



County and City Income Taxes Clustered in States with Poor Tax Climates

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Beginning July 1, 2008, workers in Philadelphia will see a little bit more in their paychecks. That day marks the second reduction within a year in that city's wage tax imposed on both residential and nonresidential workers in Philadelphia, although it remains the highest in the nation.

The new rates are 3.98% for residents (down from 4.219% in early 2008 and 4.26% in 2007) and (precise to the ten-thousandth digit) 3.5392% for nonresidents (down from 3.7242% in early 2008 and 3.7557% in 2007). Thus, a resident who earns \$1,000 a week will keep \$124 more per year; a nonresident earning that much will keep an additional \$96.

Local income or wage taxes can be a part of a sound tax system, particularly if revenue is used to reduce other taxes that may do more economic harm. Using local income tax revenue to reduce corporate income taxes or property taxes can still produce a friendly tax climate.

However, local-level taxes on wages and income are clustering in areas with poor business tax climates. Philadelphia is one of just six of America's twenty largest cities by population that impose a city- or county- level tax measured by compensation, be it a tax on wages, earned income, or occupational privilege.¹ (The others are New York City, Detroit, Indianapolis, Columbus (OH), and Baltimore. It should also be noted that Washington, D.C., while imposing a state-like income tax on its residents, has long sought to impose a "commuter tax" on nonresident workers, but is prohibited from doing so by federal law.²

Among the states with extensive local-level wage and income taxes are Indiana, Kentucky, Maryland, Michigan, Ohio, and Pennsylvania. With the exception of Indiana, each of these states were in the bottom half of the country in the Tax Foundation's *2008 State Business Tax Climate Index*. Indiana, Michigan, and Pennsylvania also are among the ten states with the most outbound moves according to United Van Lines's 2005 Migration Study.

Anecdotal evidence suggests that moving to escape local-level income and wage taxes is not unusual. With a highly mobile population, cities are hard pressed to buck the competitive pressure for lower tax rates. In some areas, such as New York City, municipal services and opportunities may keep residents in the city even with a high local income tax rate. In others, high local tax rates may simply accelerate an ongoing decline.

Many states and cities impose local wage and income taxes only on residents, while others also impose them on nonresidents at an equal or lower rate. It is hard to justify taxing nonresidents at a similar rate, since nonresidents use fewer city services that the taxes fund. However, the incentive to export tax burdens and fleece a captive (and non-voting) workforce may be behind non-differential rates.

Cities and counties should be cautious when imposing local-level taxes on wages, income, and occupational privilege. First, officials should consider whether the tax is worth the compliance costs imposed on workers and businesses. As one example, taxpayers in Albion, Michigan, must fill out a city income tax form (16 pages with instructions), separate from state and federal income tax forms.³ In Iowa, 666 jurisdictions impose a local-level income tax. Simplicity and transparency would serve residents better.

Second, officials should keep in mind the tax burden in their jurisdiction and other jurisdictions, to ensure that tax policy is not driving out jobs and capital investment. Third, officials should avoid using nonresident workers as a captive revenue source, particularly if the taxes are likely to exceed city services used by those workers. Such taxpayers are not captive, but in fact can be highly mobile.

Philadelphia workers will now have a little more in their pockets. Other cities and counties now may want to follow Philadelphia's lead.

Table 1
Local Wage, Income, and Occupational Privilege Taxes

City	Resident Tax Rate	Nonresident Tax Rate
AL - Birmingham	1.00%	1.00%
CA - San Francisco	1.50% (imposed on employer)	1.50% (imposed on employer)
CO - Aurora	\$2 per month on compensation over \$250	\$2 per month on compensation over \$250
CO - Denver	\$5.75 per month on compensation over \$500	\$5.75 per month on compensation over \$500
CO - Greenwood Village	\$4 per month on compensation over \$250	\$4 per month on compensation over \$250
DE - Wilmington	1.25%	1.25%
Iowa	666 school districts impose an income tax surcharge ranging from 1% to 20% of state income tax owed	--
Indiana	All 92 Indiana counties impose income tax on residents and nonresidents, ranging from 0.01% to 0.255%. Additionally, municipalities in Lake County can impose an income tax up to 1.00% on residents and 0.50% on nonresidents.	
KY - Bowling Green	1.85%	1.85%
KY - Covington	2.50% (up to Social Security cap)	2.50% (up to Social Security cap)
KY - Florence	2.00%	2.00%
KY - Lexington-Fayette	2.25%	2.25%
KY - Louisville	2.20%	1.45%
KY - Owensboro	1.33%	1.33%
KY - Paducah	2.00%	2.00%
KY - Richmond	2.00%	2.00%
Maryland	All 23 Maryland counties impose a county-level income tax on residents and nonresidents ranging from 1.25% to 3.20%. See here for a list.	
MD - Baltimore	3.05%	3.05%

MI - Albion	1.00%	0.50%
MI - Battle Creek	1.00%	0.50%
MI - Big Rapids	1.00%	0.50%
MI - Detroit	2.50%	1.25%
MI - Flint	1.00%	0.50%
MI - Grand Rapids	1.30%	0.65%
MI - Grayling	1.00%	0.50%
MI - Hamtramck	1.00%	0.50%
MI - Highland Park	2.00%	1.00%
MI - Hudson	1.00%	0.50%
MI - Ionia	1.00%	0.50%
MI - Jackson	1.00%	0.50%
MI - Lansing	1.00%	0.50%
MI - Lapeer	1.00%	0.50%
MI - Muskegon	1.00%	0.50%
MI - Muskegon Heights	1.00%	0.50%
MI - Pontiac	1.00%	0.50%
MI - Port Huron	1.00%	0.50%
MI - Portland	1.00%	0.50%
MI - Saginaw	1.50%	0.75%
MI - Springfield	1.00%	0.50%
MI - Walker	1.00%	0.50%
MO - Kansas City	1.00%	1.00%
MO - St. Louis	1.00%	1.00%
NJ - Newark	1.00% (on employers)	1.00% (on employers)
NY - New York City	2.907% - 3.648%	--
NY - Yonkers	10% of net state tax	0.50%
Ohio	Approximately 180 school districts and 579 cities impose income taxes ranging from 0.50% to 2.75%; the twelve largest cities by population are below.	Approximately 579 cities impose income taxes ranging from 1.00% to 2.75%; the twelve largest cities by population are below.
OH - Akron	2.25%	2.25%
OH - Canton	2.00%	2.00%
OH - Cincinnati	2.10%	2.10%
OH - Cleveland	2.00%	2.00%

OH - Columbus	2.00%	2.00%
OH - Dayton	2.25%	2.25%
OH - Hamilton	2.00%	2.00%
OH - Lorain	2.00%	2.00%
OH - Parma	2.50%	2.50%
OH - Springfield	2.00%	2.00%
OH - Toledo	2.25%	2.25%
OH - Youngstown	2.75%	2.75%
OR - Tri-Met transit district (inc. Portland)	0.6318%	0.6318%
OR - Lane County transit district (inc. Eugene- Springfield)	0.60%	0.60%
Pennsylvania	Most of PA's 2,621 townships and cities impose income, wage, or occupational privilege taxes not exceeding 2.00%. Cities that impose higher rates are listed below.	
PA - Philadelphia	3.98%	3.5392%
PA - Pittsburgh	3.00%	1.00%
PA - Reading	2.70%	1.00%
PA - Scranton	3.40%	1.00%
PA - Wilkes-Barre	2.85%	1.00%
WV - Charleston	\$104 per year city service fee	\$104 per year city service fee
WV - Huntington	\$104 per year city service fee	\$104 per year city service fee

Source: Tax Foundation, Commerce Clearing House, USDA National Finance Center.
Note: Does not include the District of Columbia.

Additionally:

- **Arkansas:** Seven Arkansas school districts impose an income tax surcharge at the rate of 10% of total computed tax before credits: Berryville (Carroll Co.), Green Forest (Carroll Co.), Westside (Craighead Co.), Hope (Hempstead Co.), Huntsville (Madison Co.), Waldron (Scott Co.), and Marshall (Searcy Co.).
- **Oregon:** Multnomah County, Oregon (including Portland, Oregon) imposes a 1.45% business income tax.

- **Pennsylvania:** At least 18 cities, including Philadelphia, Reading, Scranton, and Wilkes-Barre, impose a services tax of up to \$52 per year on employees working within the city.

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Notes

1. U.S. Census Bureau, population estimates, 1990-2005.
2. *See, e.g.*, Eric M. Weiss, "Washington's Bid To Impose Commuter Tax Denied," *Washington Post* (Nov. 5, 2005), p. A01, *citing* *Banner v. United States*, 428 F.3d 303 (D.C. Cir. 2005).
3. *See* City of Albion Tax Forms, at http://www.ci.albion.mi.us/taxforms/2007/2007_City_Tax_Forms.htm.

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