INSTITUTE ON TAXATION AND ECONOMIC POLICY

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Informing the debate over tax policy nationwide

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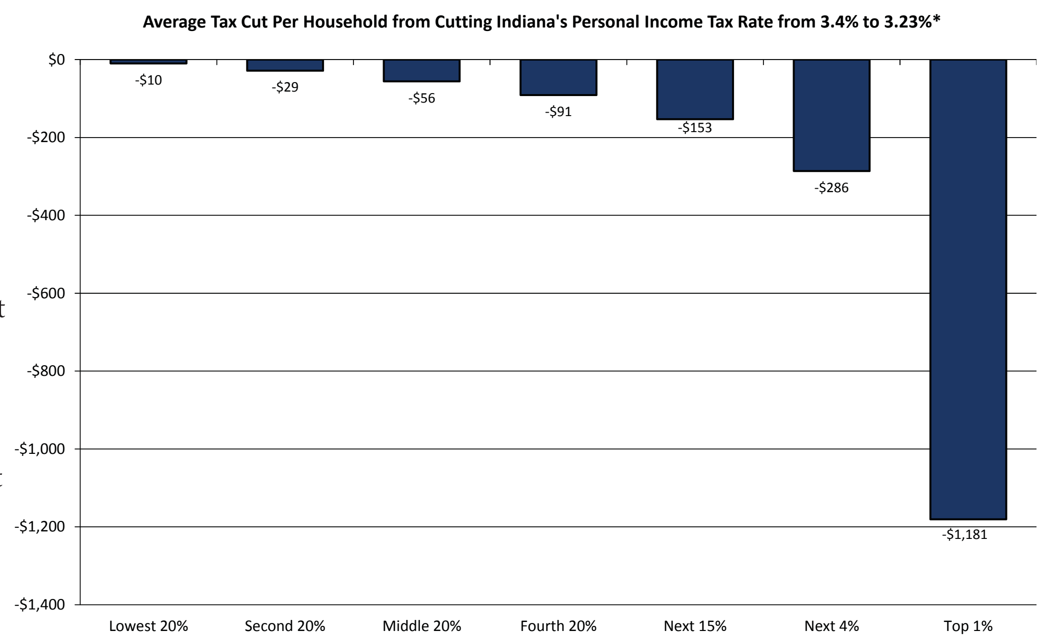
5% Cut in Indiana's Income Tax is Stacked in Favor of the Wealthy

Indiana Governor Mike Pence and the state's legislative leaders recently announced a budget agreement that, among other things, phases the state's flat personal income tax rate down from 3.4 percent to 3.23 percent by 2017.[1] This 5 percent cut in the state's income tax rate is a scaled-back version of Governor Pence's campaign pledge to cut the rate to 3.06 percent next year. While this new agreement is more modest than Governor Pence's original proposal, its impact on the distribution of Indiana taxes is very similar. Most of its benefits will flow to the state's wealthiest households, while one in three of the state's poorest residents will see no tax cut at all.[2]

Given the uncertainty in economic forecasts for 2017, ITEP used its Microsimulation Tax Model to illustrate the impact that cutting the state's personal income tax rate to 3.23 percent would have had if implemented in Tax Year 2012—the year for which most Indiana residents just finished filing their income tax returns. ITEP's analysis shows that:

- Cutting Indiana's personal income tax rate to 3.23 percent would have reduced the tax bill of the richest 1 percent of Indiana households by an average of $1,181 in 2012.
- That same cut in the state's income tax rate would have reduced the average tax bill of middle-income households by just $56.
- Low-income households would have fared worst of all. If the recently announced agreement had been in effect for 2012, the tax cut for the poorest 20 percent of Indiana households would have averaged just $10, and roughly one in three members of this group would have received no tax cut at all.



Source: Institute on Taxation and Economic Policy Tax Model, April 2013.
* 3.23% tax rate will not take effect until Tax Year 2017. Given uncertainty in economic forecasts, results are presented for Tax Year 2012 to illustrate the plan's impact.

These findings are particularly worrisome in light of ITEP's recent *Who Pays?* report.[3] ITEP found that while low-income Indiana households pay little in state income taxes, they face the seventh highest overall state and local tax bill in the country, once sales, excise, and property taxes are taken into account. Under current law, Indiana's poorest households pay an average of 12.3 percent of their income in state and local taxes each year, while the state's most affluent residents pay just 5.4 percent. If this agreement is signed into law, this lopsided distribution of Indiana's tax system—ranked ninth worst in the country by ITEP—will be made even worse.

[1] http://www.news-sentinel.com/apps/pbcs.dll/article?AID=/20130425/NEWS/130429758/1005

[2] ITEP's analysis of the Governor's tax plan can be found at: http://itep.org/itep_reports/2013/04/indiana-senates-income-tax-cut-just-as-lopsided-as-the-governors.php

[3] http://www.itep.org/whopays/

Personal Income Tax Rate Cut Agreed to by Governor and Legislative Leaders, from 3.4% to 3.23%

All Indiana Residents, 2012 income levels

2012 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%	State Tax Change ($1000)	Federal Tax Change ($1000)	Federal Offset %	Net Tax Change ($1000)
Income Range	Less Than $19,000	$19,000 – $34,000	$34,000 – $56,000	$56,000 – $85,000	$85,000 – $154,000	$154,000 – $357,000	$357,000 – Or More				
Average Income in Group	$ 12,000	$ 27,000	$ 45,000	$ 69,000	$ 109,000	$ 211,000	$ 891,000				
Tax Cut as % of Income	–0.08%	–0.11%	–0.12%	–0.13%	–0.14%	–0.14%	–0.13%	–245,000	+30,000	12%	–216,000
Average Tax Cut	–10	–29	–56	–91	–153	–286	–1,181				
% with Tax Cut	68%	84%	95%	99%	99%	98%	100%				
Share of Total Tax Cut	2%	7%	13%	22%	28%	14%	14%				

Detail	
% of Total Tax Cut Going to Bottom 60%	23%
% of Total Tax Cut Going to Top 20%	55%
% of Total Tax Cut Going to Top 5%	28%

SOURCE: Institute on Taxation and Economic Policy, April 2013

Baseline assumes no automatic taxpayer refund in order to provide a more generalizable outlook on the plan's impact. This refund amount will vary significantly from year to year.