

Two New Tax Brackets for High-Income Households Would Limit State Economic Damage

Louisiana is in the midst of a crisis of historic proportions. Public needs are growing and the resources it takes to meet them have shrunk. To solve this crisis—to get Louisiana's budget out of the ditch—without further damaging institutions and reducing services critical to the state's future growth, will take more than a cuts-only strategy. Instead we need a more balanced approach, one that includes additional sources of revenues. This Research Note is the second in a series of revenue proposals aimed at helping Louisiana solve its problems in a responsible way that promotes job-creation and future prosperity.

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One of the most effective ways state fiscal policy can support the economy's recovery is to limit cuts to crucial investments that promote prosperity for all Louisianans. One way to do this is by raising income taxes for the state's highest-income households. Creating new income tax rates and brackets for the highest earners in Louisiana will do less damage than the significant additional service cuts that otherwise would be imposed. That's because high-income people spend more of their income out-of-state and much of the money high-income people will use to pay these taxes will come from their savings—money that is not now helping the state economy. These funds, when taxed, will flow into the state economy as it is spent on services, contracts with private vendors, and paychecks for police officers, teachers, and other essential public workers.

As Nobel Prize winning economist Joseph Stiglitz and Peter Orszag, former Director of the Office of Management and Budget, have written:

“Compared to lower-income families, higher-income families . . . have much lower propensities to consume *local* goods, both because they have lower propensities to consume overall and because locally produced goods constitute a smaller share of what they purchase. A tax increase concentrated on higher-income families thus is likely to have a smaller adverse impact on the state economy than other budget balancing alternatives. . . .

“The conclusion is that, if anything, tax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run. Reductions in government spending on goods and services, or reductions in transfer payments to lower-income families, are likely to be more damaging to the economy in the short run than tax increases focused on higher-income families.”¹

In the past three years, ten states—California, Connecticut, Delaware, Hawaii, Maryland, New Jersey, New York, North Carolina, Oregon, and Wisconsin—have taken the responsible course of limiting spending cuts by creating new tax brackets or raising rates for the highest-income households.

Sustaining as much as possible Louisiana's investments in the education and health of our people and in the safety of our communities is also smart for another reason: these investments pay off for everyone in Louisiana in the long run, through a more productive future workforce that is attractive to businesses, higher incomes, and stronger economic growth.

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Finally, cutting public services hurts most those who are vulnerable in an economic downturn. The more than 750,000 residents in Louisiana who live in poverty—people who are disproportionately African-American—will be more adversely affected by cuts to education, health care, public safety, and other social services than those at the other end of the income scale. Moreover, because high-income people in Louisiana pay a smaller share of their income in overall state and local taxes than do low-income people, increasing income taxes for well-off households will make the state’s tax system somewhat more equitable.

Louisiana’s state income tax has three brackets, with rates of 2 percent, 4 percent, and 6 percent. The highest rate—6 percent—applies only to taxable income over \$100,000 a year for joint filers and over \$50,000 for single individuals. The proposed system would raise \$186 million more a year for Louisiana’s public needs by adding the following two brackets:

- A 7.5 percent rate on taxable income between \$150,000 and \$200,000 for joint filers and between \$75,000 and \$100,000 for single individuals.
- An 8 percent rate on income greater than \$200,000 for joint filers and \$100,000 for single individuals.

Table 1, below, shows how the revised rate system would affect taxpayers.

Table 1					
Louisiana Tax Brackets With Proposed Changes					
Personal Income Tax Rate	2%	4%	6%	7.5%	8%
Singles	\$1 – \$12,500	\$12,501 – \$50,000	\$50,001 – \$75,000	\$75,001 – \$100,000	Over \$100,000
Married Filing Jointly	\$1 – \$25,000	\$25,001 – \$100,000	\$100,001 – \$150,000	\$150,001 – \$200,000	Over \$200,000

Sixteen states have more than three income brackets *and* higher tax rates for upper income taxpayers than Louisiana.² In addition, because of the way the brackets are structured, Louisiana is one of just 13 states in which some families below the federal poverty line are still liable for income taxes.³

The new revenue raised through this change would come from upper-income taxpayers—those with incomes over \$170,000 (Table 2). The vast majority (96 percent) of Louisianans would see no increase in their state income taxes.⁴ Families making between \$86,000 and \$170,000, who make on average \$116,000 per year, would pay an average of only \$13 more annually. Over 98 percent of the new money raised would be paid by those making over \$170,000 per year—those who benefited most from the recent extension of the 2001 and 2003 Bush tax cuts.)

Table 2							
Analysis of Adding Two Income Tax Rates and Brackets							
	Lowest 20% Less Than \$16,000	Second 20% \$16,000 - \$31,000	Middle 20% \$31,000 - \$49,000	Fourth 20% \$49,000 - \$86,000	Next 15% \$86,000 - \$170,000	Next 4% \$170,000 - \$433,000	Top 1% \$433,000 Or More
Average Income in Group	\$11,000	\$23,000	\$40,000	\$64,000	\$116,000	\$243,000	\$1,150,000
New Tax as a % of Income	0	0	0	0	+ 0.0%	+ 0.1%	+ 0.7%
Average State Tax Change	0	0	0	0	+ \$13	+ \$284	+ \$8,400
Percent of Revenue Generated	0	0	0	0	2%	12%	86%
Percent with Tax Hike	0	0	0	0	9%	45%	95%

For even the relatively small number of Louisianans who would pay significantly higher taxes—those in the top 1 percent of income, a major portion of that increase—over 10 percent on average—would in effect be subsidized by the federal government. This is because most of the affected taxpayers deduct state income taxes from their federal returns. In 2008, for example, 89 percent of Louisiana tax returns reporting incomes of \$200,000 or more itemized deductions for their state income taxes. According to an analysis done for the Louisiana Budget Project by the Institute on Taxation and Economic Policy, the new tax rates and brackets would result in a \$20 million offset in federal income taxes for state taxpayers. Thus, of the \$186 million that the state would raise by adding these two new brackets, the federal government would pay \$20 million and taxpayers \$166 million.

These changes would have a minimal impact on taxpayers with the greatest ability to afford a tax increase. Households making over \$1 million per year on average (over 20 times the median income of \$42,167 in Louisiana) would contribute an additional 0.7 percent of their yearly income, an average of \$8,400 per year. The impact is even smaller for families that bring home between \$170,000 and \$433,000 annually. On average, these households would owe an additional \$284 in state taxes, which is only 0.1 percent of the average income in this category. These are the same households that benefitted most from the repeal of the Stelly Plan in 2007 and 2008, the largest state tax cuts in Louisiana history and a significant cause of the state's current fiscal crisis.

Adding these additional tax brackets provides a more balanced approach to resolving Louisiana fiscal crisis than relying on spending cuts alone and:

- Avoids further weakening its economy through spending cuts, just as the nation emerges from the deepest recession since the Great Depression.
- Does less damage than cutting services that create a healthier, more educated workforce that attracts new businesses and encourages existing businesses to expand.
- Provides \$186 million annually in new revenue to help close the projected \$1.6 billion deficit.

A fiscal crisis is an excellent opportunity to reform the tax structure into one that is fairer and provides a more stable and reliable source of revenue to fund vital state programs. Adding two income tax rates and brackets to upper-income taxpayers would be a good start.

Previous Research Notes in series

Itemized Deduction for State and Local Income Taxes Costs Money We Can't Afford to Lose

<http://www.labudget.org/lbp/wp-content/uploads/2011/03/Itemized-Deduction-for-State-and-Local-Income-Taxes.FINAL.pdf>

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About the Louisiana Budget Project

The Louisiana Budget Project (LBP) provides independent, nonpartisan research and analysis of Louisiana fiscal issues and their impact on Louisiana families and businesses. We seek to bring wider prosperity to Louisiana through a deeper understanding of the state budget, broadening fiscal policy debates, and increasing public participation in decision-making. As part of the State Fiscal Analysis Initiative's 40 state budget projects that are coordinated by the national Center on Budget and Policy Priorities, we uphold a commitment to issuing work that is Credible, Timely, and Accessible.

End Notes

¹ Orszag, Peter, and Joseph Stiglitz. "Budget Cuts vs. Tax Increases at the State Level: Is One More Counter Productive than the Other During a Recession?" *Center on Budget and Policy Priorities*. November 6, 2001.
<http://www.cbpp.org/archiveSite/10-30-01sfp.pdf>

² "The ITEP Guide to Fair State and Local Taxes." *Institute on Taxation and Economic Policy*. March 2011.
http://itepnet.org/state_reports/guide2011.php

³ Oliff, Phil and Ashali Singham. "The Impact of State Income Taxes on Low-Income Families in 2009." *Center on Budget and Policy Priorities*. April, 2010.
<http://www.cbpp.org/files/4-29-10sfp2.pdf>

⁴ "Table 2. Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2008, Louisiana." *Internal Revenue Service*.
<http://www.irs.gov/taxstats/article/0,,id=171535,00.html>