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BUILDING A BETTER TAX CUT

Alternative to SB 87 Would Cut Taxes for Twice as Many Louisianans – at Half the Cost

On Wednesday, May 14, 2008, the House Ways and Means Committee approved SB 87, a measure originally sponsored by Senator Buddy Shaw and now backed by Governor Bobby Jindal. The measure would reduce state income taxes by close to $300 million per year, but a new analysis by the Washington, DC-based Institute on Taxation and Economic Policy (ITEP) shows that a sensible and fair alternative could cut taxes for twice as many Louisianans at half the cost.

SB 87, which could be considered by the full House of Representatives later this week, would repeal one element of the landmark 2002 "Stelly Plan," raising the income levels at which Louisianans begin to pay the state's top 6 percent income tax rate from $50,000 to $100,000 for married couples (and from $25,000 to $50,000 for single people). As a result, SB 87 would reduce annual income tax revenue by several hundred million dollars, but would only cut taxes for the just over one-third of Louisianans who currently pay at the 6 percent rate. One common-sense alternative to SB 87 would instead expand the 2 percent tax bracket, which would benefit many more middle-income Louisianans, and would increase the value of the state Earned Income Tax Credit (EITC) established last year. Such an alternative would be far less expensive – reducing tax revenue by $134 million per year – but would be far broader in scope – shrinking the taxes paid by more than three-quarters of Louisianans.

Tax Cuts at a Glance

	SB 87	Alternative
% of Taxpayers Affected	38%	76%
% of Tax Cut to Wealthiest 5%	27%	6%
% of Tax Cut to Poorest 60%	6%	54%
Increase in Federal Taxes	$38 M	$6 M

Analysis assumes a 2008 effective date

Of note, SB 87 would be heavily skewed towards the most affluent Louisianans, while the alternative described here would deliver the bulk of its tax cut to working families and individuals – who now pay a much larger share of their incomes in state and local taxes than the wealthy do. If SB 87 were enacted into law, the wealthiest 5 percent of Louisiana taxpayers – who are expected to have incomes over $138,000 in 2008 – would receive 27 percent of the total tax cut, while taxpayers with incomes below $43,000 would receive just 6 percent of the tax cut. In contrast, more than half the benefits of the alternative described here would accrue to taxpayers with incomes below $43,000, with the richest 5 percent of taxpayers garnering just 6 percent.

The details of ITEP's analysis – including a description of Louisiana's regressive state and local tax system under current law and an examination of the impact of the two proposals on the federal income taxes paid by Louisianans – follow.

Alternative to SB 87 Would Provide a Larger Tax Cut to Middle Class Louisianans

In altering Louisiana's personal income tax brackets, SB 87 would reduce the amount of income subject to the state's 6 percent income tax rate. As only a minority of Louisianans presently pays that 6 percent rate, a more far-reaching approach would be to reduce the amount of income subject to the state's 4 percent rate, which many more taxpayers face, and instead tax that income at the state's lowest rate of 2 percent. This could be accomplished by increasing the income level at which Louisianans begin to pay the 4 percent rate – from $25,000 to $30,000 for married couples (and from $12,500 to $15,000 for single people). This change could also be paired with an increase in the state's Earned Income Tax Credit (EITC), which is currently equal to 3.5 percent of the federal version of the credit. Raising it to 7 percent of the federal credit would be more in line with the size of the EITC offered in other states and would help to offset the higher fuel, food, and other prices working Louisianans have seen in recent months.

Impact of Two Personal Income Tax Proposals
All Louisianans, 2008 income levels

2008 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $14,700	$14,700 – $26,100	$26,100 – $43,300	$43,300 – $72,600	$72,600 – $138,200	$138,200 – $351,200	$351,200 – Or More
Average Income in Group	$ 8,800	$ 19,200	$ 33,400	$ 55,100	$ 97,400	$ 206,200	$ 975,100

SB 87: Increase the starting point for the top (6%) income tax bracket to $100,000 for married couples and to $50,000 for single people and heads of households

Tax Change as Share of Income	0.0%	–0.0%	–0.1%	–0.3%	–0.5%	–0.4%	–0.1%
Average Tax Change	0	–0	–46	–153	–507	–851	–877
Share of Total Tax Change	0%	0%	6%	19%	48%	22%	5%

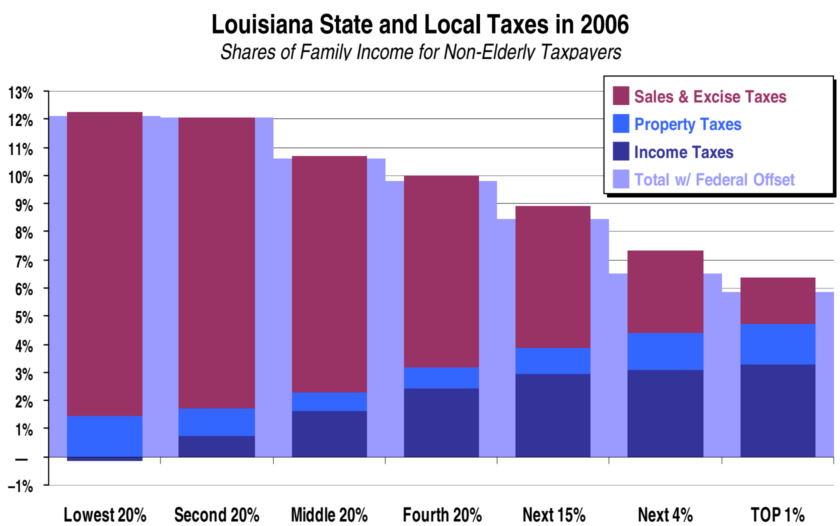
ALTERNATIVE: Increase the starting point for the middle (4%) income tax bracket to $30,000 for married couples and to $15,000 for single people and heads of households; raise the Louisiana Earned Income Tax Credit (EITC) to 7% of the federal EITC

Tax Change as Share of Income	–0.4%	–0.4%	–0.2%	–0.1%	–0.1%	–0.0%	–0.0%
Average Tax Change	–31	–82	–68	–70	–85	–91	–88
Share of Total Tax Change	9%	24%	21%	21%	19%	5%	1%

As the table above indicates, such an alternative would, on average, provide larger tax cuts to low- and middle-income Louisianans than they would receive if SB 87 were enacted. For instance, under SB 87, middle class Louisianans – families and individuals with incomes between $26,100 and $43,300 in 2008 – would see their income taxes fall by $46 on average; the alternative approach would produce an average tax cut of $68 for the same set of taxpayers. The same is true, albeit to a far greater degree, for low-income Louisianans. Taxpayers with incomes below $14,700 would experience absolutely no change in their income taxes under SB 87, but would have their taxes go down by about $30 on average if this alternative were made law.

Alternative to SB 87 Would Improve Tax Fairness in Louisiana

In a word, Louisiana's current tax system is regressive. It requires low- and middle-income families and individuals to pay much larger shares of their incomes in state and local taxes than the best-off must pay. In fact, as the chart below demonstrates, on average, the poorest fifth of non-elderly taxpayers in Louisiana paid approximately 12.1 percent of their incomes in state and local taxes in 2006. This effective tax rate is ***more than twice*** that paid by the richest 1 percent of taxpayers; non-elderly taxpayers with incomes in excess of $300,000 – that is, the best-off one percent – paid just 5.9 percent of their incomes in state and local taxes, after accounting for the federal offset, in 2006. Middle-income taxpayers fared a little better than the poor under Louisiana's tax system – on average, they paid 10.6 percent of their incomes in taxes that year.



SB 87 would make this situation even worse. It would provide the richest five percent of taxpayers with tax cuts averaging more than $850 per year, but would do nothing for the poorest twenty percent of taxpayers. On the other hand, an alternative approach consisting of an expansion in the bottom income tax bracket and a doubling of the state's EITC would be a small but noticeable step towards greater tax fairness. While such an approach would yield tax cuts that, in dollar terms, would be larger for upper-income taxpayers, those tax cuts would constitute a substantially larger share of income for low- and middle-income Louisianans. Indeed, such an approach would reduce the income taxes paid by the bottom 40 percent of taxpayers by 0.4 percent of income, thus helping to mitigate further the impact of regressive sales and property taxes.

Alternative to SB 87 Would Mean a Smaller Federal Tax Increase

There is one other way in which the alternative to SB 87 would be better targeted – it would yield a smaller increase in the federal income taxes owed by Louisianans.

One aspect of tax policy that is often overlooked is the interaction among federal, state, and local tax systems, yet this interaction can significantly reduce the overall impact of a proposed state tax change. In particular, Louisianans who use itemized deductions in determining their federal income taxes can take their state income taxes as one such deduction. This, in turn, means that the state and federal income taxes owed by Louisianans move in opposite directions – as their Louisiana income taxes fall, their federal itemized deductions fall, their federally taxable incomes grow, and the federal income taxes they owe rise.

SB 87 – because of its larger size and because it would principally be received by Louisianans who use federal itemized deductions – would produce a larger "federal offset" than the alternative. If SB 87 were to become law, the federal income taxes owed by Louisianans would climb by about $38 million in 2008 – or by about 12 percent of the amount of the state tax cut. The alternative – due to its comparatively smaller size and since it would not lead to a change in federal taxes for many of its recipients – would yield an aggregate federal tax increase of just $6 million.

The Institute on Taxation and Economic Policy (ITEP) is one of the leading research and education organizations in the country working on government taxation and spending policy. The analysis presented here was conducted using the organization's Microsimulation Tax Model, the same type of model used by the U.S. Treasury Department, the Congressional Joint Committee on Taxation, the Congressional Budget Office, and many state revenue departments. To learn more about ITEP and its Microsimulation Tax Model, visit www.itepnet.org.

Agenda for Children, Louisiana's statewide child advocacy organization, works to make Louisiana a state in which all children can thrive. For more information, please visit the Agenda for Children website at www.agendaforchildren.org.