

Arise Income Tax Reform Plan 2000

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In the past 15 years, forty of the 41 states that collect income tax have taken significant steps to reduce the tax burden on families with poverty-level incomes. For example, eleven states created an Earned Income Tax Credit, and at least one more will do so in 2000. All but five have adjusted the rules so that working families on very low incomes are completely exempt from income tax.

Alabama is the exception. With the lowest tax threshold in the country \$4,600 for a family of four and the second-highest tax rate on poverty-level incomes, Alabama continues to tax poor families deeper into poverty.

Need for reform

The need for comprehensive reform in Alabama has been apparent for a long time. Yet broad-based reform efforts involving income, property, and sales taxes have failed to pass the Legislature. Top state leaders are reluctant to try this approach again in 2000.

Arise's Income Tax Reform Plan represents a change in strategy. Instead of overhauling the entire tax structure, this plan would change just one tax at a time. The aim is to improve fairness with a simple plan while making progress toward the long-term goal of comprehensive reform.

In the current political climate, any tax

Arise's Income Tax Reform Plan for 2000

- ! Raises personal exemption to \$2,800 per adult
- ! Raises dependent deduction to \$2,800 per child
- ! Raises standard deduction to \$7,350 per couple
- ! Creates an Alabama Earned Income Tax Credit (EITC)
- ! Repeals deduction for federal income tax paid
- ! Revenue neutral: No increase in tax revenue

plan must be revenue-neutral to win support from state leaders. That is, it must be designed not to increase tax revenue overall. Arise's plan meets this condition.

Deduction for federal income tax paid

The plan is simple: Eliminate Alabama's most extravagant tax break for wealthy taxpayers, and use the savings to benefit poor and middle-class families.

The result: Fairer taxation *without* an overall increase in taxes.

Alabama's most extravagant tax break is the deduction of federal personal income taxes from state taxable income. The wealthiest 1% of Alabama taxpayers receive 32% of the benefits from this tax break, while an 80% majority must share less than 22% of the benefits. It costs the state about \$450 million in lost revenue.

Arise's plan eliminates this tax break and uses the savings to pay for higher tax exemptions and an Alabama Earned Income Tax Credit.

Higher exemptions

Most states use standard deductions and exemptions to exclude a basic amount of income from taxation. This is especially important to low-income taxpayers, to whom this small amount may be a large share of income. But in Alabama these exclusions are all comparatively low.

The **standard deduction**, used by taxpayers who don't itemize deductions, is well below average. Moreover, because the standard deduction is a capped percentage of income, an estimated 15% of Alabama's poorest taxpayers do not receive the maximum benefit from it. Arise's plan sets the standard deduction for married couples at a fixed \$7,350 and nearly twice the current \$4,000 maximum. Single heads of households will be able to exempt \$6,450; other single payers will be able to exempt \$4,400.

The **personal exemption** of \$1,500 was set when the income tax was adopted in 1933. Arise's plan nearly doubles the personal exemption to \$2,800, the same as the federal level.

The **dependent deduction**, also unchanged since 1933, is the lowest in the country at \$300. Arise's plan raises it to the federal level, \$2,800.

Earned Income Tax Credit

What will this plan accomplish?

- ! It will raise the income tax threshold for a family of four from \$4,600 to \$23,900 and one of the 10 best in America
- ! It will create a poverty-fighting earned income tax credit for Alabama
- ! It will cut taxes for 70 % of households that pay income tax
- ! It will raise income tax only on the wealthiest 30%

Arise-s plan also creates an Alabama Earned Income Tax Credit (EITC) set at 15% of the federal level.

President Ronald Reagan called the EITC the best anti-poverty, the best pro-family, the best job creation measure to come out of Congress. Conservatives and liberals unite in supporting the federal EITC, which has been proven to help poor families earn their way out of poverty. The EITC provides an incentive to work, by adding to low wages rather than subtracting from them.

Alabama Deductions for a Family of Four

Of the 41 states with an income tax, eleven also provide a state Earned Income Tax Credit. That number is growing: The Missouri legislature is considering an EITC proposal, and the Republican governor of New Jersey has already budgeted a new state EITC. Like Arise-s plan, it's set at 10% of the federal EITC.

Critics have complained in the past that the federal EITC program has a high rate of fraud. But the number of claims going to unqualified applicants has been steadily declining for over a decade. Alabama will benefit from the experience of other states in guarding against fraudulent claims and administrative errors.

In any case, the low cost of fraudulent or mishandled claims is more than offset by the benefit of helping over 400,000 taxpayers to keep working, earning, spending, and saving in Alabama.

Results

Once Arise-s Income Tax Reform Plan is passed, it will go before the voters for their approval. Once it takes effect, this reform will bring about a number of benefits:

Instead of having the lowest income tax

threshold in the country (\$4,600 for a family of four), Alabama will have one of the 10 best. A family of three will start paying income tax at \$21,300 a year. A family of four will start paying at \$23,900.

Over two-thirds of Alabamians who file income taxes will pay less than they do now. For example:

- ! A family of four with an income of \$42,000 will pay \$422 less.
- ! A family of four making \$65,000 will also pay less. The amount will vary depending on the family's other deductions and credits.
- ! Only the top 1% (those making over \$238,000 a year) will pay substantially more. But this increase will be significantly offset by a reduction in federal tax liability, because state income tax payments can be deducted on federal tax returns.

Arise-s plan will lower the total state and local tax burden on the poorest fifth of households, from about 11.5% of their incomes to 9.7%. It increases total state and local taxes on the top 1% of households from about 3.6% to 4.3% of income.

This plan will not solve Alabama-s tax problems. Overall, the state will continue to tax poor and middle-class families more heavily than the rich. Comprehensive tax reform will take more time, more effort, and more public involvement. But we have to start somewhere. Arise-s Income Tax Reform Plan is an important first step.

Two parents, annual income \$42,000	
Deduction	Current
	system
Federal tax paid	\$2,518
Personal exemption	3,000
Dependent deduction	600
Standard deduction	<u>4,000</u>
Total deductions	\$10,118
Alabama income tax	\$1,514
Result: A \$422 tax reduction under Arise plan	

For a copy of AA Plan for Progressive Tax Reform in Alabama by The Institute on Taxation and Economic Policy, visit www.itepnet.org, visit Arise-s website, or contact Arise at: