

## Bill Analysis: House Bill 238 (LC 34 4895S)

### Slashing Income Tax Delivers Meager Benefit to Most, Jeopardizes Public Services

By Wesley Tharpe, Senior Policy Analyst

Georgia lawmakers are considering a pair of proposals that offer a miniscule tax cut to the majority of Georgia families and a massive benefit to the highest-income individuals who need it least, while jeopardizing lawmakers' ability to meet the needs of a rapidly growing state. The first plan, House Bill 238, calls for a series of immediate changes to Georgia's personal income tax that proposed earlier in Senate Bill 280 (LC 34 4760). Meanwhile, Senate Resolution 756 calls for a constitutional amendment to restrain the growth of Georgia's future revenues and deliver further tax cuts down the road. That proposal is briefly explained in the companion GBPI fact sheet "Senate Resolution 756 Threatens to Disrupt Georgia's Long-Term Finances."

The potential income tax alterations proposed in HB 238 include a reduced top rate, increased exemptions that shield a certain amount of income from the tax and a new cap on taxpayers' ability to claim special deductions for things like property taxes and mortgage interest. The proposal also eliminates Georgia's corporate net worth tax, a minor levy that acts as a kind of minimum tax on some businesses. Here are the key effects of the pending bill.

- **Provide a small, poorly targeted tax cut to working families and the middle class.** *More than half of the resulting tax cut from HB 238 would flow to the wealthiest 20 percent of Georgians if it passes in its current form.* The legislation proposes slightly lower income taxes for most Georgia families, though the gains would be small except for the very top earners. Personal income taxes for the bottom 80 percent of Georgia households, or people making less than about \$100,000 a year, would drop by less than \$100 a year on average. On the other hand, the wealthiest 1 percent of Georgia households, or those making more than half a million dollars a year, would see an average annual tax cut of nearly \$2,850.
- **Hit Georgia's treasury with a sizable revenue loss over coming years.** Together, the changes in HB 238 could cost Georgia somewhere between \$281 million<sup>1</sup> and \$442 million<sup>2</sup> a year once fully phased-in according to a pair of estimates from nonpartisan tax experts. That's a big risk in a state that still faces critical challenges like underfunded K-12 schools, shuttering rural hospitals and roads in need of repair. Public investments are an essential ingredient of a prosperous state economy and high quality of life.

Certain aspects of the Senate's tax plans are smart reforms as standalones that should not be thrown out along with the more flawed elements.<sup>3</sup> But as a whole the package contains more bad than good. The bill undermines positive reforms such as raising personal exemptions with a misguided reduction in the personal income tax *rate*. That's a top-down approach that mostly benefits families at the very top who are already getting a good deal, at an enormous cost in lost state revenue. State legislators should reject the misguided roadmap to so-called reform and go back to the drawing board in future years to come back with a more measured, pro-family approach.

## Tax Package Includes Several Big Changes

House Bill 238 includes revisions to Georgia's personal income tax, as detailed below. It would also eliminate Georgia's corporate net worth tax, a small minimum tax on C-corporations operating in the state.

- **It flattens Georgia's personal income tax and cuts the top rate.** Georgia's income tax currently uses a graduated structure to tax different increments of income at rates between 1 percent and 6 percent. A married couple's first \$1,000 of taxable income is taxed at 1 percent, the next \$2,000 is taxed at 2 percent and so on. Once a couple's taxable income reaches \$10,000, they pay the 6 percent top rate on the remainder of their earnings. HB 238 replaces this graduated system with a flat rate of 5.4 percent of all taxable income.
- **It increases Georgia's personal and dependent exemptions.** State taxpayers are able to shield some of their annual income through broadly available exemptions. This tax shield includes the standard deduction for typical Georgia taxpayers, a personal exemption and, for taxpayers with children, a dependent exemption. HB 238 proposes to raise the personal exemption to \$4,700 from its current \$2,700 level and raise the dependent exemption to \$5,000 from its current \$3,000.
- **It limits Georgians' ability to claim special deductions on their state income taxes.** When families file Georgia income returns, they take *either* the standard deduction or a series of special deductions known as itemized deductions. About a third of Georgia taxpayers itemized deductions in 2013, at an average value of \$24,000.<sup>4</sup> HB 238 would limit itemized deductions to mortgage interest payments, charitable contributions and large medical expenses. It would also create a new cap of \$25,000 per person on mortgage interest, though deductions for charity and medical expenses would remain limitless.

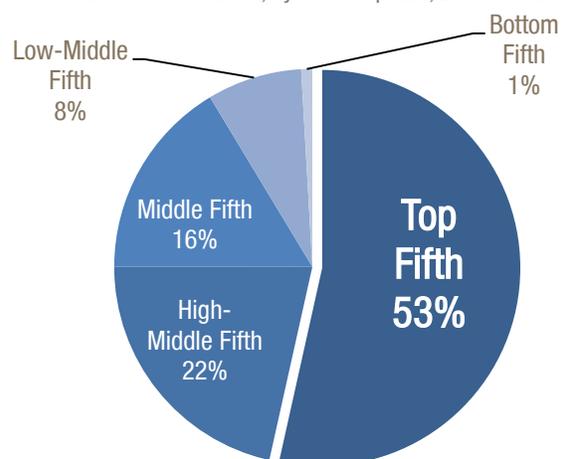
## Proposed Tax Changes are Poorly Targeted to Help Working Families

The alterations called for in HB 238 combine to cut personal income taxes for many Georgia families, but the bulk of benefits flow to taxpayers already doing quite well. Most middle-income families would barely notice the difference and working families trying to afford the basics would likely see little benefit at all.

Higher-income families would receive larger *average* benefits through HB 238, so the lion's share of the *overall* aggregate tax cut would flow to people at the top. **The most affluent fifth of Georgia taxpayers, those making more than about \$100,000 a year, would receive more than half of the total benefit from the reduction in state taxes,** as further illustrated in the accompanying pie chart. Taxpayers in Georgia's top 1 percent of incomes, or people who make at least a half-million dollars a year, would claim an estimated 21 percent of the total tax cut.

### Wealthiest 20% of Georgians Get More than Half of Benefit

Share of overall tax cut, by income quintile, 2016 incomes



Source: Institute on Taxation and Economic Policy

Digging into details of HB 238 reveals how bad a deal it is for the vast majority of Georgians, just as it delivers a windfall to taxpayers already at the top of the income ladder. Some brief information on methodology can be found in an endnote.<sup>5</sup>

- **The bottom 80 percent of Georgia households, or those with incomes below about \$100,000, would gain an average tax cut of less than \$100 a year.** Georgia families earning from \$59,000 to \$98,000 a year, for example, would receive an average tax cut of \$87, or about \$7 a month. The income range directly below them would receive an estimated average of \$85 a year. Benefits are even more meager for people making less than \$35,000 a year, with the poorest fifth of Georgians realizing no average gain at all.
- **High-income Georgians enjoy larger average benefits, especially the wealthiest 1 percent.** The average Georgia household with more than about \$100,000 in annual income would receive a larger tax cut from HB 238 than those in lower brackets. This is especially true for the wealthiest 1 percent of Georgians who make more than \$500,000 a year. They'd receive an average annual tax cut of nearly \$2,850. One important caveat is that tax bills for more affluent Georgians could vary significantly under HB 238, due to the plan's proposed cap on itemized deductions. A wealthy family with two large homes would feel the pinch from a new cap on mortgage interest, for example, whereas an affluent young professional who rents would not.

Plan's Payoff Tilted Toward High-Income Families							
All state residents, 2016 income levels							
Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$19K	\$19K-\$35K	\$35K-\$59K	\$59K-\$98K	\$98K - \$205K	\$205K-\$501K	\$501K+
Average Income in Group	\$12,000	\$26,000	\$46,000	\$77,000	\$134,000	\$295,000	\$1,300,000
<b>Tax Change as % of Income</b>	0.0%	-0.2%	-0.2%	-0.1%	-0.1%	-0.1%	-0.2%
<b>Average Tax Change</b>	\$2	-\$44	-\$85	-\$87	-\$114	-\$255	<b>-\$2,845</b>

*Source: Institute on Taxation and Economic Policy (ITEP), provided upon request February 2016*

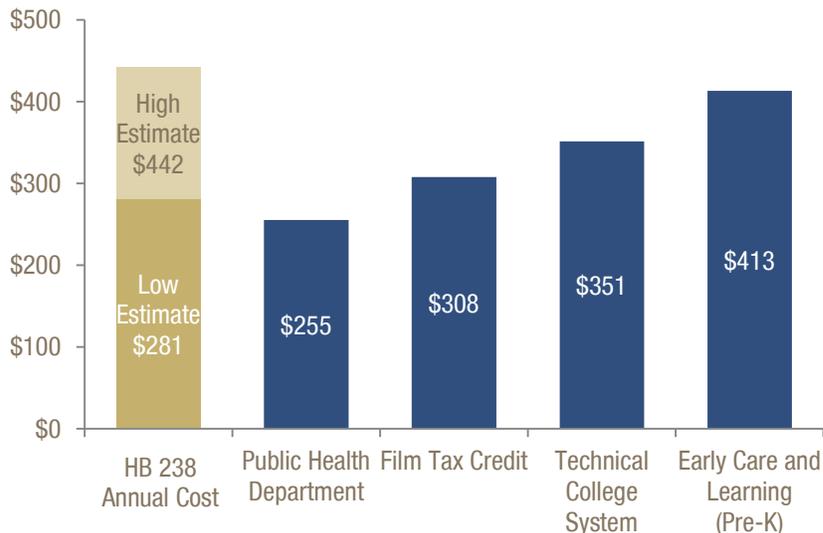
## Changes Conspire to Jeopardize Georgia's Public Investments and Economy

The changes proposed in HB 238 threaten to hit Georgia's treasury with a sizable revenue loss in coming years. *The estimated annual cost of the bill in future years ranges from a low of \$281 million, according to the state's official calculations, to a high of \$442 million according to the nonpartisan, Washington D.C.-based Institute on Taxation and Economic Policy.* For context, the following chart compares the potential yearly revenue loss caused by HB 238 to some of Georgia's annual expenses.

Potentially shortchanging core state investments could make Georgia communities less attractive places to live, work or start a business. High-quality public services and strategic community investments are key ingredients of thriving local economies and a strong quality of life. Businesses rely on high-quality public services like roads, fire and police services to protect their enterprises and schools to generate a well-trained workforce. Families rely on those same well-funded services to travel to and from work, educate themselves and their children and to live in safe, attractive communities. The changes HB 238 calls for could lead to significant revenue losses at a time when Georgia still faces critical challenges like underfunded K-12 schools, shuttering rural hospitals and roads in need of repair.

## Tax Package Carries Hefty Price Tag

Estimated lost revenue from HB 238 vs. selected FY 2017 expenditures



Sources: Institute on Taxation and Economic Policy; Georgia Department of Audits and Accounts; Georgia FY 2017 Tax Expenditure Report; Gov. Deal's FY2017 Proposed Budget

### Conclusion: Drastic Tax Plan is Bad for Families, Economy and Communities

Slashing the personal income tax rate is an inherently top-down approach to cutting taxes, since it delivers an outsized benefit to affluent taxpayers with large amounts of income subject to the tax. HB 238 in its current form delivers the largest benefit to Georgians already thriving in today's economy and holds the potential to jeopardize key state investments critical to a strong economy and high quality of life. Georgia lawmakers should reject the package, yet keep some of its positive pieces in mind for a more targeted, balanced and bottom-up approach to tax reform in coming years.

### ENDNOTES

<sup>1</sup> The \$281 million estimate represents the average cost of the bill from fiscal year 2018 to 2021; the proposal would result in an estimated \$109 million in lost revenue in the upcoming 2017 fiscal year, with the lower cost to certain changes phasing-in at later dates. Official fiscal note for HB 238 (LC 34 3760) as presented by the Georgia Department of Audits and Accounts and prepared by the Georgia State Fiscal Research Center. January 28, 2016.

<sup>2</sup> Estimate provided by the nonpartisan, nonprofit Institute on Taxation and Economic Policy (ITEP) in Washington, D.C.

<sup>3</sup> GBPI included variations on these reforms in our 2015 report, "A Tax Blueprint to Strengthen Georgia."

<sup>4</sup> "Analysis of State Individual Income Taxes," Georgia Department of Audits and Accounts. Pg. 30.

<sup>5</sup> ITEP houses one of the most advanced tax simulators in the country, widely considered to be on par with those used by the congressional Joint Committee on Taxation, the U.S. Treasury Department and the Congressional Budget Office. The model is unique in its ability to produce analysis at the federal and state levels and to analyze income, consumption and property based taxes. Developed in 1996, the ITEP Microsimulation Tax Model relies on one of the largest databases of tax returns in existence, encompassing close to three quarters of a million records. For more details, visit [http://www.itep.org/about/itep\\_tax\\_model\\_simple.php](http://www.itep.org/about/itep_tax_model_simple.php)