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Bill Analysis

Income Tax Bill Offers Earned Income Tax Credit Upside, Flat Tax Downside

Updated Bill Analysis: House Bill 329 (LC 43 0564)

By Wesley Tharpe, Research Director – Updated February 27, 2017

Members of the Georgia House are set to consider a large income tax proposal that contains a mix of positive reforms and measures that raise significant concerns. Some aspects of the bill offer benefits to working class Georgia families, while others could harm similar taxpayers or weaken revenue growth long-term. While the bill provides a reasonable starting point for a productive conversation about tax reform, key changes are needed to avoid causing more harm than good.

The income tax alterations proposed in House Bill 329 include a new flat tax rate of 5.4 percent to replace Georgia's graduated structure with rates ranging from 1 percent to 6 percent; a new nonrefundable Earned Income Tax Credit (EITC) set at a 10 percent match of the federal credit; and an overdue fix to a tax break that allows some taxpayers to deduct the value of their state income taxes twice. Here are the key effects of the House proposal.

- **Provides a sizable tax cut to many low-wage workers *with* children, while likely raising taxes for most low-wage childless workers**. The interplay among different aspects of HB 329—specifically the move to a new flat tax on one hand and the creation of a new EITC on the other—creates some nuanced effects for low- and moderate-income taxpayers. The primary winners in the proposal are low-wage workers with children, whereas low-wage workers without children stand to lose. For example, under HB 329 a childless single worker living at the poverty line gets an estimated annual tax *hike* of $126. In contrast, a single parent living at the poverty line with two children gets an estimated annual tax *cut* of $311.

- **Delivers an outsized benefit to the wealthiest slice of Georgia taxpayers**. In contrast to the nuanced effect on taxpayers of modest means, HB 329 provides an obvious benefit to affluent taxpayers. Cutting the state's personal income tax *rate* provides a disproportionate tax cut to families who are already getting a good deal, since people with more income bring in more taxable income subject to the top rate. About a third of the tax cut in HB 329 goes to the top 1 percent of Georgia taxpayers, and about three-quarters of the gain would go to taxpayers with incomes above $97,000 a year. As a principle, tax measures that raise taxes on people at the bottom of the income ladder should not also cut them for those at the very top.

The annual cost of the package could range from about $20 million to $154 million in lost revenue, according to two separate estimates from reliable sources.[1] The potential revenue loss is not as large as some other recent tax system makeover proposals. Nonetheless, annual revenue losses at the top of the potential cost range would add an extra challenge for Georgia lawmakers in future years to adequately fund key investments. Lawmakers can rethink the proposed shift to a flat rate structure and find a way to eliminate the likely tax increases for working class Georgians without children. They can also scale back the scope of the proposed rate cut to minimize the long-term loss in state revenue for schools, health care and other vital services.

Tax Package Proposes Three Big Changes

House Bill 329 offers three important revisions to Georgia's personal income tax system.

- **It flattens Georgia's personal income tax and cuts the top rate**. Georgia's income tax is now a graduated structure that taxes 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. The HB 329 proposal replaces this graduated system with a flat rate of 5.4 percent applied to all taxable income. In effect, this raises taxes on people with low levels of income and reduces them on high levels of income.

- **It creates a new nonrefundable state Earned Income Tax Credit (EITC) set at a 10 percent match of the federal credit.** Twenty-six states and the District of Columbia provide a targeted tax benefit to families with modest incomes working their way to the middle class. Like the federal version of the EITC, state versions provide a bottom-up tax cut to workers earning low wages such as sales clerks, nurses, construction workers and teaching assistants. The benefits are especially great for working *parents*. All but four states allow qualified taxpayers to keep the full value of the tax credit, even if it exceeds their income tax liability and spills over into a refund. In contrast, Georgia's proposed EITC is *non*refundable.

- **It eliminates the "double deduction" for state income taxes.** A positive aspect of HB 329 is it offers Georgia a chance to conform with sound state tax policies that disallow an unusual tax break available to a small set of affluent taxpayers. Georgia is one of only four states that allow taxpayers to claim a lucrative tax break for state income taxes available only to households that itemize deductions. Oddly enough, Georgia taxpayers who itemize can now write off their state income tax payments when calculating how much state income tax they owe. This is a circular quirk in the law created by Georgia's system of linking its tax code to federal standards. Forty-six states disallow this practice, including Oklahoma where Republican Gov. Mary Fallin pushed for its repeal in 2016.[2] Georgia's special council on tax reform recommended eliminating the break in 2010.[3]

Proposed Tax Reforms Create Nuanced Effects for Working Families

The key to understanding HB 329 is recognizing that working families can feel very different effects from the bill depending on their circumstances. Two of the three proposed changes– the new flat tax of 5.4 percent on one hand and the new EITC on the other – combine to affect low- and moderate-income taxpayers in some nuanced ways. In general, the primary winners are low-wage workers *with* children. Low-wage workers *without* children stand to lose. Here are the reasons why.

On one hand, moving from a graduated income tax structure to a flat tax raises taxes on lower-income taxpayers across the board. The proposed package would apply a flat 5.4 percent rate to all taxable income earned by Georgia families. That contrasts with the current system which taxes different increments of income at rates between 1 percent and 6 percent. The result is HB 329 proposes to *lower* the state's top income tax rate, yet it *raises* the rate levied on smaller levels of income. This means most working class families would face a larger total income tax liability *before taking a new EITC or other tax credits into account*.

An Earned Income Tax Credit could offset the effects of a flat tax—but only for workers with children. The tax plan offers a nonrefundable Georgia EITC set at 10 percent of the value of the federal version of the credit. In practice this means a Georgia taxpayer eligible for a $3,000 federal credit can claim a $300 state matching credit, as long as the Georgia version does not spillover into a refund. Because the federal EITC provides disproportionate benefit to low-wage workers raising dependent children, a Georgia version does the same. So a single parent with two children earning a poverty-level income of $20,420 can claim a $510 Georgia tax credit under HB 329. That compares to a single worker with no children earning a poverty-level income of $12,060 who is eligible for an estimated Georgia tax credit of just $22.

These two competing forces will deliver sizable tax cuts to some low-income taxpayers, while others face a sizable tax increase. The variable is number of children. Many working parents gain access to large-enough tax credits to offset the effects of a new flat tax. Meanwhile childless adults in low-wage jobs are hit with higher taxes from the flat rate without much if any return from the new credit. The table below shows how taxpayers at the poverty line fare under the bill. As a note of clarity, the poverty line varies under federal law based on family size.

New Flat Tax and Earned Income Tax Credit Combine to Raise Taxes for Poor Childless Workers, Cut Them for Poor Families

		State Income Taxes Owed		
Family Type	Poverty Line	Under Current Law	Under HB 329	Tax Change
Single, no children	$12,060	$226	$352	$ 126
Married, no children	$16,240	$134	$273	$ 140
Single, one child	$16,240	$242	$98	$ (144)
Married, one child	$20,420	$191	$42	$ (149)
Single, two children	$20,420	$311	$0	$ (311)
Married, two children	$24,600	$250	$0	$ (250)

Source: GBPI calculations based on Georgia Code Section 48 and House Bill 329 and IRS tables for Earned Income Credit

Lion's Share of Proposed Cut Flows to Georgians Already Getting Good Deal

In contrast to the nuanced effect on low-income Georgians, HB 329 offers a clear benefit to affluent taxpayers. It provides larger and more consistent tax cuts for wealthier taxpayers than working class ones. As detailed in the table below, more than nine in 10 Georgians with incomes in the top 5 percent, or more than $220,000 a year, receive a tax cut under the bill. To compare, only 15 percent of taxpayers at the bottom fifth of the income ladder with incomes less than $22,000 a year are taxed less overall.

The size of the expected cut for people at the top is also larger. The tax proposal provides the wealthiest 1 percent of Georgia households with incomes of at least $536,000 a year an estimated annual tax cut of $2,576. This is expected since cutting the income tax *rate* provides a disproportionate tax cut to families with the most taxable income. The wealthiest 1 percent of residents accounted for an estimated 64 percent of all income growth in Georgia from 2009 to 2012.[4]

HB 329 Provides Large, Consistent Tax Cut to Affluent Taxpayers, Inconsistent Benefit for Working Families							
Income Level	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $22K	$22K-37K	$37K-$57K	$57K-$97K	$97K-$220K	$220K-$536	$536K or more
Average Income in Group	$14,000	$29,000	$45,000	$73,000	$137,000	$324,000	$1,822,000
% of Taxpayers in Group with Income Tax Cut	15%	25%	28%	22%	56%	94%	99%
Average Tax Change	+25	+4	+15	+30	–48	–383	–2,576
Share of total tax cut	4%	10%	6%	6%	15%	22%	37%
Source: Institute on Taxation and Economic Policy, February 2017							

The proposal offers higher-income families larger *average* benefits, so the lion's share of the *overall* aggregate tax cut flows to people at the top. The most affluent fifth of Georgia taxpayers—those who make more than $97,000 a year—receive an estimated 74 percent of the total benefit from the reduction in state taxes. Taxpayers in Georgia's top 1 percent of income—those who make at least a $536,000 dollars a year—would claim an estimated 37 percent of the total tax cut.

Deep Rate Cut Could Cause Long-Term Funding Headaches

The annual cost of HB 329 could range from about $20 million to $154 million in lost revenue, according to two separate estimates from reliable sources. The state's official fiscal note estimates the bill's price at about $19.5 million a year once phased-in in the 2019 budget year. An alternative estimate from the nonpartisan Institute on Taxation and Economic Policy in Washington, D.C. estimates the annual cost at $154 million a year. The D.C.-based tax policy organization routinely models the cost of state tax proposals and is widely considered as reliable as the Joint Committee on Taxation, the U.S. Treasury Department and the Congressional Budget Office.[5]

Although potential revenue loss from HB 329 is not as sizable as some other recent tax cut proposals, annual revenue losses near the top of the potential cost range pose some concern. Personal income taxes account for about 45 percent of Georgia's total general fund revenue. At a time when Georgia's K-12 school funding formula is short $166 million a year and its annual budget for helping working families afford child care is underfunded by tens of millions each year, even modest revenue hits can add up to make a difference over time.

Income taxes are also better than sales taxes and other levies at keeping pace with a changing economy, making them Georgia's primary resource to collect revenue needed to pay for future growth. Georgia is expected to add another 4 million people by 2050 and a healthy personal income tax is the most proven way to keep up with the associated rising needs. From the 1995 to 2013 budget years, Georgia's per capita spending rose by 24.5 percent. Per capita revenues from the personal income tax funded those rising needs, rising by nearly 16 percent during that same time span. In contrast, per capita revenues from the state sales tax fell by 24 percent and from the corporate income tax fell by 38 percent.[6] This trend is mainly due to the proliferation of sales tax loopholes in recent decades,[7] combined with the personal income tax's ability to bring in revenue from people gaining the most income from economic growth.

Conclusion: Changes Needed to Ensure Tax Package Does More Good Than Harm

Lawmakers can consider two key changes to the HB 329 tax package to address some of the shortcomings.

- **Reconsider the shift to a flat rate structure** to eliminate the likely tax increases for working class Georgians without children. Georgia's current graduated tax structure provides a modicum of fairness to offset sales taxes, fees and other levies that fall more sharply on working families. If Georgia's top income tax rate is destined for a change, lawmakers can do that without upending the underlying structure of the system.

- **Scale back the scope of the proposed rate cut** to minimize the potential long-term cost in state revenue. The personal income tax is the workhorse of Georgia's state revenue system and is more proven than the sales tax at adapting to the state's needs in the face of a rapidly growing population and a changing economy. Cutting too deeply could jeopardize Georgia's ability to fully fund schools, health care, public safety and other building blocks of a strong economy and thriving communities.

ENDNOTES

[1] The state's official fiscal note estimates the pricetag of HB 329 at $19.5 million a year between the 2019 and 2022 budget years. An alternative estimate from the nonpartisan Institute on Taxation and Economic Policy in Washington, D.C. estimates the annual cost at $154 million a year. The fiscal note from Georgia's Department of Audits and Accounts was not available to GBPI at the time this report was originally published and as a result was not included.

[2] "States Look at Axing 'Double Deduction' Tax Break," Stateline. 4/10/2015.

[3] "Current Georgia law allows income taxes paid to the state to be included as an itemized deduction. This is not a common practice in other states and does not appear to have economic justification." Special Council on Tax Reform and Fairness for Georgians, Final Report. Page 15.

[4] "The Increasingly Unequal States of America," Economic Policy Institute. 1/26/2015.

[5] ITEP houses one of the most advanced tax simulators in the country. 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. Details: http://www.itep.org/about/itep_tax_model_simple.php

[6] "Georgia's Revenue and Expenditure Portfolio in Brief: FY 2013 Data," Georgia State University Fiscal Research Center. 8/16/2016.

[7] "Georgia's Incredibly Shrinking Sales Tax Base," Georgia State University Fiscal Research Center. October 2015