



June 9, 2006

Economic vs. Legal Incidence: Comparing Census Bureau Figures with Tax Foundation Tax Burdens

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Fiscal Fact No. 59

Every one to two years, the U.S. Census Bureau releases new data on state and local tax collections around the country. Each release is widely reported in the press, resulting in a large number of news stories about state and local taxes throughout the popular media.

This periodic surge of interest in state and local taxes frequently leads to confusion about the relationship between Census Bureau state and local tax collections figures, and Tax Foundation figures for state and local tax burdens. The purpose of this Fiscal Fact is to explain the difference between these two measures of state and local taxes, and clarify when each is most appropriate for different kinds of tax analysis.

Latest Census Bureau Data Release

This month, the Census Bureau released new figures for state and local tax collections for Fiscal Years 2003 and 2004 (available at <http://www.census.gov/govs/www/estimate04.html>). The latest release was consistent with previous years, showing that governments in the Northeast generally continued to collect the nation's highest state and local taxes, while those in Southern states generally collected the least. Overall, the State of New York ranked first in state and local tax collections per capita, followed by Connecticut, New Jersey, Wyoming and Massachusetts. States with the lowest state and local collections were South Dakota, Tennessee, Arkansas, Mississippi and Alabama.

Tax Collections vs. Tax Burdens

A common source of confusion among users of Census Bureau figures is the difference between tax collections and tax *burdens*, such as those calculated by the Tax Foundation (available at <http://www.taxfoundation.org/taxdata/show/335.html>). While the two measures are related, there are important differences between them that lawmakers, journalists and taxpayers should be aware of.

The most important difference is that Census Bureau figures measure what economists call the "legal incidence" of state and local taxes, while Tax Foundation figures measure

the “economic incidence”—that is, the economic tax burden—of state and local taxes. The legal incidence of taxes is borne by those with the legal obligation to remit tax payments to state and local governments. Legal incidence is established by law when new taxes are enacted, and specifies which individuals or companies must physically remit tax payments to state and local treasuries.

However, the legal incidence of taxes is generally very different from their final economic burden. Because taxes influence the relative prices facing individuals, they lead to changes in individual behavior. These tax-induced changes in behavior cause some portion of the economic burden of taxes to be shifted from those bearing the legal incidence onto others in society. For example, the legal incidence of local retail sales taxes typically falls on companies. But economists agree that some portion of these taxes is shifted forward to others, in the form of higher prices to consumers, lower wages to workers, reduced returns to corporate shareholders or some combination of the three.

This tax-shifting behavior often causes the economic burden of taxes to differ dramatically from the legal incidence. Once these tax-induced changes in behavior throughout the economy are accounted for, the final distribution of the economic burden of taxes is called the “economic incidence.” Economists refer to measures of this economic incidence as the “tax burden” faced by individuals.

Because Census Bureau tax collections represent a tally of legal tax payments made to state and local governments, they measure legal incidence only. In contrast, Tax Foundation tax burdens use a geographical incidence analysis to allocate taxes to states that are economically affected by them. As a result, Tax Foundation figures attempt to measure the economic incidence of taxes, not the legal incidence.

Is the Difference Important?

For some states, the difference between legal and economic incidence is large. For example, the State of Alaska currently levies high severance taxes on oil extracted from the state. The legal incidence of these taxes falls on oil companies within Alaska’s borders. However, oil companies do not bear the full economic incidence. Instead, some portion is shifted forward in the form of higher prices faced by oil and gas consumers throughout the 50 U.S. states.

Census Bureau figures consistently rank Alaska’s state and local taxes well above the national average. But because they measure only legal tax incidence, this ranking is misleading for the purposes of an economic analysis of the tax burden faced by Alaska residents. In contrast, Tax Foundation figures allocate Alaska’s oil severance taxes to other U.S. states based on oil and gas consumption, providing a much more accurate measure of the economic incidence of these taxes. Once economic incidence is taken into account, Alaska’s state and local tax ranking falls from 14th highest in the nation in 2004 to 50th—the lowest in the nation.

Table 1 illustrates the difference between legal and economic incidence of state and local taxes. It presents per capita state and local tax collections from the Census Bureau

(representing legal incidence) along with per capita state and local tax burdens from the Tax Foundation (representing economic incidence) for 2004. As is clear from the table, the economic incidence of state and local taxes differs markedly from legal incidence in many U.S. states.

Table 1. Legal vs. Economic Incidence of State and Local Taxes Varies Dramatically in Some States

State	Legal Incidence of State and Local Taxes, Per Capita, 2004 (Census Bureau) ¹	Rank	Economic Incidence of State and Local Taxes, Per Capita, 2004 (Tax Foundation) ²	Rank	Difference in Rank Between Legal and Economic Incidence
Alabama	\$ 2,328.26	50	\$2,544.52	49	1
Alaska	\$ 3,610.38	14	\$2,356.97	50	-36
Arizona	\$ 2,871.28	36	\$3,085.49	31	5
Arkansas	\$ 2,535.70	48	\$2,751.44	46	2
California	\$ 3,735.66	11	\$3,950.59	10	1
Colorado	\$ 3,168.53	25	\$3,556.88	20	5
Connecticut	\$ 4,921.44	2	\$5,264.34	1	1
Delaware	\$ 3,607.62	16	\$3,048.99	33	-17
Florida	\$ 3,094.02	27	\$3,265.41	26	1
Georgia	\$ 2,876.74	35	\$3,234.40	27	8
Hawaii	\$ 3,813.04	8	\$4,024.45	9	-1
Idaho	\$ 2,728.19	42	\$2,978.68	36	6
Illinois	\$ 3,554.97	17	\$3,866.67	13	4
Indiana	\$ 2,999.04	29	\$3,384.44	24	5
Iowa	\$ 3,054.10	28	\$3,280.62	25	3
Kansas	\$ 3,380.39	22	\$3,455.10	22	0
Kentucky	\$ 2,766.90	39	\$2,965.31	37	2
Louisiana	\$ 2,898.92	33	\$3,071.16	32	1
Maine	\$ 3,789.00	10	\$4,138.38	7	3
Maryland	\$ 4,015.67	6	\$4,403.23	5	1
Massachusetts	\$ 4,216.50	5	\$4,452.68	4	1
Michigan	\$ 3,313.36	24	\$3,488.96	21	3
Minnesota	\$ 3,810.80	9	\$4,338.47	6	3
Mississippi	\$ 2,443.54	49	\$2,592.44	48	1
Missouri	\$ 2,822.11	38	\$3,114.64	29	9
Montana	\$ 2,622.80	45	\$2,759.93	45	0
Nebraska	\$ 3,608.63	15	\$3,838.27	14	1
Nevada	\$ 3,416.89	21	\$3,453.57	23	-2
New Hampshire	\$ 3,132.93	26	\$2,889.52	39	-13
New Jersey	\$ 4,554.78	3	\$4,672.64	3	0
New Mexico	\$ 2,860.83	37	\$2,776.87	44	-7
New York	\$ 5,260.43	1	\$5,113.44	2	-1
North Carolina	\$ 2,928.86	31	\$3,091.38	30	1
North Dakota	\$ 2,989.07	30	\$2,989.84	35	-5

Ohio	\$ 3,419.32	20	\$3,769.34	15	5
Oklahoma	\$ 2,677.34	43	\$2,779.48	43	0
Oregon	\$ 2,916.79	32	\$3,132.38	28	4
Pennsylvania	\$ 3,446.66	19	\$3,590.15	19	0
Rhode Island	\$ 3,890.99	7	\$4,088.34	8	-1
South Carolina	\$ 2,662.36	44	\$2,864.72	40	4
South Dakota	\$ 2,614.69	46	\$2,848.13	41	5
Tennessee	\$ 2,536.34	47	\$2,683.09	47	0
Texas	\$ 2,880.86	34	\$3,038.11	34	0
Utah	\$ 2,734.91	41	\$2,952.82	38	3
Vermont	\$ 3,681.45	13	\$3,756.65	16	-3
Virginia	\$ 3,342.11	23	\$3,644.26	17	6
Washington	\$ 3,451.74	18	\$3,867.13	12	6
West Virginia	\$ 2,739.94	40	\$2,819.20	42	-2
Wisconsin	\$ 3,713.84	12	\$3,877.95	11	1
Wyoming	\$ 4,437.28	4	\$3,626.66	18	-14
D.C.	\$ 7,154.42	-	\$7,094.12	-	-
U.S. Total*	\$ 3,446.83	-	\$3,633.83	-	-

*Totals do not match due to differences between fiscal and calendar year bases.

1. Fiscal year basis
2. Calendar year basis

Source: Department of Commerce, Bureau of the Census; Tax Foundation.

Which Measure Is Best?

For certain purposes, Census Bureau figures are a more appropriate measure of state and local taxes. For example, when assessing the tax revenues available to lawmakers in the State of Alaska for spending programs, the legal incidence of tax collections is a more useful figure than tax burdens. However, for the purposes of assessing whether residents of Alaska are heavily or lightly taxed, it is essential to account for economic incidence. Only tax burdens that reflect the economic incidence of taxes provide information about the true cost of taxes borne by the Alaskan economy.

Because Census Bureau collections reflect only legal tax incidence, they do not provide state and local policymakers with information about the true tax burden faced by individuals within their jurisdictions.

Other Key Differences

Aside from economic versus legal tax incidence, there are two other differences between Census Bureau and Tax Foundation figures that analysts should be aware of. First, Census Bureau collections are generally released after a significant time lag—up to two years, as was the case with most recent release. In an attempt to provide policymakers with more current estimates of state and local tax burdens, Tax Foundation figures are forecasted up to the current year. Second, Tax Foundation figures are based on the regular calendar year of January 1 through December 31, while Census Bureau figures are based on the fiscal year used by most U.S. states, which runs from July 1 through June 30.

Table 2 summarizes the key methodological differences between Census Bureau state and local tax collections and tax burdens from the Tax Foundation.

Table 2. Key Differences Between Census Bureau and Tax Foundation Measures of State and Local Taxes

	U.S. Census Bureau	Tax Foundation
What do they measure?	Official state and local tax payments.	Economic burden of state and local taxes.
Legal or economic tax incidence?	Measures legal incidence only.	Measures economic incidence.
How current are the data?	One- to two-year time lag on releases of new data.	Data are forecasted up to the current year.
What time period is used?	Fiscal year (July-June).	Calendar year (January-December).

Source: Tax Foundation.

(For additional information about Tax Foundation estimates of state and local tax burdens, visit our "Tax Burdens and Tax Freedom Day" section at <http://www.taxfoundation.org/research/topic/86.html>. For more information, please contact William Ahern at (202) 464-5101.)

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