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Georgia's Individual Income Tax: Options for Reform

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**GEORGIA'S INDIVIDUAL INCOME
TAX: OPTIONS FOR REFORM**

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Georgia's Individual Income Tax: Options for Reform

I. Introduction

The state individual income tax is an important source of revenue across the U.S. In 2009, the individual income tax accounted for 34.4 percent of all state tax collections, making the individual income tax second only to general sales and gross receipts taxes as a state revenue source. The individual income tax constituted an average of 26.1 percent of *all* state own-source revenue in 2008.¹

The State of Georgia introduced the individual income tax in 1929, a time when only 14 other states imposed the tax. The importance of the tax to Georgia's fiscal system has grown over time. In 1970, the income tax comprised 20.4 percent of state government net tax revenue. By 1996, that percentage had risen to 42.6 percent and by 2009 it had grown further to 48.5 percent.²

The state individual income tax has some significant benefits:

1. It is income elastic, i.e., its revenues grow in proportion to income.³
2. It imposes some equity in the tax system because it is progressive in its distribution of tax burdens.⁴
3. At relatively low rates that are similar across forms of income, the tax can be relatively neutral in its effects on economic decisions, thus reducing distortions in the economy.
4. It is deductible at the federal level, thus reducing the overall burden on Georgia residents.
5. It is a well-known tax and may be filed on-line, reducing compliance and some administrative costs.

There are some negative aspects as well:

1. Because it is income elastic, revenues may decline during economic downturns.

¹ U.S. Bureau of the Census, Internet site, <http://www.census.gov/govs/> (accessed 08/30/ 2010).

² Georgia State Department of Revenue, *Statistical Report*, various years. and U.S. Bureau of the Census (2009).

³ Elasticity refers to the percentage change in tax revenue divided by a percentage change in income.

⁴ A progressive tax is one where the tax paid is a higher percentage of income as income increases.

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2. The tax is progressive, which may discourage higher-income individuals from living in Georgia and from locating their businesses in the state.
3. “Bracket creep” due to inflation results in potentially increased tax burdens with no change in real income; a progressive rate schedule may guarantee that taxes will grow faster than real income.
4. The tax is often used to give special preferences to certain groups or certain income types, thus disrupting the equity and efficiency advantages of the tax.
5. Taxpayers feel that compliance with the tax is cumbersome and expensive.
6. The tax requires a high level of administration, which is costly.
7. The actual Georgia tax schedule is relatively flat, thus decreasing the potential progressivity of the tax.
8. There are some nuances in the system such as the tax treatment of residents with income from other states, the deductibility of state income taxes, potential marriage penalty, and the like that reduce the revenue generation of the tax while increasing its complexity and possible decreasing equity.

In this report, we provide an overview of the state of individual income tax in Georgia and analyze a series of options aimed at increased efficiency, equity, and/or compliance and administration. The analysis is performed using FRC’s income tax microsimulation model. Wallace and Edwards (1997) provide an earlier but more extensive review of the Georgia personal income tax.

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II. Issues in the Design of the Individual Income Tax

The Georgia individual income tax is imposed on the taxable net income of all residents and non-residents of Georgia. Taxpayers can file returns based on one of the following categories: single, married filing separately, head of household, or married filing jointly. The information below (and Table 1) shows how the tax is computed starting from the Federal Adjusted Gross Income (FAGI) for tax year 2009.

Two sets of adjustments are made to FAGI to arrive at Georgia Adjusted Gross Income (GAGI). First, the following items are subtracted from FAGI:

1. retirement income for taxpayers aged 62 and older or for permanently disabled persons up to but not to exceed \$35,000 (\$70,000 if married and filing jointly when both individuals earn sufficient income to qualify separately for the \$35,000 exclusion);
2. interest or dividends on federal obligations to the extent included in FAGI if these amounts are exempt from state taxation by federal law;
3. social security benefits or tier 1 and tier 2 railroad retirement benefits to the extent included in FAGI;
4. salaries and wages eliminated in computing FAGI because of the federal jobs tax credit;
5. withdrawals from Individual Retirement Accounts (IRAs), Keough, SEP and SUB-S plans where tax was previously paid to Georgia due to differences in state and federal law in the years 1981 through 1986;
6. depreciation due to differences in Georgia and federal income tax during the tax years 1981 through 1986;
7. the amount of a dependent's unearned income included in FAGI of parent's return;
8. income tax refunds, from all states except Georgia, included in FAGI;
9. income from public pension or retirement funds, programs, or systems if exempt by federal law and included in the taxpayer's FAGI;
10. adjustments to FAGI for shareholders who are Georgia residents for Subchapter S income where the Sub S election is not recognized by Georgia or another state, if recognized by another state then credit for taxes paid to another state applies;

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11. the amount received during the year that represented contributions to the Teachers' Retirement System of Georgia by the taxpayer between July 1, 1987 and December 31, 1989 and previously taxed by Georgia;
12. amount claimed by employers in food and beverage establishment who claimed a credit instead of a deduction for FICA tax paid on cash tips;
13. 10 percent of qualified payments to minority subcontractors (limited to \$100,000 per tax year);
14. deductible portion of contributions to Georgia Higher Education Savings Plan. This amount is limited to the amount contributed but cannot exceed \$2,000 per beneficiary;
15. adjustments due to Federal tax changes;
16. combat zone pay exclusion;
17. up to \$10,000 of unreimbursed travel and lodging expenses, and lost wages incurred as a direct result of the taxpayer's donation of all or part of a kidney, liver, pancreas, intestine, lung or bone marrow during the tax year;
18. adjustments to FAGI for Georgia residents who are in a partnership or member in a LLC where such entities are taxed at the entity level in another state. This adjustment is only for the portion of income which was taxed; and
19. an amount equal to 100 percent of the premium paid on highly deductible health plans during the tax year and included in FAGI.

In the second set of adjustments, the following items are added to FAGI:

1. interest income on non-Georgia municipal bonds and dividends from mutual funds that derived income from these municipal bonds;
2. loss carry-overs from years when the taxpayer was not subject to Georgia income tax;
3. lump-sum distributions from employee benefit plans reported on IRS Form 4972;
4. depreciation due to differences between Georgia and federal tax laws in tax years 1981 through 1986;
5. adjustments due to Federal tax changes;

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6. Federal deduction for income arising from domestic production under I.R.C. Section 199;
7. payments of more than \$600 made to unauthorized employees within the tax year;
8. the portion of charitable contributions for which an education expense credit was given; and
9. taxable portion of withdrawals which fall under the Georgia Higher Education Savings Plan.

TABLE 1. COMPUTATION OF GEORGIA TAX LIABILITY, 2009

FEDERAL AGI

Subtract

- retirement income (not to exceed limits specified by Georgia law)
- interest on U.S. obligations
- social security benefits (taxable portion)
- railroad retirement (taxable portion)
- other

Add

- interest on non-Georgia municipal & state bonds
- lump sum distributions of employee benefits
- other

=GEORGIA AGI

subtract

Georgia standard deduction *OR* Federal itemized deduction

and

Georgia personal exemptions

Singles

Rate	Taxable Income
1%	< \$750
2%	750-2250
3%	2250-3750
4%	3750-5250
5%	5250-7000
6%	>7000

Married Filing Separately

Rate	Taxable Income
1%	< \$500
2%	500-1500
3%	1500-2500
4%	2500-3500
5%	3500-5000
6%	>5000

Joint, Head of Household

Rate	Taxable Income
1%	< \$1,000
2%	1,000-3,000
3%	3,000-5,000
4%	5,000-7,000
5%	7,000-10,000
6%	> 10,000

=TAX BEFORE CREDITS

subtract

credits (low-income tax, employment/investment tax,
credits for tax payments to other states, and other credits)

=GEORGIA TAX LIABILITY

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Georgia taxable income is then derived by subtracting the following amounts from GAGI: (1) either itemized nonbusiness deductions used in computing the federal taxable income or a standard deduction, with additional \$1,300 deductions allowed when the taxpayer and/or spouse (for joint returns) is blind or aged 65 or older and (2) Georgia's personal exemptions of \$5,400 for joint filers and \$2,700 for individuals using other filing types, with \$3,000 allowed for each dependent. The standard deduction allowance also varies by filing status, with a deduction of \$2,300 for single and head of household; \$1,500 for married filing separately; and \$3,000 for married filing jointly.

A graduated rate structure ranging from 1 to 6 percent is applied to the Georgia taxable income to arrive at the before-credit tax liability. Georgia's income tax allows a myriad of deductions and credits, including: a credit for taxes paid to another state; low and zero emission vehicle credit; qualified education expense credit; driver education credit; low income credit, and; the clean energy credit.

TABLE 2A. COMPARISON BETWEEN FEDERAL ADJUSTED GROSS INCOME AND GEORGIA ADJUSTED GROSS INCOME (2005)

FAGI Category	N	FAGI Sum	GAGI Sum	Difference
Less than \$5000	342,433	-3,775,265,611	-1,139,380,745	2,635,884,866
\$5,000 up to \$9,999	351,947	2,646,124,078	2,219,191,250	-426,932,828
\$10,000 to \$19,999	675,271	10,022,871,883	8,274,419,693	-1,748,452,189
\$20,000 to \$29,999	536,682	13,296,022,842	11,394,714,154	-1,901,308,688
\$30,000 to \$49,999	688,465	26,912,406,659	23,022,868,565	-3,889,538,095
\$50,000 to \$74,999	504,751	30,998,954,577	26,188,960,207	-4,809,994,369
\$75,000 to \$99,999	294,071	25,375,104,282	21,562,164,992	-3,812,939,290
\$100,000 to \$149,999	238,846	28,653,382,517	24,370,696,991	-4,282,685,526
\$150,000 to \$199,999	80,286	13,759,410,666	11,472,668,685	-2,286,741,981
More than \$200,000	126,155	137,743,544,053	49,403,471,242	-88,340,072,812
Total	3,838,907	285,632,555,945	176,769,775,033	-108,862,780,912

The credits and exemptions reduce Georgia adjusted gross income and Georgia taxable income relative to federal adjusted gross income. In Table 2a, we provide a comparison of the Federal AGI, Georgia AGI, and Georgia taxable income by Federal AGI (FAGI) groups. These data are for 2005. As seen in Table 1, there is a gap of \$108.9 billion between Federal AGI and Georgia AGI—an amount equal to

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38 percent of FAGI. The difference between FAGI and Georgia AGI is most pronounced at the lowest income end (where Georgia AGI is larger than FAGI) and the highest income end—where deductions reduce Georgia AGI to 36 percent of FAGI. Table 2b reports the same information for residents and also for part-year and non-residents. As seen there, the \$9.6 billion of the gap pertains to Georgia residents, while the remainder is attributed to part-year (\$8.9 billion) and non-residents (\$90.3 billion). FAGI for non-residents includes non-Georgia income, so the large difference is not surprising.

We next briefly review the performance of the income tax before turning to options for reform.

**TABLE 2B. COMPARISON BETWEEN FEDERAL ADJUSTED GROSS INCOME AND GEORGIA ADJUSTED GROSS INCOME (2005)
BY RESIDENCY STATUS**

	FAGI Category	N	Mean	GA AGI Total	FED AGI Total	Difference Fed – GA
FULL-YEAR	Less than \$5,000	325,191	-3,504	-1,139,443,249	-1,087,728,124	51,715,125
	\$5,000 up to \$9,999	330,314	6,718	2,219,128,727	2,482,623,508	263,494,781
	\$10,000 to \$19,999	628,307	13,169	8,274,212,581	9,318,974,027	1,044,761,446
	\$20,000 to \$29,999	496,638	22,943	11,394,519,592	12,303,426,728	908,907,137
	\$30,000 to \$49,999	631,286	36,469	23,022,160,810	24,663,927,371	1,641,766,562
	\$50,000 to \$74,999	457,909	57,191	26,188,378,938	28,115,122,637	1,926,743,699
	\$75,000 to \$99,999	265,231	81,295	21,561,821,530	22,880,767,551	1,318,946,021
	\$100,000 to \$149,999	212,339	114,769	24,369,854,002	25,451,527,979	1,081,673,977
	\$150,000 to \$199,999	69,270	165,620	11,472,516,796	11,862,836,621	390,319,825
	More than \$200,000	93,121	530,528	49,403,255,984	50,339,636,993	936,381,009
	Total	3,509,606		176,766,405,710	186,331,115,292	9,564,709,581
PART-YEAR	Less than \$5,000	6,798	9	64,536	-14,980,957	-15,045,492
	\$5,000 up to \$9,999	11,552	4	41,709	87,815,878	87,774,169
	\$10,000 to \$19,999	25,814	5	119,906	386,055,340	385,935,434
	\$20,000 to \$29,999	20,259	4	73,662	500,769,458	500,695,796
	\$30,000 to \$49,999	26,590	13	336,945	1,041,183,832	1,040,846,887
	\$50,000 to \$74,999	19,231	14	272,007	1,180,516,089	1,180,244,082
	\$75,000 to \$99,999	11,618	7	85,097	1,005,824,748	1,005,739,651
	\$100,000 to \$149,999	11,066	13	144,514	1,338,433,917	1,338,289,403
	\$150,000 to \$199,999	4,357	35	151,281	746,867,267	746,715,986
	More than \$200,000	5,292	0	0	2,675,045,989	2,675,045,989
	Total	142,577		1,289,658	8,947,531,562	8,946,241,905

Table 2B continues next page...

TABLE 2B (CONTINUED). COMPARISON BETWEEN FEDERAL ADJUSTED GROSS INCOME AND GEORGIA ADJUSTED GROSS INCOME (2005) BY RESIDENCY STATUS

	FAGI Category	N	Mean	GA AGI Total	FED AGI Total	Difference Fed – GA
NONRESIDENT	Less than \$5,000	10,443	0	-1,598	-2,672,555,016	-2,672,553,417
	\$5,000 up to \$9,999	10,081	2	21,031	75,683,914	75,662,883
	\$10,000 to \$19,999	21,150	4	87,555	317,839,874	317,752,318
	\$20,000 to \$29,999	19,785	6	121,745	491,826,807	491,705,062
	\$30,000 to \$49,999	30,588	11	336,723	1,207,257,890	1,206,921,167
	\$50,000 to \$74,999	27,611	11	310,768	1,703,317,344	1,703,006,576
	\$75,000 to \$99,999	17,222	15	257,371	1,488,512,271	1,488,254,900
	\$100,000 to \$149,999	15,441	45	699,106	1,863,422,196	1,862,723,090
	\$150,000 to \$199,999	6,659	0	0	1,149,706,515	1,149,706,515
	More than \$200,000	27,742	8	215,915	84,728,860,985	84,728,645,070
	Total	186,722		2,048,615	90,353,872,781	90,351,824,165

Source: FRC Income Tax Microsimulation Model. 2005 levels.

III. Performance of Georgia's Individual Income Tax

As noted above, Georgia's income tax provides a substantial share of the state's revenue. Before discussing reform options it is important to understand the tax's performance. Georgia's relatively low threshold for income taxation and narrow tax brackets lead to a system where the majority of tax payers are found in the top bracket of 6 percent (see Figure 1). The tax burden (or effective tax rate), that is, taxes paid divided by a measure of income, is progressive, but there is not much variation in tax burden across income levels, as measured by FAGI (Figure 2). Most taxpayers pay between 3 percent and 5 percent of FAGI in income tax. The result is that the tax may be considered less fair than it could be in that individuals at different levels of income pay about the same percent of their income in tax. On the other hand, a flat rate tax discourages taxpayer behavior to "game" the system—or to move to a lower tax bracket. This efficiency effect of a flat tax should be considered a benefit to the economy but should be weighed against the lack of equity in such a system.

The overall burden of the income tax is similar to that of the average state in the U.S. on a per capita basis. As a percent of personal income, the income tax in Georgia is slightly more burdensome than the national average. While income taxes are not the only factor affecting economic growth and the overall tax burden should be the focus, it is important to note that substantial increases in the individual income tax would put Georgia in the top fifty percent of income tax burdens in the U.S.

How tax revenues move with the economy (measured as buoyancy) is one criterion for evaluating a tax since it indicates whether the tax "keeps up" with growth in the economy. Year to year, the buoyancy also measures the volatility of the tax and the ability of government to meet the demands of their constituents. As an economy grows (and income of taxpayers grows), the demands for public services tend to increase. If tax revenues grow less quickly than the economy, then the public sector may not be able to meet increased demands for better schools and roads, more parks and trash collection, etc. without having to raise the income tax rate. Low tax buoyancy suggests that governments may face increased public pressure for better and/or more services with slower growing revenue sources. It is also important to

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FIGURE 1. MARGINAL TAX RATES

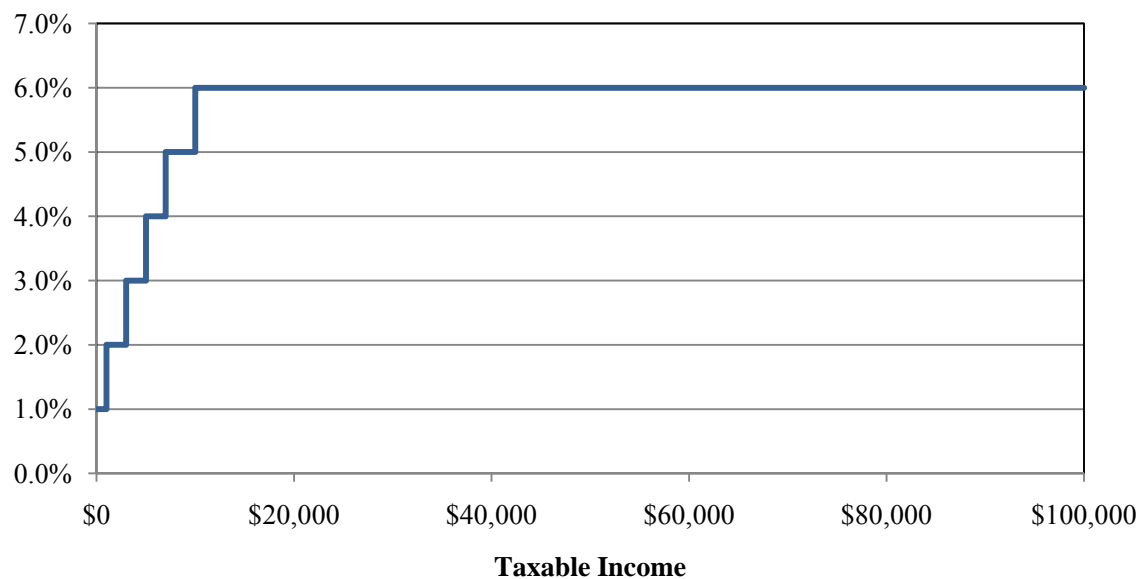
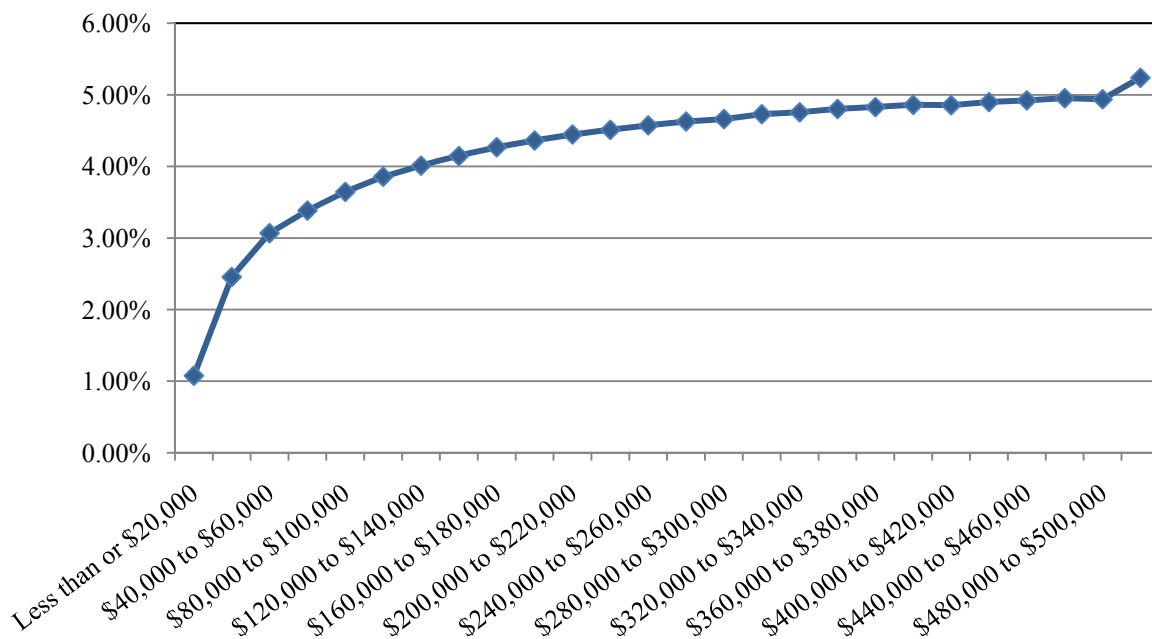


FIGURE 2. EFFECTIVE TAX RATE (FULL-YEAR RESIDENTS; TAX YEAR 2005)



Source for Figures 1 and 2: FRC Income Tax Microsimulation Model.

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know the buoyancy of specific revenue sources when forecasting revenues—if personal income is expected to grow, but if tax buoyancy is less than one, we would not forecast revenues to grow at the same rate as the economy.

In the case of Georgia's individual income tax, previous studies (Wallace 2009) suggest that the buoyancy of the tax has decreased over time and has become more erratic in recent years. There are many possible reasons for this trend, but at this point, the most promising explanation in terms of its magnitude is the changing composition of personal income away from taxable wages toward less-taxable fringe benefits. A radical change to the income tax (such as a move to a consumption type tax) would mitigate the effects of a growth in fringe benefits on income tax revenue.

In addition to the economic performance of the tax, the administration of and compliance with the tax are important baseline considerations when considering tax reform. Relative to the federal income tax and income taxes of some states, Georgia's income tax is relatively simple. However, a proliferation of exemptions, tax credits, and the donation add-ons complicate the system and reduces the efficiency of the income tax as a revenue vehicle. These more technical items complicate the system unnecessarily and in many cases reduce income tax revenues in an ad hoc fashion.

Reform Options

There are perhaps three types of income tax reforms that might be considered:

- those that address equity concerns;
 - those that address efficiency in the economic sense of reducing the impact on the behavior of individuals; and
 - those that simplify the system and potentially reduce compliance costs. These are not mutually exclusive reform options, but we treat them as separate items in the analysis found below.
1. Equity based reforms:
 - a. Increase the standard deduction and personal exemptions (also a simplification);
 - b. Institute a refundable low income credit of between \$100 and \$200;
 - c. Add a 7 percent bracket to the current system;

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- d. Reduce/eliminate the elderly exemption (also a simplification);
 - e. Institute an earned income tax credit.
- 2. Economic efficiency based reforms:
 - a. Impose a flat rate income tax.
- 3. Simplification based reforms:
 - a. Eliminate all tax credits;
 - b. Eliminate all donation add-ons;
 - c. Couple to federal income tax liability/Federal AGI/federal taxable income;
 - d. Eliminate the deduction for Georgia income taxes;
 - e. Revise the treatment of non-residents vis-à-vis residents with respect to calculation of Georgia taxable income.

These options are discussed in the next section.

IV. Analysis of Options

Increase the Standard Deduction and Personal Exemptions to Federal Levels

Currently, Georgia's standard deductions and personal exemptions are at levels below the federal amounts, reducing the progressivity of the overall income tax system. Georgia's personal exemptions are \$2,700 and \$3,000, respectively, for taxpayers and dependents while federal exemptions were \$3,650 for taxpayers and dependents in 2009 (the federal amount is indexed annually for inflation). Georgia's standard deduction is currently \$3,000 for married joint taxpayers while it is \$11,400 at the federal level.

Using the 2005 individual income tax return data for Georgia, we show that the revenue impact of this option is a loss of Georgia income tax liability of 10.8 percent. Based on a forecast of \$7.3 billion in revenue for FY2011, this amounts to approximately \$778 million in lost revenue. All taxpayers would benefit from such a change, but the largest reductions in tax liability are seen at income levels between \$5,000 and \$75,000 of federal adjusted gross income.

The revenue impact of changes in the deductions and exemptions is not quite linear due to the impact of non-refundability at the low end and itemized deductions at the upper income end. However, as a frame of reference, increasing the standard deduction and personal exemption by \$1,000 each yields a reduction in tax revenue of 4.3 percent.

Introduce a Replacement Low Income Credit, Refundable

Georgia's low income tax credit is available to individuals with federal adjusted gross income up to \$19,999. Individuals who receive food stamps are not eligible for the credit. The credit was refundable through 2010 and the revenue impact of eliminating the refundability was \$24.2 million (2005 levels).

Estimates of a new refundable tax credit for individuals and families at 75 percent of the poverty level were made using the 2005 income tax return data. Using U.S. Government poverty levels by family size to determine eligibility, we estimate that a \$150 refundable credit (no phase out) per family would lead to a revenue reduction of approximately 1.0 percent or \$78 million (netting out the revenue impact

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associated with the 2010 law). By design, the distributional impact of this proposal is to provide tax relief to the low income households.

Adjustments to Tax Brackets

There are many ways that income tax brackets could be adjusted if the state wished to increase the progressivity and revenue generation of the individual income tax. One scenario would apply a new 7 percent bracket as follows:

Joint Filers:	Taxable income greater than \$14,000
Single Filers:	Taxable income greater than \$10,500
Married separate:	Taxable income greater than \$7,000

The estimated revenue increase from this change is 13.6 percent of revenue—approximately \$994 million in FY2011 under current forecasts.

Couple Closely to Federal Adjusted Gross Income (AGI)/Reduce the Elderly Income Exemption

Georgia allows adjustments to federal adjusted gross income to calculate Georgia adjusted gross income. In 2005, the Georgia adjustments totaled \$108 billion. Currently, there are no detailed data for Georgia on the composition of those adjustments so it is difficult to determine what the main source of adjustment is between FAGI and Georgia AGI. Another complication is that the IRS reports Federal Adjusted Gross Income for Georgia returns as \$199.2 billion (for 2005), while the Georgia income tax file reports \$285.6 billion (for 2005), and the Georgia DOR annual report claims \$284.2 billion (for 2005). The difference is mainly due to residency reporting—for IRS purposes, filers are identified as Georgia returns if they are full time residents of Georgia. Georgia allows subtractions for some appropriation of LLC and Subchapter S income (but this is not separately captured in the tax return file data).

Another part of the FAGI-Georgia AGI wedge is due to Georgia's retirement income exclusion and the exclusion of social security income. We refer to the sum of these two exclusions as the elderly exemption. For Georgia residents, the gap between FAGI and Georgia AGI is \$9.4 billion (2005). The IRS reports \$2.8 billion in taxable social security income for Georgia federal income tax filers in 2005. Using

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reported tax expenditure estimates associated with the increases in the retirement exemptions beginning in 1994, we estimate an income adjustment of \$4 billion in 2005 associated with the retirement exemption. Combined, these data suggest that \$6.8 billion of the \$9.6 billion Georgia adjustments might be attributed to these base reducing deductions (Social Security and retirement income)—which is the majority of the adjustment level. The revenue gain by eliminating these exclusions at 2005 levels would be \$267 million or 3.65 percent of revenue in 2005.

In 2010, legislation was passed to gradually eliminate the income tax on retirement income (i.e., expanding the exemption). The revenue cost of this phase in is estimated to be \$14.9 million in FY2012, increasing to \$149.5 million by FY2016. An option to eliminate Georgia's retirement exclusion (this does not include any changes to the social security exemption), relative to current law (exemption of \$35,000), would therefore include the revenue increase from reversing the new law. In FY2012, the result is to increase revenue by 3.68 percent (\$280 million).

The revenue impact reaches across all income groups with federal adjusted gross income over \$15,000.

Institute an Earned Income Tax Credit (EITC)

The earned income tax credit is designed to provide tax relief to working taxpayers. The value of the federal EITC depends on the level of earned income in the family, family status, and family size. In 2009, the maximum federal credit for a single parent family with one child was \$3,043. The federal credit is refundable. Currently, 23 states plus the District of Columbia have an earned income credit. In most of those states, the credit is refundable, similar to the federal EITC.

An option for Georgia is to consider an EITC equal to 5 percent of the amount of the federal EITC. A refundable credit of this magnitude would cost approximately 1.5 percent of income tax revenue. In 2011, this would amount to \$95 million.

Eliminate All Tax Credits

Georgia's income tax allows personal credits for a variety of purposes, as noted above. For calendar year 2007, the Georgia Department of Revenue (2009)

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reports \$29 million in low income credit (1,158,000 returns). The total amount of credits (not including the low income credit) taken in 2005 was \$198 million (based on calculations of the amounts reported on 2005 individual income tax returns). These credits amount to approximately 2.7 percent of income tax revenue (\$197 million in 2011). Note that these credits do not include the business tax credits such as the job tax credit.

Impose a Flat Rate Income Tax

A flat rate income tax coupled with a larger standard deduction could simplify the individual income tax system and maintain some progressivity due to the level of standard deduction. There are again a variety of scenarios that could be investigated. Here, we estimate the revenue impacts of applying a 4.5 percent rate with current standard deduction and exemption amounts. That is, eliminate all of the brackets by increasing the tax rates below 4 percent to 4.5 percent and reducing the tax rates above 5 percent to 4.5 percent. The net revenue impact is a revenue loss of 17.8 percent, with the largest reductions going to high income taxpayers. A flat rate of 5.5 percent is approximately revenue neutral under the same assumptions regarding the current standard deductions and personal exemptions.

An alternative “flat rate” version would be to eliminate all but the 6 percent tax bracket; in other words, reducing all of the rates below 6 percent to zero. Using the tax model, we estimate the revenue cost of such a reform option to be about 10.6 percent of current revenue—\$776 million in 2005 and \$774 in 2011.

Eliminate All Donation Add-Ons

There is little evidence that eliminating the donation add-ons from the individual income tax form will directly affect income tax revenue. There are potentially some administrative cost savings due to the reduced complexity of collection. In 2005, \$467,450 was donated to the Wildlife Conservation Fund and \$297,266 to the Children and Elderly Fund and \$384,026 for the Cancer Research Fund. We have no data on the other funds.

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Eliminate the Deduction for Georgia's Income Tax

There are 34 states that allow federal itemized deductions. Georgia is the only state that allows its own income taxes to be deducted at the state level. This reduces the overall level of tax paid by itemizers, leads to a revenue loss for the state and affects the overall equity (horizontal and vertical) of the system. The Internal Revenue Service (IRS, 2010) reports that about 1/3 of Georgians itemize their tax returns, but approximately 60 percent of those with federal adjusted gross income greater than \$50,000 itemize returns and nearly 90 percent of those with federal adjusted gross income greater than \$100,000 itemize. The data necessary to establish a precise revenue estimate are difficult to obtain, but the additional revenue associated with elimination of this deduction are in the order of magnitude of 2 percent of income tax revenue, or about \$78 million.

Revise the Treatment of Non-Residents vis-à-vis Residents with Respect to Calculation of Georgia Taxable Income

Georgia taxes non-residents as well as residents on income earned in Georgia. Our understanding of the current law is that Georgia limits the tax credit for Georgia residents with income from other states to the lesser of Georgia computed liability on income earned in Georgia (using the standard Georgia brackets and rates) or the actual payment to the other state. Often, the Georgia credit is substantially smaller than the actual tax paid to another state because the other state taxes the total level of income and then pro-rates the credit. A non-resident with Georgia income calculates his home state income tax by applying the tax rates of the home state and subtracting a credit for Georgia tax paid. This credit is typically equal to the lesser of a prorated share of the home state tax liability or actual Georgia liability (which Georgia calculates for Georgia based income only—thereby reducing the effective tax rate

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due to the progressive rate structure). The net result is that non-residents often pay less total tax.⁵

Georgia could consider revising this treatment so that Georgia residents are taxed more in line with non-residents either by apportioning the Georgia tax liability as a pro-rated share of total tax liability (pro-rated by the percent of income from Georgia). The revenue implication is likely to be small.

Eliminate Itemized Deduction, Double Standard Deduction, Eliminate Credits, Eliminate the Retirement Income Exclusion and Lower the Top Rate by 1 Percentage Point.

An alternative approach to flattening the income tax would be to eliminate the exclusion of retirement income (but not social security), eliminate all of the credits, eliminate the itemized deduction, and double the standard deduction. This would generate additional revenue that could be used to reduce the income tax rates. We ran this option allowing for a reduction in the top income tax rate to 5 percent. The result of these changes is an estimated revenue increase of \$259.8 million.

The effective tax rate increases for all income categories, but taxpayers with Federal AGI less than \$100,000 experience a sizable increase in their effective tax rate. Upper income taxpayers would see very little change in their effective tax rates.

⁵ The following example developed by Jay Starkman demonstrates the current law impact:

Example 1: A married New York resident with \$70,000 income of which \$10,000 is Georgia source. The NY tax on \$70,000 is \$4,001. The Georgia tax on \$10,000 is \$340. NY will allow a credit for the lesser of \$571 (1/7 of \$4,001, the total tax) or the actual \$340 paid to Georgia. Taxpayer's total NY and GA state tax is \$4,001.

Example 2: A married Georgia resident with \$70,000 income of which \$10,000 is NY source. The Georgia tax on \$70,000 is \$3,940. NY will calculate his tax on \$70,000 and the tax is \$4,001 for which NY will require \$571 (1/7th). Georgia will limit his credit for taxes paid to NY to just \$340 (\$10,000 at the first graduated rates). The taxpayer's total GA and NY state tax is \$4,171.

Had Georgia in Example 2 calculated the tax like NY does, the credit for taxes paid to NY would be \$563: the lesser of 1/7 of \$3,940 or the actual \$571. The total GA and NY state tax would be \$3,948.

Had Georgia in Example 1 calculated the tax like NY does, the nonresident would calculate \$3,940 Georgia tax on \$70,000 total income and pay 1/7th, or \$563, to Georgia. NY would allow its resident a credit equal to the lesser of \$571 or \$563, so his combined GA and NY tax would still be \$4,001.

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The revenue effects of these alternative options are summarized in Table 3.

TABLE 3. SUMMARY REVENUE ESTIMATES

Proposal	Estimated One Year Revenue Impact 2011
Increase the standard deduction and personal exemption to federal levels	- \$778 million
Refundable low income credit	- \$78 million
Impose a new 7 percent bracket	+ \$994 million
Eliminate the retiree deduction	+ \$280 million
Impose an earned income tax credit	- \$95 million
Eliminate all credits	+ 197 million
Impose a flat 4.5 percent rate (holding constant current deductions, exemptions, etc.)	- \$1,300 million
Impose a flat 5.5 percent rate (holding constant current deductions, exemptions, etc.)	Revenue neutral
Impose a flat 6 percent rate at the current 6 percent bracket (all other rates below set to 0)	- \$774 million
Eliminate all credits, eliminate the itemized deduction, double the standard deduction, eliminate the retirement income exclusion, and reduce top tax rate to 5 percent.	+\$259.8 million

Notes: Revenue impacts were derived from analysis of the 2005 income tax data and projected forward using the FY2011 individual income tax forecast of \$7.3 billion. The estimates are for one year and represent the revenue impact over the calendar year, which will result in different fiscal year effects depending on the method of payment.

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