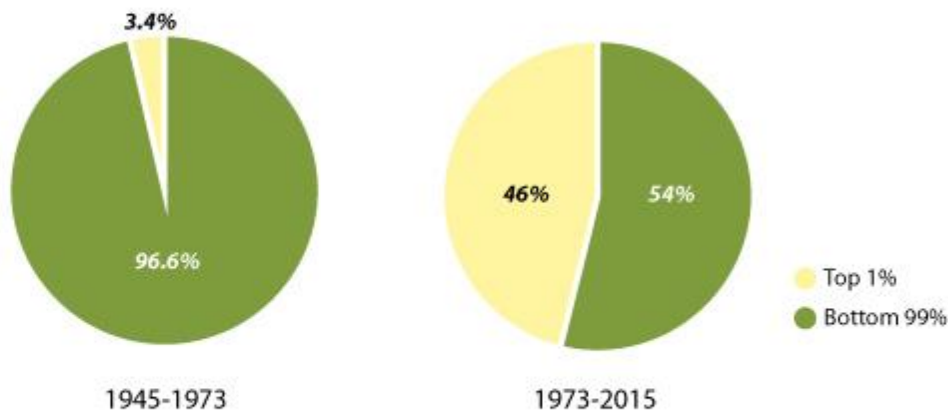


Figure 3



Source: Sommeiller, Estelle, and Mark Price. 2018. The New Gilded Age: Income Inequality in the U.S. by State, Metropolitan Area, and County. Economic Policy Institute, July 2018.

Our Broken Tax System

The revenue problem in Pennsylvania is a result of decisions made in both the distant past and more recent times.

The Uniformity Clause

The greatest limitation on our tax system is the Pennsylvania Constitution's "uniformity clause." This clause was introduced when the electorate ratified the "Reform Constitution" in 1874 at a time when the power of corporations, especially those engaged in railroad and mining industries, was at its greatest. The charter "was drafted in an atmosphere of extreme distrust of the legislative body and of fear of the growing power of corporations." In fact, the purpose of the uniformity clause was to limit the Pennsylvania Legislature's authority to pass "corrupt legislation" that would give preferential treatment to "favored industries and individuals." One document from 1886 tells us that the authors of the uniformity clause worried about the result of preferential laws leading to a situation in which "the burden of maintaining the state had been, in repeated instances, lifted from the shoulders of favored classes, and thrown upon the remainder of the community."[15]

Despite the original intent, the uniformity clause has limited Pennsylvania's ability to enact progressive taxation aimed at ensuring the rich aren't effectively paying a smaller share of taxes than the poor. While many states have similar clauses, the uniformity clause in Pennsylvania has been interpreted by our Supreme Court in a way that strictly limits the kinds of taxation the General Assembly can enact. In particular, it requires that Pennsylvania have a flat income tax, prohibiting the introduction of graduated income taxation rates, in which the percentage of income taxed goes up as a taxpayer's income rises.

Our uniformity clause makes it difficult, but not impossible, to increase taxes on those with high and rapidly rising incomes without also taxing those whose incomes are low or growing slowly. And it turns our whole tax system upside-down. In every state, sales taxes and property taxes take a larger share of the income from those at the bottom than those at the top.[16] But in most other states, graduated income tax rates reduce the disparity. Because our uniformity clause prohibits graduated tax rates, state and local taxes in Pennsylvania take far more from low-income families and individuals than from those with high incomes. As figure 4 shows, the 20% of Pennsylvania families with the lowest incomes (making less than $23,000 per year and an average income of $13,000) pay 13.8% of their income in state and local taxes, while those in the top 1% (making, on average, $1.7 million per year) only pay 6.0% of their income on state and local taxes. The bottom 60% of income earners, on average, pay at nearly double the tax rate of what the richest Pennsylvanians pay on average.

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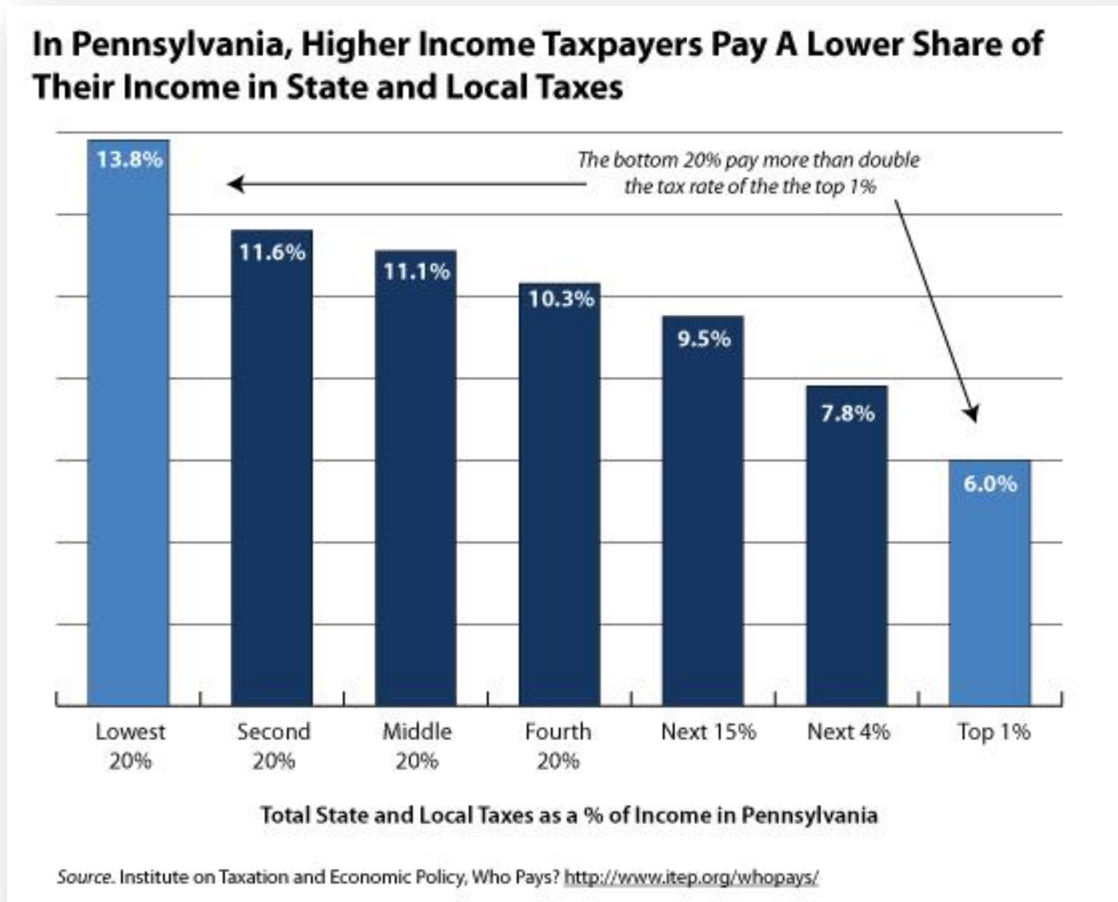
[15] "Sands Bethworks Gaming, LLC v. Pennsylvania Department of Revenue, et al." J-38-2018, MO: Saylor, C.J. Supreme Court of Pennsylvania Middle District – Concurring Opinion, Unified Judicial System of Pennsylvania, April 26, 2019, http://www.pacourts.us/assets/opinions/Supreme/out/concurring%20opinion%20%20questions%20answered%20%2010396958856638517.pdf.

[16] Sales taxes do so for two reasons. First, those at the middle and top of the income scale save some part of their income, but those at the bottom spend all of it in order to meet the necessities of life. Second, sales taxes in many states, including Pennsylvania, tax many goods (although not food, clothing, and medicine) but don't tax services. As incomes rise, however, families tend to spend more on services. For example, they go out to eat more (and at more expensive restaurants) and partake in more expensive forms of entertainment. Property taxes tend to take a larger percentage of the income of families at the bottom or middle than the top because the value of property owned by families does not tend to rise in proportion to their income. Real estate is generally the only wealth held by those in the middle. Only the rich own substantial intangible property such as stocks and bonds.

State tax systems do not need to be upside-down. Appendix 2 provides a similar analysis of the tax systems in the states that surround Pennsylvania. While only one state among our neighbors has a truly progressive tax system in which the share of income paid in state and local taxes rises as household income rises, every one of those states has a tax system that is fairer than Pennsylvania's, often remarkably so. And Delaware, the state known for a low corporate income tax, has a truly progressive state and local tax system.

Figure 4



Our upside-down tax system is unjust. Indeed, Pennsylvania's tax system is so bad that Pennsylvania ranks as the 7th most unfair tax system in the country as identified by the Institute on Taxation and Economic Policy (ITEP).[17]

But our tax system is more than unfair. It also leads to our state's revenue inadequacy. We simply cannot raise enough revenue if we rely on raising revenues from those whose wages have remained stagnant and incomes are low and are unwilling to tax those who have the highest and fastest-growing incomes in the state. Our broken tax system makes it impossible to solve our both our budget and public investment deficits.

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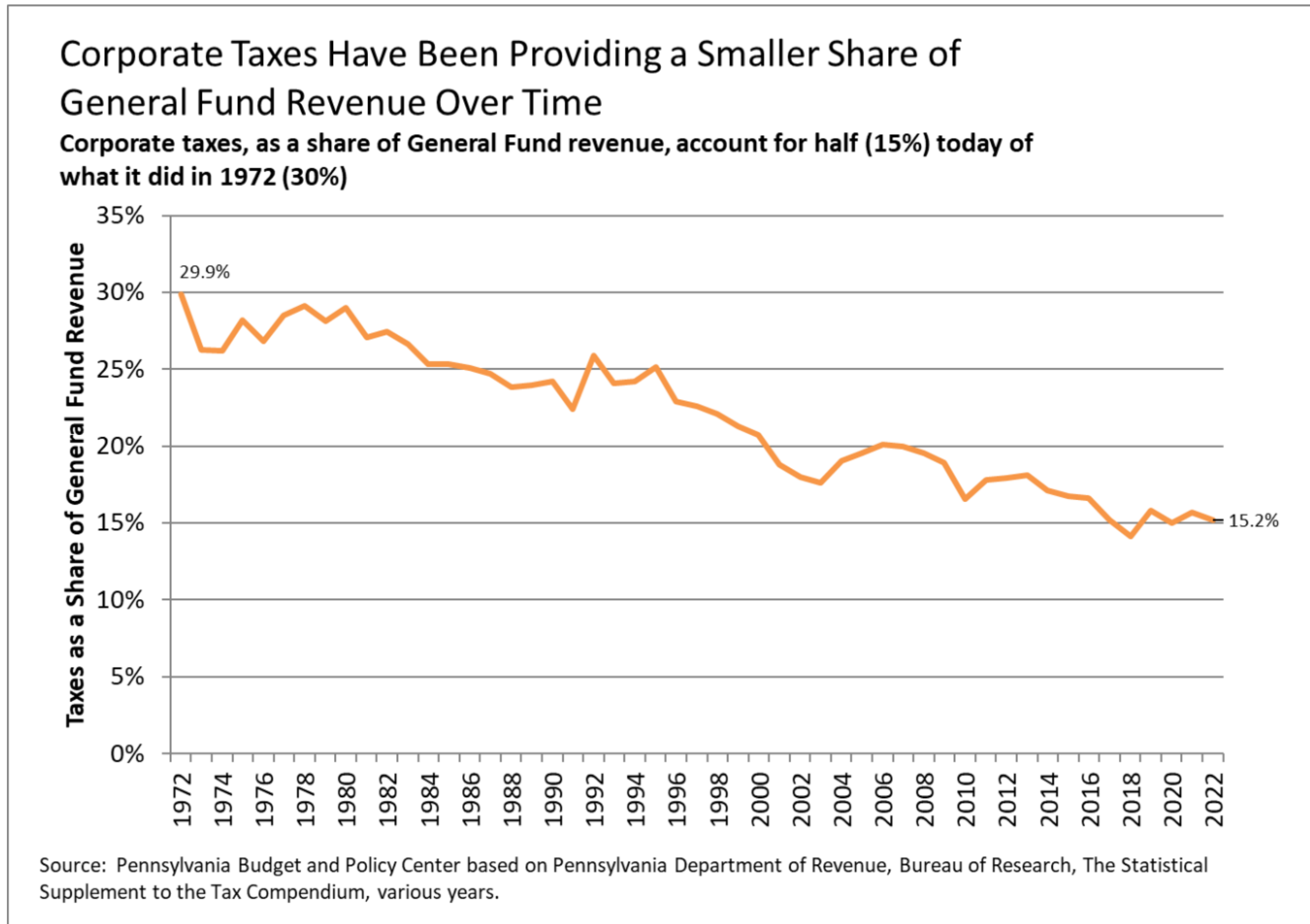
[17] Institute on Taxation and Economic Policy, *Fairness Matters: A Chart Book on Who Pays State and Local Taxes*, March 2019.

Corporate Tax Cuts

This long-term problem has been exacerbated by decisions made by the General Assembly in more recent years, supported by members of both political parties, to cut corporate taxes. One corporate tax, the Capital Stock Franchise Tax, has been entirely phased out. Meanwhile, changes in the Corporate Net Income Tax have reduced revenues as well.

The dramatic decline in the contribution of corporate taxes to General Fund revenues can be seen in figure 5. Corporate taxes in the early 1970s provided 30% of General Fund revenue. Today it only provides half of that at 15%.

Figure 5



If we had not cut corporate taxes in the last 15 years, the commonwealth would be receiving an additional $4 billion per year, funds that could be used to close the public investment deficit in many areas. There would be funds available to invest in education, human services, infrastructure, and protecting our air and water.[18]

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[18] Corporate tax cuts were defended on the assumption that they would lead to increased economic growth and the creation of new jobs. This did not happen, as we have shown in Ellis Wazeter and Mark Price, *The Final Verdict: A Cuts-Only Approach to the Budget Doesn't Work*, Pennsylvania Budget and Policy Center, June 23, 2015. Available online at http://keystoneresearch.org/finalverdict. See also Mark Price, *Pennsylvania at*

To make matters worse, our state's Corporate Net Income Tax rate will be decreasing over the next several years, as decided as part of the last state budget (2022-23). In January 2023, the rate reduced from 9.99% to 8.99%. Each year, the rate will decrease an additional half a percentage point until it reaches 4.99% in 2031. The IFO estimates that the combined effect of these corporate tax changes will cost the state $853 million by fiscal year 2025-26 and $1.3 billion by fiscal year 2027-28.

The Fair Share Tax: Raising Additional Revenue Through a Tax on Income From Wealth

We put forward our proposal for fixing our broken tax system by creating a tax on income from wealth in the spring of 2016.

The Basic Idea Behind the Fair Share Tax

Our basic idea is to bifurcate the current personal income tax. Currently, eight classes of income, which are defined under federal law, are subject to the Pennsylvania Personal Income Tax: gross compensation (mostly wages, salaries, and tips); interest; dividends; net income from a business, profession, or farm; capital gains; net income from rents, royalties, patents, and copyrights; gambling and lottery winnings; and income from estates or trusts.[19] We propose creating two new taxes to replace the Personal Income Tax. The first would be a tax on what we call income from work (or earned income) that includes two classes of income, wages and salaries, and bank interest. It would be set below the current Personal Income Tax rate. The second would be a tax on the other six classes which would be set higher than the current Personal Income Tax rate. We call those other seven categories "income from wealth" or "passive income" because they mostly include income that is earned from the ownership of some kind of wealth (including, among other things, intangible and real property) as opposed to income from work.

Most people under the age of retirement have income from compensation, that is, wages, salaries, tips, and interest. But what we call "income from wealth" is mostly earned by those with higher incomes. Thus, by taxing income from wealth at a higher rate we can generate more tax revenue from those whose overall incomes are high and have been growing fast.

Given how upside-down our taxes are, we need to start raising more revenue from those whose incomes are going up and give those whose incomes are static or declining a break. In this paper we propose two options of the Fair Share Tax.

1. The first option would increase the tax on income from wealth from the current 3.07% to 6.5% while reducing the tax on income from work from 3.07% to 2.8%, where it was when Tom Ridge was governor. This would raise roughly $2.68 billion per year.
2. The second option, which we share in appendix 1, would raise significantly more money—slightly more than $5 billion per year—by raising the tax on income from wealth to 12% and reducing the tax on income from work to 1.9%.

Another Crossroads, Pennsylvania Budget and Policy Center, October 6, 2015, https://pennbpc.org/pacrossrds. State and local taxes are only a small fraction of business costs. While tax reductions for businesses have a large effect on the state budget and public employment, they are a small share of business costs and do little to change the market forces that shape employment growth in the Commonwealth over the long term. Labor is one of the largest costs for most businesses. Since one of the primary roles of public spending is investment in education and training, which makes workers more productive, our failure to adequately invest in our children now will undercut future prosperity.

[19] Pennsylvania Department of Revenue, *Pennsylvania Personal Income Tax Guide*, revised March 7, 2014, p. 9 of 53, http://www.revenue.pa.gov/FormsandPublications/PAPersonalIncomeTaxGuide/Pages/default.aspx.

Complications With Regard to "Self-Employment Income"

While the basic difference between income from work and income from wealth is clear, there are some complications which we want to mention, before examining our projections of who pays more or less and how much more revenue is raised under the first version of the Fair Share Tax. We do this both to explain the proposal more completely and because the data on the impact of the Fair Share Tax we report below does not precisely match our proposal.

One of the complicating factors in estimating the impact of the Fair Share Tax is that self-employment income of many different kinds is included on schedule C of federal tax returns. Those who report self-employment income have to pay not only federal income taxes on their income but Social Security and Medicare taxes (commonly known as payroll taxes) as well, taxes that are withheld from wages on payroll checks for those who are employed by others. The self-employed pay Social Security and Medicare taxes at twice the rate of wage earners because they pay both the worker and the employer half of those taxes.

There are two broad kinds of schedule C income. The first includes self-employment income received by gig workers, such as drivers for Uber and Lyft, contract workers such as consultants for businesses including many of those who work for long periods of time with a business in this capacity, and sole proprietors in a small business or a profession, such as the owners of corner shops in urban areas or lawyers. We believe that this kind of income should be treated similarly to wage income and taxed at the lower rate since it is almost entirely earned by the labor of the self-employed.

Schedule C income also includes self-employment income that is passed through a subchapter S corporation, limited liability company, partnership, or other artificial entity. These entities are able to enter capital markets to secure funds that then enable them to earn some income from wealth, that is from investments of various kinds—in facilities, stock, tools and machinery, offices, and much more advertising than is typically carried out by small proprietors. These enterprises typically have more employees than small proprietors and solo practitioners and thus earn income from the work of others. Limited liability entities, such as subchapter S corporations, limited liability companies (LLCs), limited liability partnership (LLPs) also protect their owners by limiting their liability to creditors. Partnerships, whether they are organized as LLPs or not, have the structural advantages of allowing the members to raise capital more readily and extensively. They are also able to pool their talents and resources—including capital resources—more efficiently, share and spread out costs, and provide for business continuity upon departure of a member.

None of the entities described in the last paragraph pay any corporate tax. Instead, their profits are passed through to their owners as self-employment income on which personal income taxes are paid.

Recognizing that no system of dividing income between income from work and wealth is perfect, we believe that this second kind of self-employment income should be classified as income from wealth and should be taxed at the higher rate.

The decision to classify different kinds of self-employment income as income from work or income from wealth is imperfect and is not based on the amount of income people in these two groups typically earn. There is no question that some contract workers earn very high incomes while others earn low incomes—just like some people who only earn income from wages earn very high incomes and others earn very low or moderate incomes. And, by the same token, not all who earn self-employment pass-through income have high incomes. But, on average, the first category of self-employment income—that of gig and contract work and sole proprietors—goes to households with lower incomes as a whole than the households that earn the second kind of self-employment income—pass-through income from S corporations, LLCs, LLPs, and partnerships. And, more importantly, for our purposes, those with the second kind of self-employment income earn income from wealth as well as work.

The data we present on who would pay more or less under the Fair Share Tax comes from the Institute on Tax and Economic Policy (ITEP). Limitations of the data in their economic model makes it impossible for them to disaggregate the two kinds of schedule C self-employment income. We have looked at the results of the analysis we present below with all this income taxed first at the lower rate and then at the higher rate, and the differences are not that extraordinary. We have chosen to include it all as income from work to be taxed at the lower rates we propose. This has the effect of somewhat *underestimating* both the amount of revenue that would be generated and how much of that new income would be paid by households with the highest incomes.

The Tax on Income From Wealth and the Pennsylvania Constitution

To some extent, the impact of a Fair Share Tax simulates the pattern of tax distribution that would result from Pennsylvania having a graduated income tax by raising taxes on households with higher overall incomes and cutting taxes for households with lower overall incomes. But it is not a graduated income tax. That is why the Fair Share Tax is not inconsistent with the uniformity clause of the Pennsylvania Constitution.

The uniformity clause requires that a tax must be "uniform upon the same class of subjects." The different classes of income are well-defined in both federal and state law. Under the Fair Share Tax, each class of income is taxed at a single rate. And variations in the tax rate on different classes of income is a long-standing tradition in federal tax law and that of many states.

As we show in more detail in a piece written by Richard Feder, a well-known tax lawyer in Pennsylvania, the usual interpretation of the uniformity clause as shown in a large body of case law—and many examples of taxes that are similar to the Fair Share Tax in one way or another—would not stand in the way of the General Assembly enacting our proposal.[20] Perhaps most importantly, Pennsylvania's courts have long allowed for different tax rates on different "readily recognizable, well-established" classes or categories of income that are "regularly subject to differential treatment in the business world, the financial world, and/or the regulatory world." As our brief shows, the distinction between active and passive income, or earned and unearned income, is long established in all these areas.

In addition, while a policy rationale for taxing different categories of income at different tax rates is ***not*** required to pass muster under uniformity clause case law, there are a number of sound rationales for taxing income from work and income from wealth differently.

First, taxes on labor tend to reduce the economic incentive to seek employment or to work longer hours. By enacting the Fair Share Tax, the General Assembly would be creating a strong incentive for Pennsylvanians to work and to work more by rewarding those who do.

Second, Pennsylvanians need to produce active income in order to meet their daily living expenses; thus, the Legislature has good reasons to ease the burdens on workers, as the tax burden simply takes money off the table from people who really could use the money. In contrast, passive income, or income from property or wealth, is generally received by those with greater means, who can more easily afford a higher tax burden.

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[20] This section of the current paper draws heavily on this piece. Richard Feder, J.D., *The Fair Share Tax Is Uniform Under the Pennsylvania Constitution,* Pennsylvania Budget and Policy Center, January 13, 2022, https://krc-pbpc.org/research_publication/the-fair-share-tax-proposal-is-uniform-under-the-pa-constitution/.

Third, income from wealth also involves some measure of speculative activity; taxpayers use their wealth to purchase and maintain some income-producing property. The Legislature could conclude rationally that those who can afford to take such risks can also afford to absorb a slightly higher tax burden.

Fourth, the huge expansion of inequality in America in the last 35 years is the result of the returns to labor declining relative to the returns to capital or wealth. This is, first, contrary to the basic premise of our country and state. America and Pennsylvania have always been dedicated to the proposition that hard work should be rewarded. As wages have stagnated, that is increasingly untrue. We can partly compensate for the tilt in our economy from labor to wealth by creating a tax system that taxes the latter at higher rates than the former.

Fifth, increasing wealth is also dangerous to our democracy as both our Founders and later advocates for preserving our democracy from huge accumulations of wealth, such as Theodore Roosevelt and Louis Brandeis, warned. Wealth can too easily be translated into political power. Increasing the tax on wealth is one way, among others, to limit the kinds of wealth accumulation that threaten our democracy.

And sixth, racial justice demands that we tilt our tax system from taxing wages to taxing income from wealth. Even after slavery, economic and residential segregation, as well as government policies such as redlining, have made it more difficult for people of color to accumulate wealth relative to white people. Taxing income from wealth more than wages is one way to right the balance.

Misconceptions: Seniors and Small Businesses

Two misconceptions often arise about the impact of increasing the tax on income from wealth.

The first is that the tax would disproportionately affect seniors. This might be true if Social Security benefits, pensions, and 401k distributions were to fall under the tax. But they are not taxed at all in Pennsylvania, which would remain one of the most tax-friendly states for retirees in the country after the Fair Share Tax is created. Some seniors do rely on other income from wealth to sustain them during retirement. But this is primarily true only for the wealthiest seniors. In fact, the Institute on Taxation and Economic Policy (ITEP) analysis of the Fair Share Tax finds that 72% of seniors (65+) would see a tax cut or no change in their taxes. Further, the highest-income fifth of seniors (average income $323,700) would pay 91% of the increase in taxes among seniors.

The second is a concern that small businesses would be hurt by an increase in the tax on income from wealth because that tax includes business profits. Some of those business owners would be protected by the proposal discussed above to tax the self-employment income of sole proprietors and family businesses at the lower tax rate. But there is another way in which small, family business owners can avoid paying taxes at the higher tax rate. Under current Pennsylvania law and regulations, owners of small businesses who actively work in the business, including those classified as subchapter S corporations, can earn income either as business profits or as wages. The latter would be taxed at a lower rate. Family-owned and other small businesses can thus avoid higher taxes under the Fair Share Tax by taking more of their income as wages rather than business profits. This built-in loophole for small, family businesses would not be available to larger business that have to show higher business profits to secure new capital.

The Fair Share Tax Raises $2.68 billion yearly by increasing the tax on income from wealth to 6.5% and decreasing the tax on income from wages, interest, and self-employment income to 2.8%.

Who Would Pay the Fair Share Tax Statewide:

The Fair Share Tax would raise $2.68 billion per year, primarily from those with the most ability to pay.

As table 2 shows, only 17% of Pennsylvania taxpayers would pay more under the Fair Share Tax. The vast majority of taxpayers, 83%, would see their taxes go down (57%), or remain unchanged (26%).

Table 2

Impact of Fair Share Tax on Pennsylvania Taxpayers	
Decrease	57%
No Change	26%
Increase	17%
Source: Pennsylvania Budget and Policy Center analysis of data from the Institute of Taxation and Economic Policy (ITEP)	

Whose Taxes Would Increase Under the Fair Share Tax?

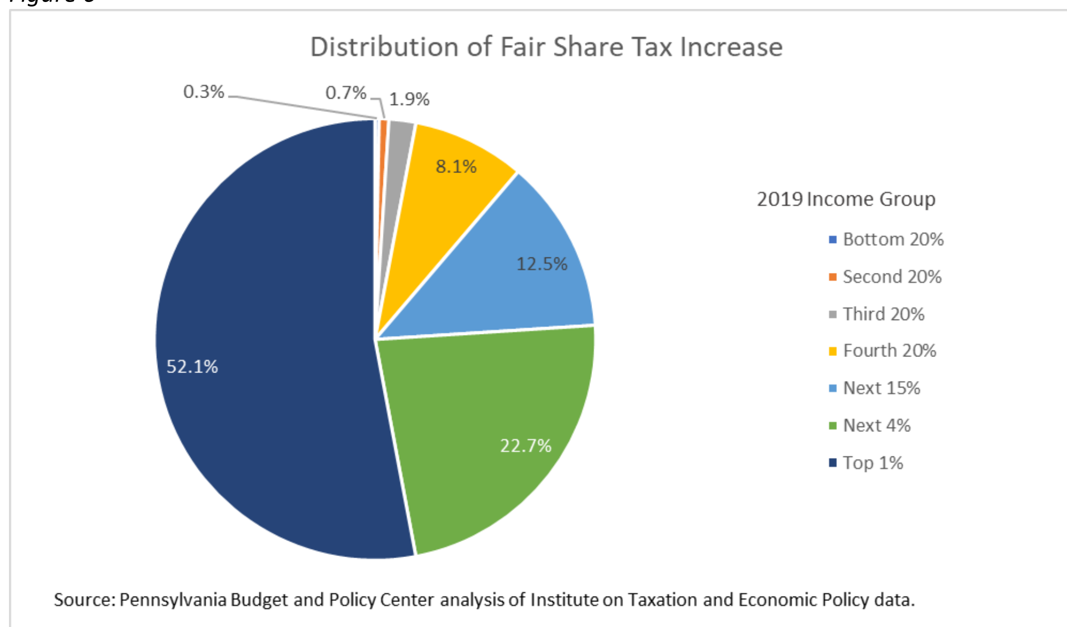
Table 3 and figure 6 show whose taxes would increase under the Fair Share Tax but only among Pennsylvanians (i.e. this analysis excludes non-residents who pay income tax to Pennsylvania).

Given what we said about the distribution of income from wealth, it should come as no surprise that most of the increase in taxes would be on taxpayers with the greatest incomes. Fifty-two percent of the money raised from Pennsylvanians by the Fair Share Tax comes from taxpayers in the top 1% of income, with earnings of $667,000 or more and an average income of $1.75 million. Another 23% of taxes raised by the plan from Pennsylvanians comes from taxpayers in the next 4%, from the 95th to 99th percentile, with incomes between $273,000 to $667,000. Thus, taken together, three-quarters of the new revenue comes from families with incomes in the top 5% earning more than $273,000. Just 13% of revenues raised from Pennsylvanians comes from taxpayers from the 80th to 95th percentile, with incomes between $129,000 and $273,000. And only 11% of revenues come from the bottom 80% of families.

Table 3

Pennsylvania Fair Share Tax All State Residents, 2023 Incomes							
2023 Income	**Bottom 20%**	**Second 20%**	**Third 20%**	**Fourth 20%**	**Next 15%**	**Next 4%**	**Top 1%**
Income Range Start	Less Than	$23,000	$48,000	$78,000	$129,000	$273,000	$667,000
Income Range End	$23,000	$48,000	$78,000	$129,000	$273,000	$667,000	And Above
Average Income	$12,000	$35,000	$61,000	$103,000	$176,000	$389,000	$1,748,000
Tax Wages, Interest, and Self-Employment Income at 2.8%; Tax Income from Wealth at 6.5%							
Tax Change as % of Income	-0.01%	-0.12%	-0.07%	0.08%	0.11%	0.64%	1.49%
Average Tax Change	-$1	-$41	-$44	$86	$188	$2,483	$25,999
% with Income Tax Cut	26.2%	67.5%	72.1%	63.0%	68.2%	50.4%	18.5%
Avg. Tax Cut for Those w/ Cut	-$32	-$86	-$129	-$190	-$341	-$743	-$1,314
Share of Resident Tax Cut	1.5%	10.8%	17.1%	22.1%	32.2%	13.9%	2.2%
% with Income Tax Increase	2.3%	9.4%	11.7%	26.2%	27.3%	49.4%	81.5%
Avg. Tax Increase for Those w/ Increase	$327	$187	$419	$782	$1,542	$5,787	$32,199
Share of Resident Tax Increase	0.3%	0.7%	1.9%	8.1%	12.5%	22.7%	52.1%

Figure 6



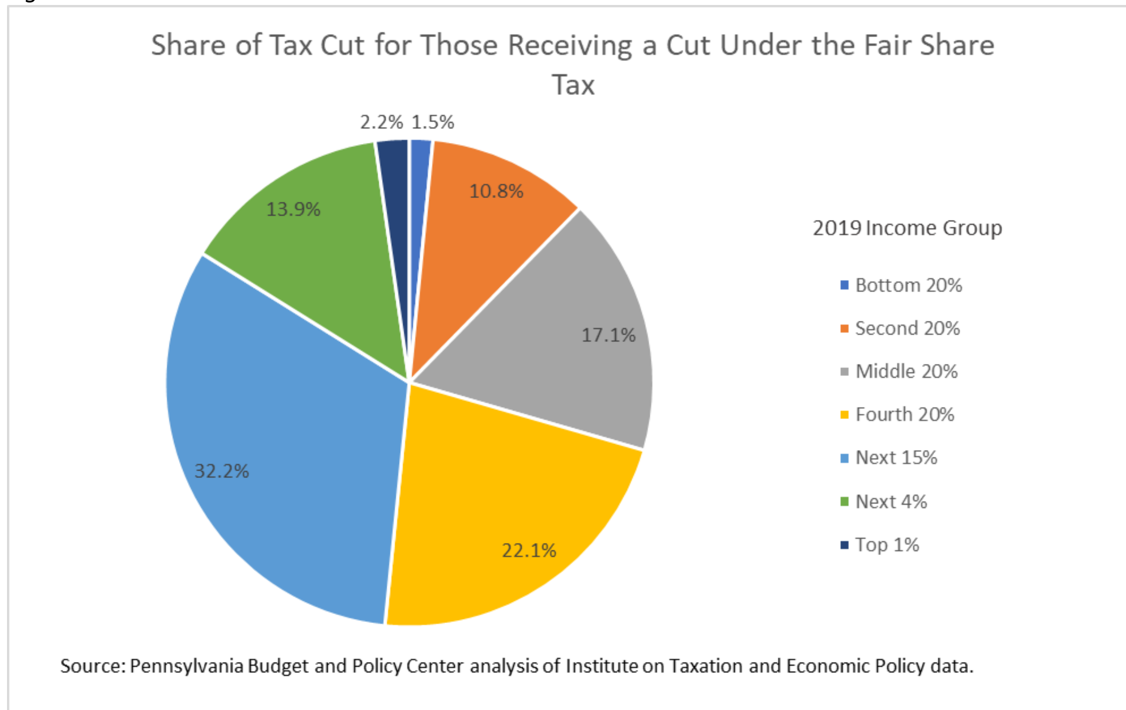
Source: Pennsylvania Budget and Policy Center analysis of Institute on Taxation and Economic Policy data.

Most people with low and moderate incomes do not have the kind of wealth that is taxed by a tax on income from wealth. But a small portion do. Some of them may be small business owners who could adjust their compensation to reduce the tax. Others may be young people who have inherited some intangible wealth, or older people whose Social Security and pension income is not taxed and thus who have low taxable incomes except for income they earn from investments. While 18% of adults would see an increase in taxes, only 11.5% of children and 9.5% of seniors would.

Whose Taxes Are Decreased Under the Fair Share Tax?

Turning to the distribution of tax reductions in table 3 (above) and figure 7 (below) among Pennsylvanians, we can see that 52% of the tax reductions go to families in the bottom 80% of income earners. Family incomes in these groups are below $129,000. Relatively little tax reduction goes to the bottom 20% with incomes less than $23,000, in part, because their incomes are low to begin with and, in part, because many families in this group benefit from the state's income tax forgiveness program. A significant share of the tax cut (48%) are from families in the top 20% who would also see their taxes reduced under the Fair Share Tax, presumably because they earn most of their money from higher-paying jobs.

Figure 7



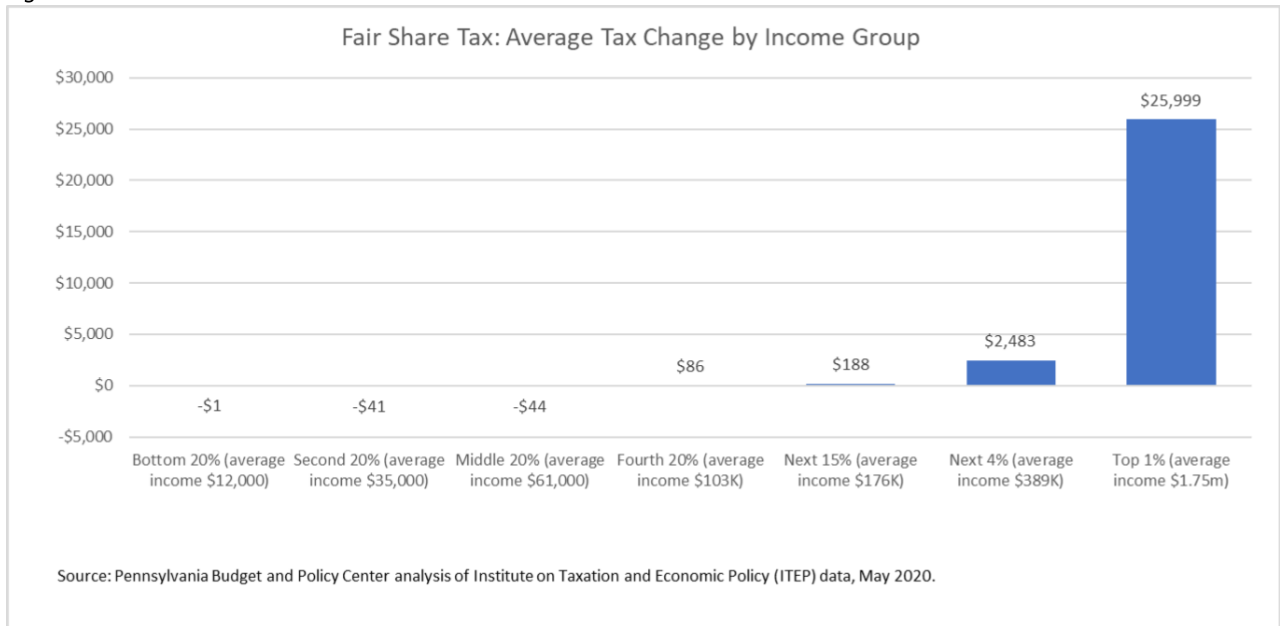
What Each Income Group Pays in the Fair Share Tax

Figure 8 gives details on how much the average taxpayer in each category would pay or save under the Fair Share Tax.

The top 1% of families would pay substantially more—on average, $26,000. Yet this increase is relatively small considering that the average income in this group is more than $1.75 million. The Fair Share Tax only takes another 1.49% of the income of this group of households. In the next group, from the 95th to the 99th percentile, with incomes between $273,000 and $667,000, the additional tax averages $2,483 per year. This only increases the tax rate they pay by .64%. In the group with incomes between $129,000 and $273,000, from the 80th to the 94th percentile, the average tax change would be only $188 more. This is only an increase of .11% in their tax rate. Below the top 20%—for the fourth quintile with an average income of $103,000, the average tax change is minimal—only $86 less than the cost of a cup of coffee once a week for a year. Remember that these are averages for a large class of families. Only 26.2% of the families in this group would see their taxes go up, while 63% would see their taxes go down.

Taxpayers in the bottom three quintiles would, on average, see little change in their taxes and, on average, would see a slight decrease in taxes. The averages in these quintiles hover near no change, although, as we mentioned above, the lowest quintile benefits from income tax forgiveness and, thus, does not pay substantial income taxes under current law.

Figure 8

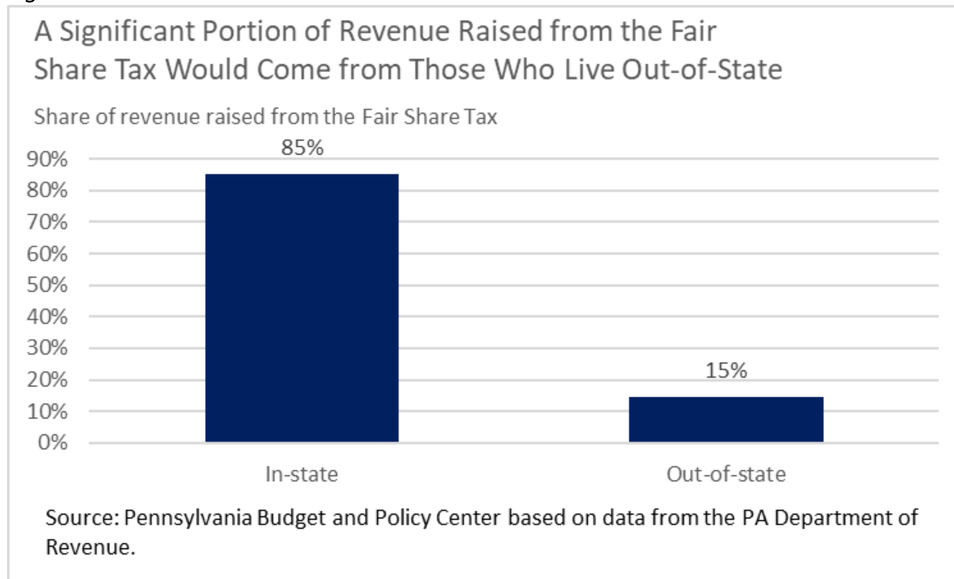


Out-of-State Taxpayers[21]

The highest-income taxpayers in Pennsylvania would pay for the majority of the Fair Share Tax. Another thing to note, however, is that as shown in figure 9, approximately 15% of the revenue generated for the Fair Share Tax would come from individual taxpayers who live outside of the state. Presumably, these individuals live elsewhere but may work part-time in Pennsylvania or own intangible property that generates income they have to report on Pennsylvania tax returns.

[21] This data is from tax year 2020. We are awaiting updated data and will update this section when analysis is complete.

Figure 9

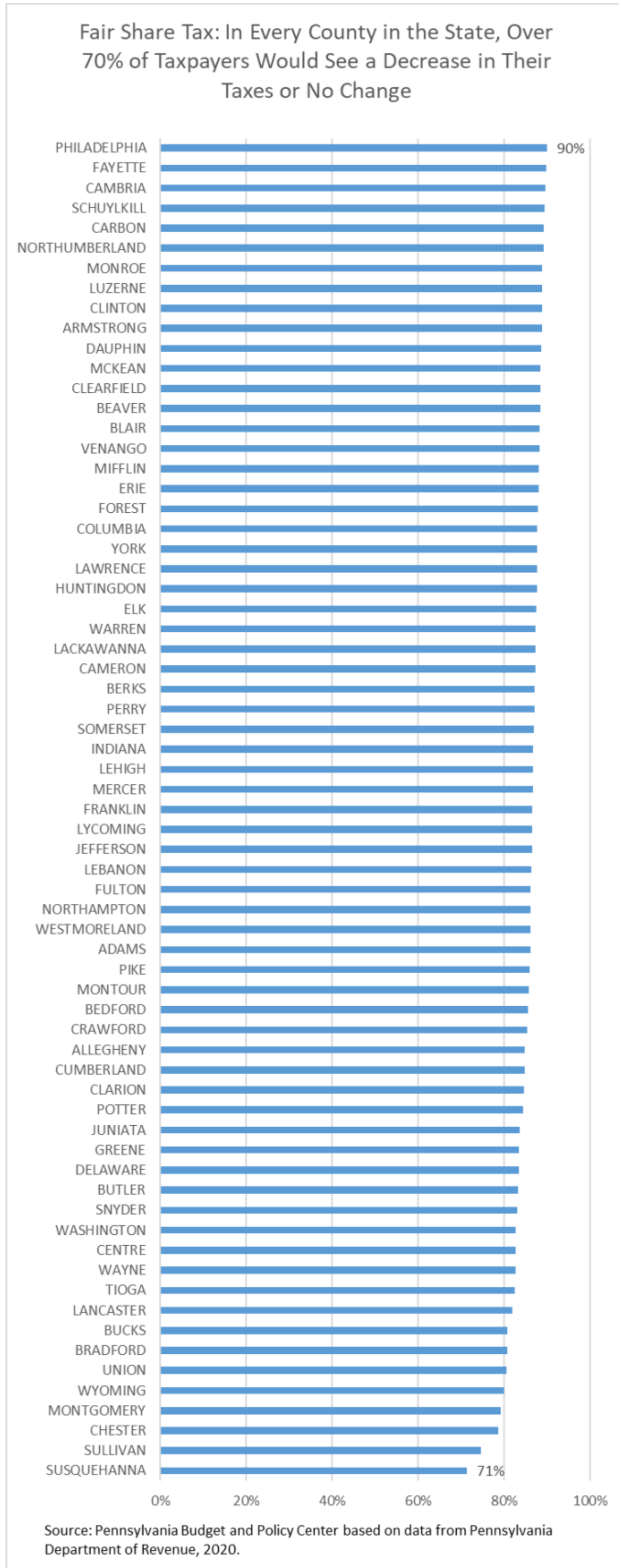


Who Pays the Fair Share Tax: A County-by County Breakdown:[22]

There is not a great deal of variation in the impact of the Fair Share Tax on a county-by-county basis. As figure 10 shows, the range in the percent of taxpayers who would see their taxes reduced or remain unchanged runs from 71% to 90%. In all but four counties, the percent of taxpayers whose taxes are reduced or unchanged is more than 80%.

[22] This data is from tax year 2020. We are awaiting updated data and will update this section when analysis is complete.

Figure 10



Source: Pennsylvania Budget and Policy Center based on data from Pennsylvania Department of Revenue, 2020.

Impact by House and Senate Districts[23]

In the past, we also looked at the impact of the Fair Share Tax in each state House and state Senate district. We found that variation from district to district is quite low. In all but a very few House and Senate districts, mostly found in Southeast Pennsylvania, more than 80% of taxpayers would see a reduction or no change in their taxes under the Fair Share Tax. We will update House and Senate district data later this year.

Pennsylvania Taxes on the Top 1% Would Remain Below Most Neighboring States

Some politicians, pundits, and citizens always point out that an increase in state taxes would undermine economic activity in the state or drive people to move away. We think this fear is unjustified when tax increases are relatively small, since, as we have pointed out elsewhere, taxes are a very small portion of business costs and there is little evidence that high taxes lead people to move from one state to another.[24]

At any rate, there is little to worry about when it comes to the Fair Share Tax. While an increase in the rate on income from wealth to 6.5% sounds like a big jump, keep in mind that the rate is applied to six categories of income, but not to the largest category: wages. Thus, the impact of the higher rate on the overall tax rate is minimized, even on the top 1%.

As figure 11 shows, even after implementation of the Fair Share Tax, the overall tax rate on the top 1% of families in Pennsylvania would be only 4.7%. This remains one of the lowest rates of any of our neighboring states and is significantly below the tax rates of the top 1% in New York, the District of Columbia, New Jersey, and Maryland. (Data from other states is from 2018. Since then, New York has raised its tax rate on the highest income earners.[25])

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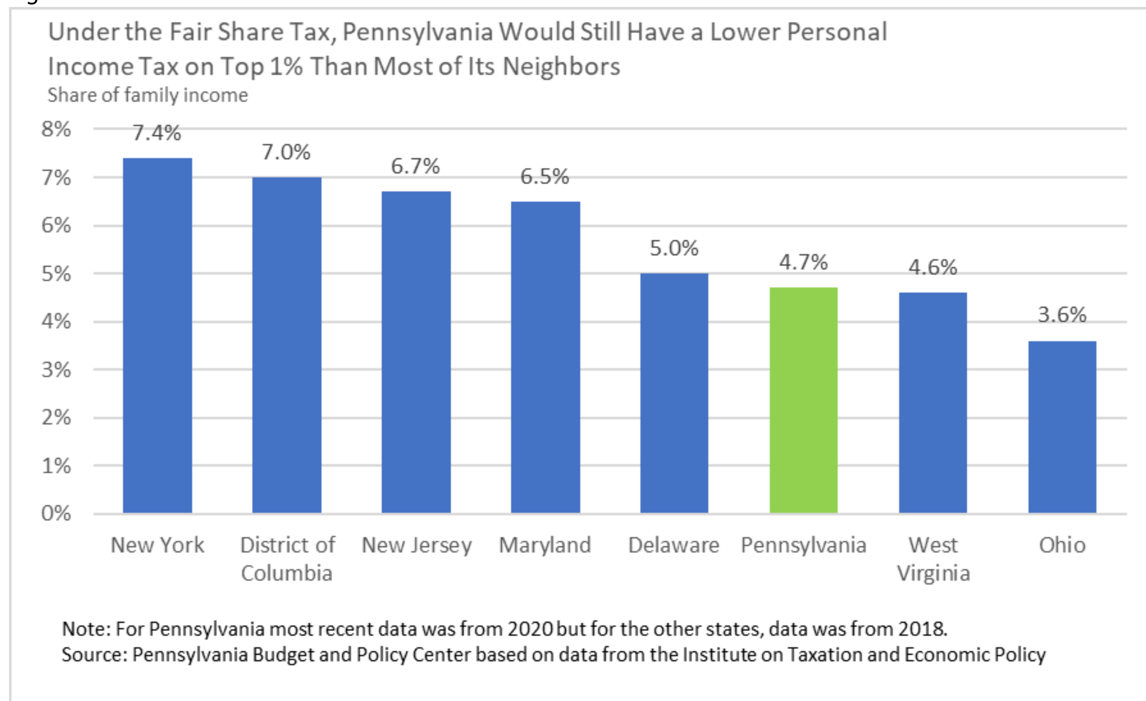
[23]This data is from tax year 2020. We are awaiting updated data and will update this section when analysis is complete.

[24] We review the evidence showing that tax rates have a limited impact on where people choose to live in: Marc Stier and Eugene Henninger-Voss, "It's Time to Reinstate the Philadelphia Intangible Wealth Tax", Pennsylvania Budget and Policy Center, March 29, 2022.

[25] See Richard Gander, "NYC's Ultra-rich Face 52% Combined Top Income Tax Rate," Money Watch, April 7, 2021.

Figure 11



The Impact of the Fair Share Tax on Our Upside-Down Tax System

The Fair Share Tax Alone

The Fair Share Tax would begin to fix our upside-down tax system. Figure 12 shows what happens to our upside-down tax system if we were to pass the Fair Share Tax. By increasing the tax on income from wealth to 6.5% and decreasing the tax on income from wages, the share of taxes paid increases for those with the most ability to pay, which would make our upside-down tax system a little better. The top 1% would pay 7.5% of their income in taxes, compared to the 6% they currently pay, which lessens slightly the huge gap that exists between the 1% and the bottom 20%.

The Fair Share Tax Alone and a State Earned Income Tax Credit

We pointed out above that the Fair Share Tax plan does not reduce taxes by much for the lowest income Pennsylvania families, because the state's income tax forgiveness program spares them from paying much if any Personal Income Tax. So low-income Pennsylvania families would still pay state and local at an extremely high rate. To address this problem, we have proposed that the state institute an Earned Income Tax Credit that would piggyback on the federal Earned Income Tax credit.[26]

The federal Earned Income Tax Credit (EITC) is a program that puts more money into the pockets of low- and middle-income families by giving them a credit against the taxes they pay. Because it is a refundable program, even those families who pay no federal taxes get a benefit.

Other than Social Security, no federal program reduces poverty as much. And the program has enjoyed broad political support because it provides a strong incentive to work. The benefits of the EITC are

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[26] We discuss the reasons we should institute a state Earned Income Tax in detail in Diana Polson and Marc Stier, "Why Pennsylvania Needs a State EITC," Pennsylvania Budget and Policy Center, August 25, 2020, https://krc-pbpc.org/research_publication/report-why-pennsylvania-needs-a-state-earned-income-tax-credit-eitc/.

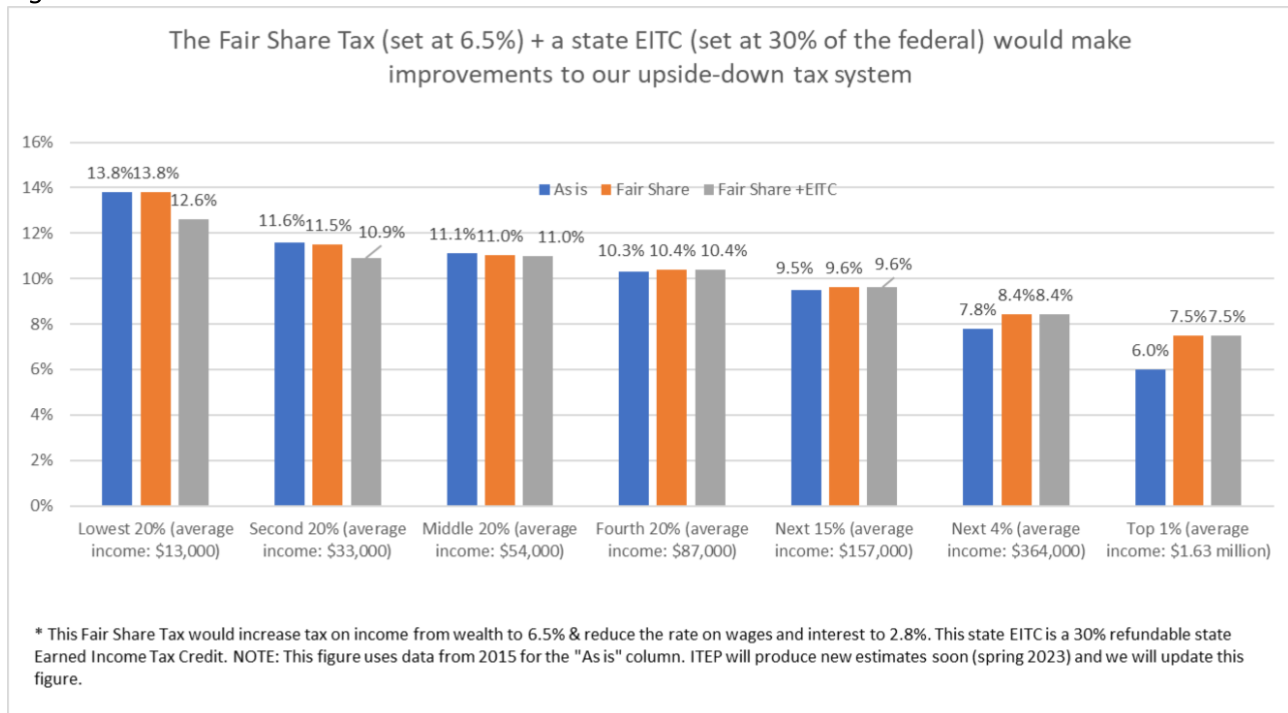
slowly reduced as members of a family earn more income, ensuring that their additional work effort is rewarded. (As we pointed out above, by increasing rewards to work, the Fair Share Tax itself has the same impact.)

Twenty-nine other states have expanded the benefits of a federal EITC by enacting a state EITC.

Pennsylvania should follow their lead. A state EITC is a relatively inexpensive program that is easy for states to implement, especially if it is modelled on the federal EITC. The benefits of increasing the annual income for low-income families and reducing poverty is indisputable. It improves maternal and infant health, enhances school performance for children, and leads to higher high school graduations and college attendance rates. The EITC has even been shown to boost future earnings and work prospects for children who live in families that receive it.

The gray bars in figure 12 show the combine impact of instituting the Fair Share Tax and a Pennsylvania State EITC. Adding a state EITC makes our tax system clearly fairer. Instituting a state EITC would cost the state between $400 million and $600 million per year. Combining an EITC with the Fair Share Tax would reduce the income raised by the tax from $2.68 billion to between $2.08 and $2.28 billion.

Figure 12



Conclusion

The Fair Share Tax is a way to raise more revenue from those with higher incomes and, in doing so, begin to fix our broken tax system.

The Fair Share Tax proposals we put forward here calls for an increase in the tax on income from wealth and a decrease on the tax on wages and interest. Our goal is to generate substantial revenues with which to close our structural deficit and investment deficit while taking a large step toward turning our upside-down tax system right side up.

Appendix 1: Another option under the Fair Share Tax

Bifurcating the Personal Income Tax can allow more flexibility to raise taxes for those who can afford it and decrease taxes for those who are overburdened. Below we share another scenario that would raise significantly more revenue than the standard Fair Share Tax explored above.

The Fair Share Tax can be structured to bring in additional revenue to the state as needed. Option 2 would decrease taxes on income from wages—from 3.07% to 1.9%—and increase income from wealth to 12%. Doing so would bring in $6.22 billion to Pennsylvania per year, over $3 billion more yearly than the standard Fair Share Tax proposal.

Who Would Pay the Fair Share Tax Statewide Under Option 2?

The Fair Share Tax Option 2 would raise over $6 billion by raising the tax on income from wealth to 12% and decreasing the tax on income from wages and interest to 1.9%.

As table 4 shows, only 15% of Pennsylvania taxpayers would pay more under the Fair Share Tax. The vast majority of taxpayers, 85%, would see their taxes go down (59%) or remain unchanged (26%).

Table 4

Impact of Fair Share Tax on Pennsylvania Taxpayers	
Decrease	59%
No Change	26%
Increase	15%

Source: Pennsylvania Budget and Policy Center analysis of data from the Institute of Taxation and Economic Policy (ITEP)

Whose Taxes Would Increase Under the Fair Share Tax Option 2?

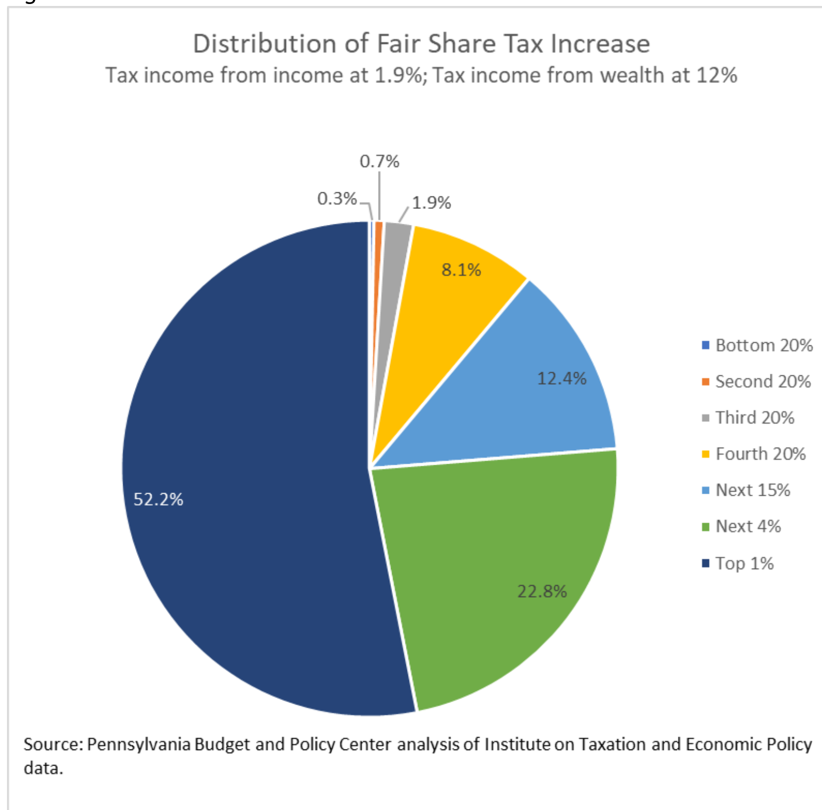
Table 5 and figure 13 show whose taxes would decrease under the Fair Share Tax Option 2 but only among Pennsylvanians (i.e. this analysis excludes non-residents who pay income tax to Pennsylvania). Given what we said about the distribution of income from wealth, it should come as no surprise that most of the increase in taxes would be on taxpayers with the greatest income. Fifty-two percent of the money raised from Pennsylvanians by the Fair Share Tax Option 2 comes from taxpayers in the top 1% of income, with earnings of $1.6 million on average. Another 23% of taxes raised by the plan from Pennsylvanians comes from taxpayers in the next 4%, from the 95th to 99th percentile, with incomes between $251,000 to $592,000. Thus, taken together, more than three-quarters of the new revenue comes from families with incomes in the top 5%. Just 12% of revenues raised from Pennsylvanians comes from taxpayers from the 80th to 95th percentile, with incomes between $112,000 and $251,000. And only 11% of revenues comes from the bottom 80% of families.

Most people with low and moderate incomes do not have the kind of wealth that is taxed by a tax on income from wealth. But a small portion do. Some of them may be small business owners who could adjust their compensation to reduce the tax. Others may be young people who have inherited some intangible wealth, or older people whose Social Security and pension income is not taxed and thus who have low taxable incomes except for income they earn from investments.

Table 5

Pennsylvania Fair Share Tax All State Residents, 2023 Incomes							
2023 Income	**Bottom 20%**	**Second 20%**	**Third 20%**	**Fourth 20%**	**Next 15%**	**Next 4%**	**Top 1%**
Income Range Start	Less Than	$23,000	$48,000	$78,000	$129,000	$273,000	$667,000
Income Range End	$23,000	$48,000	$78,000	$129,000	$273,000	$667,000	And Above
Average Income	$12,000	$35,000	$61,000	$103,000	$176,000	$389,000	$1,748,000
Tax Wages, Interest, and Self-Employment Income at 1.9%; Tax Income from Wealth at 12%							
Tax Change as % of Income	-0.15%	-0.62%	-0.49%	-0.06%	-0.03%	1.37%	3.69%
Average Tax Change	-$19	-$214	-$303	-$64	-$57	$5,320	$64,579
% with Income Tax Cut	26.3%	68.2%	73.7%	67.2%	70.2%	55.6%	20.4%
Avg. Tax Cut for Those w/ Cut	-$141	-$374	-$570	-$857	-$1,567	-$3,376	-$6,094
Share of Resident Tax Cut	1.5%	10.0%	16.5%	22.5%	32.3%	14.7%	2.4%
% with Income Tax Increase	2.1%	8.7%	10.0%	22.1%	25.3%	44.2%	79.6%
Avg. Tax Increase for Those w/ Increase	$870	$472	$1,174	$2,320	$4,130	$16,290	$82,646
Share of Resident Tax Increase	0.3%	0.7%	1.9%	8.1%	12.4%	22.8%	52.2%

Figure 13



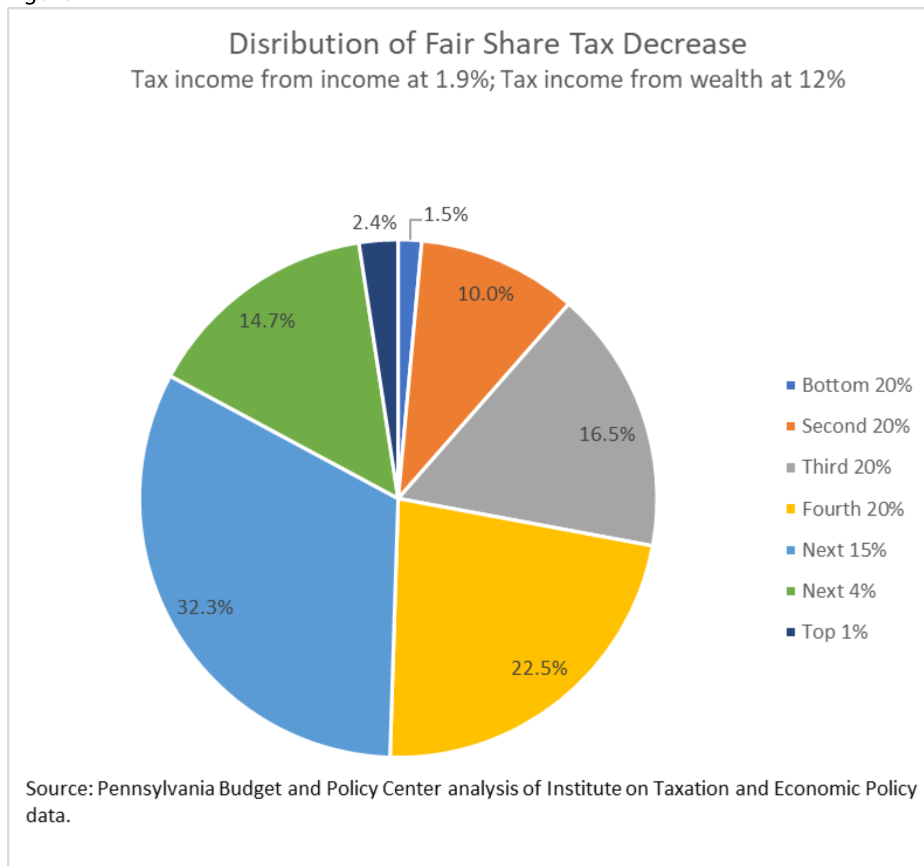
Source: Pennsylvania Budget and Policy Center analysis of Institute on Taxation and Economic Policy data.

Whose Taxes Are Decreased Under the Fair Share Tax Option 2?

Turning to the distribution of tax reductions in table 5 and figure 14 among Pennsylvanians, we can see that about half (49%) of the tax reductions go to families in the middle three quintiles, from the 20th to the 80th percentile. Family incomes in these three groups range from $23,000 to $112,000. A large part of the decrease would go to the top 20%, presumably because members of this group have significant

wage, interest, and self-employment income. Relatively little tax reduction goes to the bottom 20% with incomes less than $23,000, in part, because their incomes are low to begin with and, in part, because many families in this group benefit from the state's income tax forgiveness program.

Figure 14



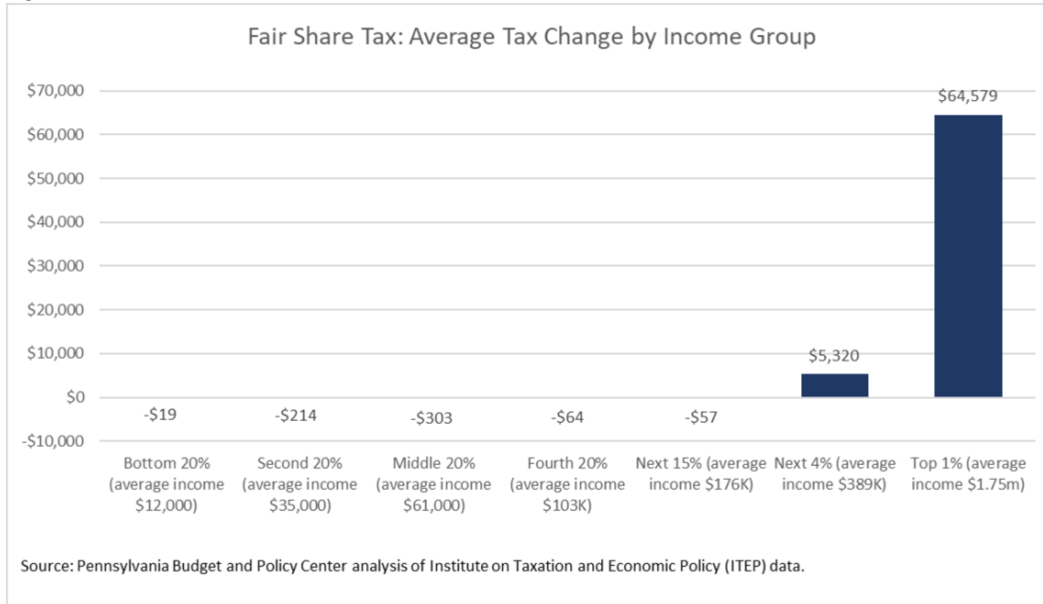
What Each Income Group Pays in the Fair Share Tax Option 2

Figure 15 gives details on how much the average taxpayer in each category would pay or save under the Fair Share Tax.

The top 1% of families would pay substantially more—on average $64,594. Yet this increase is relatively small considering the average income in this group is more than $1.6 million. It would increase the average tax rate on this group by only 3.69%. In the next group, from the 95th to the 99th percentile—with incomes between $251,000 and $592,000—the additional tax is $5,320 on average. This group would pay, on average, an additional 1.37% of their income in state and local taxes.

In the group with incomes between $112,000 and $251,000, from the 80th to the 94th percentile, the average tax change is -$57. Taxes on the bottom four quintiles of families would, on average, see a reduction in their state and local taxes.

Figure 15

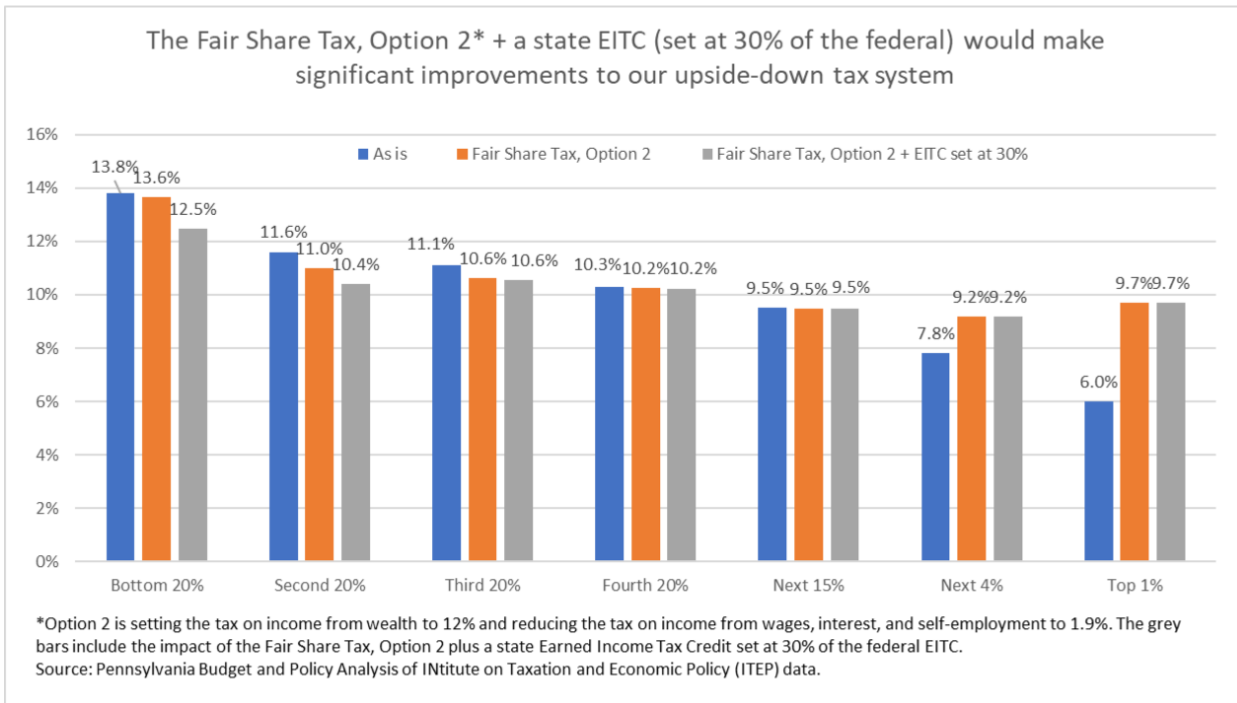


How would the Fair Share Tax Option 2 impact our upside-down tax system?

Figure 16 shows Option 2's impact on our upside-down system (red bars). Implementing a more aggressive Fair Share Tax would raise the share of taxes that our highest-income residents are paying. The top 1% of income earners would pay 10% of their income on state and local taxes, up from the 6% they currently pay. The Fair Share Tax would bring down, slightly, the share of taxes the lowest 20% of income earners pay—from 13.8% to 13.3%.

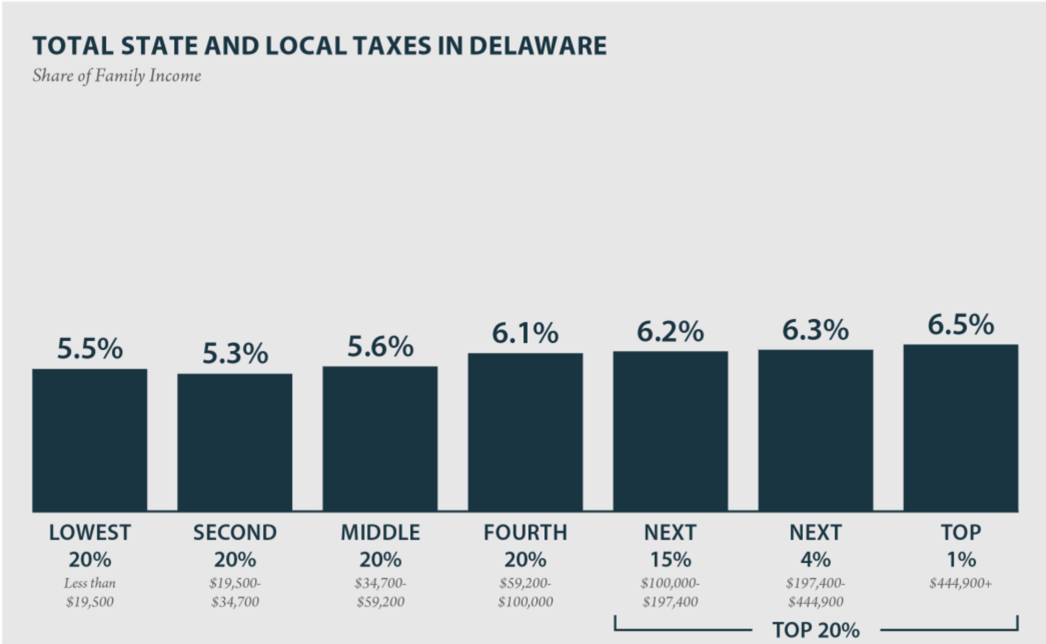
As we did for our first Fair Share Tax option, figure 16 also shows the impact of adding a state Earned Income Tax Credit to the Fair Share Tax proposal. By setting a state EITC at 30% of the federal EITC, the tax burden on the lowest-income Pennsylvanians would further decrease, making our tax system much fairer.

Figure 16

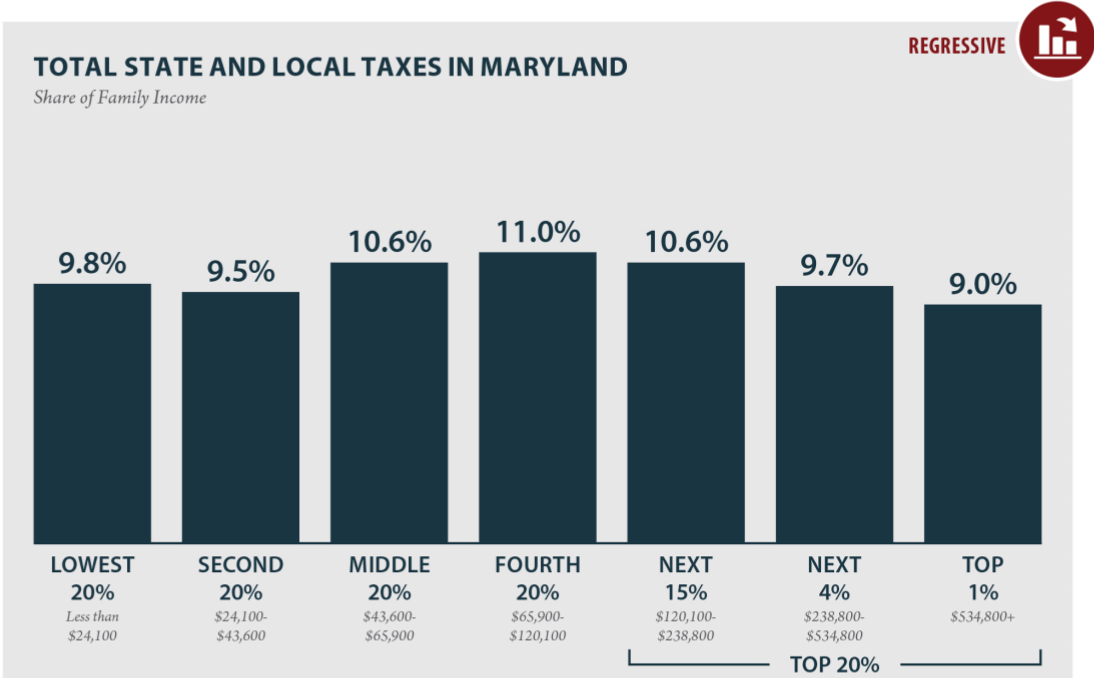


Appendix 2: Distribution of the Tax Burden in Neighboring States[27]

Delaware

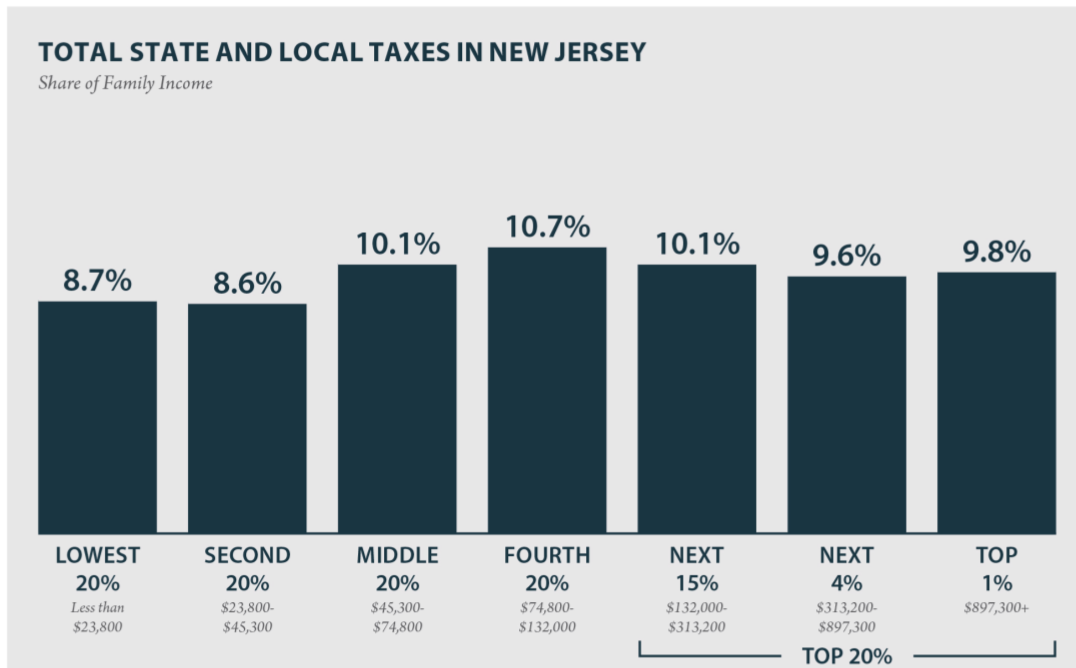


Maryland

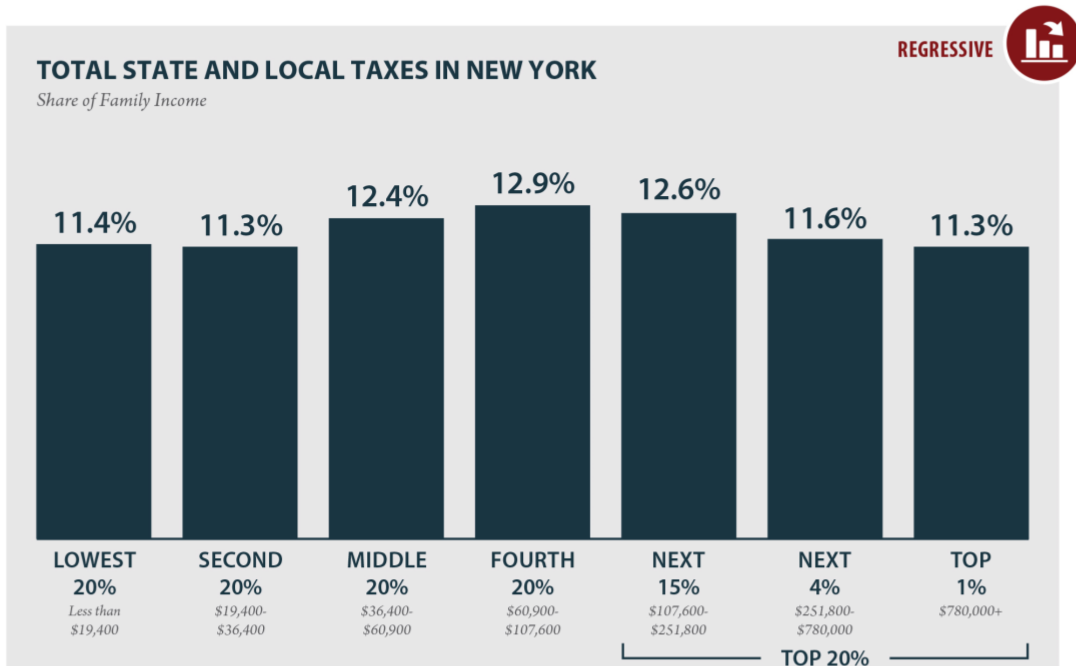


[27] From Institute on Taxation and Economic Policy's report "Who Pays? 6th Edition."

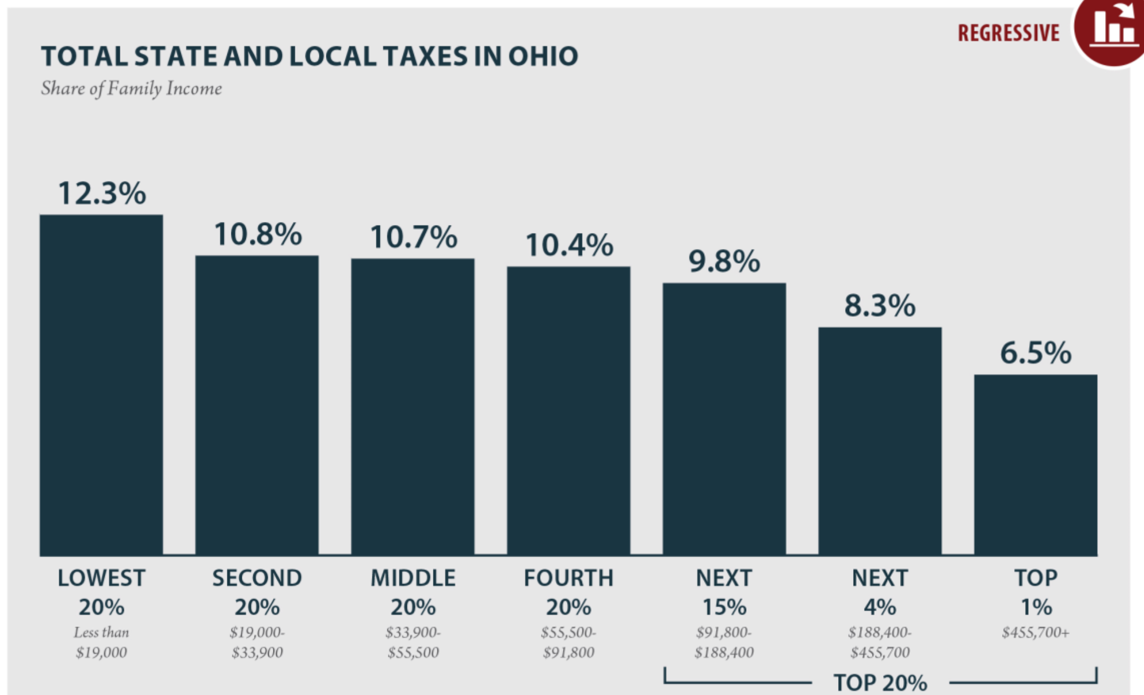
New Jersey



New York



Ohio



West Virginia