As the Georgia economy has grown and changed over the past two decades, so has the state’s reliance on the individual income tax. While the tax has served the state well, the Georgia economy and population have changed, and there are now opportunities to modernize the income tax to bring it more into sync with the economy. This is the motivation for this research, to point the way toward future adjustments in the income tax and to lay out the policy options that are open in the future. Because there is no crisis in income taxation in Georgia, now is the best time to discuss how this tax might be adjusted in the future.

Georgia is one of 43 states which impose an individual income tax and one of 14 states which authorize the use of a local income tax. Georgia was one of the earliest states to use an income tax, but no local governments in Georgia have ever adopted a local income tax.

Since the initial imposition of the individual income tax in 1929, the state’s reliance on the tax has grown. In 1970, the income tax comprised 20.4 percent of state government net revenue. By 1996, that share had risen to 42.6 percent.

Some significant advantages offered by the individual income tax are that it is income elastic, (e.g., its revenues grow faster than the growth in aggregate income); it is progressive in its distribution of tax burdens; it is relatively neutral in its effects on economic decisions, thus reducing distortions within the economy; and it is deductible at the federal level, reducing the overall burden on a third of Georgia residents. Opponents of the tax contend that, because it is income elastic, revenues may decline during economic downturns; the progressivity of the tax may discourage higher-income individuals from living in Georgia and locating their businesses in the state; "bracket creep" due to inflation results in potentially increased tax burdens with no change in real income; 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; taxpayers feel that compliance with the tax is burdensome and expensive; and the tax requires a high level of administration, which is costly.

The same basic structure of the individual income tax has existed since 1937, with the last major set of adjustments occurring in 1987. The tax calculation begins with federal adjusted gross income. Adjustments are made for retirement income and social security benefits, lump sum distributions, and interest earned on Georgia and federal obligations. Next, deductions for exemptions and for either federal itemized deductions or the standard deduction are taken.
Finally, a graduated rate structure is applied, with rates ranging from one percent on the lowest income groups to six percent for income in excess of $10,000 for married filing jointly and head of household filers. Tax credits for low-income filers, for tax payments to other states, and for economic development activities are then deducted to arrive at the tax payable.

When comparing the structure of Georgia's individual income tax with those in the Southeast and throughout the nation, several observations are appropriate. Georgia's income tax structure is relatively "clean," with few adjustments and credits. The number of brackets is similar to that of other states, but the rates are a bit lower than those of the nation as a whole. The tax brackets are relatively narrow, with the top taxable income bracket being imposed at a lower income amount than that of most other states. The income tax structure does not provide for indexation (i.e., adjustments for inflation) of rates or brackets. The elderly with retirement income receive more generous tax treatment than that provided by most states for non-state pensioned retirees.

Comparison of the revenue received from the individual income tax in Georgia to other states in the Southeast region shows that Georgia receives a much higher percentage of total state tax revenue from this tax than the other states, with the exception of Virginia. Two factors explain the high percentage of revenues obtained from the individual income tax. First, Georgia reaches the threshold of its highest taxable income at lower income levels than most states in the region. Second, Georgia's per capita income is higher than the average for the Southeastern states, providing a larger taxable base relative to population than most of the other states.

How is the state income tax burden (taxes paid as a percent of income) distributed in the state? Using 1993 income levels and applying the requirements of laws in effect for 1996, we conclude that the tax burden is progressive throughout the entire range of income. Households earning less than $5,000 have a tax burden of 0.01 percent, while households with incomes in excess of $100,000 have the highest burden, 4.61 percent. Households in the middle-income brackets have an average tax burden of 3 to 4 percent.

**POLICY ISSUES**

A thorough analysis of Georgia's individual income tax uncovers the following policy issues which could be addressed through changes in the individual income tax code:

- The individual income tax is becoming a flat rate tax due to the low income level at which the tax rate is reached and the lack of indexation.

- While the system is not overly complex, the complexity could be reduced by using either federal taxable income or the federal tax liability as the tax base.

- The cost of the retirement income deduction is high. Georgia offers one of the most generous retirement income deductions. As the numbers of retirees grow, income exempted from individual income taxation will continue to grow, which will erode the individual income tax base. Considerations for change include lowering the retirement income deduction and using the federal guidelines for determining the taxable portion of social security benefits while increasing the standard deduction and personal exemption for all individuals. These measures would afford protection to the poor elderly as well as the poor population in general.

- The growth and importance of the individual income tax presents a cause for concern. The state relies heavily on the income tax, but the elasticity of the tax has decreased somewhat over the last decade. Much of the natural growth has been used up since the majority of individuals are in the highest tax bracket and the state has afforded retirement income increased exemptions. Policy makers should address whether a stable source that grows predictably with income is desired, or is it time to increase elasticity to ensure continued long-term growth of the individual income tax? If a stable source is desirable, a flat-rate tax would be preferable to the current structure. If increased elasticity is desired, additional brackets could be added or existing brackets widened.

- Currently, none of Georgia's individual income tax system is indexed for inflation. This lack of indexation results each year in additional low-income individuals having to pay an income tax even though their inflation-adjusted income may not have increased. The state has made some adjustments through increases in exemptions and deductions, but these adjustments are not done regularly. An annual system of indexing
would decrease political and time cost of adopting reforms every few years. It also serves to protect individuals with relatively low incomes from being subject to income taxation.

- Although not as significant as the first five issues, two other issues should be addressed. First, the state allows individuals who itemize to deduct state income tax paid to Georgia within the calendar year, effectively lowering potential state revenues and decreasing horizontal equity. Second, the state individual income tax system exempts the unearned income of dependents, leading to revenue losses for the state and reducing the horizontal and vertical equity of the system.

POLICY OPTIONS

The report from which this Policy Brief is drawn considers six policy options to address the issues listed above.

- Increase the standard deduction of all filers to the 1996 federal standard deduction level. Anticipated effects: Decrease individual income tax receipts by five percent and lower the tax burdens for all filers.

- Increase the personal exemption for all filers to the 1996 federal levels. Anticipated effects: Decrease individual income tax receipts by 4.5 percent and decrease the tax burden for all filers.

- Increase both the personal exemption and standard deductions to the 1996 federal levels. Anticipated effects: Decrease individual income tax receipts by 9.3 percent and lower the tax burdens for all filers.

- Use Georgia's adjusted gross income (as currently defined by Georgia's Tax Code) but with federal exemptions and deductions and a six percent flat rate for all taxpayers. Anticipated effects: Increase individual income tax receipts by 8.2 percent and decrease the progressivity somewhat, with slightly higher effective income tax rates. This option decreases the current elasticity of the income tax but would simplify the system.

- Eliminate all retirement income exemptions. Anticipated effects: Increase individual income tax receipts by 1.5 percent and increase the tax burdens for most income groups except the very lowest. Over time, this change would increase the elasticity of the tax, relative to the present system.

- Add a seven percent tax bracket at $8,250 for singles, $13,000 for married filing jointly, and $6,550 for head of household filers. Anticipated effects: Increase individual income tax receipts by 12.6 percent, increase the progressivity and elasticity of the system, and increase the tax burden for all but the lowest income groups.

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For a free copy of the study from which this Policy Brief is drawn, or any of the other publications listed, call the Fiscal Research Program at 404/651-0422 or fax us at 404/651-0416.

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The Fiscal Research Program is one of several prominent policy research centers and academic departments housed in the School of Policy Studies. The FRP, directed by Dr. David Sjoquist, provides research and technical assistance in the evaluation and design of state and local fiscal policy, including both tax and expenditure issues. These briefs are published periodically to provide an overview of important public policy issues currently facing the state. For more information on the Fiscal Research Program, contact Jeanie Thomas at 404/651-0518.
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