The Economic Impact of State Income Tax Elimination

The Council of Economic Advisers

January 2026

Executive Summary

For years, no-income-tax states like Texas, Tennessee, and Florida have often led the pack in attracting and retaining residents looking to put down roots where they do not have to split ownership over the fruits of their labor with state government. In particular, of the 9 states that currently have no personal income tax, 5 of them rank amongst the top 10 states in terms of GDP growth over the past decade and 4 of them rank amongst the top 10 states in terms of net migration rates from other states.[1] At the other end of the spectrum, high-income-tax states like California, New York, and New Jersey have suffered a population exodus as people vote with their feet and wallets. Perhaps seeing Texas, Tennessee, and Florida as models, an increasing number of states with income taxes have indicated an interest in transitioning away from the income tax through some combination of belt-tightening and finding less damaging forms of tax collection.

This paper studies the economic impacts and feasibility of states phasing out their income tax. Recognizing that states have to collect tax revenue *somehow*, the analysis here studies two different scenarios. In the first scenario, the state pursues full revenue replacement by broadening the sales tax, leaving the baseline forecasted growth of total tax revenue unchanged. In the second scenario, the reform combines a broader sales tax base with a limit on spending *growth* that maintains government services at current levels instead of allowing their continued expansion.

The quantitative analysis in this paper is done on an individual state-by-state level, studying the impact of these two reform scenarios on key economic outcomes like GDP, wages, business startup activity, and the migration of high-income taxpayers. This paper also reports the sales tax rate needed to accomplish the reform under each scenario (base broadening only; base broadening coupled with spending growth limits).

Key insights distilled from the economics literature include:

- Income taxes are more economically damaging than sales or property taxes;
- The harmful economic effects of state income taxes include outmigration, brain drain, stifled innovation and entrepreneurship, and reduced GDP;
- The harmful fiscal effects of state income taxes include revenue volatility with "feast and famine" cycles, with states often gaining little or no new tax revenue from income tax hikes because of the negative economic effects they unleash.

Key findings from CEA's analysis of state income tax phase-outs include:

- A 1 to 1.6 percent increase in the level of GDP for the average state;
- A 16 to 19 percent increase in new startups for the average state;
- A $4,000 increase in the average wage;
- A significant influx of new high-income taxpayers;
- An average state sales tax rate of under 8 percent under full revenue replacement with no limits on spending growth;
- An average state sales tax rate of 6.2 percent under a scenario with spending growth limits.

[1] Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, and Wyoming have no state personal income tax of any sort. Washington has no state personal income tax except on capital gains for certain high earners.

Introduction

When financing state programs, policymakers face an array of tax instruments for collecting revenue—most prominently, taxes on income, sales, property, or some combination thereof. It is not just the level of taxes that affects economic well-being. The *form* of taxation shapes economic decisions in ways that affect job creation, innovation, productivity, and economic growth.

States differ dramatically in their tax structures. Nine states levy no personal income tax, while others derive more than 40 percent of revenue from it (Vermeer, 2023). Some rely heavily on sales taxes; others on property taxes. This variation reflects both uncertainty about economic effects and differing policy priorities. Fortunately, a substantial economic literature has exploited this variation to shed clear light on the tradeoffs associated with each tax instrument.

Understanding the consequences of each instrument is essential for states seeking to finance public services while allowing the private sector to thrive by unleashing human creativity and potential. This paper examines the economic evidence and finds that property and sales taxes better enable economic growth, job creation, and innovation than personal and corporate income taxes. Property and sales taxes also provide more stable and predictable revenue streams, avoiding the boom-bust cycles that force procyclical fiscal policy under balanced budget requirements.

The paper comes to these conclusions on both theoretical and empirical grounds by studying the state-of-the-art economics literature on the topic and by undertaking an original quantitative analysis to study the impact of each state individually phasing out its income tax and replacing it with a combination of spending restraint (a limit on spending *growth*) and a broadening of the sales tax base.

The Costs of Different Forms of Taxation: Theory and Evidence

Debates over taxation frequently center around the issue of how much tax revenue should be collected, which is a proxy for how expansive government services should be. However, to properly understand the costs of different forms of taxes, it is important to separate the level of total taxation from its composition. Moreover, while a lot of attention is paid to the idea that taxes transfer resources from the private sector to the government, that is not the only cost they impose on society. After all, some resources do need to be transferred to the public sector to finance essential services. An additional harm imposed by taxes is when they cause mutually beneficial trades to no longer occur—such as when the tax drives a wedge between the worker's take-home pay and an employer's compensation costs to the point where the job is no longer viable for either or both sides of the transaction, or when a tax prevents an investment from occurring, or a purchase of property or a good.

Economists have extensively studied these losses from taxation. The key insight is that not all taxes are equally efficient—some taxes create far more economic damage per revenue dollar than others. An efficient tax changes behavior as little as possible; an inefficient tax causes substantial changes in economic decisions, reducing overall economic output and welfare well beyond the dollars collected.

Economists distinguish between two types of tax burden. The **statutory burden** is simply the number of dollars collected by a particular tax. The **excess burden** (or deadweight loss) represents the additional economic cost imposed when taxes alter decisions about buying, working, or investing. A highly efficient tax has low excess burden relative to revenue raised, while an inefficient tax generates substantial excess burden.

Evidence from Cross-Country Studies

A number of cross-country studies have examined how tax structure affects economic growth using variation across OECD countries over several decades. What is striking is that empirical analyses consistently show that local economies with property and sales taxes have faster GDP per capita than those with income taxes:

Johasson et al. (2008) examine growth rates in 21 OECD countries from 1970 to 2005. They find that corporate and personal income taxes are negatively associated with GDP growth per capita, while property and sales taxes predict higher growth. They estimate that shifting 1% of tax revenues from income taxes to consumption and property taxes would increase long-run GDP per capita by 0.25 to 1.0 percentage points.

Arnold et al. (2011) find that property taxes are least harmful to economic growth, followed by consumption taxes, with personal income taxes more harmful and corporate income taxes most harmful. Higher progressivity in personal income tax schedules is associated with lower GDP per capita growth.

Acosta-Ormaechea et al. (2019) expand the analysis to more countries and find similar results: corporate and personal income taxes are associated with lower growth while property and consumption taxes predict higher growth. The negative effects of income taxes on growth are especially large in developed countries including the United States.

Sen and Kaya (2023) find that corporate income taxes are most growth-damaging, followed by personal income taxes. Revenue-neutral shifts from income taxes toward consumption taxes are associated with higher economic growth. Shifts away from property taxes toward income or payroll taxes have significant negative effects on growth.

Study	Most Harmful	Second Most Harmful	Second Least Harmful	Least Harmful
Johansson et al. (2008)	Corporate Tax	Personal Income Tax	Consumption Tax	Property Tax
Arnold et al. (2011)	Corporate Tax	Personal Income Tax	Consumption Tax	Property Tax
Acosta-Ormaechea et al. (2019)	Personal Tax	Corporate Income Tax	Consumption Tax	Property Tax
Sen & Kaya (2023)	Corporate Tax	Personal Income Tax	Consumption Tax	Property Tax

***Note**: Rankings are based on each study's empirical analysis of the relationship between tax structure and economic growth/GDP per capita across OECD countries. All studies control for overall tax levels and examine revenue-neutral shifts between tax instruments.*

The empirical evidence is remarkably consistent across studies, time periods, and countries: income taxes—particularly corporate income taxes—are substantially more harmful to economic growth than property or consumption taxes. This cross-country pattern motivates a closer examination of US state-level evidence, where tax base mobility may be even more pronounced.

The Economic Costs of State Income Taxation

The case against income taxation finds strong empirical support in US state-level data. When states raise income taxes, they trigger unwanted behavioral responses that compound into substantial economic losses for the state and its citizens. This section examines several key channels through which state income taxes harm economic prospects.

Tax-Induced Migration and Brain Drain

The most direct response to state income taxation is geographic mobility. Workers and businesses can avoid taxes by moving to lower-tax jurisdictions, and high-income individuals—those with the greatest tax liability and often the most career flexibility—are particularly responsive to income taxes.

The historical evidence is striking. Cassidy, Dincecco, and Troiano (2024) examine the adoption of state income taxes throughout the 20th century and find that implementation of a state income tax led to significant population losses. The out-migration was so substantial that states saw little net revenue gain from their new income taxes—the expanded tax base was largely offset by the loss of taxpayers who left. This wasn't merely a one-time adjustment—the migration effects persisted over time as the tax remained in place.

The migration response is particularly pronounced among high earners and highly skilled workers. These individuals face the largest tax bills in absolute terms and often have greater geographic flexibility in their careers. The result is a troubling pattern: income taxes drive out precisely the residents who contribute most to innovation, entrepreneurship, and economic dynamism. This selective migration amplifies the economic cost beyond the simple loss of population, as states lose their most productive residents while retaining those with fewer outside options.

Stifling Innovation and Entrepreneurship

Income taxes significantly reduce innovation activity within states through multiple channels. Akcigit, Grigsby, Nicholas, and Stantcheva (2021) find that personal income taxes reduce both the quantity and quality of innovation. A one-point increase in the marginal tax rate for the 90th percentile of earners reduces patenting by 4 percent, and the resulting patents tend to be less valuable. These effects operate through two mechanisms: inventors reduce their innovative effort in response to lower after-tax returns, and inventors migrate to lower-tax states, taking their innovative capacity with them.

The migration of innovative talent extends beyond domestic relocation. Akcigit, Baslandze, and Stantcheva (2016) show that low state taxes attract "superstar" inventors from other countries. States with lower personal income taxes successfully recruit top international talent, while high-tax states lose out in global competition for innovative workers. This matters enormously for economic growth, as superstar inventors generate disproportionate value through their research productivity and spillovers to other researchers and firms (Bernstein et al., 2022).

Corporate income taxes compound these problems by discouraging startup formation. Fairlie, Fossen, Johnston, and Lyu (2025) find that corporate income tax cuts increase employer startup formation by 4.7 percent and their employment by 3.9 percent, while tax increases produce symmetric negative effects. Curtis and Decker (2018) find similar magnitudes: each percentage point increase in state corporate tax rates leads to a 3.7–4.4 percent drop in workers employed at startups. The mechanism is straightforward: corporate taxes reduce the after-tax returns to entrepreneurship, making the risky prospect of starting a business less attractive relative to wage employment.

The combined evidence reveals a consistent pattern: income taxes discourage the risk-taking, creative effort, and new firm formation that drive long-run economic growth. States with high income taxes produce fewer patents, attract fewer innovative workers, and see less startup activity. These effects accumulate over time, as reduced innovation today means less technological progress and lower productivity growth tomorrow.

Displacing Business Activity

Beyond their effects on new startups, income taxes displace business activity among existing firms. This occurs through two channels: firms relocate capital and operations out of high-tax states, and firms reduce their investment and employment within high-tax states.

Giroud and Rauh (2019) provide detailed evidence on these mechanisms using establishment-level data that tracks individual business locations. They find that both corporate and personal income taxes significantly reduce business activity within states. When a state raises corporate income taxes, firms with establishments in multiple states shift investment and employment toward their facilities in lower-tax jurisdictions. The effects are substantial and occur relatively quickly as firms adjust their operations in response to tax changes.

Personal income taxes operate through a different but equally important channel. Higher personal income taxes make a state less attractive to workers, raising the effective cost of labor for firms operating there. To attract workers to high-tax states, firms must pay higher pre-tax wages to deliver equivalent after-tax compensation. This labor cost channel means that personal income taxes affect business location decisions even for firms whose corporate tax liability doesn't vary across states.

The responsiveness of business activity to corporate income taxes has an important fiscal implication. Mertens and Ravn (2013) find that the corporate tax base is so elastic that cuts in corporate income taxes have essentially no effect on state revenues. When states reduce corporate tax rates, they lose revenue on the existing tax base, but the expansion in business activity and associated tax revenue from other sources

largely offsets this loss. Conversely, increases in corporate tax rates raise less revenue than predict because businesses flee the higher tax burden through real relocation and tax planning strategies that shift reported profits to lower-tax jurisdictions.

In short, *a corporate tax hike raises essentially no additional revenue, while a tax cut forgoes none, all because the tax base is so responsive*.

Aggregate Effects on Growth and Employment

The various channels through which income taxes harm state economies—driving out residents, suppressing innovation, discouraging entrepreneurship, and displacing business activity—compound into substantial effects on aggregate economic outcomes. The evidence on GDP growth and labor market performance confirms that income taxes impose significant costs on overall economic prosperity.

The most comprehensive evidence on income taxes and economic growth comes from careful studies that isolate exogenous variation in tax policy. Romer and Romer (2010) develop a narrative approach to identifying tax changes, carefully distinguishing tax changes motivated by revenue needs or ideological preferences from those responding to current economic conditions. They find that tax increases are highly contractionary: a tax increase of 1 percent of GDP lowers real GDP by approximately 2-3 percent. This is a remarkably large effect, suggesting that the economic costs of taxation substantially exceed the direct revenue collected.

Mertens and Ravn (2013) extend this analysis to distinguish between different types of income taxes. Using a similar identification strategy, they find that personal income tax cuts have substantial positive effects on economic growth. A one percentage point cut in personal income taxes raises real GDP per capita by 1.4 percent immediately and up to 1.8 percent three quarters later. These are large, economically meaningful effects that accumulate over time as the tax changes persist. These estimates likely represent lower bounds on the true effects of income taxation. Both studies identify variation in federal tax policy, which is uniform across states and therefore does not capture the reallocation of economic activity toward states with more competitive tax structures.

Corporate income taxes also significantly affect aggregate economic activity, though through somewhat different mechanisms than personal income taxes. As discussed earlier, corporate taxes primarily operate by affecting business entry and closure decisions. The cumulative effect of reduced business investment, diminished startup formation, and firm closure creates substantial drag on overall economic growth in high-tax states.

Income taxes also harm labor market performance beyond their effects on GDP. Davis and Henrekson (2004) examine how taxes affect various dimensions of labor market activity across countries and find that lower income taxes are associated with more robust labor markets on multiple margins—a unit standard deviation tax difference of 12.8 percentage points leads to a 4.9 percentage point difference in the employment-population ratio. Lower taxes lead to workers putting in more hours and reduced informal or black-market economic activity. Higher income taxes create a tax wedge between the cost of labor to employers and the take-home pay received by workers. This wedge discourages both labor supply (workers

choose leisure or home production over taxed market work) and labor demand (employers cut back on hiring in response to higher labor costs).

The labor market effects are especially pronounced for certain demographic groups (Suarez Serrato and Zidar, 2016). Lower-skilled workers, who face relatively flat labor demand curves, bear much of the employment loss from income taxes through reduced hiring. Secondary earners in households, who often have greater flexibility about whether to work, are particularly responsive to after-tax wage rates.

Young workers deciding whether to invest in additional education face distorted incentives when income taxes claim a large share of the returns to skill acquisition. The responsiveness of human capital investment to returns is well-documented: Abramitzky and Lavy (2014) show that when Israeli kibbutzim reduced income redistribution, young people dramatically increased their educational effort and achievement, demonstrating how strongly skill investment responds to changes in after-tax returns.

These aggregate effects reveal the full economic cost of income taxation. The various micro-level distortions—reduced innovation, suppressed entrepreneurship, displaced business activity, diminished labor supply—accumulate into substantially lower GDP growth and worse labor market outcomes. States that rely heavily on income taxation sacrifice significant economic prosperity relative to states that raise equivalent revenue through less distortive tax instruments.

Revenue Volatility and Fiscal Instability

Beyond their efficiency costs, income taxes create a fiscal management problem for states: revenue instability over the business cycle. This volatility forces states into procyclical fiscal policy that amplifies economic fluctuations and makes planning public services especially difficult.

Income tax revenue is inherently volatile because the tax base—personal income and corporate profits—fluctuates sharply with economic conditions. During recessions, unemployment rises and incomes fall, causing personal income tax revenue to decline. Because states cannot run persistent deficits, this volatility forces them into procyclical fiscal policy that amplifies economic fluctuations and makes planning public services especially difficult. Corporate profits are even more cyclical, often falling dramatically during downturns. Capital gains realizations, which contribute significantly to income tax revenue in many states, essentially evaporate during market downturns. The result is a feast-or-famine revenue pattern: income tax revenue collapses precisely when states face the greatest demands for public services.

The empirical evidence on revenue volatility is unambiguous. Seegert (2018) examines revenue stability across different tax instruments using state-level data and finds that income taxes—particularly corporate income taxes—produce the most volatile revenue streams. Property taxes generate the most stable revenue, as property values change slowly and property tax assessments typically lag market values by several years. Sales tax revenue is more stable than income tax revenue, though it does decline during recessions as consumers reduce spending.

The Tax Foundation confirms these patterns using comprehensive data on state revenue fluctuations during the Great Recession (Walczak, 2020). States heavily reliant on personal and corporate income taxes

experienced revenue declines of 20–30 percent or more from peak to trough. In contrast, states relying primarily on sales and property taxes saw much more modest revenue declines, typically in the range of 5-15 percent. This difference in revenue stability had enormous practical consequences for state budgets and public services during the crisis.

Pew Charitable Trusts (2025) extends this analysis through the Covid-19 pandemic and subsequent recovery. They find that income tax revenue proved extremely volatile, with some states experiencing initial revenue collapses followed by unexpected surges as high earners' incomes and capital gains realizations soared. This feast-or-famine pattern creates fiscal planning nightmares for state governments. During the initial collapse, states faced budget crises and were forced to cut spending or raise taxes despite weak economic conditions. During the subsequent surge, states struggled to distinguish temporary revenue windfalls from permanent increases, leading to potentially unsustainable spending commitments.

This revenue volatility forces states into destructive procyclical fiscal policy. When recessions hit and income tax revenue collapses, states face immediate budget shortfalls. Most states face balanced budget requirements that bar deficit financing. The result is that states must either cut spending or raise tax rates precisely when the economy is weakest—exactly the opposite of sound fiscal policy. These procyclical adjustments amplify economic downturns, as state spending cuts and tax increases reduce aggregate demand when the private economy is already contracting.

The spending cuts forced by revenue volatility often fall on vital public services. Education funding, infrastructure investment, and safety net programs face cuts during recessions when revenues decline (Jackson, Wigger, Xiong, 2021). These cuts can have long-lasting effects: delayed infrastructure maintenance, reduced public health capacity, and diminished educational quality. Moreover, the boom-bust cycle in state revenues makes long-term planning nearly impossible. State agencies cannot reliably project budgets from year to year, making it difficult to undertake multi-year initiatives or maintain stable service levels.

The contrast with property and sales taxes is stark. Property tax revenue remains relatively stable through economic cycles, experiencing typical declines of only 5-15 percent even during severe recessions, allowing states to maintain consistent public services without dramatic adjustments. Sales tax revenue does decline during recessions, but much less sharply than income tax revenue, and rebounds more predictably during recoveries. States relying primarily on property and consumption taxes can engage in more sensible fiscal policy, maintaining steady public services while avoiding the procyclical mistakes forced on income-tax-dependent states.

This revenue stability advantage represents an independent reason to prefer property and sales taxes over income taxes, beyond the efficiency considerations. Even if policymakers were unconcerned about economic distortions, the fiscal management benefits of stable revenue streams would favor property and consumption taxation. Combined with the substantial efficiency advantages documented throughout this memo, the case for avoiding heavy reliance on income taxation becomes overwhelming.

Evaluating the Impact of State Income Tax Elimination

Given the many disadvantages of income taxation over other forms of taxation, the CEA has estimated the benefits to each state of replacing state income taxes with a broadened state sales tax. We do this under two different scenarios:

> **Spending Limit:** State income taxes are replaced with a broadened state sales tax that is set at the rate required to provide the necessary revenue under a scenario where state government spending grows by no more than the rate of inflation for a 10-year period but real GDP grows by 2.5 percent annually.[2]
>
> **Full Revenue Replacement:** State income taxes are replaced with a broadened state sales tax that is set at the rate required to provide full revenue replacement assuming state government spending grows at the same rate as state GDP.

As we demonstrate, under either scenario, there are substantial benefits to state GDP, wages, startup activity, and number of taxpayers for states that do not already have no income tax.

Scope of the Broadened Sales Tax

To maximize the tax base and minimize the extent of distortions in order to deliver the lowest possible sales tax rate, we consider a sales tax that would apply to all final consumer goods and services with only a few modest exceptions:

- The sales tax would not apply to rent or housing more generally.
- The sales tax would not apply to groceries.
- The sales tax would not apply to any category of good that is already taxed under an excise tax or other selective tax (gasoline, alcohol, tobacco, etc.)

This new sales tax would replace existing income taxes and the existing general sales tax but allow excise/selective taxes levied by the state to continue. The new sales tax would also not apply to any capital expenditure by businesses such as equipment or R&D services; such taxes tend to be more distortionary.

The biggest difference between this new sales tax and existing sales tax is that it would place a tax on both goods and services. Sales taxes in most states are currently levied only on goods and a limited set of services. Because spending on goods is only 30 percent of total personal consumption expenditure, the taxable base of currently-existing sales taxes is quite low relative to what it could be. Consequently, as we will show, most states can replace their personal income tax, corporate income tax, and existing general sales tax with this new sales tax below 10 percent and still attain full revenue replacement. Exempting rent

[2] Technically, in this scenario, what is being assumed is that the consumption component of GDP is growing at 2.5 percent annually in real terms.

and groceries from tax helps ensure that the burden of this new tax system does not fall on low-income citizens.

We compute the required rate of the new sales tax under each scenario by making use of data from the Census Bureau on the amount of state government revenue generated by each existing tax (personal income tax, corporate income tax, general sales tax) along with data from the Bureau of Economic Analysis on personal consumption expenditure by type of good/service by state. We also use the interest elasticity of saving from Boskin (1978) to adjust for the fact that the reform makes saving relatively more attractive and consumption relatively less attractive. Together, these sources allow us to compute the tax rate that would be necessary to apply to personal consumption expenditure (minus the above categories) in order to either replace the lost revenue from the old taxes. Table 1 displays these rates for each state.

Estimating Impacts on GDP

To quantify the impacts of these tax changes on state GDP, the CEA utilizes an extended version of the same user cost of capital (UCC) model previously employed to estimate the effects of OBBB (CEA 2025). This model was also previously used by the CEA in 2017 to estimate the effects of the TCJA – estimates which proved to be quite accurate over the ensuing years. Intuitively, lower taxes reduce the cost of purchasing and holding additional capital such as machinery or factories. This leads businesses to buy extra capital, which then generates extra output.

The model is further enriched with four separate capital stocks (equipment, structures, intellectual property, and residential) and two separate sectors (C-corporate and passthrough). It also allows for capital investment to be potentially exempted from sales taxes for state income tax payment to potentially be deductible for the purpose of federal taxes (as is the case for corporate income tax).[3] In the model, UCC is calculated as follows:

$$UCC_{i,j} = (1 + \sigma_i)(r + \delta_i)\frac{1 - (\tau_j^s + \tau_j^f - \rho_j \tau_j^s \tau_j^f)\lambda_i}{1 - (\tau_j^s + \tau_j^f - \rho_j \tau_j^s \tau_j^f)},$$

where σ_i is the sales tax rate (if any) on capital of type *i*, *r* is the interest rate, δ is the depreciation rate for capital of type *i*, τ_j^s is the state income tax rate on businesses in sector *j*, τ_j^f is the state income tax rate on businesses in sector *j*, ρ_j is an indicator specifying whether or not state tax payments are deductible for the purpose of federal taxes in sector *j*, and λ is the net present value of depreciation allowances for capital of type *i*. We obtain data on tax rates and the net present value of depreciation allowances from the Tax Foundation.

The key parameter in such a model is the UCC elasticity of investment, which specifies the percent change in investment resulting from a given change in the user cost of capital. Here, a UCC elasticity of -1 is used. In addition to being the neoclassical benchmark, this number is consistent with empirical estimates of the

[3] For passthrough businesses, we assume no deductibility of state income tax payments on federal taxes (due to the SALT cap).

elasticity and is the same elasticity used by the CEA in 2017 in estimating the effects of TCJA – estimates which turned out to be quite accurate. CEA (2018) discusses this parameter choice in detail.

To make this more concrete, consider a specific numerical example. Suppose in some state corporate income tax is cut from 5 percent to 0 percent and there has never been a sales tax on structures investment. Then, with a federal corporate tax rate of 21 percent and a net present value of depreciation allowances for structures of 0.35 (per Tax Foundation data), it is possible to calculate the resulting change in C-corporate structures investment as below.[4] C-corporate investment in structures thus increases approximately 6.3 percent as a result of this change.

$$\Delta I_{s,c} = \Delta UCC_{s,c} = -1 * \frac{\frac{1-0.21*0.35}{1-0.21} - \frac{1-(0.21+0.05-0.21*0.05)*0.35}{1-(0.21+0.05-0.21*0.05)}}{\frac{1-(0.21+0.05-0.21*0.05)*0.35}{1-(0.21+0.05-0.21*0.05)}} = 3.6\%$$

The increased investment resulting from reduced user costs gradually builds up the capital stock to a new level, which leads to GDP increasing to a new steady state level over time as well. The conversion of additional capital of each type into additional aggregate output is determined by the income share of each type of capital, data which is available in the BLS Multifactor Productivity Tables. For illustrative purposes, continuing with the previous example, in the long run the additional capital increases GDP by $\Delta Y = \omega_c \alpha_s \Delta I_{s,c} = 0.1\%$, where $\alpha_s = 0.09$ is the structures share of income and $\omega_c = 0.36$ is the share of the capital stock attributable to C-corporations.

This yields information on the effects on GDP through the user cost of capital channel. Tax changes also have effects on labor supply, and CEA uses estimates of the labor supply elasticity from Chetty (2011) for this purpose. We apply the elasticity to the change in the average individual's after-tax real purchasing power resulting solely from the direct effects of the reform on the tax code. Intuitively, lower personal income taxes lead to higher after-tax wages, which incentivizes workers to work more. However, there is a countervailing effect in that higher sales taxes effectively decrease the real wage (since they increase the price of consumption but do not increase wages), which incentivizes workers to work less. We incorporate both of these channels in our analysis.

Table 1 displays the net effects on GDP of eliminating state income taxes and replacing them with a broadened sales tax. We note that our findings are broadly in line with the empirical results of Nguyen, Onnis, and Rossi (2021), who find that shifting the burden of taxation from income to consumption increases GDP.

[4] We assume the net present value of depreciation allowances is the same at the state level as at the federal level. To the extent that some states have less generous depreciation allowances than the federal tax codes (e.g., some states have not adopted full expensing of equipment), our calculations thus understate the full benefit of these state tax changes. This is because, in the context of full expensing, the tax rate is irrelevant for the cost of capital.

Table 1: Required Tax Rates and Impacts on GDP

	Approach 1: Spending Freeze			Approach 2: Full Revenue Replacement		
State	Sales Tax Rate	GDP (%)	GDP (Billions)	Sales Tax Rate	GDP (%)	GDP (Billions)
Alabama	5.74%	1.03% to 1.16%	$3.5 to 3.9 B	7.35%	0.65% to 0.78%	$2.2 to 2.6 B
Arizona	5.34%	1.02% to 1.08%	$6.1 to 6.4 B	6.84%	0.66% to 0.72%	$3.9 to 4.2 B
Arkansas	7.06%	1.34% to 1.42%	$2.6 to 2.8 B	9.04%	0.86% to 0.94%	$1.7 to 1.8 B
California	9.32%	3.34% to 3.76%	$140.8 to 158.5 B	11.93%	2.68% to 3.1%	$113 to 130.7 B
Colorado	4.12%	0.66% to 0.78%	$3.8 to 4.5 B	5.27%	0.38% to 0.51%	$2.2 to 2.9 B
Connecticut	8.77%	1.97% to 2.11%	$7.3 to 7.9 B	11.22%	1.34% to 1.48%	$5 to 5.5 B
Delaware	5.57%	1.65% to 1.75%	$1.9 to 2 B	7.13%	1.26% to 1.36%	$1.5 to 1.6 B
District of Columbia	10.59%	2.79% to 3.09%	$5.4 to 5.9 B	13.55%	2.03% to 2.33%	$3.9 to 4.5 B
Georgia	5.62%	1.16% to 1.28%	$10.6 to 11.7 B	7.19%	0.78% to 0.9%	$7.1 to 8.2 B
Hawaii	11.53%	2.21% to 2.56%	$2.7 to 3.2 B	14.76%	1.44% to 1.79%	$1.8 to 2.2 B
Idaho	8.94%	1.67% to 1.79%	$2.2 to 2.4 B	11.44%	1.08% to 1.21%	$1.5 to 1.6 B
Illinois	7.15%	1.15% to 1.23%	$13.7 to 14.6 B	9.15%	0.64% to 0.72%	$7.7 to 8.6 B
Indiana	6.18%	1.44% to 1.46%	$7.8 to 7.9 B	7.91%	1% to 1.02%	$5.4 to 5.5 B
Iowa	7.15%	1.29% to 1.35%	$3.5 to 3.7 B	9.15%	0.8% to 0.86%	$2.2 to 2.4 B
Kansas	7.77%	1.55% to 1.67%	$3.7 to 4 B	9.94%	1.02% to 1.14%	$2.4 to 2.7 B
Kentucky	6.57%	1.39% to 1.46%	$4.2 to 4.4 B	8.41%	0.93% to 1%	$2.8 to 3 B
Louisiana	5.28%	0.77% to 0.79%	$2.6 to 2.6 B	6.76%	0.41% to 0.43%	$1.4 to 1.4 B
Maine	6.79%	2.34% to 2.54%	$2.4 to 2.6 B	8.69%	1.86% to 2.06%	$1.9 to 2.1 B
Maryland	6.99%	1.53% to 1.68%	$8.6 to 9.5 B	8.95%	1.04% to 1.19%	$5.9 to 6.7 B
Massachusetts	8.22%	2.43% to 2.65%	$19.8 to 21.6 B	10.52%	1.84% to 2.06%	$15 to 16.8 B
Michigan	5.78%	1.54% to 1.63%	$11.1 to 11.8 B	7.39%	1.14% to 1.24%	$8.3 to 8.9 B
Minnesota	9.13%	2.45% to 2.74%	$12.9 to 14.5 B	11.69%	1.8% to 2.1%	$9.5 to 11.1 B
Mississippi	7.30%	1.72% to 1.83%	$2.8 to 3 B	9.34%	1.21% to 1.33%	$2 to 2.2 B
Missouri	4.86%	0.93% to 1.03%	$4.3 to 4.8 B	6.22%	0.59% to 0.69%	$2.8 to 3.2 B
Montana	4.39%	1.44% to 1.53%	$1.2 to 1.3 B	5.62%	1.12% to 1.22%	$0.9 to 1 B
Nebraska	7.31%	1.31% to 1.44%	$2.6 to 2.8 B	9.36%	0.8% to 0.93%	$1.6 to 1.8 B
New Jersey	7.56%	2.94% to 3.33%	$25.9 to 29.3 B	9.68%	2.39% to 2.78%	$21 to 24.5 B
New Mexico	8.56%	1.63% to 1.78%	$2.5 to 2.7 B	10.96%	1.06% to 1.21%	$1.6 to 1.8 B
New York	8.10%	2.05% to 2.38%	$50.1 to 58.1 B	10.37%	1.48% to 1.8%	$36.1 to 44.1 B
North Carolina	6.01%	1.18% to 1.23%	$10.4 to 10.9 B	7.69%	0.77% to 0.83%	$6.8 to 7.3 B
North Dakota	4.52%	0.92% to 1%	$0.7 to 0.8 B	5.79%	0.59% to 0.67%	$0.5 to 0.5 B
Ohio	4.71%	1.29% to 1.37%	$12.3 to 13.1 B	6.03%	0.95% to 1.03%	$9.1 to 9.9 B
Oklahoma	5.33%	1.09% to 1.19%	$3 to 3.2 B	6.82%	0.72% to 0.82%	$1.9 to 2.2 B
Oregon	5.86%	2.37% to 2.66%	$8.1 to 9.1 B	7.50%	1.96% to 2.25%	$6.6 to 7.6 B
Pennsylvania	5.41%	1.26% to 1.28%	$13.2 to 13.4 B	6.93%	0.87% to 0.9%	$9.1 to 9.4 B

Rhode Island	6.67%	1.86% to 2.03%	$1.5 to 1.7 B	8.54%	1.39% to 1.55%	$1.2 to 1.3 B
South Carolina	5.91%	1.76% to 1.95%	$6.6 to 7.3 B	7.57%	1.36% to 1.55%	$5.1 to 5.8 B
Utah	7.23%	1.36% to 1.41%	$4.3 to 4.4 B	9.25%	0.86% to 0.91%	$2.7 to 2.9 B
Vermont	5.91%	2.45% to 2.73%	$1.2 to 1.3 B	7.56%	2.03% to 2.3%	$1 to 1.1 B
Virginia	6.44%	1.51% to 1.62%	$11.9 to 12.8 B	8.24%	1.06% to 1.17%	$8.4 to 9.3 B
West Virginia	5.83%	1.68% to 1.75%	$1.8 to 1.9 B	7.47%	1.27% to 1.34%	$1.4 to 1.5 B
Wisconsin	7.30%	2.08% to 2.3%	$9.7 to 10.8 B	9.35%	1.56% to 1.78%	$7.3 to 8.3 B
Average (all states)	6.23%	1.44% to 1.56%	$10 to 11 B	7.97%	1% to 1.13%	$7 to 8 B

Table 2: Impacts on Wages, Migration, and Startup Activity

State	Average Wage ($)	New Top 1% Taxpayers	New Startups
Alabama	$3236 to 3540	287	16% to 20%
Arizona	$2867 to 3053	225	10% to 13%
Arkansas	$2345 to 2471	135	11% to 14%
California	$7314 to 8533	6557	31% to 35%
Colorado	$3445 to 3990	349	12% to 15%
Connecticut	$6547 to 6763	340	21% to 26%
Delaware	$6531 to 6487	89	26% to 32%
District of Columbia	$7974 to 8910	100	26% to 31%
Georgia	$3692 to 3939	709	15% to 18%
Hawaii	$5447 to 6597	202	24% to 27%
Idaho	$3700 to 3944	132	16% to 19%
Illinois	$5503 to 5526	807	20% to 26%
Indiana	$2958 to 2761	260	11% to 14%
Iowa	$3651 to 3682	151	15% to 19%
Kansas	$3904 to 4108	203	17% to 20%
Kentucky	$2757 to 2778	211	13% to 15%
Louisiana	$2862 to 2685	158	12% to 15%
Maine	$4719 to 5218	136	23% to 27%
Maryland	$5771 to 6275	475	20% to 24%
Massachusetts	$6867 to 7445	856	24% to 28%
Michigan	$3347 to 3522	552	14% to 18%
Minnesota	$5936 to 6750	754	27% to 33%
Mississippi	$2384 to 2636	146	13% to 16%
Missouri	$2704 to 2872	361	12% to 14%
Montana	$4234 to 4244	87	18% to 21%
Nebraska	$3215 to 3520	130	14% to 17%
New Jersey	$7484 to 9157	1330	31% to 37%

New Mexico	$3236 to 3582	155	16% to 20%
New York	$5810 to 6757	2839	25% to 29%
North Carolina	$2307 to 2242	560	9% to 10%
North Dakota	$2295 to 2637	25	10% to 12%
Ohio	$2261 to 2470	531	10% to 12%
Oklahoma	$2510 to 2679	217	12% to 14%
Oregon	$7180 to 7940	536	36% to 45%
Pennsylvania	$4376 to 4199	518	16% to 20%
Rhode Island	$4363 to 4895	91	18% to 22%
South Carolina	$2997 to 3571	410	16% to 18%
Utah	$3959 to 3834	184	13% to 15%
Vermont	$4963 to 5781	79	24% to 29%
Virginia	$4773 to 4968	638	16% to 20%
West Virginia	$3117 to 3132	100	16% to 20%
Wisconsin	$4351 to 4925	600	22% to 26%
Average (all states)	$3884 to 4180	455	16% to 19%

Estimating Impact on Wages

Higher investment leads to a larger capital stock, which makes workers more productive and increases the demand for labor. The intensified competition to hire workers then bids up real wages. To quantify the increase in wages resulting from these state tax changes, the CEA uses an elasticity of wages to changes in the taxation of business pass-through income of -0.115 derived from Risch (2024) and an elasticity of wages to changes in the taxation of corporate income of -0.17 directly from Azemar and Hubbard (2015). As discussed in CEA (2018), this latter number is actually on the lower side of estimates of this parameter, helping ensure that our estimates are not excessive. The overall wage impact in percent terms comes from multiplying each of these elasticities by the percent change in the respective tax rate (inclusive of both state and federal taxes) and summing the products. To put this in dollar terms, this percent increase can then be multiplied by the state's average household income and the share of average income that is from wages and salaries (78 percent). Table 2 displays the effects on average wages by state of eliminating state income taxes and replacing them with a broadened sales tax.

Estimating Impacts on Migration and Startup Activity

To estimate impacts on migration and startup activity, we rely on another set of elasticities. Rauh and Shyu (2024) estimate the impacts of state income tax changes on migration of high earners by studying California's addition of several new higher tax brackets in 2013. We use the elasticity implied by their findings along with IRS Statistics of Income data on the number of high-earning taxpayers by state to compute migration responses of high earners. Fairlie et al. (2025) estimate the impacts of state tax changes of various types on startup activity; they find large impacts of personal and corporate tax changes

but no significant effects of sales tax changes. We use the elasticities implied by their findings for personal and corporate tax changes. Table 2 also displays the impacts on migration of high earners and on startup activity of eliminating state income taxes and replacing them with a broadened sales tax.

A crucial point that should be noted about these impacts on migration and startup activity as displayed in Table 2 is that the estimate for any given state assumes it is the *only* state that cuts its income taxes. If other states do so as well, effects are likely to be smaller. Intuitively, if one state gets rid of all its income taxes, it is likely (based on these estimates) to experience a rush of high earners and startup activity into the state. However, if *every* state cuts their income taxes to zero, there is little reason to relocate. This is different from the impacts on GDP and wages, which do not entail such an assumption and are expected to be realized whether or not other states follow suit in eliminating income taxes.

REFERENCES

Abramitzky, Ran, and Victor Lavy. "How responsive is investment in schooling to changes in redistributive policies and in returns?." *Econometrica* 82, no. 4 (2014): 1241-1272.

Akcigit, Ufuk, Salomé Baslandze, and Stefanie Stantcheva. "Taxation and the International Mobility of Inventors." *American Economic Review* 106, no. 10 (2016): 2930-2981.

Akcigit, Ufuk, John Grigsby, Tom Nicholas, and Stefanie Stantcheva. "Taxation and Innovation in the Twentieth Century." *Quarterly Journal of Economics* 137, no. 1 (2022): 329-385.

Arnold, Jens Matthias, Bert Brys, Christopher Heady, Åsa Johansson, Cyrille Schwellnus, and Laura Vartia. "Tax Policy for Economic Recovery and Growth." *Economic Journal* 121, no. 550 (2011): F59-F80.

Azémar, Céline, and R. Glenn Hubbard. "Country Characteristics and the Incidence of Capital Income Taxation on Wages: An Empirical Assessment." *Canadian Journal of Economics/Revue canadienne d'économique* 48, no. 5 (2015): 1762-1802.

Bernstein, Shai, Rebecca Diamond, Abhisit Jiranaphawiboon, Timothy McQuade, and Beatriz Pousada. *The contribution of high-skilled immigrants to innovation in the United States*. No. w30797. National Bureau of Economic Research, 2022.

Boskin, Michael. "Taxation, Saving, and the Rate of Interest." *Journal of Political Economy* 86, no. 2 (1978): S3-S27.

Cassidy, Traviss, Mark Dincecco, and Ugo Troiano. "The Introduction of the Income Tax, Fiscal Capacity, and Migration: Evidence from US States." No. w32728. National Bureau of Economic Research, 2024.

Council of Economic Advisers. *Economic Report of the President*. 2018.

Council of Economic Advisers. "The One Big Beautiful Bill: Legislation for Historic Prosperity and Deficit Reduction." White Paper, 2025.

Chetty, Raj, et al. "Are Micro and Macro Labor Supply Elasticities Consistent? A Review of Evidence on the Intensive and Extensive Margins." *American Economic Review* 101, no. 3 (2011): 471-475.

Curtis, C. Christian, and Ryan Decker. "Entrepreneurship and state taxation." *Finance and Economics Discussion Series* 2018-003. Board of Governors of the Federal Reserve System, 2018.

Davis, Steven J., and Magnus Henrekson. "Tax Effects on Work Activity, Industry Mix and Shadow Economy Size: Evidence from Rich-Country Comparisons." *NBER Working Paper* No. 10509 (2004).

Fairlie, Robert, Frank M. Fossen, Andrew C. Johnston, and Ke Lyu. "The Effects of Local Taxes and Incentives on Entrepreneurship: Evidence from the Universe of US Startups." *Available at SSRN 5262559* (2025).

Giroud, Xavier, and Joshua Rauh. "State Taxation and the Reallocation of Business Activity: Evidence from Establishment-Level Data." *Journal of Political Economy* 127, no. 3 (2019): 1262-1316.

Jackson, C. Kirabo, Cora Wigger, and Heyu Xiong. "Do school spending cuts matter? Evidence from the Great Recession." *American Economic Journal: Economic Policy* 13, no. 2 (2021): 304-335.

Johansson, Åsa, Christopher Heady, Jens Matthias Arnold, Bert Brys, and Laura Vartia. "Taxation and Economic Growth." *OECD Economics Department Working Papers* No. 620, OECD Publishing, Paris (2008).

Mertens, Karel, and Morten O. Ravn. "The Dynamic Effects of Personal and Corporate Income Tax Changes in the United States." *American Economic Review* 103, no. 4 (2013): 1212-1247.

Nguyen, Anh DM, Luisanna Onnis, and Raffaele Rossi. "The Macroeconomic Effects of Income and Consumption Tax Changes." *American Economic Journal: Economic Policy* 13.2 (2021): 439-466.

Pew Charitable Trusts. "Fiscal 50: State Trends and Analysis." Pew Charitable Trusts, 2025. [Note: You should verify this exact citation and potentially provide a more specific title/URL]

Rauh, Joshua, and Ryan Shyu. "Behavioral Responses to State Income Taxation of High Earners: Evidence from California." *American Economic Journal: Economic Policy* 16, no. 1 (2024): 34-86.

Risch, Max. "Does Taxing Business Owners Affect Employees? Evidence from a Change in the Top Marginal Tax Rate." *Quarterly Journal of Economics* 139, no. 1 (2024): 637-692.

Romer, Christina D., and David H. Romer. "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks." *American Economic Review* 100, no. 3 (2010): 763-801.

Seegert, Nathan. "Optimal Taxation with Volatility: A Theoretical and Empirical Decomposition." *American Economic Journal: Economic Policy* 10, no. 3 (2018): 1-33.

Şen, Hüseyin, and Ayşe Kaya. "Do Revenue-Neutral Tax Swaps Boost Growth?" *Journal of Economic Policy Reform*26, no. 4 (2023): 401-420.

Suárez Serrato, Juan Carlos, and Owen Zidar. "Who benefits from state corporate tax cuts? A local labor markets approach with heterogeneous firms." *American Economic Review* 106, no. 9 (2016): 2582-2624.

Tax Foundation. "Facts & Figures 2020: How Does Your State Compare?" Tax Foundation, 2020.

Vermeer, Timothy. "State individual income tax rates and brackets, 2023." Tax Foundation. February 21, 2023. https://taxfoundation.org/data/all/state/state-income-tax-rates-2023/

Walczak, Jared. "Income taxes are more volatile than sales taxes during an economic contraction." Tax Foundation, March 17 (2020).