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Revised February 14, 2008

STATE LOW-INCOME TAX RELIEF IN THE ABSENCE OF AN INCOME TAX

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Most states target tax relief to low- and moderate-income households. In part, this is because without such relief, state and local taxes would absorb a much larger share of the income of poor and near-poor families than of families at higher income levels. This is particularly true in states that do not use a personal income tax, because they rely more heavily on sales, excise and property taxes. The regressivity of state taxes — the higher burden on lower-income households — can add to the difficulty lower-income earners have in supporting their families.

In states without an income tax, however, the task of targeting tax relief becomes somewhat more difficult because there is no readily available mechanism to measure who should receive relief. Nor is there necessarily an existing administrative structure for delivering the tax relief. Nevertheless, the lack of an income tax is not a bar to providing effective, targeted relief from property tax or sales tax burdens.

- A number of states without income taxes operate tax relief programs that are targeted on low-income households or particular types of residents. South Dakota, Tennessee, Nevada and Wyoming are examples.
- In addition, a number of states that do levy an income tax also deliver their targeted tax relief without using the income tax as a delivery mechanism. In particular, many of the states that offer income-related property tax relief administer that relief *outside* of any personal income tax system.

This report briefly reviews avenues states are using to deliver targeted tax relief to individuals outside of an income tax. It highlights two innovations in particular: South Dakota's existing approach to food sales tax refunds, and the possibility (not yet adopted by any state) of creating a state Earned Income Tax Credit separate from an income tax. Some of the key points that emerge from surveying the administration of state relief programs are:

Among states that do have income taxes, many administer low-income tax relief programs outside of their income taxes. In some cases, this may occur because they use different definitions of income for their tax relief programs. While income such as welfare, SSI, Social Security, pensions, workers compensation, or child support may not be included in income for purposes of a state's income tax, most states include such types of income in determining eligibility for tax relief when that relief is administered outside of an income tax.

Most states with income taxes exempt families with below-poverty income; in such states, many or most of the families who would be eligible for a property tax rebate or sales tax credit are not required to file state income tax returns. Thus, the advantage of using the income tax may be less than it first appears to be.

Verification is possible even if a credit or rebate is not administered through an income tax. Some states that administer their low-income tax relief programs outside of an income tax require applicants to submit their *federal* income tax return, if any, with the application. Some require other documentation of income as well. Other states rely on self-certification.

Some states provide applicants with relief in forms other than a cash rebate. Some states provide a direct reduction on the property tax bill for homeowners whose applications have been approved. Others provide certificates that homeowners can remit in payment of property taxes. This principle could be further extended to provide certificates or vouchers that recipients could use to pay rent; the vouchers could then be used by landlords to pay property taxes. South Dakota uses a debit card system to transfer sales tax relief electronically.

No matter what the delivery mechanism, there are two basic features that must be present for a program to be successful in relieving tax burdens of low-income populations.

- A tax relief program must be coupled with an aggressive outreach program.
- A tax relief program must provide sufficient relief to make it "worth the while" of the potential applicant to go through the application procedure.

In addition, to continue to be effective over time, income limits for eligibility should be indexed for inflation.

Examples of State Tax Relief Programs That Are Independent of State Income Taxes

A number of states provide property tax relief specifically targeted to low- and moderate-income families. These programs may rebate or forgive a portion of the property tax that exceeds a given percentage of a family's income, or they may simply provide relief as a percentage of income that declines as a family's income increases.

Despite the close tie between income and the amount of property tax relief provided to families under these programs, many states have chosen to administer them separately from their income taxes. The following are examples of states with and without income taxes that independently administer income-related property tax relief programs.

Examples in States with an Income Tax

Illinois - Illinois' property tax circuit breaker for the elderly and disabled has an application procedure that is completely separate from its state income tax. The four-page form asks for information about income (defined more broadly than for the income tax) and property tax or rent paid. It does not require any documents to verify income. Relief is provided as a rebate.

A program that pays a portion of pharmaceutical costs for low-income elderly and disabled residents is administered through the same form.

Kansas - Kansas provides low-income property tax relief to homeowners and renters who are over age 55, have dependent children under age 18, or are disabled. A broad definition of income, including welfare payments, disability benefits, and SSI is used. Kansas requests (but does not insist) that applicants attach a copy of their *federal* income tax return.

Claimants have a choice of receiving a refund check or of crediting their rebate directly to their property tax bills.

Maryland- Maryland has a homeowners' property tax credit and a renters' tax credit, both of which operate outside of the income tax framework.

The homeowners' credit is available to all homeowners, regardless of age, with income below $60,000 for whom property taxes exceed specified proportions of income. Maryland requires applicants to attach a copy of their federal income tax return if they file one, and Social Security recipients must attach a copy of their benefit statement.

Depending on the timing of the submission and processing of the form, homeowners may receive a credit on their property tax bill, a certificate that may be used towards payment of their property tax bill, or a refund of taxes already paid.

Eligibility for the Maryland renters' tax credit is limited to families with children under age 18 who do not receive federal or state housing assistance, and elderly and disabled renters. Recipients must also meet certain income requirements. Renters receive their tax relief as a rebate.

Examples in States without an Income Tax

South Dakota – In addition to the Sales Tax on Food Refund Program (described below), South Dakota administers a refund program for low-income elderly and disabled residents intended to offset the effect of sales taxes, property taxes, or both. Applicants must provide a copy of their federal tax return, proof of residency, and proof of age if they are applying based upon age. As in other states, a much broader definition of income is used for determining qualification for the refund than for federal income tax purposes; for refund purposes, residents must count income derived from Social Security, SSI, and other sources.

Wyoming- Wyoming, another state without an income tax, administers a combined rebate to relieve the burden of the sales and use tax, the property tax and utility or energy costs for low-income elderly or disabled residents

Nevada- Nevada has a property tax refund for elderly low income homeowners and renters. Residents receive their relief as a rebate check.

Tennessee-Low-income elderly or disabled Tennessee residents may receive a reimbursement from the state for 25 percent of property taxes paid on the first $25,000 of the market value of their property.

South Dakota's Sales Tax on Food Refund Program: An Alternative Model for Low-Income Tax Relief

South Dakota is an instructive example of a state without an income tax that provides targeted tax relief to low income families because it uses multiple mechanisms to deliver that relief. In addition to the property tax/sales tax refund described above, the state provides a refund to low-income families to offset the regressivity of South Dakota's sales tax on food. This Sales Tax on Food Refund Program administers tax relief in an unconventional way: through the state's Electronic Benefit Transfer System.

Eligibility rules and application procedures for the program are straightforward. For a household to receive a refund under the program, that household must have gross income at or below 150 percent of the federal poverty level. (The federal poverty line varies by family size and is adjusted each year for inflation; 150 percent of the federal poverty line for a family of four in 2007, for example, was $30,975). Eligible households must submit an application detailing their gross income for the last three months. The application requires that applicants provide a social security number, but does not require them to submit proof of income. Applicants can receive applications at local Department of Social Services offices, or online, or can call a toll free number to receive applications by mail. Food stamp recipients are automatically enrolled. To continue to receive their refund households must fill out a form every quarter stating whether they have experienced any changes to their income or family size.

The refund is issued quarterly and is based on an estimate of how much sales tax a household spent on food during the quarterly period (using a tax rate of 5.9 percent). Rather than require households to submit receipts for the cost of their food, the state assumes that all households eligible for the rebate spend an amount equal to U.S. Department of Agriculture's Thrifty Food Plan (TFP). The TFP is USDA's estimate of what a low-cost nutritious diet costs on a monthly basis.[1] It is also used to determine the maximum food stamp benefit. For the period spanning July through December of 2007 the average quarterly rebate paid under the program was approximately $25. Households eligible for a refund amount equal to $10 or less all receive a minimum rebate of $10. Table 1 shows the maximum quarterly refund that families of various sizes are eligible to receive.

TABLE 1: Maximum Sales Tax on Food Refund	
Household Size	Maximum Quarterly Refund
1 Person	$27
2 People	$50
3 People	$71
4 People	$90
5 People	$107
6 People	$129

When the state calculates the amount that households receiving food stamps spend on food, it subtracts their monthly food stamp benefit from the TFP. This is because households do not pay sales tax on purchases made with food stamps.

South Dakota's refund program is unique because the refund may only be used to purchase food. The argument for limiting the refund to a food benefit is that it is replacing low-income households' food purchasing power lost to the sales tax. The state is able to achieve this limitation by providing the refund via the same mechanism through which it issues food stamp benefits – an electronic benefit card. Each quarter the state

[1] For more on the Thrifty Food Plan, see "Thrifty Food Plan, 2006", Center for Nutrition Policy and Promotion, USDA at http://www.cnpp.usda.gov/Publications/FoodPlans/MiscPubs/TFP2006Report.pdf
and for information on the historic cost of the TFP see: http://www.cnpp.usda.gov/USDAFoodCost-Home.htm

deposits recipients' food tax refunds into an Electronic Benefit Transfer (EBT) account, which is a state-administered bank account used to provide certain benefits.

South Dakota has undertaken a number of measures to maximize program participation. When the program was initiated in 2004, the Department of Social Services conducted a major outreach campaign to spread awareness of the program. The state has also enlisted the help of grocers to inform the public about the refund. From July 2006 through June 2007 approximately 38,334 households or slightly over half of all eligible households participated in the program.

South Dakota's model could easily be applied in other states. Every state currently uses an Electronic Benefit Transfer system to administer its food stamp program. EBT benefits can be limited to food purchases or they can be provided as cash. It would not be particularly complex or expensive for other states to follow the South Dakota example and provide refunds or other tax relief to low income households through Electronic Benefit Transfer accounts—either in cash or as a food voucher.

The Earned Income Tax Credit: An Additional Idea for Low Income Relief in the Absence of an Income Tax

The federal EITC is a credit for low-income families with children that have earnings from work. In states with income taxes, piggybacking on the federal Earned Income Tax Credit with a state EITC can be one of the most effective ways to reach low-income households. Twenty-three states (including the District of Columbia) maintain state EITCs that are administered as a percentage of the federal credit. In just the past year, four states enacted new state EITCs.

No state without an income tax has yet enacted a state EITC that piggybacks on the federal EITC. There is no reason, however, why a state could not make a direct tax relief payment to residents that is a percentage of the federal credit, using a copy of the federal form. Indeed, the EITC model has a number of characteristics that make it well suited to delivering low-income relief in the absence of an income tax.

- A state EITC is easy to calculate; it can be simply a flat percentage of a recipient's federal credit.
- The state can get from the IRS a list of households that have claimed the federal credit and are therefore eligible for the state credit. The IRS checks eligibility, relieving the state of the need to do so.
- The IRS can also provide a list of addresses for in-state recipients of the federal EITC, facilitating the state's outreach efforts.
- Those who are eligible for and claim the federal EITC would already have completed federal tax forms and could submit copies of those forms to confirm their eligibility.
- The paperwork would be minimal. Families would simply need to confirm their residency within the state.

- A high percentage of eligible families claim the federal EITC; in almost all states there are active outreach campaigns to encourage people to file for the credit. As a result the percentage of eligible families who claim state EITCs tends to be substantially higher than the participation rate for other forms of state rebates.

Given the well-documented success of the federal EITC in encouraging work and alleviating poverty and its administrative flexibility, it is a compelling additional option for states seeking to provide low income tax relief in the absence of an income tax.[2]

[2] For more information about how such an EITC might work see the Washington State Budget and Policy Center's policy brief "A Working Families Credit for Washington State" at http://www.budgetandpolicy.org/WorkingFamiliesCredit.htm