Additional Adjustment Options to Improve Fairness in the Tax Recommendations

By Sarah Beth Gehl, Deputy Director

Summary

The Special Council on Tax Reform and Fairness for Georgians provided recommendations that make improvements to structural issues plaguing Georgia's tax system. The Tax Council took strong action to broaden tax bases—a tenet of good tax policy. Although the Tax Council's recommendations would improve Georgia's ability to meet current and future needs, they would do so by shifting taxes away from wealthy Georgians and onto middle- and low-income Georgians.

The Georgia Budget & Policy Institute provided three options for improving equity within the Tax Council's recommendations in January. This policy brief provides four additional adjustment options. These options focus on ways to re-craft the proposed personal income tax credit to make it stronger in offsetting the tax changes in the sales tax, with estimates from the Institute on Taxation and Economic Policy. Each of these options would need to be carefully studied as to their impact on revenues.

Options from January GBPI Report

- ***Option 1 -- Maintain the grocery exemption and reduce the income tax rate to 4.5 percent rather than 4 percent.*** The sales tax exemption on groceries makes the sales tax slightly fairer towards low-income Georgians. Thus, removing that exemption is one of the main tax shifts in the Tax Council's recommendations. Legislators could enact all of the Tax Council's recommendations with those two changes—keeping the grocery exemption and lowering the income tax rate to 4.5 percent rather than 4 percent—to improve fairness in the tax package.

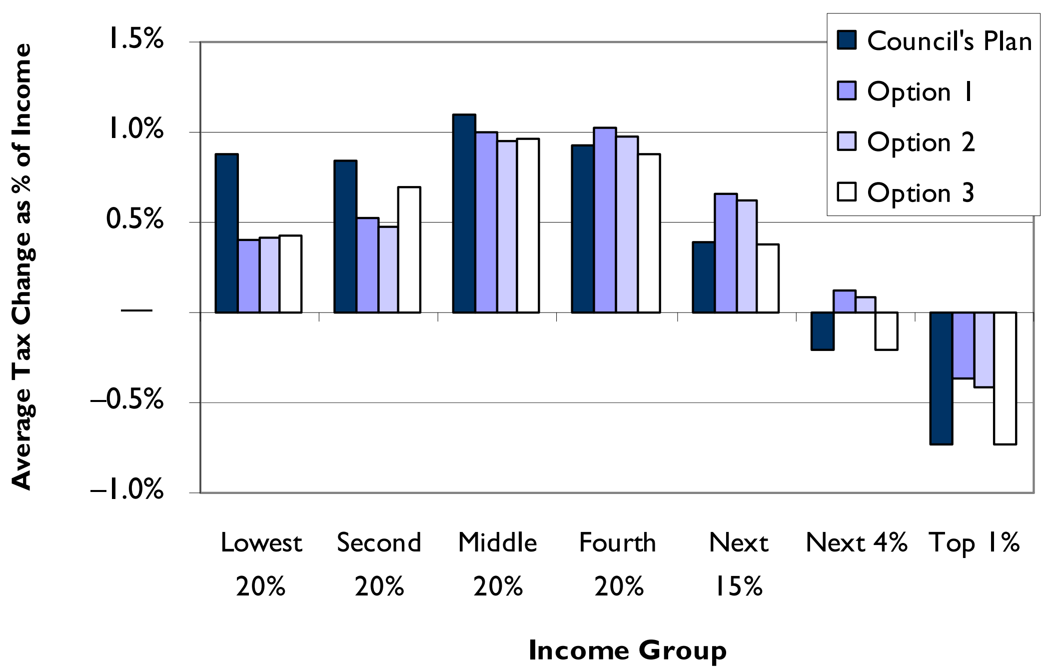
- ***Option 2 -- Use the broadened sales tax base to lower the sales tax rate.*** The Tax Council broadened bases in both the sales and income tax, but only lowered rates in the income tax. If legislators insist on eliminating the sales tax exemption on groceries, they should consider lowering the sales tax rate to help offset a portion of the shift onto low-income taxpayers. For example, an alternative proposal could include the base broadening changes the Tax Council recommends while also:
  - Lowering the state sales tax rate to 3.5 percent, and

- Lowering the income tax rate to 4.5 percent, rather than the full 4 percent recommended by the Tax Council.

- ***Option 3 – Re-craft the proposed personal income tax credit into a refundable low income tax credit and a targeted standard deduction.*** The personal credit in the Tax Council's report replaces current personal exemptions and deductions for taxpayers earning less than $50,000. In addition, a targeted $50 credit provides a small offset to the new sales tax on groceries. Although the credit is supposed to hold low-income families harmless, it only does so for the income tax. It must be more generous and refundable to offset the additional sales taxes placed on low-income families and seniors. The Tax Council's language leaves the door open to adjustments to the personal credit by stating that the credit should provide "at least tax neutrality for low-income taxpayers." Re-crafting the personal credit into a more robust, refundable low income tax credit and a standard deduction would provide a better offset to the new sales taxes on moderate- and low-income taxpayers. For example, legislators could institute a $5,000 standard deduction that begins to phase out at $20,000 for singles ($10,000 deduction that begins to phase out at $40,000 for married couples filing jointly). The refundable credit could be an expanded version of the existing low income tax credit with $50 per person maximum and double credits for seniors.

Chart 1 **Original Adjustment Options to Improve Fairness in the Tax Reform Proposal**

(Average Tax Change as a Percentage of Income for the Combined **Income, Sales, and Cigarette** Tax Proposals)



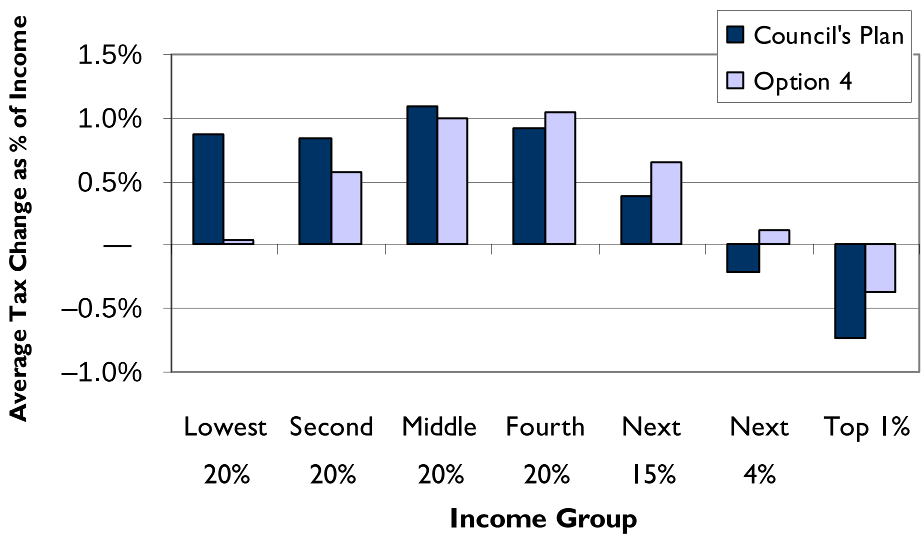
Source: Preliminary estimates by the Institute on Taxation and Economic Policy, January 2011

Additional Options

- ***Option 4 – Combination of Options 1 and 3.*** This option would:
  - Maintain the grocery exemption,
  - Reduce the income tax rate to 4.5 percent rather than 4 percent,
  - Replace the proposed personal income credit with a $5,000 standard deduction that begins to phase out at $20,000 for singles ($10,000 deduction that begins to phase out at $40,000 for married couples filing jointly).
  - Replace the $50 credit with a refundable credit of $50 per person maximum based on the existing low income credit with double credits for seniors.

Chart 2 **Option 4 to Improve Fairness in the Tax Reform Proposal**

(Average Tax Change as a Percentage of Income for the **Income, Sales, and Cigarette** Tax Changes)

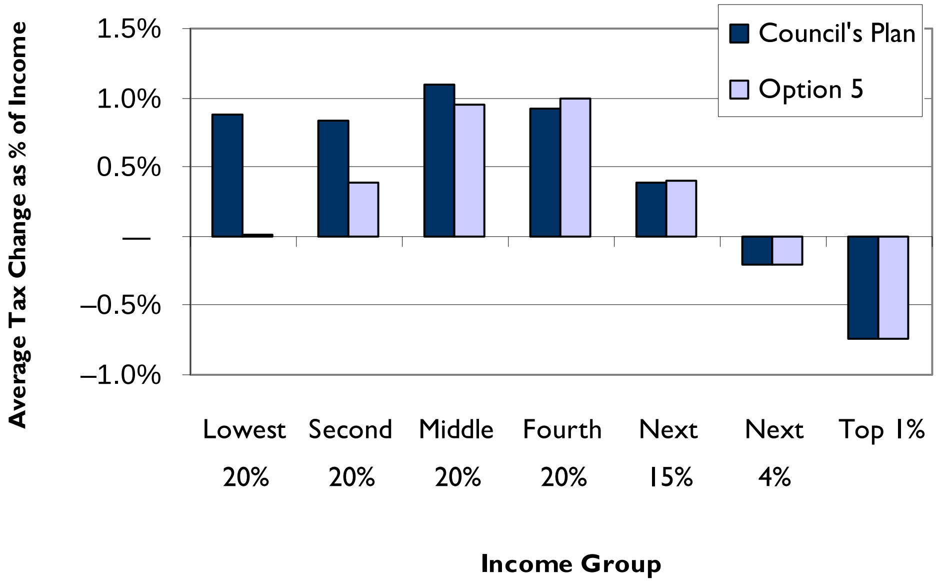


Source: Preliminary estimates by the Institute on Taxation and Economic Policy, February 2011

- ***Option 5 – Replace proposed personal income tax credit with a 25 percent refundable earned income tax credit.*** Since 1986, 23 states and the District of Columbia have created state-level earned income tax credits (EITC) to offset highly regressive state and local sales taxes. The credits are modeled after the federal earned income tax credit, and thus can ease compliance and keep pace with inflation as the federal credit adjusts automatically. Replacing the proposed personal income tax credit with a refundable 25 percent EITC would provide additional offsets against the new sales tax for low-income families.

Chart 3 **Option 5 to Improve Fairness in the Tax Reform Proposal**

(Average Tax Change as a Percentage of Income for the **Income, Sales, and Cigarette** Tax Changes)

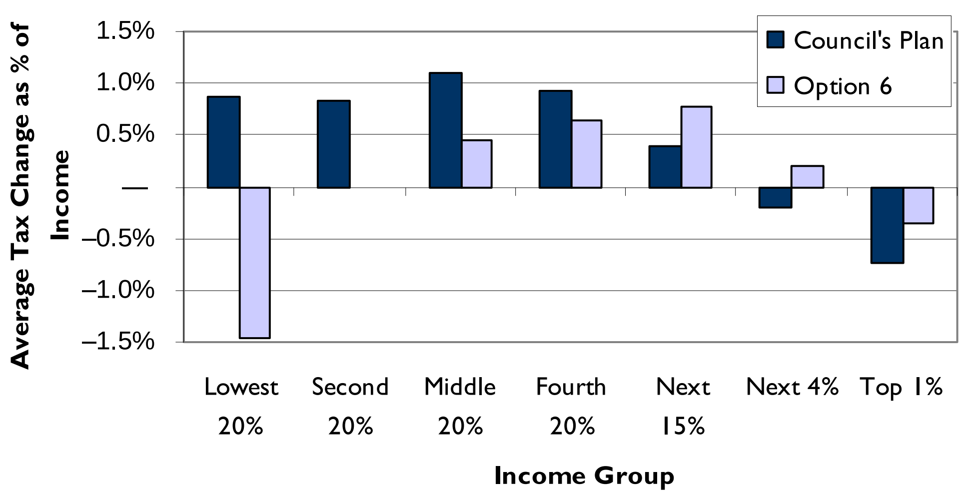


Source: Preliminary estimates by the Institute on Taxation and Economic Policy, February 2011

- ***Option 6 – Replace proposed personal income tax credit with a refundable $250 credit per person and lower income tax rate to 4.5 percent instead of 4 percent.*** This option would provide a refundable $250 credit per person that would phase out between $30,000 and $50,000 federal adjusted gross income for singles ($60,000 to $80,000 phase-out for married filing jointly). The credit would be $375 per person for seniors with the same phase-out scenario. These credits would replace the proposed personal income credit. In addition, the income tax rate would be lowered to 4.5 percent instead of 4 percent to ensure adequacy.

Chart 4 **Option 6 to Improve Fairness in the Tax Reform Proposal**

(Average Tax Change as a Percentage of Income for the **Income, Sales, and Cigarette** Tax Changes)

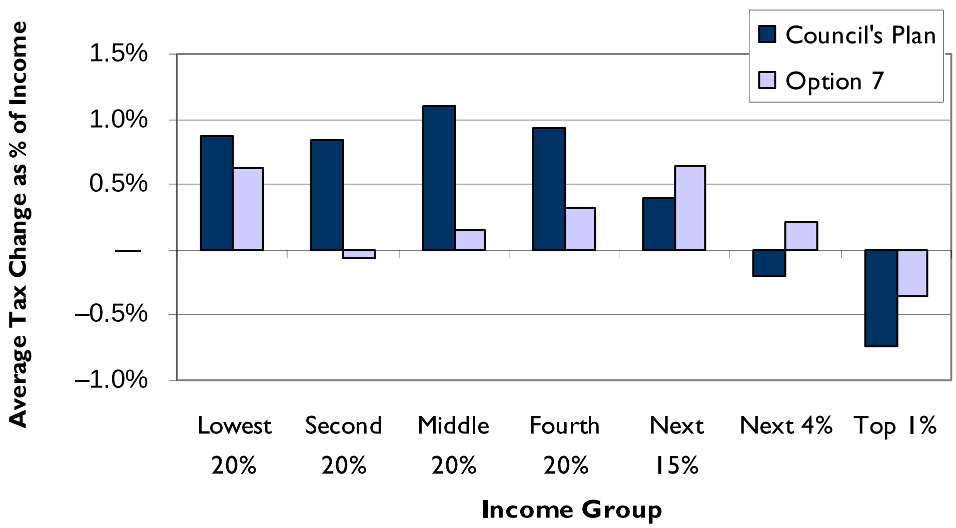


Source: Preliminary estimates by the Institute on Taxation and Economic Policy, February 2011

- ***Option7 – Replace proposed personal income tax credit with a targeted standard deduction and lower income tax rate to 4.5 percent instead of 4 percent.*** This option would replace the personal income tax credit with a standard deduction of $10,000 for single tax filers that would phase out between $40,000 and $60,000 ($20,000 for married filing jointly with phase-out between $70,000 and $90,000). The income tax rate would be lowered to 4.5 percent rather than 4 percent to assist in adequacy of revenues.

Chart 5 **Option 7 to Improve Fairness in the Tax Reform Proposal**

(Average Tax Change as a Percentage of Income for the **Income, Sales, and Cigarette** Tax Changes)



Source: Preliminary estimates by the Institute on Taxation and Economic Policy, February 2011

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