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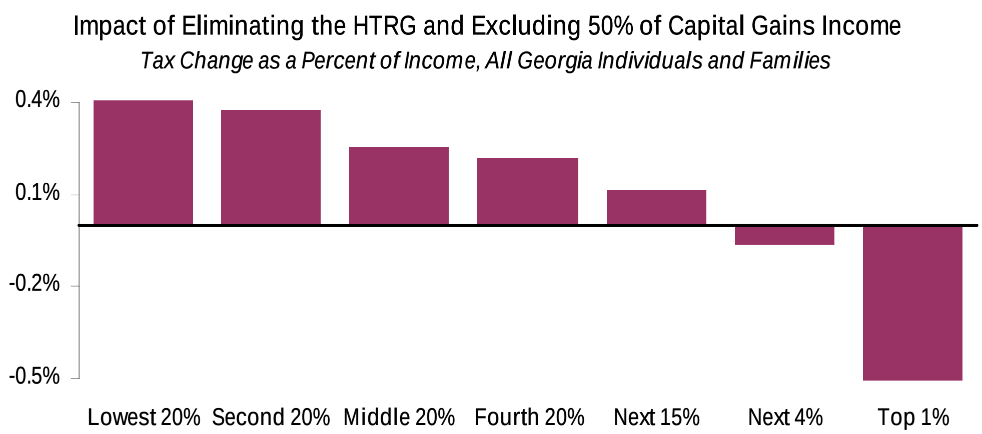
Georgia Budget Raises Taxes on Middle-Income Families to Pay for Capital Gains Tax Breaks for Wealthiest Investors

On Friday, April 3, the Georgia General Assembly passed a budget for fiscal year 2010 that includes a major new tax cut (an exclusion for long-term capital gains income) and a substantial tax increase (eliminating a state-funded property tax relief program). A new analysis by the Washington, DC-based Institute on Taxation and Economic Policy (ITEP) shows that the net impact of these two provisions will likely be a substantial tax increase on most low- and middle-income Georgians, and a very large tax cut for a small group of the very wealthiest Georgia taxpayers. Governor Sonny Perdue has not yet signed these tax changes into law, and has indicated he might veto the capital gains cut. As ITEP director Matthew Gardner noted, "Governor Perdue has an opportunity to prevent Georgia lawmakers from making middle-income homeowners foot the bill for an unneeded tax break for the investor class."



Assessing the Impact of the Budget's Capital Gains Tax Cut

The proposed capital gains tax break would allow investors to exclude 50 percent of their long-term capital gains income from the state income tax when the tax cut is fully implemented in 2012. Capital gains are profits from the sale of an asset, such as stocks, bonds, investment or vacation real estate, art, or antiques. Under Georgia and federal income tax rules, capital gains are not taxed at all until they are "realized" – that is, unless and until the asset is sold.

ITEP's analysis of the proposed capital gains tax deduction shows that while the plan carries a hefty price tag, few Georgians would actually receive a substantial tax cut from the plan:

- If the capital gains tax cut had been fully implemented in tax year 2008, Georgia residents would have seen a **total tax cut of about $340 million**.
- **77 percent** of this tax cut **would go to the very richest 1 percent** of Georgians.

- The **80 percent** of Georgia taxpayers **earning less than $76,000** in 2008 would collectively enjoy **less than 1 percent** of the benefits from this tax cut.

Why would this proposed tax cut reach so few Georgians?

- Relatively few taxpayers realize any capital gains in a given year. ITEP estimates that in 2008, just 8 percent of Georgians will report any capital gains.
- In addition, Georgia already offers income tax breaks that allow many low- and middle-income seniors to reduce or eliminate tax on these gains. Georgia seniors can deduct up to $35,000 ($70,000 for married couples) of capital gains from their taxable income in 2008. **Virtually every Georgia senior earning less than $75,000 a year already avoids paying income on any capital gains through the existing retirement income tax break**.
- Moreover, the two most common assets held by most working Americans – their investments for retirement and their homes – generally are not treated as taxable capital gains when they are sold. Assets held in 401(k)s or Individual Retirement Accounts (IRAs) – the means by which most households own stocks and bonds – are considered "ordinary" income when they are sold and are therefore ineligible for capital gains tax breaks.

On the Chopping Block: The Homeowner Tax Relief Grant

While the legislature's 2010 budget proposal uses a wide variety of spending cuts to close the state's $2.6 billion shortfall, few of the cuts affect middle-income Georgians as directly as does the proposed repeal of the Homeowner Tax Relief Grant (HTRG). Through the HTRG program, the state of Georgia essentially pays most property taxes on the first $8,000 of a Georgia homestead's assessed value. (Since Georgia homes are assessed for tax purposes at 40 percent of their market value, this is equivalent to exempting $20,000 of a home's market value from tax.) Enacted almost a decade ago, the HTRG currently reduces Georgia homeowner property taxes by about $430 million a year.

Homestead exemptions such as the HTRG offer substantial tax benefits to homeowners at all income levels, but are especially valuable to middle- and low-income families because the $8,000 exemption represents a larger share of property taxes (and of income) for low-income taxpayers.

On the other hand, some respected analysts have argued that Georgia's HTRG is an inefficient, costly and incomplete approach to providing property tax relief. In a given taxing district, the HTRG generally gives the same tax cut to the wealthiest homeowner as to the poorest senior citizen. Conversely, the HTRG (and homestead exemptions in general) provide no tax relief to renters, even though renters pay some property tax indirectly in the form of higher rents.

One sensible cost-saving alternative to the HTRG would be a property tax "circuit breaker" credit, which is designed to ensure that for homeowners and renters earning below certain income levels, property taxes should not be allowed to exceed a certain share of a family's income. For example, the Illinois circuit breaker caps the property tax liability of low-income seniors at 3.5 percent of their annual income.

Of course, the legislature's proposed budget doesn't reform the HTRG—it simply repeals the exemption, forcing already-strapped local governments to either pass on the revenue loss to homeowners or find a way of paying for the HTRG themselves. Many local governments have indicated that they will likely be forced to pass on the full cost to homeowners in response to HTRG repeal.

Overall Result: Poorest 95% of Income Distribution Pays More; Top 5% Pays Less

Not surprisingly, the combination of a middle-income tax hike and a tax break for upper-income investors will, on balance, make Georgia's tax system more unfair. If fully implemented in 2008, the poorest 95 percent of Georgia's income distribution would see its Georgia state and local taxes increase under this plan, although some taxpayers in this income group will either see a tax cut (because, for example, they have capital gains income and don't own a home) or will see no tax change at all (because they are renters with no capital gains income).

The wealthiest 5 percent of Georgia's income distribution would, in the aggregate, see its taxes decrease under this plan. The plan's benefits would be especially concentrated among the top 1 percent of Georgians, who would see a net tax cut averaging over $5,900 from the two provisions.

Conclusion

The Georgia General Assembly's budget blueprint for fiscal 2010 is the product of many difficult choices, reflecting the severity of the budget shortfalls policymakers sought to erase. The repeal of the Homeowner Tax Relief, while politically difficult, should, in theory, have given lawmakers a important opportunity to rethink its approach to state-funded property tax relief. But the budget plan squanders most of the tax savings from HTRG repeal on a poorly-conceived long-term capital gains tax cut for a small number of the wealthiest Georgians.

"Georgia lawmakers have sent Governor Perdue a budget that dramatically shifts the cost of funding public services away from the wealthiest Georgia taxpayers, and further burdens middle- and low-income families," said ITEP director Matthew Gardner. "While paring back the HTRG could play a constructive role in helping to balance Georgia's budget in a fair and sustainable way, the legislature's decision to cut capital gains taxes for upper-income taxpayers makes the state tax system even more unfair."

Impact of 50% Capital Gains Deduction and Homestead Tax Relief Grant Repeal

All Georgia Residents, 2008 Income Levels

2008 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $15,000	$15,000 – $26,000	$26,000 – $46,000	$46,000 – $76,000	$76,000 – $162,000	$162,000 – $403,000	$403,000 – Or More
Average Income in Group	$9,000	$20,000	$36,000	$59,000	$106,000	$240,000	$1,170,000
State Tax Change as % of Income							
Capital Gains Tax Cut	–0.0%	–0.0%	–0.0%	–0.0%	–0.0%	–0.1%	–0.5%
Repeal HTRG	+0.4%	+0.4%	+0.3%	+0.2%	+0.1%	+0.1%	+0.0%
Total, These Two Changes	**0.4%**	**0.4%**	**0.3%**	**0.2%**	**0.1%**	**–0.1%**	**–0.5%**
Average Tax Change							
Capital Gains Tax Cut	–0	–0	–1	–2	–37	–315	–6,094
Repeal HTRG	+38	+76	+92	+133	+157	+167	+168
Total, These Two Changes	**+38**	**+76**	**+91**	**+131**	**+120**	**–148**	**–5,927**

SOURCE: *Institute on Taxation and Economic Policy Microsimulation Tax Model, April 2009*