

SPECIAL REPORT

November 2003
No. 125

Federal Income Taxes and the Cost of Living

States with Lower Cost of Living Enjoy Great Federal Tax Advantage

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Introduction

In 1972, Congress created the Federal Wage System (FWS) to ensure that comparable federal employees were paid salaries that would enable them to maintain comparable standards of living.¹ Put simply, the FWS's mission is to adjust federal compensation for differences in cost of living. For example, a

economic plus: the price of the federal government would go down. Unlike federal employees' salaries, the federal income tax code has no preset provisions — standard deduction, exemption, tax bracket, etc. — that are adjusted for geographic differences in the cost of living. As a result, a single government nurse with no dependent children in San Diego pays much higher federal income taxes than a nurse with the same standard of living in San Antonio: \$3,844 instead of \$2,827.

This report examines how the federal individual income tax creates different tax liabilities between taxpayers with the same standard of living. The data lead to the inevitable conclusion that our progressive federal income tax code overcharges people who live where the cost of living is high, where salaries are higher in nominal terms but not in their purchasing power. Of course, the flip side of this observation is that our current federal income tax favors taxpayers who live in a low-cost area, leaving them with a higher after-tax standard of living.

Because the federal income tax code makes no adjustments for geographic differences in the cost of living, a single government nurse in San Diego with the same standard of living as a nurse in San Antonio pays much higher federal income taxes: \$3,844 instead of \$2,827.

nurse working for the Department of Defense in San Diego, California, earns \$43,557 at grade 7, step 1. If she moved to San Antonio, Texas, she would earn \$36,781.

Even though the dollar amount of her San Antonio salary is more than 15 percent lower, it could not be called economically lower because she can maintain the same standard of living as in San Diego, including the purchase of housing and all the other goods and services included in a survey of the cost of living by the Department of Defense.

There is one important respect, however, in which the move to San Antonio would be an

Cost of Living Differences and Tax Distribution Analysis

The study of varying costs of living has profound implications for tax policy in a number of areas. Perhaps the most important is the dilemma for practitioners of tax distribution analysis—the science of determining who's earning what in America and how much they pay in taxes.

People within and outside government want to know how every new tax law will affect taxpayers at each level of income, and the research tool used to provide this information is tax distribution analysis. Unfortunately, as cur-

¹ U.S. Office of Compensation Administration: www.opm.gov/oca/wage/fwsfact.asp

Table 1
Differences in Cost of Living and Federal Income Tax Liabilities by Area
Calendar Year 2003

Area	Income Required to Pay for Median Standard of Living	Federal Income Tax	How Much Income Tax Varies from National Average	Federal Income Tax as a Percentage of Income	How Much Income Tax Varies from National Average as a Percentage of Income	Rank
National Average	\$ 72,886	\$ 7,942	–	10.9%	–	–
Alabama						
Auburn/Opelika	\$ 65,816	\$ 6,832	(\$ 1,109)	10.4%	– 0.5%	237
Decatur/Hartselle	\$ 64,723	\$ 6,668	(\$ 1,273)	10.3%	– 0.6%	265
Dothan	\$ 65,452	\$ 6,778	(\$ 1,164)	10.4%	– 0.5%	250
Florence	\$ 65,598	\$ 6,800	(\$ 1,142)	10.4%	– 0.5%	245
Huntsville	\$ 68,440	\$ 7,226	(\$ 716)	10.6%	– 0.3%	181
Mobile	\$ 65,452	\$ 6,778	(\$ 1,164)	10.4%	– 0.5%	251
Montgomery	\$ 66,909	\$ 6,996	(\$ 945)	10.5%	– 0.4%	224
Cullman County	\$ 65,452	\$ 6,778	(\$ 1,164)	10.4%	– 0.5%	252
Marshall County	\$ 65,306	\$ 6,756	(\$ 1,186)	10.3%	– 0.6%	254
Alaska						
Fairbanks	\$ 90,670	\$ 12,388	\$ 4,446	13.7%	+ 2.8%	24
Kodiak	\$ 94,752	\$ 13,408	\$ 5,466	14.2%	+ 3.3%	22
Arizona						
Flagstaff	\$ 77,769	\$ 9,162	\$ 1,221	11.8%	+ 0.9%	45
Phoenix	\$ 70,772	\$ 7,576	(\$ 366)	10.7%	– 0.2%	123
Tucson	\$ 71,064	\$ 7,620	(\$ 322)	10.7%	– 0.2%	116
Yuma	\$ 72,886	\$ 7,942	\$ 0	10.9%	+ 0.0%	84
Sierra Vista	\$ 68,221	\$ 7,193	(\$ 748)	10.5%	– 0.4%	187
Arkansas						
Fayetteville	\$ 67,420	\$ 7,073	(\$ 869)	10.5%	– 0.4%	205
Fort Smith	\$ 62,536	\$ 6,340	(\$ 1,601)	10.1%	– 0.8%	292
Jonesboro	\$ 64,213	\$ 6,592	(\$ 1,350)	10.3%	– 0.6%	275
Hot Springs	\$ 64,577	\$ 6,647	(\$ 1,295)	10.3%	– 0.6%	269
California						
Fresno	\$ 81,049	\$ 9,982	\$ 2,041	12.3%	+ 1.4%	38
Los Angeles/Long Beach	\$ 100,729	\$ 14,902	\$ 6,961	14.8%	+ 3.9%	12
Oakland	\$ 102,113	\$ 15,248	\$ 7,307	14.9%	+ 4.0%	8
Orange County	\$ 97,959	\$ 14,210	\$ 6,268	14.5%	+ 3.6%	17
Hemet/San Jacinto	\$ 75,146	\$ 8,506	\$ 565	11.3%	+ 0.4%	61
Palm Springs	\$ 84,548	\$ 10,857	\$ 2,915	12.8%	+ 1.9%	32
Riverside City	\$ 79,009	\$ 9,472	\$ 1,531	12.0%	+ 1.1%	42
San Diego	\$ 102,041	\$ 15,230	\$ 7,289	14.9%	+ 4.0%	9
San Francisco	\$ 132,143	\$ 22,812	\$ 14,871	17.3%	6.4%	3
San Jose	\$ 118,221	\$ 19,275	\$ 11,334	16.3%	+ 5.4%	4
Colorado						
Denver	\$ 77,041	\$ 8,980	\$ 1,039	11.7%	+ 0.8%	50
Fort Collins	\$ 73,105	\$ 7,996	\$ 55	10.9%	+ 0.0%	79
Loveland	\$ 78,498	\$ 9,345	\$ 1,403	11.9%	+ 1.0%	43
Grand Junction	\$ 71,866	\$ 7,740	(\$ 202)	10.8%	– 0.1%	103
Greeley	\$ 69,169	\$ 7,335	(\$ 606)	10.6%	– 0.3%	160
Pueblo	\$ 65,670	\$ 6,811	(\$ 1,131)	10.4%	– 0.5%	241
Glenwood Springs	\$ 89,286	\$ 12,041	\$ 4,100	13.5%	+ 2.6%	25
Gunnison	\$ 78,425	\$ 9,326	\$ 1,385	11.9%	+ 1.0%	44
Connecticut						
Hartford	\$ 83,527	\$ 10,602	\$ 2,660	12.7%	+ 1.8%	36
New Haven	\$ 86,734	\$ 11,404	\$ 3,462	13.1%	+ 2.3%	27
New London	\$ 85,641	\$ 11,130	\$ 3,189	13.0%	+ 2.1%	28
Stamford	\$ 110,787	\$ 17,417	\$ 9,475	15.7%	+ 4.8%	6
District of Columbia						
	\$ 98,178	\$ 14,264	\$ 6,323	14.5%	+ 3.6%	16
Florida						
Fort Walton Beach	\$ 69,898	\$ 7,445	(\$ 497)	10.7%	– 0.2%	146
Jacksonville	\$ 66,253	\$ 6,898	(\$ 1,044)	10.4%	– 0.5%	231
Orlando	\$ 72,303	\$ 7,805	(\$ 136)	10.8%	– 0.1%	96
Panama City	\$ 70,772	\$ 7,576	(\$ 366)	10.7%	– 0.2%	124
Pensacola	\$ 71,356	\$ 7,663	(\$ 278)	10.7%	– 0.2%	111
Punta Gorda/Charlotte County	\$ 67,347	\$ 7,062	(\$ 880)	10.5%	– 0.4%	208
Bradenton	\$ 68,149	\$ 7,182	(\$ 759)	10.5%	– 0.4%	190
Sarasota	\$ 76,093	\$ 8,743	\$ 802	11.5%	+ 0.6%	55
Tallahassee	\$ 73,396	\$ 8,069	\$ 128	11.0%	+ 0.1%	76
St. Petersburg/Clearwater	\$ 65,816	\$ 6,832	(\$ 1,109)	10.4%	– 0.5%	238
Tampa	\$ 70,918	\$ 7,598	(\$ 344)	10.7%	– 0.2%	120

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rently practiced, it is plagued by inaccuracies caused by false assumptions and insufficient data.

One is the failure to account for mobility up and down the income spectrum. An even more basic flaw is the lumping together of couples with individuals. This report explores one more: the failure of distributional analysis to account for how geography and cost of living affect taxpayers' nominal incomes.

Distributional analysis assumes, for example, that if one family has a much higher income than another family, then it must also have a higher standard of living and, thus, a greater ability to pay taxes. But as this study shows, it is clearly possible for two families to have the same standard of living, but widely different incomes—and tax burdens—simply because of where they live.

For example, an income of \$132,143 in San Francisco, California, yields the same standard of living as \$84,111 in Portland, Oregon. But the San Francisco family pays \$22,812 in federal income taxes while the Portland family pays \$10,748. See Table 1.

The income difference is illusory because it does not result in a higher standard of living. However, the tax burden on that illusory income is real because the tax code is not adjusted for cost-of-living differences.

Measuring Differences in the Cost of Living

Measures of cost of living have grown in importance because America has become such a mobile society. A quick internet search will yield a dozen or more cost-of-living “calculators” that are useful to both employers and employees. An employee can use such a calculator to find out whether a job offer that requires a move from Atlanta to Los Angeles will result in a higher or lower standard of living.

For example, suppose that Mike is the employee contemplating such a move. When he goes to the grocery store in Atlanta to pick up some breakfast, milk, bread, eggs and sausage total \$6.99. However, if he accepts the job in Los Angeles, the bill for those same grocery items rises to \$10.17. This differential of \$3.18, a 45.5 percent increase, is a simple illustration of differentials in cost of living.²

In any cost-of-living comparison, it is essential to examine the cost of housing because it is generally the largest single expense for any household. Mike rents his apartment in Atlanta for \$756 a month. In Los Angeles, however, his rent will soar to \$1,381 a month—a whopping increase of 82.7 percent.

² “Cost of Living Index,” ACCRA, www.accra.org

*Table 1 (continued)
Differences in Cost of Living and Federal Income Tax Liabilities by Area
Calendar Year 2003*

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National Average	\$ 72,886	\$ 7,942	-	10.9%	-	-
Florida (cont.)						
West Palm Beach	\$ 77,769	\$ 9,162	\$ 1,221	11.8%	+ 0.9%	46
Vero Beach/ Indian River	\$ 70,116	\$ 7,477	(\$ 464)	10.7%	- 0.2%	138
Georgia						
Albany	\$ 65,598	\$ 6,800	(\$ 1,142)	10.4%	- 0.5%	246
Atlanta	\$ 71,356	\$ 7,663	(\$ 278)	10.7%	- 0.2%	112
Marietta	\$ 65,087	\$ 6,723	(\$ 1,218)	10.3%	- 0.6%	260
Augusta/Aiken	\$ 66,982	\$ 7,007	(\$ 934)	10.5%	- 0.4%	222
Savannah	\$ 72,376	\$ 7,816	(\$ 125)	10.8%	- 0.1%	93
Americus	\$ 65,889	\$ 6,843	(\$ 1,098)	10.4%	- 0.5%	235
Douglas	\$ 62,974	\$ 6,406	(\$ 1,535)	10.2%	- 0.7%	284
LaGrange/ Troup County	\$ 64,140	\$ 6,581	(\$ 1,361)	10.3%	- 0.6%	276
Tifton	\$ 64,650	\$ 6,657	(\$ 1,284)	10.3%	- 0.6%	268
Valdosta	\$ 67,274	\$ 7,051	(\$ 890)	10.5%	- 0.4%	211
Hawaii						
Honolulu	\$ 111,370	\$ 17,562	\$ 9,621	15.8%	+ 4.9%	5
Idaho						
Boise	\$ 69,315	\$ 7,357	(\$ 584)	10.6%	- 0.3%	155
Pocatello	\$ 65,598	\$ 6,800	(\$ 1,142)	10.4%	- 0.5%	247
Idaho Falls	\$ 67,128	\$ 7,029	(\$ 912)	10.5%	- 0.4%	216
Twin Falls	\$ 66,253	\$ 6,898	(\$ 1,044)	10.4%	- 0.5%	232
Illinois						
Champaign/Urbana	\$ 69,242	\$ 7,346	(\$ 595)	10.6%	- 0.3%	157
Chicago	\$ 101,312	\$ 15,048	\$ 7,106	14.9%	+ 4.0%	10
Joliet/Will County	\$ 76,749	\$ 8,907	\$ 966	11.6%	+ 0.7%	51
Peoria	\$ 69,169	\$ 7,335	(\$ 606)	10.6%	- 0.3%	161
Springfield	\$ 69,606	\$ 7,401	(\$ 541)	10.6%	- 0.3%	151
Danville	\$ 68,294	\$ 7,204	(\$ 737)	10.5%	- 0.3%	185
Quincy	\$ 68,294	\$ 7,204	(\$ 737)	10.5%	- 0.3%	186
Indiana						
Evansville	\$ 69,971	\$ 7,456	(\$ 486)	10.7%	- 0.2%	142
Fort Wayne/ Allen County	\$ 68,659	\$ 7,259	(\$ 683)	10.6%	- 0.3%	173
Lafayette	\$ 68,659	\$ 7,259	(\$ 683)	10.6%	- 0.3%	174
South Bend	\$ 71,428	\$ 7,674	(\$ 267)	10.7%	- 0.2%	108
Terre Haute	\$ 64,577	\$ 6,647	(\$ 1,295)	10.3%	- 0.6%	270
Iowa						
Cedar Rapids	\$ 67,857	\$ 7,139	(\$ 803)	10.5%	- 0.4%	198
Davenport/Moline/ Rock Island	\$ 70,044	\$ 7,467	(\$ 475)	10.7%	- 0.2%	140
Des Moines	\$ 69,315	\$ 7,357	(\$ 584)	10.6%	- 0.3%	156
Waterloo/Cedar Falls	\$ 67,128	\$ 7,029	(\$ 912)	10.5%	- 0.4%	217
Ames	\$ 71,939	\$ 7,751	(\$ 191)	10.8%	- 0.1%	100
Burlington	\$ 68,877	\$ 7,292	(\$ 650)	10.6%	- 0.3%	167
Mason City	\$ 65,160	\$ 6,734	(\$ 1,208)	10.3%	- 0.6%	258
Kansas						
Lawrence	\$ 73,979	\$ 8,215	\$ 273	11.1%	+ 0.2%	71
Topeka	\$ 66,399	\$ 6,920	(\$ 1,022)	10.4%	- 0.5%	230
Dodge City	\$ 69,388	\$ 7,368	(\$ 573)	10.6%	- 0.3%	154
Garden City	\$ 67,930	\$ 7,149	(\$ 792)	10.5%	- 0.4%	197
Hays	\$ 70,991	\$ 7,609	(\$ 333)	10.7%	- 0.2%	118
Hutchinson	\$ 64,723	\$ 6,668	(\$ 1,273)	10.3%	- 0.6%	266
Manhattan	\$ 71,064	\$ 7,620	(\$ 322)	10.7%	- 0.2%	117
Salina	\$ 63,557	\$ 6,494	(\$ 1,448)	10.2%	- 0.7%	280
Kentucky						
Hopkinsville	\$ 66,545	\$ 6,942	(\$ 1,000)	10.4%	- 0.5%	227
Lexington	\$ 68,513	\$ 7,237	(\$ 705)	10.6%	- 0.3%	180
Louisville	\$ 66,982	\$ 7,007	(\$ 934)	10.5%	- 0.4%	223
Bowling Green	\$ 69,096	\$ 7,324	(\$ 617)	10.6%	- 0.3%	164
Murray	\$ 63,265	\$ 6,450	(\$ 1,492)	10.2%	- 0.7%	283
Paducah	\$ 65,670	\$ 6,811	(\$ 1,131)	10.4%	- 0.5%	242
Somerset	\$ 68,221	\$ 7,193	(\$ 748)	10.5%	- 0.4%	188

Continued

Table 1 shows how the purchasing power of a median dual-income couple with no dependent children varies dramatically from one city to another (see methodology section).

In 2003, the nationwide median income for such a couple was \$72,866. This income would buy the median standard of living in a location where the cost of living is close to the national average. Milwaukee, Wisconsin, is such a location.

The same standard of living that costs \$73,105 in Milwaukee has a comparable price as low as \$60,131 in Cookeville, Tennessee, (population 42,000) and as high as \$159,621 in New York City (Manhattan). In other words, \$60,131 in Cookeville will buy the same basket of goods and services as \$159,621 in New York City.

Among all the metropolitan areas surveyed by ACCRA, this is the greatest cost-of-living differential. Naturally, an even greater differential could be found between New York and a rural area or a smaller town. In fact, one does not have to leave a state to find wide disparities in the cost of living. In New York, the \$95,554 income of a Queens couple with no dependents is equivalent to \$74,635 in Buffalo. In Illinois, a couple earning \$101,312 in Chicago can afford the same standard of living as one earning \$69,606 in Springfield. In Michigan, earning \$84,402 in Detroit is equivalent to earning \$68,950 in Lansing.

Such facts are often greeted with a dismissive, "That's life in the big city." People are able to accept the notion that everything is more expensive in major metropolitan areas. However, there can be significant differences between the cost of living in cities of comparable size. In Boston, Massachusetts, for example, a couple with no dependents earning \$100,364 can only afford the same standard of living as a couple earning \$71,356 in Atlanta, Georgia. In Portland, Oregon, a couple's \$84,111 income is equivalent to \$70,772 in Phoenix, Arizona. In Grand Rapids, Michigan, the couple's income of \$73,688 is equivalent to \$66,472 in San Antonio, Texas.

Difference in Federal Income Tax Liabilities

Unfortunately, most cost of living measurements, including the ACCRA survey this report relies on, do not factor in the differential impact of taxes, even though federal, state and local taxes combined are by far the biggest item in any American family's budget (see Figure 1). Of course, state and local taxes vary significantly from one metropolitan area to another, and the Tax Foundation provides several annual state-by-state comparisons of

Table 1 (continued)
Differences in Cost of Living and Federal Income Tax Liabilities by Area Calendar Year 2003

Area	Income Required to Pay for Median Standard of Living	Federal Income Tax	How Much Income Tax Varies from National Average	Federal Income Tax as a Percentage of Income	How Much Income Tax Varies from National Average as a Percentage of Income	Rank
National Average	\$ 72,886	\$ 7,942	–	10.9%	–	–
Louisiana						
Baton Rouge	\$ 74,052	\$ 8,233	\$ 292	11.1%	+ 0.2%	69
Lafayette	\$ 68,877	\$ 7,292	(\$ 650)	10.6%	– 0.3%	168
Lake Charles	\$ 68,003	\$ 7,160	(\$ 781)	10.5%	– 0.4%	194
Monroe	\$ 68,659	\$ 7,259	(\$ 683)	10.6%	– 0.3%	175
New Orleans	\$ 76,312	\$ 8,798	\$ 856	11.5%	+ 0.6%	53
Shreveport/Bossier City	\$ 66,472	\$ 6,931	(\$ 1,011)	10.4%	– 0.5%	228
Maryland						
Baltimore	\$ 68,950	\$ 7,303	(\$ 639)	10.6%	– 0.3%	165
Massachusetts						
Boston	\$ 100,364	\$ 14,811	\$ 6,870	14.8%	+ 3.9%	14
Fitchburg/Leominster	\$ 79,956	\$ 9,709	\$ 1,767	12.1%	+ 1.2%	40
Michigan						
Detroit	\$ 84,402	\$ 10,821	\$ 2,879	12.8%	+ 1.9%	33
Grand Rapids	\$ 73,688	\$ 8,142	\$ 200	11.0%	+ 0.2%	73
Holland	\$ 71,428	\$ 7,674	(\$ 267)	10.7%	– 0.2%	109
Lansing	\$ 68,950	\$ 7,303	(\$ 639)	10.6%	– 0.3%	166
Minnesota						
Duluth	\$ 74,708	\$ 8,397	\$ 456	11.2%	+ 0.3%	62
Minneapolis	\$ 81,122	\$ 10,001	\$ 2,059	12.3%	+ 1.4%	37
Rochester	\$ 73,979	\$ 8,215	\$ 273	11.1%	+ 0.2%	72
St. Cloud	\$ 72,595	\$ 7,869	(\$ 73)	10.8%	– 0.1%	88
Mississippi						
Biloxi/Gulfport/Pascagoula	\$ 70,189	\$ 7,488	(\$ 453)	10.7%	– 0.2%	136
Hattiesburg	\$ 67,565	\$ 7,095	(\$ 847)	10.5%	– 0.4%	202
Jackson	\$ 67,420	\$ 7,073	(\$ 869)	10.5%	– 0.4%	206
Tupelo	\$ 65,452	\$ 6,778	(\$ 1,164)	10.4%	– 0.5%	253
Vicksburg	\$ 70,772	\$ 7,576	(\$ 366)	10.7%	– 0.2%	125
Missouri						
Columbia	\$ 68,221	\$ 7,193	(\$ 748)	10.5%	– 0.4%	189
Joplin	\$ 62,318	\$ 6,308	(\$ 1,634)	10.1%	– 0.8%	293
St. Louis	\$ 77,405	\$ 9,071	\$ 1,130	11.7%	+ 0.8%	47
Springfield	\$ 64,286	\$ 6,603	(\$ 1,339)	10.3%	– 0.6%	274
Jefferson City	\$ 68,367	\$ 7,215	(\$ 726)	10.6%	– 0.3%	182
Nevada	\$ 63,338	\$ 6,461	(\$ 1,481)	10.2%	– 0.7%	282
Montana						
Billings	\$ 71,501	\$ 7,685	(\$ 256)	10.7%	– 0.1%	106
Great Falls	\$ 68,149	\$ 7,182	(\$ 759)	10.5%	– 0.4%	191
Missoula	\$ 69,971	\$ 7,456	(\$ 486)	10.7%	– 0.2%	143
Bozeman	\$ 72,084	\$ 7,773	(\$ 169)	10.8%	– 0.1%	99
Helena	\$ 70,189	\$ 7,488	(\$ 453)	10.7%	– 0.2%	137
Kalispell	\$ 71,720	\$ 7,718	(\$ 224)	10.8%	– 0.1%	105
Nebraska						
Lincoln	\$ 71,866	\$ 7,740	(\$ 202)	10.8%	– 0.1%	104
Omaha	\$ 67,638	\$ 7,106	(\$ 836)	10.5%	– 0.4%	201
Grand Island	\$ 72,449	\$ 7,832	(\$ 109)	10.8%	– 0.1%	92
Hastings	\$ 65,160	\$ 6,734	(\$ 1,208)	10.3%	– 0.6%	259
Nevada						
Las Vegas	\$ 72,740	\$ 7,905	(\$ 36)	10.9%	+ 0.0%	87
Reno/Sparks	\$ 73,688	\$ 8,142	\$ 200	11.0%	+ 0.2%	74
New Jersey						
Bergen/Passaic	\$ 105,831	\$ 16,178	\$ 8,236	15.3%	+ 4.4%	7
Jersey City	\$ 135,131	\$ 23,649	\$ 15,708	17.5%	+ 6.6%	2
Hunterdon County	\$ 92,930	\$ 12,952	\$ 5,011	13.9%	+ 3.0%	23
Middlesex	\$ 99,635	\$ 14,629	\$ 6,687	14.7%	+ 3.8%	15
Monmouth/Ocean	\$ 95,918	\$ 13,700	\$ 5,758	14.3%	+ 3.4%	19
Newark/Elizabeth	\$ 100,437	\$ 14,829	\$ 6,888	14.8%	+ 3.9%	13
Trenton	\$ 95,481	\$ 13,590	\$ 5,649	14.2%	+ 3.3%	21
New Mexico						
Albuquerque	\$ 72,376	\$ 7,816	(\$ 125)	10.8%	– 0.1%	94
Rio Rancho	\$ 72,886	\$ 7,942	\$ 0	10.9%	+ 0.0%	85

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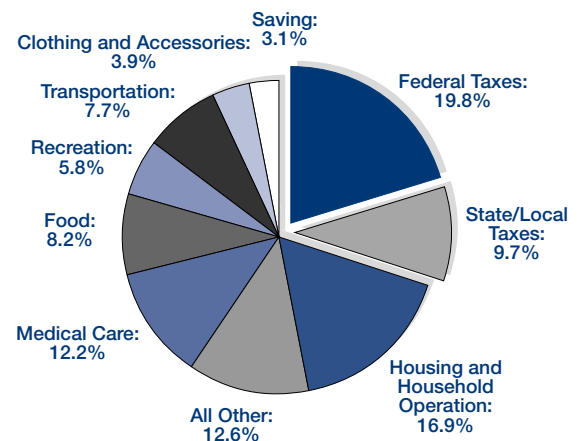
state and local tax systems.³

Despite three straight years of heated debate over the federal income tax, little attention has been paid to its disparate geographic impact. Some states have a generally low cost of living, and earnings are correspondingly lower. Others have the opposite situation.

The federal income tax takes almost no notice of these differences, imposing a significantly higher tax burden on the latter group of states—those with a high cost of living and correspondingly higher earnings per capita, even though these taxpayers do not have a higher standard of living. The state-by-state variation in its impact is caused by the fixed dollar amounts that federal tax laws apply nationwide regardless of the cost of living in various areas.

For example, at the end of 2003, every American taxpayer will have until April 15 to file a federal income tax return. No matter

Figure 1
The Typical American Family's Budget 2003



Source: Tax Foundation

where taxpayers (in this study, a couple with no dependents) live and earn a living, they will be calculating their liability according to the same federal income tax brackets as everyone else in the country, taking the same standard deduction, and using the same dollar amounts for exemptions.

In Cookeville, Tennessee, the federal income tax liability for a couple with no dependents earning an income sufficient to purchase the nation's median standard of living is \$5,980. That is 9.9 percent of income taken by Uncle Sam. On the other hand, in New York

³ See especially the ranking of state-local tax burdens at www.taxfoundation.org/statelocaltaxburdens.html, and the State Business Tax Climate Index at www.taxfoundation.org/statebusinessstaxclimate.html.

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National Average	\$ 72,886	\$ 7,942	-	10.9%	-	-
New Mexico (cont.)						
Las Cruces	\$ 70,335	\$ 7,510	(\$ 431)	10.7%	- 0.2%	133
Los Alamos	\$ 84,839	\$ 10,930	\$ 2,988	12.9%	+ 2.0%	30
Santa Fe	\$ 84,839	\$ 10,930	\$ 2,988	12.9%	+ 2.0%	31
Carlsbad	\$ 70,918	\$ 7,598	(\$ 344)	10.7%	- 0.2%	121
Farmington	\$ 69,242	\$ 7,346	(\$ 595)	10.6%	- 0.3%	158
Hobbs	\$ 67,420	\$ 7,073	(\$ 869)	10.5%	- 0.4%	207
New York						
Buffalo	\$ 74,635	\$ 8,379	\$ 437	11.2%	+ 0.3%	63
Dutchess County	\$ 84,256	\$ 10,784	\$ 2,843	12.8%	+ 1.9%	34
Glens Falls	\$ 75,510	\$ 8,598	\$ 656	11.4%	+ 0.5%	58
Nassau County	\$ 101,166	\$ 15,011	\$ 7,070	14.8%	+ 3.9%	11
New York (Manhattan)						
New York (Manhattan)	\$ 159,621	\$ 30,506	\$ 22,565	19.1%	8.2%	1
New York (Queens)	\$ 95,554	\$ 13,608	\$ 5,667	14.2%	+ 3.3%	20
Syracuse	\$ 72,522	\$ 7,850	(\$ 91)	10.8%	- 0.1%	90
Plattsburgh	\$ 70,481	\$ 7,532	(\$ 409)	10.7%	- 0.2%	131
Sullivan County	\$ 75,802	\$ 8,670	\$ 729	11.4%	+ 0.5%	56
Watertown/ Jefferson County	\$ 74,417	\$ 8,324	\$ 383	11.2%	+ 0.3%	66
North Carolina						
Asheville	\$ 74,417	\$ 8,324	\$ 383	11.2%	+ 0.3%	67
Charlotte	\$ 70,116	\$ 7,477	(\$ 464)	10.7%	- 0.2%	139
Gastonia	\$ 68,149	\$ 7,182	(\$ 759)	10.5%	- 0.4%	192
Fayetteville	\$ 68,367	\$ 7,215	(\$ 726)	10.6%	- 0.3%	183
Goldensboro	\$ 69,242	\$ 7,346	(\$ 595)	10.6%	- 0.3%	159
Winston/Salem	\$ 68,659	\$ 7,259	(\$ 683)	10.6%	- 0.3%	176
Durham	\$ 69,460	\$ 7,379	(\$ 562)	10.6%	- 0.3%	152
Raleigh	\$ 71,939	\$ 7,751	(\$ 191)	10.8%	- 0.1%	101
Wilmington	\$ 74,052	\$ 8,233	\$ 292	11.1%	+ 0.2%	70
Albemarle/ Stanly County						
Albemarle/ Stanly County	\$ 67,347	\$ 7,062	(\$ 880)	10.5%	- 0.4%	209
Marion/McDowell County						
Marion/McDowell County	\$ 70,772	\$ 7,576	(\$ 366)	10.7%	- 0.2%	126
Wilkesboro	\$ 70,700	\$ 7,565	(\$ 377)	10.7%	- 0.2%	128
North Dakota						
Bismarck/Mandan	\$ 68,805	\$ 7,281	(\$ 661)	10.6%	- 0.3%	171
Grand Forks	\$ 67,128	\$ 7,029	(\$ 912)	10.5%	- 0.4%	218
Minot	\$ 62,901	\$ 6,395	(\$ 1,546)	10.2%	- 0.7%	286
Ohio						
Akron	\$ 71,501	\$ 7,685	(\$ 256)	10.7%	- 0.1%	107
Cincinnati	\$ 69,971	\$ 7,456	(\$ 486)	10.7%	- 0.2%	144
Cleveland	\$ 75,729	\$ 8,652	\$ 711	11.4%	+ 0.5%	57
Dayton/Springfield	\$ 68,367	\$ 7,215	(\$ 726)	10.6%	- 0.3%	184
Troy/Miami County	\$ 71,939	\$ 7,751	(\$ 191)	10.8%	- 0.1%	102
Lima	\$ 70,918	\$ 7,598	(\$ 344)	10.7%	- 0.2%	122
Toledo	\$ 71,356	\$ 7,663	(\$ 278)	10.7%	- 0.2%	113
Youngstown/Warren	\$ 67,347	\$ 7,062	(\$ 880)	10.5%	- 0.4%	210
Findlay	\$ 73,542	\$ 8,106	\$ 164	11.0%	+ 0.1%	75
Oklahoma						
Enid	\$ 65,306	\$ 6,756	(\$ 1,186)	10.3%	- 0.6%	255
Edmond	\$ 67,711	\$ 7,117	(\$ 825)	10.5%	- 0.4%	200
Oklahoma City	\$ 66,108	\$ 6,876	(\$ 1,065)	10.4%	- 0.5%	234
Ardmore	\$ 65,014	\$ 6,712	(\$ 1,229)	10.3%	- 0.6%	262
Bartlesville	\$ 67,201	\$ 7,040	(\$ 901)	10.5%	- 0.4%	212
Muskogee	\$ 65,670	\$ 6,811	(\$ 1,131)	10.4%	- 0.5%	243
Ponca City	\$ 70,481	\$ 7,532	(\$ 409)	10.7%	- 0.2%	132
Pryor Creek	\$ 62,682	\$ 6,362	(\$ 1,579)	10.2%	- 0.7%	291
Stillwater	\$ 65,743	\$ 6,821	(\$ 1,120)	10.4%	- 0.5%	240
Oregon						
Corvallis	\$ 79,519	\$ 9,600	\$ 1,658	12.1%	+ 1.2%	41
Portland	\$ 84,111	\$ 10,748	\$ 2,806	12.8%	+ 1.9%	35
Salem	\$ 74,344	\$ 8,306	\$ 364	11.2%	+ 0.3%	68
Coos County	\$ 72,886	\$ 7,942	\$ 0	10.9%	+ 0.0%	86
Klamath Falls	\$ 71,428	\$ 7,674	(\$ 267)	10.7%	- 0.2%	110
Lincoln County	\$ 77,405	\$ 9,071	\$ 1,130	11.7%	+ 0.8%	48

Continued

City (Manhattan), the corresponding federal income tax liability is \$22,565, a tax burden of 19.1 percent of income, more than double.

Again, that is the most extreme case, but since cost-of-living differentials exist all over the United States, so do uneven federal income tax liabilities. In New York, the couple in Queens would pay \$13,608 (14.2 percent of income) while the couple in Buffalo would pay \$8,379 (11.2 percent of income). In Illinois, the couple in Chicago would pay \$15,048 (14.9 percent of income) while the couple in Springfield would pay \$7,401 (10.6 percent of income). In Michigan, the couple in Detroit would pay \$10,821 (12.8 percent of income) while the couple in Lansing would pay \$7,303 (10.6 percent of income).

Differences between large and small communities are perhaps to be expected, but it is surprising to see wide differences between similarly sized cities in different states. The couple in Boston would pay \$14,811 (14.8 percent of income) while the couple in Atlanta would pay \$7,663 (10.7 percent of income). The couple in Portland, Oregon would pay \$10,748 (12.8 percent of income) while the couple in Phoenix would pay \$7,576 (10.7 percent of income). The couple in Grand Rapids would pay \$8,142 (11 percent of income) while the couple in San Antonio would pay \$6,931 (10.4 percent of income).

When all metropolitan areas in each state are averaged together, we do see that cost of living, earnings per capita and income tax liability all differ significantly from state to state. Figure 2 on page 8 is a U.S. map showing federal income tax liabilities as a percentage of adjusted gross income (AGI). Tax liabilities by state range from a high of 16.5 percent of AGI in Connecticut to a low of 9.5 percent of AGI in Utah.

Ramifications for Tax Policy

Tax distribution analysis has long been an important measure for policymakers when making changes in tax policy. Table 2 shows a simple example of traditional tax distribution analysis, similar to data published by virtually every tax research organization in or out of government. It applies only to calendar year 2001, the latest year that official data from the IRS are available. It shows a typical distribution of income for an advanced Western nation, with the top-earning five percent of all taxpayers accounting for about a third of all the individual income earned. This same group paid more than one half of all the income taxes collected, a distribution that results from a progressive income tax structure designed to

*Table 1 (continued)
Differences in Cost of Living and Federal Income Tax Liabilities by Area
Calendar Year 2003*

Area	Income Required to Pay for Median Standard of Living	Federal Income Tax	How Much Income Tax Varies from National Average	Federal Income Tax as a Percentage of Income	How Much Income Tax Varies from National Average as a Percentage of Income	Rank
National Average	\$ 72,886	\$ 7,942	-	10.9%	-	-
Pennsylvania						
Johnstown	\$ 67,128	\$ 7,029	(\$ 912)	10.5%	- 0.4%	219
Philadelphia	\$ 88,338	\$ 11,804	\$ 3,863	13.4%	+ 2.5%	26
Pittsburgh	\$ 70,991	\$ 7,609	(\$ 333)	10.7%	- 0.2%	119
Williamsport/ Lycoming County	\$ 72,522	\$ 7,850	(\$ 91)	10.8%	- 0.1%	91
York County	\$ 71,137	\$ 7,631	(\$ 311)	10.7%	- 0.2%	115
Indiana County	\$ 68,586	\$ 7,248	(\$ 694)	10.6%	- 0.3%	178
South Carolina						
Charleston/ N. Charleston	\$ 72,157	\$ 7,784	(\$ 158)	10.8%	- 0.1%	97
Columbia	\$ 69,825	\$ 7,434	(\$ 508)	10.6%	- 0.2%	148
Greenville/Spartanburg/ Anderson	\$ 67,565	\$ 7,095	(\$ 847)	10.5%	- 0.4%	203
Myrtle Beach	\$ 69,169	\$ 7,335	(\$ 606)	10.6%	- 0.3%	162
Sumter	\$ 67,201	\$ 7,040	(\$ 901)	10.5%	- 0.4%	213
Camden	\$ 69,825	\$ 7,434	(\$ 508)	10.6%	- 0.2%	149
Hilton Head Island	\$ 76,749	\$ 8,907	\$ 966	11.6%	+ 0.7%	52
South Dakota						
Sioux Falls	\$ 69,971	\$ 7,456	(\$ 486)	10.7%	- 0.2%	145
Vermillion	\$ 71,210	\$ 7,641	(\$ 300)	10.7%	- 0.2%	114
Tennessee						
Chattanooga	\$ 67,201	\$ 7,040	(\$ 901)	10.5%	- 0.4%	214
Clarksville	\$ 62,974	\$ 6,406	(\$ 1,535)	10.2%	- 0.7%	285
Jackson/ Madison County	\$ 65,525	\$ 6,789	(\$ 1,153)	10.4%	- 0.5%	249
Johnson City	\$ 65,233	\$ 6,745	(\$ 1,197)	10.3%	- 0.6%	256
Kingsport	\$ 63,775	\$ 6,526	(\$ 1,415)	10.2%	- 0.7%	277
Knoxville	\$ 65,233	\$ 6,745	(\$ 1,197)	10.3%	- 0.6%	257
Memphis	\$ 65,670	\$ 6,811	(\$ 1,131)	10.4%	- 0.5%	244
Nashville/Franklin	\$ 70,772	\$ 7,576	(\$ 366)	10.7%	- 0.2%	127
Cleveland	\$ 65,816	\$ 6,832	(\$ 1,109)	10.4%	- 0.5%	239
Cookeville	\$ 60,131	\$ 5,980	(\$ 1,962)	9.9%	- 1.0%	297
Dyersburg	\$ 64,504	\$ 6,636	(\$ 1,306)	10.3%	- 0.6%	271
Morristown	\$ 64,796	\$ 6,679	(\$ 1,262)	10.3%	- 0.6%	263
Texas						
Abilene	\$ 62,901	\$ 6,395	(\$ 1,546)	10.2%	- 0.7%	287
Amarillo	\$ 64,504	\$ 6,636	(\$ 1,306)	10.3%	- 0.6%	272
San Marcos	\$ 67,201	\$ 7,040	(\$ 901)	10.5%	- 0.4%	215
Beaumont	\$ 66,691	\$ 6,964	(\$ 978)	10.4%	- 0.5%	225
Brazoria	\$ 67,055	\$ 7,018	(\$ 923)	10.5%	- 0.4%	221
Dallas	\$ 70,262	\$ 7,499	(\$ 442)	10.7%	- 0.2%	134
Plano	\$ 70,262	\$ 7,499	(\$ 442)	10.7%	- 0.2%	135
El Paso	\$ 68,659	\$ 7,259	(\$ 683)	10.6%	- 0.3%	177
Arlington	\$ 68,805	\$ 7,281	(\$ 661)	10.6%	- 0.3%	172
Fort Worth	\$ 68,003	\$ 7,160	(\$ 781)	10.5%	- 0.4%	195
Weatherford	\$ 67,565	\$ 7,095	(\$ 847)	10.5%	- 0.4%	204
Conroe	\$ 66,618	\$ 6,953	(\$ 989)	10.4%	- 0.5%	226
Houston	\$ 65,889	\$ 6,843	(\$ 1,098)	10.4%	- 0.5%	236
Laredo	\$ 63,702	\$ 6,515	(\$ 1,426)	10.2%	- 0.7%	279
Longview	\$ 62,755	\$ 6,373	(\$ 1,568)	10.2%	- 0.7%	290
Lubbock	\$ 62,828	\$ 6,384	(\$ 1,557)	10.2%	- 0.7%	288
McAllen	\$ 63,557	\$ 6,494	(\$ 1,448)	10.2%	- 0.7%	281
Midland	\$ 63,775	\$ 6,526	(\$ 1,415)	10.2%	- 0.7%	278
Odessa	\$ 65,598	\$ 6,800	(\$ 1,142)	10.4%	- 0.5%	248
San Angelo	\$ 64,723	\$ 6,668	(\$ 1,273)	10.3%	- 0.6%	267
San Antonio	\$ 66,472	\$ 6,931	(\$ 1,011)	10.4%	- 0.5%	229
Seguin	\$ 62,318	\$ 6,308	(\$ 1,634)	10.1%	- 0.8%	294
Sherman/Denison	\$ 68,586	\$ 7,248	(\$ 694)	10.6%	- 0.3%	179
Texarkana	\$ 64,796	\$ 6,679	(\$ 1,262)	10.3%	- 0.6%	264
Tyler	\$ 67,857	\$ 7,139	(\$ 803)	10.5%	- 0.4%	199
Victoria	\$ 62,828	\$ 6,384	(\$ 1,557)	10.2%	- 0.7%	289
Waco	\$ 67,128	\$ 7,029	(\$ 912)	10.5%	- 0.4%	220
Palestine/ Anderson County	\$ 61,880	\$ 6,242	(\$ 1,699)	10.1%	- 0.8%	295
Paris	\$ 61,735	\$ 6,220	(\$ 1,721)	10.1%	- 0.8%	296

Continued

redistribute income.

At the upper end of the income scale, such charts are generally used to suggest that everyone above a certain level of income is living so well that they do not need tax relief, and in fact maybe they ought to be paying higher taxes. At the lower end of the income scale, the charts are usually used to demonstrate that people are living so poorly that they need assistance or a tax cut. At both ends of the income scale, cost of living is ignored.

At the heart of these traditional tax distribution analyses is the assumption that higher incomes always equate to a higher standard of living. We have seen that this is not so. An income of \$132,143 in San Francisco is said to be in the top five percent of income earners, yet it yields the same standard of living as \$84,111 in Portland, Oregon, an income that the chart would show to be below the top ten percent of incomes in the country. The difference is illusory since it does not result in a higher standard of living.

Table 3 further shows how cost of living differentials can render unadjusted income comparisons between cities almost meaningless. The dual income couple earning \$72,886 used in this study is classified in the top quintile (the top 20 percent). If the couple lived in Jacksonville, Florida, their comparable income would be adjusted down to \$66,253, and they would no longer be in the top 20 percent. However, going the other direction, if the couple lived in Orange County, California, a comparable income would be \$97,959 and they would be described as one of the "wealthy" people in the top 10 percent of the nation's earners. In San Francisco their adjusted income is \$132,143 and they move into the top 5 percent. In Manhattan their adjusted income is \$159,621 and they move into the top 3 percent.

Tax distribution analysis suffers from other false assumptions and data problems beyond the scope of this report. One well documented fallacy is that each year's snapshot of the top 10 percent of earners or any other slice of the income spectrum is composed of the same people from year to year. In fact, taxpayers' incomes change significantly over time, moving up and down the income spectrum in a fairly predictable pattern throughout their lives. Young singles are usually in the bottom 20 percent, but when they advance in their careers their incomes jump them up into at least the middle ranges. When they retire, almost all taxpayers naturally fall back down into the bottom half of the income spectrum.

Another well known problem is the lumping together of joint tax returns with individual

*Table 1 (continued)
Differences in Cost of Living and Federal Income Tax Liabilities by Area
Calendar Year 2003*

Area	Income Required to Pay for Median Standard of Living	Federal Income Tax	How Much Income Tax Varies from National Average	Federal Income Tax as a Percentage of Income	How Much Income Tax Varies from National Average as a Percentage of Income	Rank
National Average	\$ 72,886	\$ 7,942	-	10.9%	-	-
Utah						
Provo/Orem	\$ 69,169	\$ 7,335	(\$ 606)	10.6%	- 0.3%	163
Salt Lake City	\$ 75,437	\$ 8,579	\$ 638	11.4%	+ 0.5%	59
Cedar City	\$ 65,087	\$ 6,723	(\$ 1,218)	10.2%	- 0.6%	261
St. George	\$ 68,076	\$ 7,171	(\$ 770)	10.5%	- 0.4%	193
Virginia						
Charlottesville	\$ 81,049	\$ 9,982	\$ 2,041	12.3%	+ 1.4%	39
Lynchburg	\$ 66,181	\$ 6,887	(\$ 1,054)	10.4%	- 0.5%	233
Virginia Peninsula	\$ 73,032	\$ 7,978	\$ 36	10.9%	+ 0.0%	82
Richmond	\$ 73,178	\$ 8,014	\$ 73	11.0%	+ 0.1%	77
Roanoke	\$ 68,877	\$ 7,292	(\$ 650)	10.6%	- 0.3%	169
Northern Virginia	\$ 97,959	\$ 14,210	\$ 6,268	14.5%	+ 3.6%	18
Prince William	\$ 85,568	\$ 11,112	\$ 3,171	13.0%	+ 2.1%	29
Martinsville/ Henry County	\$ 64,358	\$ 6,614	(\$ 1,328)	10.3%	- 0.6%	273
Washington						
Bellingham	\$ 76,166	\$ 8,762	\$ 820	11.5%	+ 0.6%	54
Olympia	\$ 74,563	\$ 8,361	\$ 419	11.2%	+ 0.3%	64
Vancouver	\$ 70,044	\$ 7,467	(\$ 475)	10.7%	- 0.2%	141
Richland/ Kennewick/Pasco	\$ 73,105	\$ 7,996	\$ 55	10.9%	+ 0.0%	80
Spokane	\$ 73,178	\$ 8,014	\$ 73	11.0%	+ 0.1%	78
Tacoma	\$ 77,405	\$ 9,071	\$ 1,130	11.7%	+ 0.8%	49
Yakima	\$ 70,554	\$ 7,543	(\$ 398)	10.7%	- 0.2%	130
Walla Walla	\$ 74,563	\$ 8,361	\$ 419	11.2%	+ 0.3%	65
West Virginia						
Charleston	\$ 73,032	\$ 7,978	\$ 36	10.9%	+ 0.0%	83
Huntington	\$ 68,003	\$ 7,160	(\$ 781)	10.5%	- 0.4%	196
Wisconsin						
Appleton/Neenah/ Menasha	\$ 69,460	\$ 7,379	(\$ 562)	10.6%	- 0.3%	153
Eau Claire	\$ 72,157	\$ 7,784	(\$ 158)	10.8%	- 0.1%	98
Green Bay	\$ 70,700	\$ 7,565	(\$ 377)	10.7%	- 0.2%	129
Janesville	\$ 69,898	\$ 7,445	(\$ 497)	10.7%	- 0.2%	147
Milwaukee/ Waukesha	\$ 73,105	\$ 7,996	\$ 55	10.9%	+ 0.0%	81
Wausau	\$ 68,877	\$ 7,292	(\$ 650)	10.6%	- 0.3%	170
Marshfield	\$ 69,679	\$ 7,412	(\$ 530)	10.6%	- 0.3%	150
Stevens Point/ Plover	\$ 72,595	\$ 7,869	(\$ 73)	10.8%	- 0.1%	89
Wyoming						
Cheyenne	\$ 75,291	\$ 8,543	\$ 601	11.3%	+ 0.5%	60
Laramie	\$ 72,376	\$ 7,816	(\$ 125)	10.8%	- 0.1%	95

Note: Because the ACCRA Cost of Living Index Survey relies on voluntary participation for data collection, the number of cities varies in each quarterly report.

Source: Tax Foundation, ACCRA.

*Table 2
Federal Individual Income Tax Return Data
Calendar Year 2001*

Income Group	Number of Returns (000)	AGI (\$000,000)	Income Taxes Paid (\$000,000)	Group's Share of Total AGI	Group's Share of Total Taxes	Income Split Point	Average Tax Rate (Payment/AGI)
All Taxpayers	128,817	\$ 6,241,036	\$ 887,682	100.0%	100.0%	-	14.2%
Top 1%	1,288	\$ 1,094,296	\$ 300,898	17.5%	33.9%	above \$ 292,913	27.5%
Top 5%	6,441	\$ 1,996,492	\$ 472,823	32.0%	53.3%	above \$ 127,904	23.7%
Top 10%	12,882	\$ 2,690,589	\$ 576,163	43.1%	64.9%	above \$ 92,754	21.4%
Top 25%	32,204	\$ 4,071,034	\$ 736,053	65.2%	82.9%	above \$ 56,085	18.1%
Top 50%	64,409	\$ 5,379,286	\$ 852,642	86.2%	96.1%	above \$ 28,528	15.9%
Bottom 50%	64,409	\$ 861,750	\$ 35,040	13.8%	3.9%	below \$ 28,528	4.1%

Source: Preliminary data, IRS

tax returns. Tax distribution analyses like Table 2 treat a single person making \$100,000 the same as a family of five with that income, even though a single person can obviously maintain a much higher standard of living on that income. People in the top 20 percent of earners are generally middle-aged couples at the peak of their earning power.

Conclusion

The value of a dollar is not constant. It erodes over time due to inflation, and it also varies by geographic location due to variations in the cost of living. Economists almost universally agree that taxing illusory income due to inflation is economically damaging. As a result, the Economic Recovery Tax Act of 1981 indexed the federal income tax code for inflation. Since 1985, the year the change became effective, tax brackets, standard deductions, exemptions and other specified dollar amounts in the tax code have been adjusted for inflation. However, as illustrated by this report, differences in cost of living also create inequities and economic damage.

To prevent this, the federal income tax code would have to be adjusted for differences in the cost of living. One way to do so would be to multiply every taxpayer's income by a cost-of-living index like ACCRA's. The difficulty of establishing an authoritative index for every location in the U.S., and indeed the world, would be an almost insuperable administrative task, even discounting the political difficulties of raising so many rural and small-town voters' taxes so that people in major metropolitan areas can get a well deserved break. Far more logical and far easier to administer would be comprehensive tax reform, though the political hurdles would be almost as high. A flat tax rate on all income with no standard deduction, for example, would not discriminate against taxpayers living and working in high-cost areas, nor would a national sales tax with no rebate.

Methodology

Income was adjusted utilizing the “Cost of Living Index” published by ACCRA. The index has been published quarterly since 1968 and is highly regarded by government agencies such as the Census Bureau and the President’s

*Table 3
Geographic Impact on the Income Needed by a Couple with No Dependents to Purchase the Median Standard of Living
Calendar Year 2003*

Metropolitan Statistical Area	Income Needed to Buy Median Standard of Living	Income Group	Marginal Tax Rate
National Average	\$72,886	20%	25%
Milwaukee, WI	\$73,105	20%	25%
Jacksonville, FL	\$66,253	25%	15%
Orange County, CA	\$97,959	10%	25%
San Francisco, CA	\$132,143	5%	28%
New York City (Manhattan), NY	\$159,621	3%	28%

Sources: Tax Foundation, ACCRA.

Council of Economic Advisers.

In order to compare metropolitan statistical areas, this report used a national median income for a dual income couple that has no dependents and takes a standard deduction. This was done for three reasons. First, the index is weighted to represent the expenditure patterns for professional and executive households. From

a demographic perspective, such households are more likely to have two adult incomes.

Second, the couple is assumed to be childless for reasons of simplicity. In fact, adding children to the analysis would only exacerbate the tax differentials. For example, the \$1,000 per child tax credit is like all the other fixed dollar values in the current code. It is worth more, as a percentage of income, to taxpayers in low-cost areas where earnings and income tax liabilities are lower.

Third, the couple is assumed to be using the standard deduction, as opposed to itemized deductions. Arguably, itemized deductions do partially help taxpayers account for cost of living differentials. For instance, the home mortgage interest deduction would be greater for taxpayers where the cost of living is high and housing is expensive.

However, this effect is mitigated by the fact that, in 2001, only 34 percent of all taxpayers itemized their deductions. In addition, this effect is mitigated by the existence of the Alternative Minimum Tax (whose purpose is to limit the value of itemized deductions).

In 2000, the estimated median income for a dual-income couple with no dependent children was \$69,463 according to the Census Bureau. The figure was scaled up to 2003 dollars based on inflation yielding the \$72,886 income figure used in this analysis. ●



SPECIAL REPORT (ISSN 1068-0306) is published at least 6 times yearly by the Tax Foundation, an independent 501(c)(3) organization chartered in the District of Columbia.

4-12 pp.
Annual subscription: \$50
Individual issues \$10

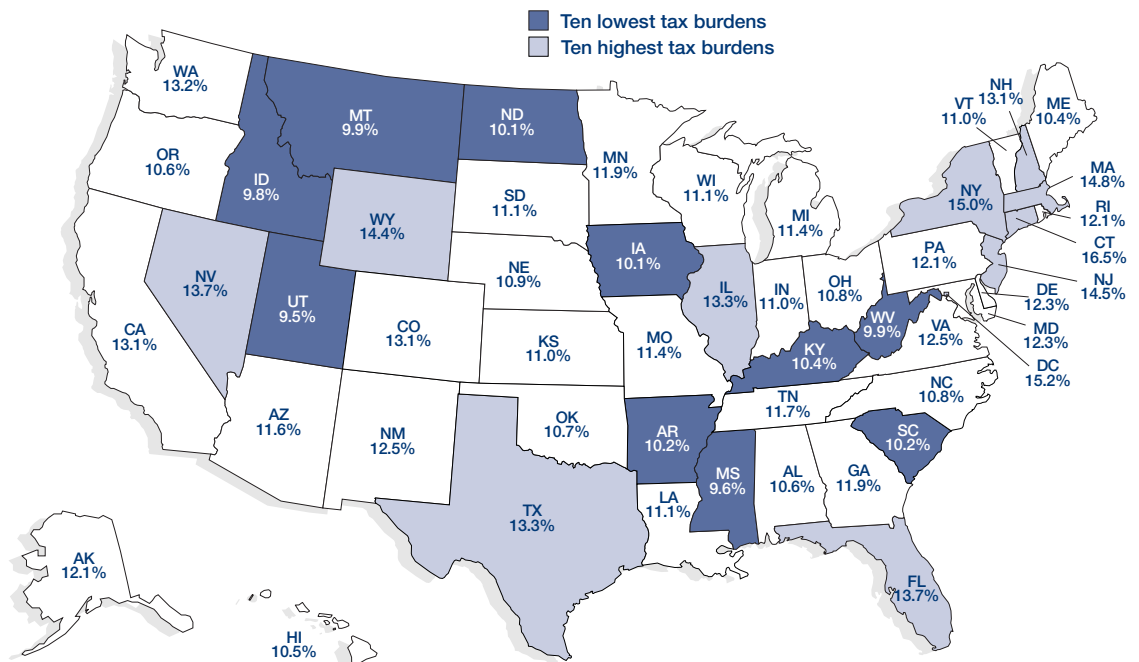
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*Figure 2
Federal Income Tax Liability as a Percentage of Adjusted Gross Income, Calendar Year 2003*



Source: Tax Foundation