Fiscal Research Center

Analysis of Selected Options for Tax Reform

Presentation to the Senate Finance Subcommittee on Tax Reform

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Analysis of Selected Options for Tax Reform

**NOTE:**

The analyses presented herein are preliminary and subject to change based on the availability of new data. Estimates with regard to any hypothetical changes to the tax code do not constitute a fiscal note. Any opinions expressed are solely my own and not those of the Fiscal Research Center. Errors and omissions are also solely my own.
Analysis of Selected Options for Tax Reform

Personal Income Tax Reforms

- Reduce the maximum statutory tax rate by:
  - Shifting from a graduated to a flat rate structure and
  - Limiting itemized deductions.
- Offset effective rate increase on income taxed at lower rates under current law by increasing exemptions.
- Estimate revenue-neutral flat rate and rates with modest static revenue losses.
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Other Issues

- Triggers for future income tax rate reductions
- Federal income tax conformity issues
  - Fed/Georgia differences in business tax preferences
- Elimination of the Corporate Net Worth Tax
**Analysis of Selected Options for Tax Reform**

**Corporate Net Worth Tax**

- Applies to all corporations organized or doing business in the state, excluding non-profits and insurance companies separately taxed.
- Filed and paid with Corporate Income Tax.
- Graduated tax based on corporate net worth, with
  - a minimum tax of $10 annually on net worth of up to $10,000 and
  - a maximum tax of $5,000 annually on net worth of more than $22 million.
Corporate Net Worth Tax

- **Annual State Revenues**

  - 3-year Average: $44.3 million
  - 68% pay <$100, 79% pay <$250, and <2% pay $5,000
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Corporate Net Worth Tax

- **Pros:**
  - Serves as a minimum tax on corporations organized or doing business in Georgia.

- **Cons:**
  - Determination of tax requires apportionment of assets as well as sales; CIT use a single sales factor.
  - Increases the cost of doing business, investing, and locating assets in the state.
  - Raises limited revenue; volatile; relatively slow-growing (2.2% p.a. since FY 2010 vs. 6.2% for all taxes). 
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Federal Income Tax Conformity Issues

- IRC Section 179 expensing of capital investment:
  - TY 2013, 28 states fully-conformed, 2 partially, incl. GA.
  - TY 2015 and beyond subject to passage of “extenders” bill in Congress and GA conformity bill. Otherwise reverts to $25k limit and phase-out beginning at $200k.
  - State revenue effect is a shift in timing rather than permanent; expensing now reduces depreciation later.
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Federal Income Tax Conformity Issues

- IRC Section 168(k) bonus depreciation:
  - TY 2013, 12 states fully-conformed, 10 partially. GA has never conformed.
  - Federal status also subject to extenders bill passage.
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Federal Income Tax Conformity Issues

- IRC Section 199 deduction for domestic production activities:
  - Permanent federal tax break for US manufacturers.
  - Deduction currently equal to 9% of the lesser of i) taxable income or ii) qualified production activity income.
  - TY 2013, 20 states fully-conformed, 2 partially. GA has never conformed.
  - Add-back to federal AGI on GA personal income tax returns for TY 2013 totaled approx. $188 million.
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**Personal Income Tax Reforms**

- Replace graduated rate structure with flat rate.
- Limit itemized deductions by allowing only mortgage interest ($ capped), charitable contributions, and medical expenses.
- Increase personal and dependent exemptions.
- Estimate revenue-neutral parameters that minimize distributional impacts.
- Estimate flat rates corresponding to static revenue losses of $100-300 million.
Who itemizes deductions?

- % Itemizers
- Mean ID (right scale)
- Median ID (right scale)

Income Group Thresholds (5% of taxpayers per group, $ thous.)

- $50,000
- $45,000
- $40,000
- $35,000
- $30,000
- $25,000
- $20,000
- $15,000
- $10,000
- $5,000
- $0
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Personal Income Tax Reforms

- All federal deductions

Federal Itemized Deductions

Income Group Thresholds (5% of taxpayers per group, $ thous.)
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Personal Income Tax Reforms

- Mortgage interest deductions

Total Mortgage Interest

![Graph showing total mortgage interest by income group thresholds.](image)
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Personal Income Tax Reforms

- Charitable deductions

Total Charitable Deductions

Income Group Thresholds (5% of taxpayers per group, $ thous.)

- 95th Pctl
- 5th Pctl
* Median
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Personal Income Tax Reforms

- Medical deductions

Total Medical Deductions

Income Group Thresholds (5% of taxpayers per group, $ thous.)
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Personal Income Tax Reforms

- Revenue- and distributionally-neutral parameters (roughly):
  - Mortgage interest deduction limit = $20,000
  - Personal/dependent exemptions increase = $2,000 (added to current $2,700 or $3,700 personal, and $3,000 dependent exemptions)
  - Flat tax rate = 5.50%
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Personal Income Tax Reforms

- Limited mortgage interest deductions

Limited Mortgage Interest

Income Group Thresholds (5% of taxpayers per group, $ thous.)
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Personal Income Tax Reforms

- “Neutral” 5.50% case change in tax liability
  - All taxpayers mean change: $0.18; median: $0
  - Share up $10+: 31%; down $10+: 41%

Evaluating the Economic and Fiscal Landscape of Georgia
### Analysis of Selected Options for Tax Reform

**Personal Income Tax Reforms**

- Alternate cases change in tax liability

<table>
<thead>
<tr>
<th>Flat Rate:</th>
<th>5.50%</th>
<th>5.40%</th>
<th>5.30%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean Tax Change</td>
<td>$0</td>
<td>($33)</td>
<td>($66)</td>
</tr>
<tr>
<td>Median Tax Change</td>
<td>$0</td>
<td>($0)</td>
<td>($9)</td>
</tr>
<tr>
<td>% up $10+</td>
<td>31%</td>
<td>26%</td>
<td>23%</td>
</tr>
<tr>
<td>% down $10+</td>
<td>41%</td>
<td>46%</td>
<td>50%</td>
</tr>
<tr>
<td>Est’d Revenue Loss (TY2014, $ millions)</td>
<td>0.01%</td>
<td>-1.9%</td>
<td>-3.8%</td>
</tr>
</tbody>
</table>
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Personal Income Tax Reforms

- Alternate cases change in tax liability (means)

![Graph showing tax liability changes for different income groups and tax rates.](image)
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Personal Income Tax Reforms

- Alternate cases change in tax liability (medians)

![Graph showing change in tax liability for different income groups.](image)

- Median @ 5.50%
- Median @ 5.40%
- Median @ 5.30%

Income Group Thresholds (5% of taxpayers per group, $ thous.): $0, $3.6, $7.0, $9.9, $12.4, $14.8, $17.3, $20.1, $23.4, $26.8, $31.2, $35.6, $41.2, $47.9, $55.9, $65.4, $76.7, $92.3, $114.9, $156.9
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Personal Income Tax Reforms

- Alternate cases Average Effective Tax Rates (AETR)
  Tax Net of Credits / Total Income

![Graph showing Average Effective Tax Rates](image-url)
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Personal Income Tax Reforms

- Shares of taxpayers paying at least $10 more (Up) or $10 less (Down) versus current law:

![Bar Chart](chart.png)

- 5.50%

Income Group Thresholds (5% of taxpayers per group, $ thous.)
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Personal Income Tax Reforms

- Shares of taxpayers paying at least $10 more (Up) or $10 less (Down) versus current law:

5.30%

Income Group Thresholds (5% of taxpayers per group, $ thous.)
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Triggers for Further Flat Rate Reductions

- FY 2016 Budget: Long Term Outlook

<table>
<thead>
<tr>
<th>($ millions)</th>
<th>FY 2016</th>
<th>FY 2017</th>
<th>FY 2018</th>
<th>FY 2019</th>
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</thead>
<tbody>
<tr>
<td>Projected Expenditures</td>
<td>$20,663</td>
<td>$21,402</td>
<td>$22,089</td>
<td>$22,765</td>
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<tr>
<td>Most Likely Revenue Estimate</td>
<td>$20,663</td>
<td>$21,550</td>
<td>$22,458</td>
<td>$23,378</td>
</tr>
</tbody>
</table>

- Revenue goals, increasing over time with needs
- Rainy day fund goals
- How to address recessionary declines?
  - PIT revenues declined by $1.8 billion from FY 2008 to FY 2010, total tax collections by $3.3 billion.