State Income Tax Burdens on Low-Income Families in 1999

Center on Budget and Policy Priorities
March 2000

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March 2000

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Acknowledgments

The authors wish to thank Center on Budget and Policy Priorities staff members Iris J. Lav and Michael Mazerov and Center interns Daniel Tenny and Susan Di Filippo, who contributed to the development of this report. We also thank Ann Miles-Brown and Wendy Burnette, who prepared the document for publication.

This report is an expansion and continuation of earlier Center publications on income tax thresholds. It builds on the work of Center staff members Alan Berube, Ed Lazere and Michael Mazerov and former Center staff members Carol E. Cohen, Christina Smith Fitzpatrick and Richard B. May, who co-wrote previous editions of this report, and of former Center staff member Frederick Hutchinson, who performed the Center's earlier analysis of this data.

The Center is grateful to the Ford Foundation, the Annie E. Casey Foundation, and the Charles Stewart Mott Foundation for their designated support of the Center's State Fiscal Project. Their support makes this work possible.

The authors are solely responsible for the contents of this report.

I. Summary

A growing number of states have chosen to exempt poor families from the income tax. As recently as 1996, the majority of states with income taxes levied income taxes on families of three or four with poverty-level incomes. Now the reverse is true: a majority of states *exempt* such families from their income taxes. And among those states that continue to tax the poor, many have reduced the burden of those taxes.

For tax year 1999, 22 of the 42 states with income taxes exempt from taxation the income of a married couple with two children with income at or below the poverty line; the number of states exempting such poor families has risen from 18 to 22 in the last three years. An even larger number of states — 24 states — exempt from taxation the income of a working single parent with two children with income at or below the poverty line.[1]

Twenty states in 1999 continue to levy income tax on poor families of four; 18 states continue to levy income tax on poor families of three. Many of these states in the last three years substantially increased the income level at which income tax is first owed and thereby reduced taxes on the poor. Nonetheless, income taxes on the poor in many states remain quite high. Moreover, 32 of the 42 states still tax the near-poor — families with incomes just above the poverty line.

At a time when states are urging more families to make the transition from welfare to work, progress in relieving state income tax burdens can be an integral part of that policy agenda.

[1] The District of Columbia is treated as a state in this report. The two states that tax only interest and dividends (New Hampshire and Tennessee) are not included among the 42 states with income taxes for purposes of this report.

Eliminating all or most state income taxes on working families with poverty-level incomes results in a boost in take-home pay that helps offset higher child care and transportation costs that families incur as they strive to become economically self-sufficient. In other words, relieving state income tax burdens on poor families is making a meaningful contribution toward "making work pay."

Many welfare recipients that take jobs continue to have very low incomes, often below poverty. Recent evidence from several states shows that although most welfare recipients who find jobs are employed close to full-time, many of them earn wages at or only slightly above the minimum wage. Moreover, many do not qualify for paid vacation or sick leave, forcing them to take unpaid leave for reasons such as a child's illness. A number of studies show that welfare recipients who find jobs have average earnings of $2,000 to $3,000 per quarter, or $8,000 to $12,000 per year; many earn less.[2] By comparison, the poverty line for a family of three in 1999 was $13,290; for a family of four, it was $17,028.

Relieving income taxes is one of the simplest ways states can help working families with low earnings. And a growing number of states that do not tax the incomes of the poor are taking the further step of providing credits that poor families with no income tax liability may use to offset the cost of other taxes such as sales and excise taxes or property taxes.

States have made more progress toward relieving the income tax burden on poor families in the last three years than they made in the six previous years combined. From 1991 to 1996, the number of states that taxed the incomes of poor families of four did not change, and only six of the states that taxed the poor in 1991 increased their thresholds by amounts greater than the increase in the poverty line during that time. By 1999, however, the number of states taxing the poor declined by four, and another 11 states brought their thresholds closer to the poverty line than they were in 1991. One of those states, Delaware, has enacted legislation that is likely to lift the threshold above the poverty line in the year 2000; another state, New Jersey, is scheduled to raise the threshold above the poverty line in 2001.

Still, progress by no means has been universal. Of the 24 states that taxed the income of some poor families in 1991, 20 continue to tax poor families' incomes in 1999. These states have not taken the opportunity afforded by some eight years of economic recovery and strong fiscal conditions to ameliorate this situation. In fact, nine of those 20 states have allowed their thresholds to decline relative to the poverty line during the 1990s. The poverty line is adjusted each year to reflect the increasing cost of supporting a family, but many states' income tax thresholds are not similarly adjusted.

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[2] These studies are summarized in *Welfare Recipients Who Find Jobs: What Do We Know About Their Employment and Earnings?*, Center on Budget and Policy Priorities, November, 1998; Jack Tweedie, Diana Reichert, and Matt O'Connor, *Tracking Recipients After They Leave Welfare*, National Conference of State Legislatures, 1999; and Sarah Brauner and Pamela Loprest, *Where Are They Now? What States' Studies of People Who Left Welfare Tell Us*, Urban Institute, 1999.

The federal government has long recognized that taxing poor families is counterproductive and unfair. As part of federal tax reform in 1986, virtually all families below the poverty line were relieved of federal income tax liability. It has taken a dozen years for a majority of the states to implement this same policy.

Many of the states that have not yet removed state income taxes from poor families have not made it a priority to do so. Most state economies expanded through the 1990s and most states experienced robust fiscal conditions. As a result, more than 30 states enacted significant personal income tax cuts in the last five years. But many of the states with the largest income tax cuts in recent years chose to cut top tax rates or cut all tax rates in ways that provide a disproportionate benefit to higher-income taxpayers. Eight of the states that have enacted personal income tax rate cuts in recent years still have income tax thresholds below the poverty line — Delaware, Hawaii, Michigan, New Jersey, Ohio, Oklahoma, Oregon, and Utah.[3]

Further tax reductions are under consideration or discussion in many states. Today's generally healthy fiscal conditions provide an opportunity for many more states to remove poor families from the income tax rolls, if they make such action a priority.

Tax Thresholds

This report assesses the impact of each state's income tax on poor families. It focuses on the income tax threshold in each state, which is the income level at which a family would begin to owe state income tax.

- In 22 of 42 states with income taxes, the income tax threshold for a family of four with two children is above the poverty line for tax year 1999.[4] For single-parent families of three, the state income tax threshold is above the poverty line in 24 states. In these states, families with below-poverty income are not required to pay income taxes.

- In the states that do levy income taxes on some poor families, the average income level at which a two-parent family of four begins to owe tax is more than $5,450

[3] New Jersey's threshold for married couples and heads of households will increase to $20,000 in 2001 and, thus, will be above the poverty line. Delaware's threshold for a family of three is above the poverty line; the threshold for a family of four is likely to rise above the poverty line for tax year 2000.

[4] The threshold for a two-parent family of four in one state, North Carolina, nearly equals the poverty line, meaning that a family begins paying tax just when its income reaches the poverty line.

Why Does This Report Focus On the Income Tax — A Tax That is Arguably the Fairest State Tax?

This report focuses on the burden of state income taxes on poor families for several reasons. First, the income tax is a major component of state tax systems, making up 21 percent of total state and local tax revenue nationally. Thus, the design of a state's income tax has major effect on the overall fairness of a state's tax system.

Moreover, it is relatively easy for states to alter their income tax provisions to relieve the burden of the income tax on the poor because information on the taxpayer's income is available at the time the tax is levied. The design of other major taxes makes such efforts much more cumbersome. For example, the sales tax is collected by merchants from consumers without regard to their income level and property taxes are passed through from property owners to renters as part of a rent payment. The income tax, on the other hand, is calculated as a percentage of a taxpayer's total income and thus offers a number of opportunities to reduce directly the burden of taxes on the poor. Indeed, a number of states have chosen to use the income tax code to offset the burden of other taxes.

While there is considerable room for improvement in the design of many states' income taxes, it is important to recognize that whether low-income families are subject to a state's income tax does not necessarily indicate whether a state's overall tax system is relatively fair or unfair to the poor. Indeed, the presence of an income tax in a state's tax system generally serves to lighten the burden of the overall tax system on poor families. The reason is that most states' income taxes, even those that tax the poor, are progressive; that is, income tax payments represent a smaller share of income for low-income families than for high-income families. By contrast, the other primary source of tax revenue for states, the sales tax, is regressive — consuming a larger share of the income of low-income families than of high-income families. Thus, states that rely heavily on taxes other than an income tax tend to place a higher overall tax burden on the poor than on high income families.

However, even in states with income taxes, low-income families often face high marginal tax rates; that is, as a family's income rises up to and beyond the poverty level the combination of higher taxes and the loss of mean-tested benefits may consume a significant share of these increased earnings. The design of the income tax makes it relatively easy for states to moderate those marginal rates by eliminating income taxes on the poor and reducing eliminating taxes on near-poor families.

Exempting poor families from the income tax can improve the progressivity of a state's income tax and the state's overall tax structure without significantly reducing the state's reliance on the income tax. For example, five of the 10 states that received the largest share of state tax revenue from income taxes in 1998 — Maryland, Massachusetts, Minnesota, New York and Wisconsin — exempted poor families of three or four from the income tax.

below the 1999 poverty line of $17,028 for a family of four. For a single-parent family of three, the average tax threshold in these states is more than $3,950 below the poverty line of $13,290.

- Four states — Alabama, Illinois, Kentucky, and Virginia — impose an income tax on very poor families of three or four, those with incomes below half the poverty line. Thirteen states impose an income tax on poor families of three with a worker earning the minimum wage, an income level several thousand dollars below the poverty line.

- The state with the highest threshold is California, where the threshold is $33,700 for a family of three and $35,500 for a family of four — more than twice the poverty lines for families of those sizes and substantially higher than the threshold for any other state. Alabama's threshold of $4,600 for either a family of three or a family of four is the lowest in the nation.

Taxes on Poor Families

The impact of state income tax policy on poor families' budgets can be significant. Levying an income tax on the poor pushes families deeper into poverty, compounding the challenge of making ends meet.

- The average 1999 income tax bill for a family with income at the poverty line in the states with below-poverty thresholds is $219 for a two-parent family of four and $154 for a single parent with two children. The 1999 tax bill is as high as $555 on a family of four (in Kentucky) and $343 on a family of three (in Alabama).

- By contrast, a number of states levied no income tax until a family's income was well above the poverty line.

- Nine states with tax thresholds above the poverty line go even further. These states — Colorado, Kansas, Maryland, Massachusetts, Minnesota, New Mexico, New York, Vermont, and Wisconsin — have state tax credits that provided refunds to low-income families with no tax liability.[5] The refundable credits act as a wage supplement and/or as an offset to the other state and local taxes paid by low-income families. In eight of these states, the refundable credits are state Earned Income Tax Credits that piggy-back on the federal Earned Income Tax Credit. The 1999 refunds provided to families with poverty-level income in these states are as high as $1,222 for a two-parent family of four and $910 for a single parent with two children.

[5] In addition, Georgia and Hawaii offered low-income credits that were refundable and led to a net refund to some families with a minimum wage income. In each state, the credit was not sufficient to fully offset tax liability at a poverty-level income, so families in Georgia and Hawaii with incomes at the poverty line paid state income tax.

Taxes on Near-Poor Families

Many families with earnings just above the poverty line continue to find it difficult to make ends meet. Federal and state governments recognize the challenges faced by low-income families with incomes slightly above the poverty line and have set eligibility levels for some low-income assistance programs such as energy assistance or school lunch subsidies at 125 percent of the poverty line — $16,613 for a family of three and $21,285 for a family of four in 1999 — or higher.

Nevertheless, some 32 states levy income taxes on near-poor families of three or four.

- The average 1999 income tax bill for a family with income at 125 percent of the poverty line in the states that levy such taxes is $332 for a two-parent family of four and $244 for a single parent with two children.

- Four states — Alabama, the District of Columbia, Hawaii, and Kentucky — levy tax of more than $500 on near-poor families of three. Those states plus three others — Arkansas, Oregon, and Virginia — levy income tax of $500 or more on near-poor families of four. The 1999 tax bill is as high as $906 on a family of four (in the District of Columbia) and $552 on a family of three (in Kentucky).

- Ten states — Arizona, California, Colorado, Connecticut, Maryland, Minnesota, New York, Pennsylvania, Rhode Island, and Vermont — have tax thresholds over $22,000 for two-parent families of four, thus eliminating taxes for families with income up to at least 125 percent of the poverty line. Those states plus four others — Iowa, Kansas, Massachusetts, and New Mexico — have thresholds over $17,000 for single-parent families of three, thereby eliminating taxes for families with income up to at least 125 percent of the poverty line.

Tax Relief Strategies

States use a variety of methods to relieve income tax burdens on the poor. States generally choose the strategies that fit best with their overall policies and philosophies of taxation.

- Most of the 22 states that do not tax the working poor for tax year 1999 allow relatively large deductions from income through personal and dependent exemptions and standard deductions. For example, the average combined value of these deductions in the seven states with the highest tax thresholds is higher than the poverty line for families of both three and four.

- Twenty-eight states have adopted measures that specifically target tax relief on low-income families. Due to the limited size of some of these measures, however, some of these states continue to tax poor families.

- Of particular note, 12 states offer credits that relieve taxes and provide tax refunds to some or all families with income below the poverty line.[6] In states where credits exceed the tax liability of poor families, the refunds from these credits are intended to boost the incomes of families with low-wage workers and to offset the burden of other state and local taxes paid by low-income families, primarily sales taxes and property taxes.

Recent Changes in Taxation of Poor Families

Several states have made significant progress in relieving state income tax burdens on low-income families in recent years.

- Major threshold increases in 1999 occurred in several states with income tax thresholds below the poverty line. The largest increases were in Hawaii, which implemented a new low-income credit; Delaware, which increased its standard deduction; and New Jersey, which raised its no-tax floor. Each of those states, however, continues to tax low-income families of four. (New Jersey has enacted legislation that will exempt poor families of three and four from taxation by tax year 2001; changes scheduled to occur in Delaware are likely to exempt poor families in 2001.)

- Among states that already exempted the poor, the biggest 1999 threshold increase was in Colorado, which increased its tax threshold for a family of four by $2,700 in 1999 by enacting an Earned Income Tax Credit.

- From 1998 to 1999, the number of states with below-poverty thresholds for a family of four rose from 19 to 20, as North Carolina's threshold slipped just below the poverty line for a family of four. But the number of states with below-poverty thresholds for a family of three declined from 19 to 18, as Delaware raised its threshold for a family of three above the poverty line.

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[6] The 12 states are Colorado, Georgia, Hawaii, Indiana, Kansas, Maryland, Massachusetts, Minnesota, New Mexico, New York, Vermont, and Wisconsin. In one of those states, Indiana, the income tax threshold remains quite low, below two-thirds of the poverty line. As a result, only very poor families — those with incomes below that threshold — benefit from the availability of the refundable credit.

Changes in Thresholds in the 1990s

Between 1991 and 1999, the dollar amount of the income tax threshold increased in nearly every state. (The exceptions were Alabama, Connecticut and Virginia.) Small changes in the nominal value of a threshold, however, do not necessarily protect a working poor family from taxation. The poverty line is adjusted upward each year as the cost of supporting a family rises. Changes in income tax thresholds must be judged by whether the change has been sufficient to relieve families living in poverty from taxation or to maintain such relief.

- Of the 24 states with below-poverty thresholds for families of four in 1991, 22 states — all but Alabama and Virginia — raised those thresholds between 1991 and 1999. In only four states, however, was the amount of increase large enough to bring the state's threshold above the 1999 poverty line. Kansas, Massachusetts, Pennsylvania, and Iowa were the only states that raised their thresholds enough since 1991 to eliminate income taxes on poor families of four. Eleven states moved their thresholds closer to the poverty line, but did not actually bring the threshold above the poverty line.

- On average, the amount of income tax owed by a family of four with poverty level income declined somewhat since 1994 in the states with below-poverty thresholds in 1991. However, the trend towards lower taxes on poor families was by no means universal. In eight states — Alabama, Arkansas, Kentucky, Louisiana, Montana, Oklahoma, Virginia, and West Virginia — the amount of tax owed by a family of four with poverty level income actually increased between 1994 and 1999.

- States that had already removed poor families of four from their income tax rolls by 1991 were much more likely to target additional income tax relief to near-poor families. These states almost universally increased their thresholds between 1991 and 1999 by amounts greater than the increase in the poverty line over that period. These increases served to provide tax relief to near-poor as well as poor families in these states. The only two states that allowed their income tax thresholds to dip below the poverty line in the mid-1990s, Maine and Mississippi, each again exempted poor working families from the income tax by 1999.

II. State Income Taxes on Poor Families in 1999

The income tax is a major component of state tax systems. Forty-two states levy an individual income tax, and individual income tax revenue makes up 21 percent of total state and local tax revenue nationally. Thus, the design of a state's income tax affects greatly the overall fairness of a state's tax system.

Because the income tax is calculated as a percentage of a taxpayer's income, it is relatively easy to determine both its impact on taxpayers of different income levels and to modify that impact. In general, state income taxes are designed to be at least modestly progressive — that is, to take a smaller share of income from lower-income taxpayers than from higher-income taxpayers. This progressivity results from either a rate structure with higher marginal rates as income rises, deductions or credits that reduce tax liability proportionately more for low-income taxpayers, or a combination of these features.

While all state income tax systems are at least somewhat progressive, each system has a different design. One way that income tax systems differ substantially among states is their treatment of families at the lowest rung of the economic ladder. This report compares the treatment of poor and near-poor taxpayers under each state's income tax structure and suggests ways that this treatment could be improved.

The relatively good fiscal conditions that many states have enjoyed in the last several years has resulted in widespread consideration of tax cuts. This is an opportunity for states to make changes in their income tax provisions that will relieve tax burdens on poor families. Nevertheless, most states with below-poverty thresholds have, thus far, failed to take full advantage of this opportunity.

This analysis is particularly important in light of the policy debates that are occurring in many states this year. Policymakers at the state and federal level, both liberal and conservative, continue to look for ways to make welfare policies more successful in helping families. In light of this focus on work, the impact of state tax policy on low-wage working families has become an important consideration of welfare policy.

Low-income families often face high marginal tax rates; that is, as a family's income rises up to and beyond the poverty level, the combination of higher taxes and the loss of means-tested benefits such as food stamps consumes a significant share of its increased earnings.[7] In addition, the expenses of working, such as child care and transportation, often absorb a large proportion of the earnings of low-income workers. Thus, as part of a larger strategy to "make work pay" for low-wage workers, it is particularly important that state income taxes not be imposed on families whose earnings are below the poverty level.

More than a decade ago, the federal government recognized the inconsistency of encouraging poor families to work and then levying taxes that pushed them deeper into poverty. President Ronald Reagan spoke forcefully in the mid-1980's about the foolishness of taxing poor households deeper into poverty. In 1986, as part of an overall tax reform package, the federal government eliminated income tax liability for poor families. Since that time, many states have followed suit, but 20 states still levy income taxes on two-parent families of four with earnings below the poverty level.

The impact of state income tax systems on poor families has been increasing in importance in recent years because the number of working poor families has been growing across the United States. The increase in the number of families that have earnings from work but remain poor can be seen by comparing poverty rates in 1998 with those in 1979, two years when the economy was growing and unemployment rates were similar. The poverty rate for families with children in which the head-of-household worked climbed from 7.7 percent in 1979 to 10.9 percent in 1998, an increase of 40 percent.[8] In 1998, roughly nine million poor children — about two out of every three poor children — lived in a family with a working parent.

It is critical that more states address the problem of taxation of poor families, both in the interest of fairness and in order to further the objective of allowing parents who work to support their families adequately. The first step is understanding the extent of the burden families bear and the features of the tax system that affect those burdens.

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[7] At some income levels, particularly those modestly above the poverty line, workers face marginal tax rates ranging from 68 percent to 80 percent from the combination of federal income and social security taxes, the phaseout of the federal earned income tax credit, and the loss of food stamps.

[8] Part of this increase reflects growth in the share of working families with children that are headed by a single female parent, since this group is much more likely to be poor than are two-parent families. Nevertheless, the poverty rate among families with a working parent has grown for both single-parent and two-parent families.

Methodology

This report calculates the tax burden on two types of low-income families: a married couple with two children and a single parent with two children. In each case, the report assumes that the family has only one wage earner and that the family's income comes entirely from earnings.[a] The tax thresholds are based on each state's personal and dependent exemptions, standard deductions, state earned income tax credits, and other deductions or credits that are available to all low-income taxpayers with children.

The threshold calculations do not incorporate low-income credits that are based in part on factors other than income, such as the dependent care credit, because not all low-income families qualify for these credits and because the value of the credit for the typical family is difficult to identify. In addition, low-income sales tax and property tax credits, which appear on income tax forms in some states, are excluded from the threshold calculations because they are not administered through the income tax in all states and, like a dependent care credit, are based on factors other than income. These types of credits, which are administered through the income tax primarily for ease of administration, are intended to offset taxes other than the income tax.

[a] A few states have credits for children that depend on the age of the child. Each family is assumed to have one younger child, under the age of six, and one older child.

Income Tax Thresholds

The tax threshold is the entry point into the income tax system. It is the income level at which a family begins to owe state income tax.[9] A state's threshold level is affected by two broad factors: provisions applicable to most or all, designed to exempt some amount of income from taxation, and provisions specifically targeted to provide low-income tax relief.

Income taxes generally are not imposed on total income. States typically allow nearly every taxpayer some subtractions from income, most often through personal and dependent exemptions and/or a standard deduction, before tax liability is calculated. Some states provide this broad tax relief through a tax credit — a dollar amount subtracted from the tax bill — for each household member or for each dependent. The size of these exemptions, deductions, and credits affects the income level at which families begin to owe tax.

[9] A state's threshold tax level is not necessarily the same as the income level above which families are required to file an income tax return. For example, many states require families to file a state income tax return if they are also required to file a federal income tax return. Federal filing requirements in 1999 for most taxpayers under age 65 are gross income of at least $9,100 for a head of household and at least $12,700 for a married couple filing jointly. Most other states specify a minimum amount of income above which families are required to file that is lower than or equal to the tax threshold level.

In addition, 28 states target special deductions, exemptions, or tax credits on low-income families.[10] These features affect the tax threshold for low-income families without altering the tax structure for families with higher incomes. (For an explanation of how exemptions, deductions, and credits work, see Chapter IV.)

Tables 1A and 1B present the 1999 state income tax thresholds for single-parent families of three and two-parent families of four, respectively. The maps on pages 15 and 16 group the states according to their tax thresholds for each type of family in relation to the poverty line. The tables and maps show that:

- In 18 states, the tax threshold for a single parent with two children falls below the poverty line of $13,290 for a family of three. In those states, the average threshold is $3,950 below the poverty line.
- In 20 states, the tax threshold for a two-parent families of four falls below the poverty line of $17,028. The average threshold in these states is $5,450 below the poverty line.
- In four states — Alabama, Illinois, Kentucky, and Virginia — families of three and four with incomes at just half the poverty line have some income tax liability.
- By contrast, the income tax threshold is well above the poverty line in a number of states. For example, 14 states do not tax families until their incomes are at least $20,000 for families of four or $17,000 for families of three.

There are some common patterns among states that help determine whether a state has a high threshold or a low threshold. Not surprisingly, the states with the lowest thresholds tend to have very low personal and dependent exemptions and standard deductions. For example, in the nine states with thresholds below $10,000 for a single-parent family of three, the combined amount of the personal and dependent exemptions and standard deduction averages only $5,860, or 44 percent of the poverty line, compared with an average of $12,380, or 93 percent of the poverty line, for the other 33 states with an income tax.[11] A similar pattern holds for the

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[10] In one state, Pennsylvania, a low-income "tax forgiveness" credit is the only method used to reduce taxes for low-income residents. The state income tax does not include personal or dependent exemptions, nor a standard deduction.

[11] These calculations reflect the combined personal and dependent exemptions and standard deductions for a single-parent family of three. They include the relevant amounts allowed on federal income taxes for those states that implicitly incorporate the federal personal and dependent exemptions and standard deduction by using federal taxable income or federal tax liability as the starting points in their state income tax systems.

In most states, personal and dependent exemptions are specified amounts that tax filers deduct from their adjusted gross income before computing their tax liability. A small number of states have personal and dependent exemption *credit*s, under which tax filers subtract a specified amount per exemption or dependent from their calculated tax liability. For states with personal or dependent exemption credits, the credit amount is converted to an equivalent income deduction amount for a low-income family for purposes of this comparison.

Table 1A
State Income Tax Thresholds for Single-Parent Families of Three, 1999

Poverty line (estimated): $13,290

Rank	State	Threshold
1	Alabama	$4,600
2	Illinois	5,000
2	Kentucky	5,000
4	Virginia	5,400
5	Montana	7,500
6	Indiana	9,000
6	Michigan	9,000
8	Oklahoma	9,100
9	Hawaii	9,200
10	New Jersey	10,000
10	Ohio	10,000
10	West Virginia	10,000
13	Louisiana	11,800
14	Georgia	12,100
15	Missouri	12,400
15	Oregon	12,400
17	Utah	12,600
18	Arkansas	13,000
Average Threshold 1999		**$9,339**
Amount Below Poverty		**$3,951**

Rank	State	Threshold
19	Delaware	$13,400
20	North Carolina	13,900
21	Mississippi	14,400
22	District of Columbia	14,600
22	Idaho	14,600
22	South Carolina	14,600
25	Nebraska	15,100
25	North Dakota	15,100
27	Wisconsin	15,700
28	Maine	16,600
29	Iowa	17,300
30	New Mexico	18,000
31	Massachusetts	18,900
32	Connecticut	19,100
33	Pennsylvania	19,500
34	Kansas	19,900
35	Arizona	20,100
36	New York	21,800
37	Colorado	22,000
38	Rhode Island	23,900
38	Vermont	23,900
40	Maryland	24,200
41	Minnesota	24,700
42	California	$33,700
Average Threshold 1999		**$18,958**
Amount Above Poverty		**$5,668**

Note: A threshold is the lowest income level at which a family has state income tax liability. In this table thresholds are rounded to the nearest $100. The 1999 poverty line is a Census Bureau estimate based on the actual 1998 line adjusted for inflation. The threshold calculations include earned income tax credits, other general tax credits, exemptions, and standard deductions. Credits that are intended to offset the effects of taxes other than the income tax or that are not available to all low-income families are not taken into account.

Source: Center on Budget and Policy Priorities

Table 1B
State Income Tax Thresholds for Two-Parent Families of Four, 1999

Poverty line (estimated): $17,028

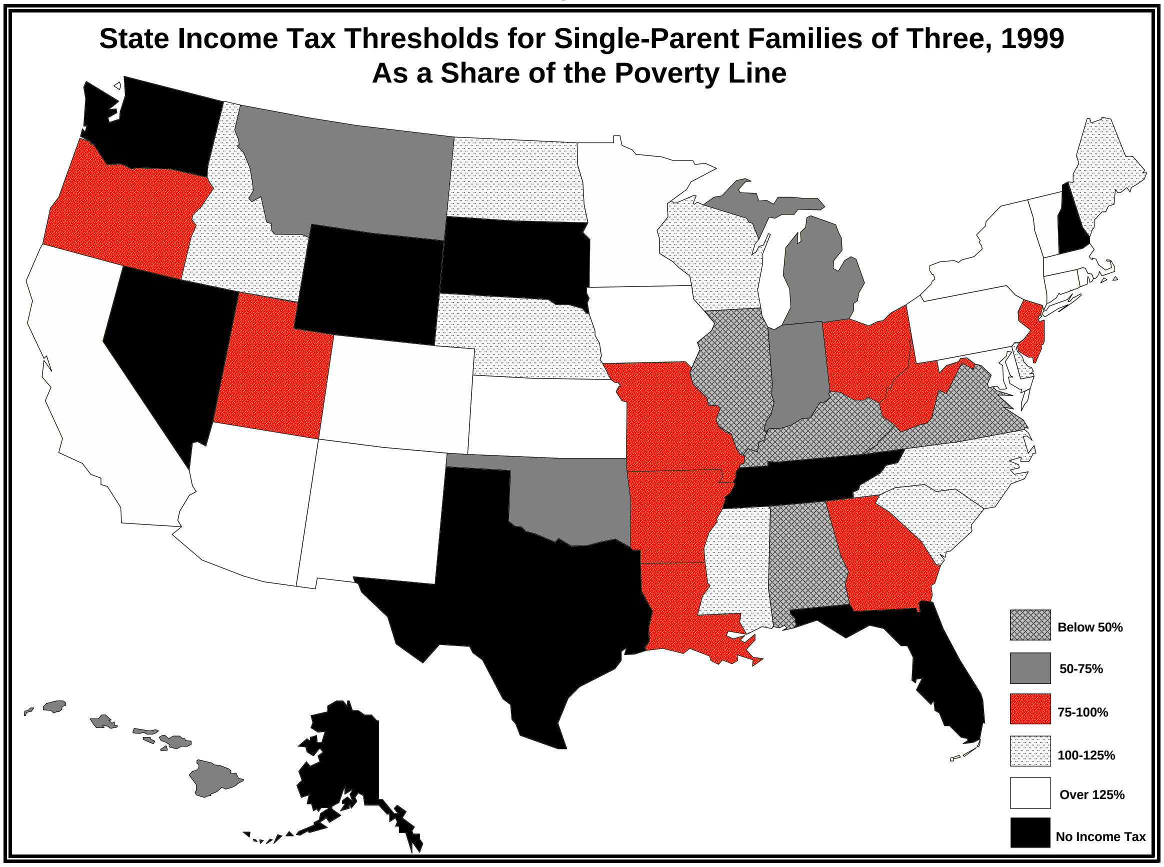
Rank	State	Threshold
1	Alabama	$4,600
2	Kentucky	5,200
3	Illinois	6,600
4	Virginia	8,200
5	Montana	9,100
6	Indiana	9,500
7	New Jersey	10,000
7	West Virginia	10,000
9	Hawaii	11,000
10	Michigan	11,800
11	Ohio	12,300
12	Louisiana	12,700
12	Oklahoma	12,700
14	Missouri	13,900
15	Oregon	14,400
16	Georgia	15,300
17	Utah	15,500
18	Arkansas	15,600
19	Delaware	16,100
20	North Carolina	17,000
Average Threshold 1999		**$11,575**
Amount Below Poverty		**$5,453**

Rank	State	Threshold
21	Iowa	$17,300
22	District of Columbia	18,200
22	South Carolina	18,200
24	Idaho	18,400
25	Mississippi	18,600
25	Nebraska	18,600
27	North Dakota	18,700
28	Wisconsin	18,800
29	Maine	20,200
30	Massachusetts	20,500
31	New Mexico	20,600
32	Kansas	20,900
33	New York	23,000
34	Arizona	23,600
35	Connecticut	24,100
36	Colorado	24,600
37	Maryland	24,800
38	Rhode Island	25,400
38	Vermont	25,400
40	Minnesota	26,000
40	Pennsylvania	26,000
42	California	35,500
Average Threshold 1999		**$22,155**
Amount Above Poverty		**$5,127**

Note: A threshold is the lowest income level at which a family has state income tax liability. In this table thresholds are rounded to the nearest $100. The 1999 poverty line is a Census Bureau estimate based on the actual 1998 line adjusted for inflation. The threshold calculations include earned income tax credits, other general tax credits, exemptions, and standard deductions. Credits that are intended to offset the effects of taxes other than the income tax or that are not available to all low-income families are not taken into account.

Source: Center on Budget and Policy Priorities

Figure 1

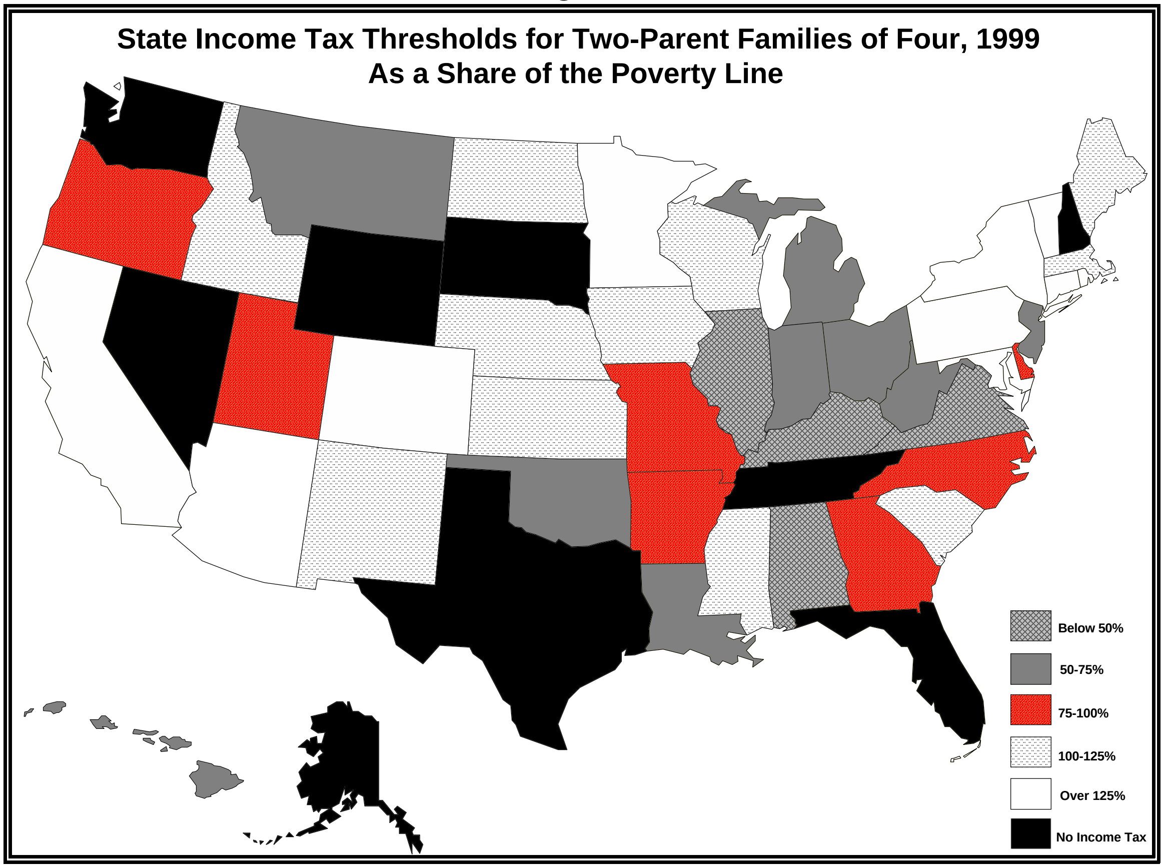


Similarly, most of the states with low income tax thresholds provide little or no targeted income tax relief for low-income taxpayers. Of the nine states with the lowest thresholds for families of three, four have no targeted income tax relief for low-income residents — Alabama, Illinois, Michigan, and Montana. The remaining five states provide a range of minimal low-income tax relief. Hawaii, Kentucky and Indiana each have small low-income credits. Oklahoma has a no-tax floor set at $9,100, about two-thirds of the poverty line. Virginia has a no-tax floor set at $5,000 for a head of household — less than half the poverty level for a family of three. The pattern was similar for states that had the lowest thresholds for families of four.

In contrast, the states with the highest thresholds tend to use tax credits and more generous personal and dependent exemptions and standard deductions to raise the threshold level.[12] The average combined value of the personal and dependent exemptions and standard

[12] The exception was Pennsylvania, which offers neither exemptions nor a standard deduction but still has a relatively high threshold. Pennsylvania relies entirely on a low-income tax credit to avoid levying state income tax (continued...)

Figure 2



deduction in the eight states with tax thresholds above $20,000 for a single-parent family of three is higher than the poverty line. The same is true for the eight states with tax thresholds above 24,000 for a two-parent family of four.[13] In other words, these states generally set basic deductions at a level sufficient to exempt poor families from owing income tax. In addition to these basic deductions, all of these states also offer substantial tax credits or deductions targeted specifically on low-income families that either raise the income tax threshold or lower taxes for low-income families.

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[12] (...continued)
on low-income families.

[13] The average value of these combined deductions for a family of three equals 121 percent of the poverty line. The average value of these deductions available to families of four equals 105 percent of the poverty line. Excluding California and Pennsylvania (the former because its deductions and credits are unusually high and the latter because it has no exemptions, deductions, or exemption credits), the average value for a family of three is 103 percent of the poverty line, and the average value for a family of four is 105 percent of the poverty line.

Taxes at the Poverty Line

Levying an income tax on the poor pushes families deeper into poverty, compounding the challenge of making ends meet. The amount of state income tax owed by families with incomes just equal to the poverty line can be quite substantial. In the states with below-poverty tax thresholds, the tax bill for poor families varies greatly, from as little as a few dollars to more than $500. By contrast, poor families who lived in states with tax thresholds above the poverty line did not owe any income tax, and in several of these states, such families actually qualified for a state tax refund.

Tables 2A and 2B show the state income tax burden on families of three and four with poverty-level income. The tables show that:

- For families of three living in states with below-poverty tax thresholds, the average income tax liability for a family with income equal to the poverty line is $154. Seven states — Alabama, Hawaii, Illinois, Indiana, Kentucky, Virginia, and West Virginia — levy a tax of $200 or more on such families.

- The average tax burden for poor two-parent families of four stands at $219 in the states with below-poverty tax thresholds. In nine states — Alabama, Arkansas, Hawaii, Illinois, Indiana, Kentucky, Oregon, Virginia, and West Virginia — the income tax bill for such a family exceeds $250. In Kentucky, a family of four with poverty-level income owes $555 in state income taxes.

- At the other end of the spectrum, families with poverty-level incomes qualify for a state tax refund in nine states — Colorado, Kansas, Maryland, Massachusetts, Minnesota, New Mexico, New York, Vermont, and Wisconsin. In the eight states other than New Mexico, the refund comes as the result of a refundable state Earned Income Tax Credit tied to the federal Earned Income Tax Credit (EITC), a tax credit for low- and moderate-income workers.[14] The federal EITC is intended to supplement the earnings of working-poor families and complement efforts to help families make the transition from welfare to work. State EITCs build on the strengths of the federal credit by further helping working families escape poverty. State EITCs also serve to offset the sizable burden of state and local sales taxes and property taxes on the poor.

  The largest state EITC for families of four with two children, in Minnesota, provides a refund of $1,222. Vermont provides the highest EITC for a family of three with two children and poverty-level income: $910.

[14] Three other states — Iowa, Oregon, and Rhode Island — also have state EITC for 1999, but these non-refundable credits can be used only to eliminate taxes on low-income families and not to provide refunds.

Table 2A
State Income Tax at Poverty Line for Single-Parent Families of Three, 1999

	State	Income	Tax
1	Alabama	$13,290	$343
2	Kentucky	13,290	334
3	Virginia	13,290	265
4	Hawaii	13,290	262
5	Illinois	13,290	250
6	Indiana	13,290	248
7	West Virginia	13,290	218
8	Michigan	13,290	189
9	Montana	13,290	171
10	New Jersey	13,290	130
11	Oklahoma	13,290	113
12	Louisiana	13,290	70
13	Oregon	13,290	67
14	Ohio	13,290	51
15	Georgia	13,290	23
16	Utah	13,290	17
17	Missouri	13,290	16
18	Arkansas	13,290	7
19	Arizona	13,290	0
19	California	13,290	0
19	Connecticut	13,290	0
19	Delaware	13,290	0
19	District of Columbia	13,290	0
19	Idaho*	13,290	0
19	Iowa	13,290	0
19	Maine	13,290	0
19	Mississippi	13,290	0
19	Nebraska	13,290	0
19	North Carolina	13,290	0
19	North Dakota	13,290	0
19	Pennsylvania	13,290	0
19	Rhode Island	13,290	0
19	South Carolina	13,290	0
34	New Mexico	13,290	(85)
35	Maryland	13,290	(190)
36	Wisconsin	13,290	(257)
37	Colorado	13,290	(310)
38	Kansas	13,290	(364)
38	Massachusetts	14,290	(364)
40	New York	13,290	(697)
41	Minnesota	13,290	(840)
42	Vermont	13,290	(910)

*The income tax threshold for a single-parent family of three in Idaho was $14,600 in 1999 but there was a $10 permanent building fund tax on each filing household.

Source: Center on Budget and Policy Priorities

Table 2B
State Income Tax at Poverty Line for Two-Parent Families of Four, 1999

	State	Income	Tax
1	Kentucky	17,208	$555
2	Alabama	17,028	423
3	Hawaii	17,028	382
4	Indiana	17,028	341
5	Illinois	17,028	313
6	Virginia	17,028	311
7	Arkansas	17,028	287
8	West Virginia	17,028	272
9	Oregon	17,028	256
10	Michigan	17,028	230
11	Montana	17,028	227
12	Oklahoma	17,028	208
13	New Jersey	17,028	168
14	Ohio	17,028	108
15	Louisiana	17,028	98
16	Missouri	17,028	68
17	Delaware	17,028	50
18	Utah	17,028	38
19	Georgia	17,028	37
20	North Carolina	17,028	2
21	Arizona	17,028	0
21	California	17,028	0
21	Connecticut	17,028	0
21	District of Columbia	17,028	0
21	Idaho*	17,028	0
21	Iowa	17,028	0
21	Maine	17,028	0
21	Mississippi	17,028	0
21	Nebraska	17,028	0
21	North Dakota	17,028	0
21	Pennsylvania	17,028	0
21	Rhode Island	17,028	0
21	South Carolina	17,028	0
34	Maryland	17,028	(20)
35	New Mexico	17,028	(70)
36	Kansas	17,028	(215)
37	Colorado	17,028	(243)
38	Massachusetts	17,028	(285)
39	Wisconsin	17,028	(400)
40	New York	17,028	(490)
41	Vermont	17,028	(713)
42	Minnesota	17,028	(1,222)

*The income tax threshold for a two-parent family of four in Idaho was $18,400 in 1999 but there was a $10 permanent building fund tax on each filing household.

Taxes at Minimum Wage

A third measure of the burden of state income taxes on poor families is the tax owed by families with minimum wage earnings, an income level that is well below the poverty line. In most states, full-time minimum wage earnings in 1999 amounted to $10,712 per year, or 81 percent of poverty level for a family of three and just 63 percent of poverty for a family of four.[15] Nine states that levy income taxes set the minimum wage higher than the federal standard during 1999; even in these states, minimum wage earnings fell significantly below the poverty line for families of three or four.

A popular stereotype holds that minimum wage workers are mostly teenagers or secondary earners in families that are not poor. Yet the reality is very different from this conception. In 1996, fewer than three in ten minimum-wage workers were teenagers. An analysis of the most recent increase in the federal minimum wage shows that 35 percent of the additional earnings resulting from the increase benefitted the lowest-income 20 percent of families.[16] Given the reliance of many low-income families on a parent earning the minimum wage, relieving income taxes on families at this income level should be a priority.[17]

Despite the difficulty of supporting a family on minimum wage earnings, a number of states levy an income tax on families in which a parent earns at this level. Tables 3A and 3B indicate the income tax liability for single-parent families of three and two-parent families of four with one full-time, year-round minimum wage worker. In the nine states with an income tax with a minimum wage higher than the federal requirement during 1999, the tax is calculated for the state-specific minimum wage.

- In 13 states — that is, in one-third of the states with an income tax — single-parent families of three with minimum wage income owe some state income tax. The average income tax on single-parent families of three with minimum wage income in these states is $116. Seven states levy a tax of more than $100, and two states — Alabama and Kentucky — impose a tax of over $200 on such a family.

- Two-parent families of four with minimum wage income owe income taxes in eight states. The average tax liability in these eight states is $104.

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[15] The federal minimum wage was $5.15 an hour in 1999.

[16] Lawrence Mishel, Jared Bernstein and John Schmitt, *The State of Working America: 1998-99*, Economic Policy Institute, 1999.

[17] It should be noted that states typically do not allow teenagers who can be claimed as a dependent on their parents' income tax return to enjoy the full benefit of personal exemptions, standard deductions, and tax credits on their own income tax returns. Therefore, states can raise income tax thresholds for families with minimum wage income levels without unduly benefitting teenagers in high-income families.

Table 3A
State Income Tax at Minimum Wage for Single-Parent Families of Three, 1999

	State	Income*	Tax
1	Kentucky		$221
2	Alabama	10,712	218
3	Illinois	10,712	173
4	West Virginia	10,712	143
5	Virginia	10,712	135
6	Indiana	10,712	116
7	Hawaii**	10,920	102
8	New Jersey	10,712	94
9	Oregon**	13,520	84
10	Montana	10,712	76
11	Michigan	10,712	75
12	Oklahoma	10,712	63
13	Ohio	10,712	13
14	Arizona	10,712	0
14	Arkansas	10,712	0
14	California**	11,960	0
14	Connecticut**	11,752	0
14	Delaware**	11,405	0
14	District of Columbia**	12,792	0
14	Idaho***	10,712	0
14	Iowa	10,712	0
14	Louisiana	10,712	0
14	Maine	10,712	0
14	Mississippi	10,712	0
14	Missouri	10,712	0
14	Nebraska	10,712	0
14	North Carolina	10,712	0
14	North Dakota	10,712	0
14	Pennsylvania	10,712	0
14	Rhode Island**	11,232	0
14	South Carolina	10,712	0
14	Utah	10,712	0
33	Georgia	10,712	(21)
34	New Mexico	10,712	(100)
35	Colorado	10,712	(324)
36	Maryland	10,712	(325)
37	Kansas	10,712	(382)
37	Massachusetts**	10,920	(382)
39	Wisconsin	10,712	(428)
40	New York	10,712	(763)
41	Minnesota	10,712	(840)
42	Vermont**	11,180	(954)

* Income reflects full-time, year-round minimum wage earnings for one worker (52 weeks at 40 hours per week).

** Nine of these states had a minimum wage higher than the federal minimum wage in all or part of 1999.

*** The income tax threshold in Idaho was higher than minimum wage earnings in 1998, but each filing household paid a $10 permanent building fund tax.

Source: Center on Budget and Policy Priorities

Table 3B
State Income Tax at Minimum Wage for Two-Parent Families of Four, 1999

	State	Income*	Tax
1	Kentucky	$10,712	$206
2	Alabama	$10,712	178
3	Illinois	$10,712	123
4	West Virginia	$10,712	83
5	Indiana	$10,712	82
6	New Jersey	$10,712	80
7	Virginia	$10,712	50
8	Montana	$10,712	32
9	Arizona	$10,712	0
9	Arkansas	$10,712	0
9	California**	$11,960	0
9	Connecticut**	$11,752	0
9	Delaware**	$11,405	0
9	District of Columbia**	$12,792	0
9	Idaho***	$10,712	0
9	Iowa	$10,712	0
9	Louisiana	$10,712	0
9	Maine	$10,712	0
9	Michigan	$10,712	0
9	Mississippi	$10,712	0
9	Missouri	$10,712	0
9	Nebraska	$10,712	0
9	North Carolina	$10,712	0
9	North Dakota	$10,712	0
9	Ohio	$10,712	0
9	Oklahoma	$10,712	0
9	Oregon**	$13,520	0
9	Pennsylvania	$10,712	0
9	Rhode Island**	$11,232	0
9	South Carolina	$10,712	0
9	Utah	$10,712	0
32	Hawaii**	$10,920	(2)
33	Georgia	$10,712	(32)
34	New Mexico	$10,712	(130)
35	Colorado	$10,712	(324)
36	Maryland	$10,712	(375)
37	Kansas	$10,712	(382)
37	Massachusetts**	$10,920	(382)
39	Wisconsin	$10,712	(534)
40	New York	$10,712	(763)
41	Minnesota	$10,712	(840)
42	Vermont**	$11,180	(954)

* Income reflects full-time, year-round minimum wage earnings for one worker (52 weeks at 40 hours per week).
** Nine of these states had a minimum wage higher than the federal minimum wage in all or part of 1999.
***The income tax threshold in Idaho was higher than minimum wage earnings in 1997, but each filing household paid a $10 permanent building fund tax.

Source: Center on Budget and Policy Priorities

- By contrast, single-parent families of three with minimum wage income qualify for a tax refund in 10 states, and two-parent families of four with the same income qualify for a tax refund in 11 states. The eight states with refundable state Earned Income Tax Credits — Colorado, Kansas, Maryland, Massachusetts, Minnesota, New York, Vermont, and Wisconsin — provide refunds ranging from $324 to $954 for both families of three and families of four with two children and minimum wage income.

In Wisconsin, the only state in which the EITC is designed to provide a larger benefit to poor families with three or more children than to other poor families, a two-parent family with three children and one minimum wage worker receives a refund of $1,230.

- New Mexico's "low income comprehensive tax rebate" and Georgia's "low income credit" result in smaller refunds compared to the states with EITCs. The New Mexico credit provides refunds of $130 for a family of four and $100 for a family of three with minimum wage earnings. The Georgia credit provides refunds of $32 for a family of four and $21 for a family of three with minimum wage earnings. Hawaii has a small refundable credit that results in a very small refund for two parent families of four with minimum wage income. However, single-parent families of three with minimum wage income in Hawaii have tax liability of over $100.

Taxes at 125 Percent of the Poverty Line

Many families with children who have incomes just above the poverty line continue to struggle to make ends meet due to the high cost of child care, health care, housing and transportation. This problem is particularly acute in states with a high cost of living. Federal and state governments recognize the challenges faced by low-income families with incomes slightly above the poverty line and have set the eligibility levels for many low-income assistance programs at amounts above the poverty threshold.[18]

However, two-thirds of the states with an income tax impose that tax on families of three with incomes at 125 percent of poverty and three-fourths of the states levy income tax on such families of four. In many states the amount of income tax owed is substantial and can compound the challenges faced by families as they move out of poverty. Tables 4A and 4B show the state

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[18] For example, the income guidelines for food stamps and school lunch eligibility are both set at 130 percent of poverty. In addition, 38 states set the eligibility guidelines for the Low Income Home Energy Assistance Program (LIHEAP) at 125 percent of poverty or higher. Similarly, states must cover under Medicaid children age 1-5 in families with incomes below 133 percent of poverty.

Table 4A
State Income Tax at 125% of Poverty Line for Single-Parent Families of Three, 1999

	State	Income	Tax
1	Kentucky	$16,613	$552
2	District of Columbia	16,613	548
3	Hawaii	16,613	531
4	Alabama	16,613	513
5	Virginia	16,613	431
6	Oregon	16,613	376
7	Indiana	16,613	361
8	Arkansas	16,613	359
9	Illinois	16,613	350
10	Michigan	16,613	335
11	West Virginia	16,613	326
12	Montana	16,613	283
13	Oklahoma	16,613	232
14	Louisiana	16,613	200
15	New Jersey	16,613	177
16	Delaware	16,613	169
17	North Carolina	16,613	164
18	Ohio	16,613	147
19	Georgia	16,613	145
20	Utah	16,613	129
21	Missouri	16,613	102
21	Wisconsin	16,613	102
23	Mississippi	16,613	66
24	Nebraska	16,613	55
25	Idaho*	16,613	51
25	South Carolina	16,613	51
27	North Dakota	16,613	42
28	Maine	16,613	41
29	Arizona	16,613	0
29	California	16,613	0
29	Connecticut	16,613	0
29	Iowa	16,613	0
29	Maryland	16,613	0
29	Pennsylvania	16,613	0
29	Rhode Island	16,613	0
36	New Mexico	16,613	(30)
37	Kansas	16,613	(185)
38	Massachussets	16,613	(273)
39	Colorado	16,613	(352)
40	New York	16,613	(423)
41	Vermont	16,613	(660)
42	Minnesota	16,613	(1,109)

*Includes the $10 permanent building fund tax on each filing household in Idaho.

Source: Center on Budget and Policy Priorities

Table 4B
State Income Tax at 125% of Poverty Line for Two-Parent Families of Four, 1999

	State	Income	Tax
1	District of Columbia	$21,285	$906
2	Kentucky	21,285	860
3	Hawaii	21,285	711
4	Oregon	21,285	679
5	Alabama	21,285	603
6	Virginia	21,285	525
7	Arkansas	21,285	500
8	Indiana	21,285	486
9	Illinois	21,285	441
10	West Virginia	21,285	430
11	Michigan	21,285	417
12	Iowa	21,285	412
12	Oklahoma	21,285	412
14	Montana	21,285	389
15	Wisconsin	21,285	383
16	Delaware	21,285	271
17	North Carolina	21,285	257
18	Ohio	21,285	245
19	Missouri	21,285	233
20	New Jersey	21,285	228
21	Utah	21,285	216
22	Georgia	21,285	212
23	Louisiana	21,285	208
24	Nebraska	21,285	96
25	Massachusetts	21,285	93
26	Idaho*	21,285	87
27	Mississippi	21,285	81
27	South Carolina	21,285	81
29	North Dakota	21,285	65
30	Maine	21,285	61
31	Kansas	21,285	24
32	New Mexico	21,285	17
33	Arizona	21,285	0
33	California	21,285	0
33	Connecticut	21,285	0
33	Maryland	21,285	0
33	Pennsylvania	21,285	0
33	Rhode Island	21,285	0
39	New York	21,285	(140)
40	Colorado	21,285	(221)
41	Vermont	21,285	(374)
42	Minnesota	21,285	(709)

*Includes the $10 permanent building fund tax on each filing household in Idaho.

Source: Center on Budget and Policy Priorities

income tax burdens on families of three and four with income at 125 percent of poverty in 1999. The tables show that:

- For families of three living in the 28 states that impose an income tax on families with incomes at 125 percent of the poverty line, the average income tax liability is $244. Four states — Alabama, District of Columbia, Hawaii, and Kentucky — levy a tax of $500 or more on such families.

The average tax burden for two-parent families of four with incomes at 125 percent of poverty in the 32 states that tax such families is $332. In seven states — Alabama, Arkansas, District of Columbia, Hawaii, Kentucky, Oregon, and Virginia — the income tax bill is $500 or more.

- By contrast, in seven states — Colorado, Kansas, Massachusetts, Minnesota, New Mexico, New York, and Vermont — a one-parent family of three with income at 125 percent of poverty receives an income tax refund. In four of those states — Colorado, Minnesota, New York, and Vermont — a two-parent family of four with income at 125 percent of poverty also receives an income tax refund. In all of these states except New Mexico, the refund comes as a result of a refundable state EITC.

III. Recent Changes in State Income Tax Burdens on the Poor

More than a decade ago, the federal government recognized that taxing poor families was counterproductive and unfair. As part of federal tax reform in 1986, virtually all families below the poverty line were removed from federal income tax rolls. Before 1987, only a handful of states exempted poor families from their income taxes. In the wake of federal tax reform, many more states followed the federal government's lead. The eight states that based their income taxes on federal taxable income or federal tax liability incorporated the federal changes into their state tax systems automatically and as a result removed poor families from their state income tax. Other states moved to revise their tax systems in similar ways. As a result, by 1991, some 18 of the 42 states with income taxes exempted married-couple families of four with below-poverty income from state income tax.

From 1991 to 1996, little additional progress was made in removing poor families from state income tax rolls. Income tax thresholds increased more than the poverty line in fewer than half of the states between 1991 and 1996, and the number of states with below-poverty thresholds did not change. Not until 1997, after many years of economic growth, did the number of states taxing poor families begin to decline appreciably, and the trend continued in 1998 and 1999.

Largely as a result of changes in the last three years, a substantial number of states had lower tax burdens on poor families in 1999 than they did in 1991. Other states, however, have shown a disappointing lack of progress during the 1990s.

The 1990s Were a Time of Change for State Income Tax Systems and for State Welfare Policy

Given the number and magnitude of changes made to personal income tax systems between 1991 and 1999, it is surprising that even more progress has not been made in removing poor families from state income tax rolls. As states adapted their tax systems to changing times, many of them have failed to make ending taxation of the poor a priority.

The 1990s began with state budgets reeling from the effects of the national economic downturn. In 1991, states confronted their most serious fiscal crisis since the recessions of the early 1980s. The economic downturn both depressed revenue and increased demand for services, aggravating state budget problems. Rising health care, prison, and education costs added to state fiscal woes. According to a May 1991 survey by the National Conference of State Legislatures, prospective state deficits for fiscal year 1992 totaled more than $30 billion.

As a result of this fiscal crisis, many states increased taxes. Most states adopting significant tax increases in the early 1990s relied largely on regressive taxes — such as sales and excise taxes — to raise revenue. While states could have lessened the burden such taxes impose on the poor through enacting offsetting reductions in income taxes, only a few chose to do so. Of the 34 states that raised taxes in 1991, only six provided some offsetting low-income tax relief.

By the 1991 tax year, the largest tax increases that resulted from the fiscal pressures of the recession had been enacted. In 1991, the average state income tax threshold for families of four equaled $11,736 or 84.3 percent of the poverty line. Income tax thresholds were below the poverty line for families of four in 24 states.

The national recession ended in 1991 and the economy began to expand again. By the mid-1990s, most state economies had been growing for a number of years. With stronger economies came stronger revenue growth, and many states were ending their fiscal years with positive balances for the first time in several years. These balances were enhanced by continued conservative budgeting as states faced the uncertainties of federal actions and future economic trends; various government programs that had been cut or eroded during the recession were not restored to their pre-recession funding levels. As a result of the budget surpluses brought about by good times and constrained spending, many states began to consider tax cuts. The personal income tax was the major focus of tax-cutting activity in many states. More than 30 states have enacted significant personal income tax cuts over the past five years.

The economic expansion affected state welfare policy as well. With unemployment falling to a remarkably low rate, it became possible for some families that had been relying on public assistance to enter the labor force. At the same time, states were building on a set of policies enacted in the late 1980s at the federal level that stressed the importance of welfare recipients finding employment. A number of states began welfare reform experiments in the early 1990s.

In 1996, the federal government passed the Personal Responsibility and Work Opportunity Reconciliation Act, which among other changes created the Temporary Assistance for Needy Families (TANF) Block Grant. Resulting changes in state welfare laws, such as limits on how long families can receive cash assistance under TANF and requirements that recipients find jobs quickly, along with the healthy economy and other factors, resulted in many welfare recipients entering the labor force. In every state, reliance on welfare has declined dramatically. Nationally, the number of welfare cases has dropped by half from their peak in 1994. Studies indicate that between half and three-quarters of former welfare recipients are employed shortly after they leave the welfare rolls.

For many families, however, the move from reliance on public assistance to reliance on a paycheck has not meant an escape from poverty. The jobs that many welfare recipients take often pay low wages and provide few, if any, benefits. At the same time, the costs associated with going to work remain substantial. Those costs include transportation and child care — and, in many states, income taxes.

The tax-cutting activity of the mid- to late-1990s provided an opportunity for states to relieve tax burdens on low-wage workers, including those making the transition from welfare to work. A number of states took advantage of this opportunity. Between 1996 and 1999 the number of states exempting poor families of four from the income tax increased to 22. By 1998, the income tax threshold in the median state had risen above the poverty line for the first time. Many states, however, failed to make low-income tax relief a priority. For tax year 1999, the threshold for families of four is below the poverty line in 20 states and for a single-parent family of three in 18 states.

Most States With Below-Poverty Thresholds in 1991 Continue to Tax the Poor — But Substantial Progress Is Being Made

In 1991, 24 states imposed income taxes on families of four with incomes below the poverty line. Table 5 shows the changes in thresholds for these states between 1991 and 1999. Of the 24 states, two did not increase their thresholds at all. Another seven states increased their thresholds, but the increase was less than the amount by which the poverty line increased during the period. A final 15 states increased their thresholds by more than the amount by which the poverty line increased. In 11 of these 15, the increases were not enough to bring the states' thresholds above the poverty line. But in four states, the tax thresholds were increased enough between 1991 and 1999 to remove poor families of four from the income tax rolls completely.

Each year, the federal poverty line is adjusted to take into account the impact of inflation on the costs of supporting a family. If a state's tax threshold remains the same or increases by less than the amount by which the poverty line rises, a higher proportion of the income of a poor family will be subject to tax. In states with below-poverty thresholds for families of four in 1991, the average increase in the tax threshold between 1991 and 1999 was over $4,500, compared with the increase of $3,100 in the poverty line. Fifteen of the 24 states raised the threshold by more than $3,100, thereby reducing the extent to which they taxed poor families of four. The other nine states either failed to raise the threshold sufficiently to keep pace with the poverty line or failed to raise the threshold at all.

Table 5
States with Thresholds below the Poverty Line in 1991

	Thresholds							Change	Change	Change
State	1991	1994	1995	1996	1997	1998	1999	1991-96	1996-99	1991-99
Pennsylvania	9,800	15,300	15,300	15,300	20,600	25,000	26,000	5,500	10,700	16,200
Massachusetts	12,000	12,000	14,000	15,500	17,400	21,100	20,500	3,500	5,000	8,500
Iowa	9,000	15,300	16,100	16,400	16,500	17,200	17,300	7,400	900	8,300
Kansas	13,000	13,000	13,000	13,000	13,000	20,700	20,900	0	7,900	7,900
Delaware	8,600	8,600	8,600	12,500	12,700	12,700	16,100	3,900	3,600	7,500
Georgia	9,000	11,100	11,100	11,100	13,100	15,300	15,300	2,100	4,200	6,300
Indiana	4,000	4,000	4,000	4,000	8,500	8,500	9,500	0	5,500	5,500
Missouri	8,900	9,700	9,900	10,000	10,200	12,000	13,900	1,100	3,900	5,000
New Jersey	5,000	7,500	7,500	7,500	7,500	7,500	10,000	2,500	2,500	5,000
Arkansas	10,700	10,700	10,700	10,700	10,700	15,600	15,600	0	4,900	4,900
Hawaii	6,300	6,300	6,300	6,100	6,100	6,100	11,000	(200)	4,900	4,700
Oregon	10,100	10,900	11,100	11,400	14,000	14,200	14,400	1,300	3,000	4,300
North Carolina	13,000	13,000	16,000	17,000	17,000	17,000	17,000	4,000	0	4,000
Michigan	8,400	8,400	9,600	9,600	10,000	11,800	11,800	1,200	2,200	3,400
Utah	12,200	13,600	14,100	14,400	14,900	15,200	15,500	2,200	1,100	3,300
Oklahoma	10,000	10,900	11,600	11,800	12,200	12,500	12,700	1,800	900	2,700
Illinois	4,000	4,000	4,000	4,000	4,000	5,200	6,600	0	2,600	2,600
Montana	6,600	7,200	7,400	8,600	8,800	9,000	9,100	2,000	500	2,500
West Virginia	8,000	8,000	8,000	10,000	10,000	10,000	10,000	2,000	0	2,000
Ohio	10,500	10,500	10,500	11,500	12,000	12,500	12,300	1,000	800	1,800
Louisiana	11,000	11,000	11,000	12,300	12,300	12,300	12,700	1,300	400	1,700
Kentucky	5,000	5,000	5,000	5,000	5,000	5,000	5,200	0	200	200
Virginia	8,200	8,200	8,200	8,200	8,200	8,200	8,200	0	0	0
Alabama	4,600	4,600	4,600	4,600	4,600	4,600	4,600	0	0	0
Average	8,663	9,533	9,900	10,438	11,221	12,467	13,175	1,775	2,738	4,513
Median	8,950	10,100	10,200	10,900	11,350	12,400	12,700	1,300	2,350	4,150
Poverty Line	13,924	15,141	15,569	16,036	16,400	16,660	17,028	2,112	992	3,104

Of the 15 states that increased their thresholds by more than the amount by which the poverty line increased between 1991 and 1999, four — Iowa, Kansas, Massachusetts, and Pennsylvania — raised their thresholds enough to move from taxing the poor to not taxing the poor.

- Iowa's threshold for a family of four increased from $9,000 in 1991 — almost $4,000 below the poverty line — to $17,300 in 1999. This increase resulted mainly from an increase in the state's no-tax floor — a special feature of Iowa's income tax that established an income below which families owe no tax. In addition, Iowa's earned income tax credit increased as a result of expansions of the federal credit.

Income Tax Thresholds for Two-Parent Family of Four							
	1991	1994	1995	1996	1997	1998	1999
Number Taxing Below Poverty	24	23	23	24	21	19	20
Poverty Line	$13,924	$15,141	$15,569	$16,036	$16,400	$16,660	$17,028
Average Threshold	$11,736	$13,088	$13,645	$14,210	$14,919	$16,488	$17,117
Average as % of Poverty Line	84.3%	86.4%	87.6%	88.6%	91.0%	99.0%	100.5%
Median Threshold	$12,100	$13,300	$14,550	$15,520	$16,200	$17,200	$17,750
Median as % of Poverty Line	86.9%	87.8%	93.5%	95.1%	98.8%	103.2%	104.2%

- Kansas in 1998 raised its threshold from $13,000 – the same level it had been throughout the 1990s – to $20,700. For 1999, Kansas's threshold increased another $200 to $20,900. The change was mostly due to enactment of a refundable earned income tax credit equal to 10 percent of the federal EITC. Kansas also raised its personal exemption and standard deduction.

- Massachusetts raised its no-tax floor for a family of four from $12,000 in 1991 to $15,500 in 1996. This change left the threshold for a family of four slightly below the poverty line. In 1997, however, Massachusetts enacted a new, refundable earned income tax credit equal to 10 percent of the federal EITC. In 1999 this was raised to 15 percent of the federal EITC effective January 2000. And in 1999, the personal exemption was raised substantially. These changes raised the income tax threshold for a family of four to $20,500, approximately $3,500 above the poverty line.[19]

- Pennsylvania increased its threshold substantially during this period by increasing its low-income "tax forgiveness" credit from $9,800 in 1991 to $15,300 in 1994. In 1996, the state's threshold for a family of four was approximately $700 below the poverty line. However, in each of the last three years the tax forgiveness credit again has been increased, raising the tax threshold to $26,000 for tax year 1999, $8,970 above the poverty line.

Eleven other states with below-poverty thresholds in 1991 increased their thresholds by an amount equal to or greater than the increase in the poverty line between 1991 and 1999.

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[19] A portion of the 1998 personal exemption increase was temporary based on surplus revenue allocated to the state's Tax Reduction Fund. The exemption and therefore the tax threshold declined in 1999.

However, the thresholds for families of four in these states were below the poverty line in 1991 and remain below the poverty line in 1999 even after these increases.

In five of these states the increase in the threshold resulted primarily from the enactment of tax reductions specifically targeted to low-income taxpayers. This tax relief took the form of low-income tax credits or no-tax floors — provisions that exempted taxpayers with incomes below a specific amount from the income tax.

- Indiana's income tax threshold for a family of four was $4,000 from 1991 through 1996. The threshold increased to $8,500 in 1997, due to adoption of a new earned income tax deduction (since converted into a credit, but not to be confused with a state EITC) and a new dependent exemption. The threshold is now 56 percent of the poverty line. In 1999, the dependent deduction was increased by $500 resulting in a threshold of $9,500.

- New Jersey's threshold for a family of four remained $7,500 from 1994 to 1998. Until 1998, New Jersey's income tax included a no-tax floor that exempted taxpayers with incomes below $7,500 from the income tax. In 1999, New Jersey enacted legislation that increases the no-tax floor to $10,000. (The no-tax floor will increase to $15,000 in tax year 2000 and to $20,000 in tax year 2001 for married taxpayers and heads of households.)

- The income tax threshold in Arkansas was $10,700 from 1991 to 1997. In 1998, Arkansas implemented a new income-tax table for low-income residents that, combined with a new credit for Social Security taxes paid and an increased standard deduction, increased the threshold for a family of four to $15,600. It remains at that level in 1999 — about $1,500 below the 1999 poverty line. Between 1991 and 1999, Arkansas' threshold increased from 65 percent of the poverty line to 92 percent.

- As part of a package of tax changes, Hawaii in 1998 enacted a new refundable low-income tax credit effective in 1999. As a result, the state's income tax threshold for a family of four increased to $11,000, remaining well below the poverty line.

- Oregon's tax threshold for a family of four increased from $10,100 in 1991 to $11,400 in 1996 due to the indexing for inflation of its personal exemption credit. In 1997 Oregon instituted a non-refundable earned income tax credit equal to 5 percent of the federal EITC. This increased the tax threshold to $14,000. Because the EITC is indexed for inflation, the threshold rose again in 1999 to $14,400, 85 percent of the poverty line.

In six additional states, increases in personal exemptions or credits and standard deductions combined with rate changes resulted in an increase in the income tax threshold.

- Delaware converted its personal exemption to a credit of $100 per family member starting in 1996. This, combined with a cut in tax rates in 1997, increased the tax threshold from $8,600 to $12,700 for a family of four. In 1999, Delaware raised its standard deduction from $1,600 to $4,000 for a married couple increasing its threshold for a family of four to $16,100. The threshold is now 95 percent of the poverty line. Additional changes enacted in 1999 are likely to raise the threshold above the poverty line in 2000.

- Georgia's threshold for a family of four increased by $2,100 between 1991 and 1994 as the result of increases in the state's dependent exemption. The threshold did not change between 1994 and 1996. In 1997 and 1998, the combined effect of several changes to Georgia's tax system increased the tax threshold from $11,100 to $15,300, where it remains in 1999. This is 90 percent of the poverty line for a family of four.[20]

- Missouri in 1998 increased its dependent exemption from $400 to $1,200, and in 1999 increased its personal exemption by $900. These changes, along with inflation adjustments to the state's standard deduction, raised the threshold from $8,900 at the beginning of the decade to $13,900 in 1999, still about $3,130 below the poverty line.

- North Carolina's threshold of $13,000 for a family of four was below the poverty line in 1991. It remained unchanged until 1994 and so stood in that year more than $2,000 below poverty. In 1995, the state increased its tax threshold through a combination of an increase in personal exemptions and the establishment of a credit of $60 per child for families with incomes below $100,000. By 1997, North Carolina's tax threshold equaled $17,000. It has not changed since and is now just below the poverty line for a family of four.

- Michigan increased its personal exemptions modestly from 1991 to 1997. In 1998, another personal exemption increase plus a new per-child deduction raised the threshold to $11,800, where it remains in 1999. This is still well below the poverty line but by a lesser amount than in 1991.

[20] As discussed on page 12, this report does not include in the calculation of tax thresholds any tax credits that are granted as offsets to other state and local taxes, such as sales taxes or property taxes. Before 1997, the Georgia low income credit was not included in the calculation of the tax threshold in this report, because the history of the credit suggested that it was intended as an offset to the sales tax on food. This apparent intention was reinforced by the denial of the credit to food stamp recipients; states are prohibited by federal law from imposing sales taxes on food purchased with food stamps. Last year, Georgia began phasing out its sales tax on food. Nonetheless, the low income credit was not reduced; moreover, in tax year 1997 the credit was not denied to food stamp recipients. Effectively, the Georgia low income credit has been converted to a general low income credit. It is treated as such in the calculation of the 1997, 1998, and 1999 thresholds.

- Utah's threshold rose automatically between 1991 and 1999 because its personal exemption and standard deductions are indexed to increase with inflation. Utah's threshold for a family of four now stands at $15,500, 91 percent of the poverty line.

Income Taxes Owed by Poor Families in States with Below-Poverty Thresholds Declined in Many States

In 1991, all the states included in Tables 5 and 6 levied some tax on families of four with poverty level income. Since then changes in exemptions, credits and tax rates have resulted in increases or decreases in the amount of tax owed by poor families in most states. As described above, only a handful of these states eliminated income taxes for families with poverty level income. For those states that did not increase their income tax threshold above the poverty line, comparing the amount of taxes owed by a family of four with poverty level income in 1994 to that owed in 1999 provides one measure of the progress a state has made towards relieving income taxes on poor families.

Table 6 shows the amount of state income tax at the poverty line for families of four in 1994 and in 1999 — a period of significant tax cutting in many states.[21] On average, in states with below-poverty thresholds in 1991, taxes on families of four with poverty level income declined somewhat between 1994 and 1999.[22]

However, the trend towards lower taxes on poor families was by no means universal. In eight states — Alabama, Arkansas, Kentucky, Louisiana, Montana, Oklahoma, Virginia and West Virginia — the amount of tax owed by a family of four at the poverty line actually increased between 1994 and 1999.[23] In four states — Iowa, Ohio, Pennsylvania and Utah — there was no change between 1994 and 1999.[24] By contrast, state income taxes declined for

[21] Tax year 1991 is not included in this table because data on tax liability were not available for that year.

[22] The tax amounts shown in Table 6 for 1994 and 1999 are the tax liabilities for a family with poverty level income in that year. The poverty line for a family of four for 1994 was $15,141; the poverty line for 1999 was $17,028. The tax amounts shown are not adjusted for inflation. For two of the eight states where taxes increased — Kentucky and Montana — the percentage increase in taxes was less than inflation over the same period.

[23] Changes of one dollar are considered no change in this count.

[24] It should be noted, however, that in Pennsylvania, a family of four at the poverty line owed no taxes in 1999 as the state's no-tax floor was higher than the poverty line. By 1996, a poverty-level family of four owed substantial taxes as Pennsylvania's threshold remained unchanged while the poverty line increased; thus, the threshold dropped below the poverty line. By 1999, the state significantly increased its no-tax floor eliminating taxes for poverty-level families.

Table 6
State Income Tax at the Poverty Line for Families of Four, 1994 and 1999
States with Below-Poverty Thresholds Below the Poverty Line in 1991

State	1994	1999	Change 94-99
Virginia	$217	$311	$94
Alabama	348	423	75
Arkansas	214	287	73
Oklahoma	139	208	69
West Virginia	215	272	57
Kentucky	499	555	56
Montana	211	227	16
Louisiana	83	98	15
Ohio	107	108	1
Utah	37	38	1
Iowa	0	0	0
Pennsylvania	0	0	0
Illinois	334	313	-21
Hawaii	406	382	-24
New Jersey	193	168	-25
Indiana	379	341	-38
Michigan	301	230	-71
Oregon	331	256	-75
Georgia	116	37	-79
Missouri	147	68	-79
North Carolina	128	2	-126
Delaware	272	50	-222
Kansas	74	-215	-289
Massachusetts	314	-285	-599
Average	$211	$161	($50)

families with poverty level income in 12 of the states with below-poverty thresholds in 1991. In four states — Delaware, Kansas, Massachusetts and North Carolina — taxes declined by more than $100. In Kansas and Massachusetts families of four at the poverty line moved from owing taxes in 1994 to receiving a refund in 1999 as the result of the adoption of state earned income tax credits.

Future Increases in Income Tax Thresholds

This report shows income tax thresholds for 1999. As a part of legislation enacted early in 2000 and in previous years, some states have adopted changes to their income tax systems that will lead to increased thresholds in 2000 and beyond. So far only one or two of those states — New Jersey and perhaps Delaware — will eliminate income taxes on the poor as a result of legislation that will take effect in 2000 or later years.

- In Colorado effective tax year 2000, the standard deduction for married taxpayers will increase from $7,200 to $8,800. This will increase the state's threshold which is already above the poverty line.

- In Delaware, the personal exemption credit will increase from $100 to $110 beginning tax year 2000. This change in conjunction with rate reductions will increase the state's threshold to $17,700. The threshold is likely to rise just above the poverty line, depending on the level of the inflation adjustment to the 2000 poverty line.

- In Georgia, the exemption for dependents is scheduled to increase from $2,700 to $3,000 in tax year 2003. The threshold will remain below the poverty line.

- Illinois in 1998 enacted legislation to increase its personal exemption from $1,000 to $2,000 over three years. Despite increasing substantially, the threshold will remain below half the poverty line.

- As part of tax changes made in 1996, Kentucky's standard deduction is being increased over several years from $650 to $1,700. After the increase is fully implemented, the standard deduction will be indexed for inflation. The increase in the standard deduction will result in a small increase in the state's tax threshold, but the threshold will remain less than half the poverty line.

- As a result of legislation adopted in 1999, Massachusetts' threshold will move further above the poverty line when the state's Earned Income Tax Credit increases from 10 percent of the federal EITC to 15 percent in 2001.

- Maryland in 1997 enacted a bill cutting tax rates and increasing the state's personal exemption by $1,200 over five years, starting in tax year 1998. This legislation is raising the state's income tax threshold, already above the poverty line, by several thousand dollars. In addition, Maryland is expanding its refundable EITC over several years from 10 percent to 15 percent of the federal credit.

- Mississippi, where the threshold is already above the poverty line, is phasing in an increase in the personal exemption for married filers. The personal exemption will increase to $12,000 in tax year 2000. The state's threshold, which is already above the poverty line, will increase further.

- As a result of legislation enacted in 1999, New Jersey's no-tax floor for married taxpayers and single heads of households will increase to $15,000 in 2000 and $20,000 in 2001. These changes will raise New Jersey's income tax thresholds above the poverty line.

- New York's threshold will rise further above the poverty line when the states Earned Income Tax Credit increases from 20 percent of the federal EITC to 25 percent in 2001.

- Wisconsin, where the income tax threshold is already above the poverty line, is phasing in a number of changes through tax year 2001 that will further increase thresholds. These changes include increasing the standard deduction, reducing rates, and replacing the dependent credit with a personal exemption.

Most States With Above-Poverty Thresholds in 1991 Raised Their Thresholds

In contrast to the states that started the 1990s with below-poverty thresholds, all but two of the states with thresholds above poverty in 1991 increased them by amounts greater than the increase in the poverty line. As Table 7 shows, threshold increases in these states from 1991 to 1999 averaged $6,540, well above the increase of $3,100 in the poverty line during that period. Because these increases go beyond the increases that were necessary to maintain the threshold at or above the poverty level, they served to exclude from income tax the incomes of more near-poor families in these states.

Tax relief for the near-poor can be particularly important in a state with a high cost-of-living. In addition, many analysts believe that the poverty line underestimates the income level that a working family needs to afford basic items in a household budget, such as housing, food, transportation, health care and child care. For these and other reasons, tax relief for working near-poor families has become a priority for a number of states.

Nine of the ten states with the largest increases in their thresholds over this period all include tax credits targeted to low- and moderate-income residents as part of their tax systems.

- New York's income tax threshold for a family of four rose from $16,900 to $23,000 between 1994 and 1999. These increases resulted from legislation enacted in 1994 and 1995 that phased in through 1996, including provisions that scaled back one low-income credit, increased the standard deduction, created a state EITC, and reduced tax rates.

- The Arizona income tax threshold for a family of four rose from $15,800 in 1994 to $23,600 in 1998 where it remains for tax year 1999. This resulted from the creation and subsequent expansion of a tax credit per family member for families with income below $23,600, as well as an increase in the state's personal exemption.

- Substantial expansions of the federal Earned Income Tax Credit through 1996 led to large increases in the income tax thresholds in four of the states with a state EITC tied to the federal credit — Maryland, Minnesota, Rhode Island, and Vermont.[25] In Rhode Island and Vermont, these increases have taken place without any major change in state tax policy. Minnesota and Maryland both supplemented the federal increases by expanding their own state EITCs in 1998.

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[25] Wisconsin's earned income credit was not calculated as a percent of the federal credit for tax year 1994 but it has since recoupled with the federal credit. However, in 1996, the state reduced the percentage that the state EITC is of the federal EITC for families with two or more children. As a result, the EITC benefit for these families remained the same or fell slightly between 1995 and 1997. In 1998, Wisconsin's threshold for a family of four rose by $1,700 to $18,700 due to a new nonrefundable tax credit for low-income working families.

Table 7
States with thresholds above the poverty line in 1991

State	Threshold 1991	1994	1995	1996	1997	1998	1999	Change 1991-96	Change 1996-99	Change 1991-99
California	20,900	22,600	23,000	23,400	23,800	36,100	35,500	2,500	12,100	14,600
Minnesota	15,500	19,000	20,000	20,900	21,600	25,200	26,000	5,400	5,100	10,500
Colorado	14,300	16,200	16,600	16,900	17,500	21,900	24,600	2,600	7,700	10,300
New York	14,000	16,900	18,700	21,600	22,300	22,800	23,000	7,600	1,400	9,000
Maryland	15,800	19,400	20,900	22,300	22,900	24,300	24,800	6,500	2,500	9,000
Arizona	15,000	15,800	20,000	20,000	20,000	23,600	23,600	5,000	3,600	8,600
Rhode Island	17,400	21,100	22,400	23,700	24,400	25,000	25,400	6,300	1,700	8,000
Vermont	17,400	21,100	22,400	23,700	24,400	25,000	25,400	6,300	1,700	8,000
New Mexico	14,300	16,300	16,600	16,900	17,500	20,300	20,600	2,600	3,700	6,300
Maine	14,100	14,800	15,000	15,200	17,500	18,700	20,200	1,100	5,000	6,100
Wisconsin	14,400	16,400	16,400	16,700	17,000	18,700	18,800	2,300	2,100	4,400
Nebraska	14,300	16,200	16,600	16,900	17,900	18,300	18,600	2,600	1,700	4,300
Idaho	14,300	16,200	16,600	16,900	17,500	17,900	18,400	2,600	1,500	4,100
North Dakota	14,700	16,500	17,100	17,400	18,000	18,400	18,700	2,700	1,300	4,000
Dist. of Columbia	14,300	16,200	16,600	16,900	17,500	17,900	18,200	2,600	1,300	3,900
South Carolina	14,300	16,200	16,600	16,900	17,500	17,900	18,200	2,600	1,300	3,900
Mississippi	15,900	15,900	15,900	15,900	15,900	17,200	18,600	0	2,700	2,700
Connecticut	24,100	24,100	24,100	24,100	24,100	24,100	24,100	0	0	0
Average	15,833	17,828	18,639	19,239	19,850	21,850	22,372	3,406	3,133	6,539
Median	14,550	16,350	16,850	17,150	17,950	21,100	21,800	2,600	1,900	6,200
Poverty Line	13,924	15,141	15,569	16,036	16,400	16,660	17,028	2,112	992	3,104

In 1999, Massachusetts and New York adopted increases in their state EITCs that will be effective in future years.

- Unlike other states, California dramatically increased its threshold in 1998 without increasing tax relief for low-income families. The threshold rose from $23,800 in 1997 to $36,100, the largest increase in any state this decade. The increase was due to a significant expansion of the state's non-refundable dependent credit. Because poor and near-poor families were already exempt from California's income tax, the great majority of the benefits from this expansion went to middle- and upper-income families. In 1999, the threshold declined somewhat to $35,500 because a portion of the increase in the dependent credit was temporary.

- In Maine, enactment of a new low-income credit raised that state's tax threshold above the poverty line in 1997, 1998, and 1999. The income tax threshold in Maine had been above the poverty line in 1991 but was below the line in 1994 through 1996. The new low-income credit enacted in 1997 raised Maine's threshold to $17,500, over $1,000 above the poverty line; in 1998 and 1999 the threshold again rose due to increases in the personal exemption.

- New Mexico substantially expanded its refundable Low-Income Comprehensive Tax Rebate in 1998. This expansion, along with inflation adjustments to the state's personal exemption and standard deduction, increased the threshold from $17,500 in 1997 to $20,600 in 1999.

Thresholds in six other states — the District of Columbia, Idaho, Nebraska, North Dakota, South Carolina, and Wisconsin — increased about the same amount as the poverty line. These increases occurred largely because these states' personal exemptions and standard deductions are indexed to increase automatically with inflation.[26]

Mississippi, the only state where the threshold for a family of four was above the poverty line in 1991 but below the poverty line in 1997, enacted changes to the personal exemption and standard deduction for married taxpayers that lifted Mississippi's threshold for families of four above the poverty line again in 1998 and resulted in a further increase in 1999.

Finally, Connecticut's income tax threshold has not changed since 1991. However, it remains well above the poverty line.

Income Tax Relief for Poor Families Has Finally Arrived in Many States But Remains Overdue in Others

In 1996, despite strong fiscal conditions and large tax cuts in many states, state income taxes on poor families remained about as burdensome as they had been in the early 1990s. Now, as families file their tax returns for 1999, a number of states have changed course, providing tax relief to low- and moderate-income taxpayers as well as to wealthier taxpayers. Nine years into the economic recovery, states have at last made substantial progress in relieving income tax burdens on low-income families.

For 1999, the number of states taxing two-parent families of four with poverty-level income has dropped by four from 1996. All of the states that had income tax thresholds above the poverty line for such families in 1991 have now regained that status. Close to three-fourths of states have taken advantage of generally healthy fiscal conditions and raised their tax thresholds during the current economic expansion by more than the poverty line increased. In states in which the tax threshold remains below the poverty line, this rate of increase in the tax threshold means fewer poor families are subject to income taxes. In states in which the tax threshold was above the poverty line to begin with, tax relief is provided to near-poor families as well.

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[26] In the District of Columbia's case, its no-tax floor is indexed by being tied to the level of federal exemptions and deductions.

Still, many states have failed to take full advantage of the opportunity that the recent healthy fiscal climate offers to remove poor families from the income tax rolls. The pace of progress in this area slowed somewhat in 1999. A number of states that still tax poor families have already cut their top income tax rates during the current recovery, which provides disproportionate benefits to the well-to-do. For example, Oklahoma and Ohio cut income tax rates while allowing their income tax thresholds to fall relative to the poverty line. Some states have also chosen to cut income taxes while retaining higher sales and excise tax rates enacted during the 1990-91 recession, a pattern that is particularly unfair to low- and moderate-income families.[27] In sum, income tax relief for poor families remains overdue in many states.

[27] See Nicholas Johnson and Iris J. Lav, *Are State Taxes Becoming More Regressive?*, Center on Budget and Policy Priorities, October 29, 1997. This report documents that many states tended to increase both personal income taxes and consumption taxes to maintain tax collections as the economy declined during the 1990-91 recession, but reduced only income taxes once the economy rebounded. Since consumption taxes are regressive, imposing a disproportionate burden on low-income households, this pattern of increases and decreases over the business cycle has made state tax systems more regressive overall.

IV. Strategies for Relieving State Tax Burdens on Poor Families

There are a host of ways that states can modify their tax systems to reduce the tax burden on the poor. This paper focuses on strategies related to the income tax for a number of reasons. It is relatively easy for states to alter their income tax provisions to relieve the burden of the income tax on the poor because information on the taxpayer's income is available at the time the tax is levied. The design of other major taxes makes such efforts much more cumbersome. For example, the sales tax is collected by merchants from consumers without regard to their income level, and property taxes are passed through from property owners to renters as part of a rent payment. The income tax, on the other hand, is calculated as a percentage of a taxpayer's total income and thus offers a number of opportunities to reduce directly the burden of taxes on the poor.

There are three basic features of a standard income tax structure that states use to reduce or eliminate the income tax burden on low-income families: the personal and dependent exemptions, the standard deduction, and credits. The role of each of these in reducing the amount of taxes paid by a taxpayer can be seen by examining a typical income tax calculation.

The total amount of income tax owed by any taxpayer is determined in a number of steps. First, the taxpayer's total gross income is determined by adding all income sources subject to a particular state's income tax. Next, this amount (the adjusted gross income) is reduced by any exemptions and deductions allowed. This determines the total amount of income subject to taxation. Next, the state's tax rate is applied to that amount to determine the amount of tax owed. Finally, any credits allowed are applied to reduce the total amount of taxes owed.

In addition, some states have enacted provisions that eliminate any income tax liability for taxpayers with income below a set level, regardless of whether the calculations described above would yield a tax liability. These provisions are known as no-tax floors.

Business Leaders and Educators Recognize the Importance of State Tax Relief for the Poor to Promoting Work

Earlier this year, the Research and Policy Committee of the Committee for Economic Development — an independent research and policy organization of some 250 business leaders and educators — issued a report titled *Welfare Reform and Beyond: Making Work Work*.[a]

The report contains recommendations to individuals, employers and federal and state policy makers designed to make welfare reform work better at achieving three goals: enhanced personal responsibility, stronger employment, and the reduction of poverty. Prominent among their recommendations are a set of policies designed to further work-based welfare reform. These include the following discussion of poor families who are required to pay state income tax in many states:

> "Taxpayers in such marginal economic circumstances contribute relatively little to state treasuries, but their tax liabilities make it substantially more difficult to move out of poverty through work. **CED recommends that states consider reducing or eliminating state income tax burdens on families below the federal poverty threshold.** They can achieve this result through appropriate changes to exemptions, rate schedules or state earned income tax credits."

[a] *Welfare Reform and Beyond: Making Work Work*, A Policy State by the Research and Policy Committee of the Committee for Economic Development, New York, New York, 2000.

Each of these elements that provide tax relief for low-income taxpayers is described in more detail below. Some combination of these strategies is generally used to achieve the goal of reducing the burden of state income taxes on low-income families.[28]

Increasing Personal and Dependent Exemptions

Personal and dependent exemptions are subtractions from income. These exemptions reduce the amount of income that is subject to tax. They can be structured in a number of ways. In 1999, most states set a specific amount to be subtracted for each taxpayer and each dependent. Some states instead set one amount for the taxpayer and a different amount for dependents.[29] Furthermore, nine states use personal or dependent credits as an alternative to personal or

[28] Additional discussion may be found in Steven D. Gold and David S. Liebschutz, *State Tax Relief for the Poor*, 2nd ed., Center for the Study of the States, Albany, NY, 1996.

[29] New York allows exemptions for dependents only. Connecticut allows only a personal exemption, but its value depends on the family structure: the exemption for single taxpayers without children is $12,000, for single heads of household it is $19,000, and for married couples regardless of the number of children it is $24,000.

dependent exemptions.[30] Unlike exemptions, which reduce taxable income, credits are subtracted from taxes that otherwise would be owed. This is an important distinction for the design of low-income tax relief and will be explained further below.

A personal exemption operates in a fairly straightforward way to reduce taxes. It reduces the amount of taxes owed by reducing the amount of income that is subject to taxation. For example, a family of four with total income of $12,000 in a state with a personal and dependent exemption equal to $1,000 would owe taxes on only $8,000 of that income ($12,000 minus four times $1,000) before any other tax provisions were taken into account. The higher the amount of the personal exemption, the more income that is sheltered from taxes. If a state wants to use the personal exemption to reduce taxes on low-income taxpayers, it can simply increase the amount of the exemption.

While increasing personal or dependent exemptions or credits may be a simple way to provide income tax relief to low-income families, it is also potentially quite expensive because the benefits are available to high-income taxpayers as well as low- and moderate-income families. The cost of increasing a personal or dependent exemption or credit — that is, the additional revenue foregone by the state — can be mitigated in a number of ways. Using a personal credit rather than an exemption is one way to target relief to low-income households and reduce costs. Another way to better target low-income tax relief is to reduce and phase out the value of the exemption or credit at higher income levels. These options are described in more detail below.

Differences Between Personal Exemptions and Personal Credits — Although both personal exemptions and personal credits ultimately reduce the amount of taxes owed, they work in somewhat different ways. Because an exemption reduces taxes indirectly by reducing the total amount of taxable income, the ultimate value to a taxpayer of a personal exemption is the amount of the exemption multiplied by the applicable tax rate. A credit, on the other hand, is subtracted directly from the amount of taxes owed. Therefore, the value of a credit generally is its face value. Consider the following two examples:

In example A, a family of four with income of $12,000 and a personal exemption of $1,000 per family member would have taxable income of $8,000. If the tax rate were four percent, the taxes owed would be $320. If, as in example B, the personal exemption were raised to $1,500 per family member, the $6,000 total exemption that the family is eligible for would

[30] The nine states are Arkansas, California, Delaware, Iowa, Kentucky, Nebraska, Ohio, Oregon and Wisconsin. Ohio has personal and dependent exemptions in addition to the personal and dependent credits. Two other states have credits for children that are similar to dependent credits. Louisiana has an "education" credit for all dependents in grades K-12. North Carolina has a child credit available to married couples with incomes below $100,000 and heads of households with incomes below $80,000.

reduce its taxable income to $6,000, and the tax liability would be lowered to $240. Thus, raising the personal exemption by $500 per person, or a total of $2,000 for a family of four, resulted in tax savings of $80. This equals the amount of the increase in the exemption ($2,000) multiplied by the four percent tax rate.

	A	**B**
Income	$12,000	$12,000
Minus: Personal Exemptions	4,000	6,000
Equals: Taxable Income	8,000	6,000
Multiplied by: Tax Rate	.04	.04
Equals: Tax	$ 320	$ 240

A tax credit works in a different way because a credit directly reduces the amount of tax owed. Therefore, when a personal or dependent credit is increased, the family tax liability is reduced by the full amount of the credit change. In example C, a family of four with taxable income of $12,000 subject to a four percent tax rate would face a tax of $480 before credits. If the personal credit equaled $40 per person, the family could claim a total personal credit of $160, and its tax liability after subtracting the credit would be $320. If, however, the personal credit were raised to $60 per person, as in example D, the family could claim a total personal credit of $240, and its taxes would be reduced to $240. Thus, an increase of $20 in a personal credit would lead to a tax savings of $80 for a family of four.[31]

	C	**D**
Taxable Income	$12,000	$12,000
Multiplied by: Tax Rate	.04	.04
Equals: Tax before Credits	480	480
Minus: Personal Credit	160	240
Equals: Tax	$ 320	$ 240

There is a difference between exemptions and credits in terms of the impact on families of different income levels if a state has a graduated rate structure. For example, consider a state with two income tax brackets: a lower bracket which taxes income below $20,000 at a four percent rate and a higher bracket which taxes income of $20,000 or more at five percent. In this case, the value of increasing a personal exemption by $1,000 would be $40 for a taxpayer in the lower tax bracket. For a taxpayer in the higher bracket, however, the value would be $50 because of the higher tax rate. On the other hand, a credit equal to $40 for all taxpayers would reduce the taxes of both these taxpayers by that amount regardless of income level. For this reason, the benefit from a personal or dependent credit is likely to represent a greater share of income for lower-income households than for those at higher incomes and so may be a better targeted and

[31] Personal credits generally are limited to the amount of the before-credit tax liability. If the credit to which the taxpayer is entitled exceeds that amount, the taxpayer does not receive the difference as a tax refund.

less costly tool to use than a personal or dependent exemption when the objective is low-income tax relief.

The fact that a credit is worth the same amount to all taxpayers, regardless of the tax rate they pay, while the tax savings from an exemption depends on the tax rate applied to that exemption, can have implications for the choice of methods used to reduce income tax burdens on the poor. In a state with a flat rate income tax — that is, a state in which all taxpayers are subject to the same tax rate regardless of level of income — the impact of increasing an exemption will be the same as that of increasing a credit if the credit is equal to the exemption times the applicable tax rate. In a state with a progressive rate structure, a credit would provide better targeting to low-income taxpayers at a lower cost.

Phasing Out Personal Exemptions or Credits — Both personal exemptions and credits may be phased out as income increases. This can provide the full benefit of the exemption or credit to low- and moderate-income households while lowering the total cost of the tax relief measure. For example, under the federal income tax, the personal exemption phases out for high-income taxpayers. The amount begins to decline at $189,950 of income for joint filers and at $126,600 for single filers. The box on page 6 shows how the federal personal exemption phase-out works.

Ten states incorporate the federal personal exemption phase-out into their own tax systems — Colorado, Idaho, Minnesota, New Mexico, North Carolina, North Dakota, Rhode Island, South Carolina, Utah, and Vermont. Four other states — California, Connecticut, Nebraska, and Wisconsin — use state-specific methods to phase out their personal exemptions, personal exemption credits, or standard deductions for families with income above a specific level.

Increasing the Standard Deduction

Most state income taxes include provisions that allow the deduction of certain taxpayer expenditures from income before taxes are computed. Taxpayers typically are given the choice of listing itemized deductions, which reflect specific taxpayer expenditures, or taking the standard deduction. The standard deduction is a subtraction from income of a fixed amount that is allowed to any taxpayer, although the amount of the standard deduction allowed may vary with family structure, with size, or in a few states with income. In this typical structure, taxpayers using the standard deduction tend to be lower- and middle-income taxpayers who do not own homes. Homeowners are more likely to itemize their deductions because mortgage interest and property tax payments frequently lift their deductible expenses above the standard deduction amount. (States such as Illinois and Ohio that do not allow itemized deductions typically also do not allow standard deductions.)

As with increasing personal and dependent exemptions, raising the standard deduction increases the tax threshold, or income level at which families begin to pay taxes. It also reduces the amount of taxes owed by families with incomes above the threshold level. Relative to increasing personal and dependent exemptions, however, raising the standard deduction may be less costly because not every taxpayer would benefit from the increase; most of those who itemize their deductions would not be affected by the change. As a result, while the benefits of the standard deduction, like the personal exemption, theoretically rise with income in states with a graduated rate structure, most taxpayers in tax brackets with higher marginal rates itemize and do not take the standard deduction. Thus, the benefits of a higher standard deduction would tend to be targeted on low- and moderate-income households.

No-Tax Floors

Another way to increase a state's income tax threshold is to set a "no-tax floor," or an income amount below which no taxes are owed. No-tax floor provisions supersede all other provisions of the income tax for taxpayers whose incomes fall below the specified level. Thus, with a no-tax floor in place, a family that would otherwise owe income taxes but whose income falls below the floor would face no income tax liability. For example, a family of four in Oklahoma with income of $12,700 in 1999 would owe $76 under the state's regular income tax structure. But because the state has a no-tax floor of $12,700, families with income up to this level owe no state income taxes.

One area of concern in the design of no-tax floors is the impact on taxpayers with income just above the floor. If the normal structure of the income tax takes effect immediately above the tax floor, families benefitting from a no-tax floor can find themselves faced with an income tax "cliff" where a single additional dollar of income triggers a significant amount of tax, sometimes $100 or more. For this reason, most of the states that use a no-tax floor also phase in the underlying tax obligations over a relatively short range of income above the floor. For example, Iowa has an alternative tax under which families with income above the no-tax floor pay the lesser of the alternative tax or regular tax amounts. Nevertheless, families in states with no-tax floors with income just above the floor typically face high tax rates on each additional dollar they earn in the transition range.[32]

A no-tax floor keeps the cost of income tax relief down by targeting relief exclusively on families with income below a specified level. Of the eight states that used a no-tax floor, only Massachusetts and Nebraska set their levels high enough to eliminate income taxes on all poor

[32] Tax cliffs are not unique to states with no-tax floors. Similar cliffs can exist when low-income credits of a fixed amount are used to offset tax liability. For example, in the District of Columbia, a two-parent family of four with income of $18,204 would receive a low-income credit of $658 which fully offsets the usual tax liability at that income level. If such a family earned $18,205, however, it would be no longer eligible for the credit and would face a tax liability of $658.

The federal income tax establishes a personal exemption phase-out threshold at a specific amount of adjusted gross income (AGI) for each filing status. The phase-out levels for tax year 1999 are:

Single Filers	$126,600
Heads of Households	$158,300
Joint Filers	$189,950

Taxpayers with adjusted gross incomes above these thresholds gradually lose the value of their personal exemptions. The phase-out occurs over the next $122,500 of income, regardless of filing status. For each $2,500 of income over the phase-out threshold level, the personal exemption is reduced by two percent. Thus in 1999, when the personal exemption equaled $2,750, each personal exemption was reduced $55 for each $2,500 in income over the threshold level. Once income exceeds the phase-out levels by more than $122,500, the exemption is completely eliminated. The table below shows the effects of the personal exemption phase-out at different income levels for single taxpayers.

Single

AGI	Personal Exemption Per Person	Reduction in Exemption Amount	Reduced Exemption Amount
$120,000	$2,750	$ 0	$2,750
130,000	2,750	110	2,640
200,000	2,750	1,650	1,100
225,000	2,750	2,200	550
250,000	2,750	2,750	0

families for 1999. Iowa, Louisiana, New Jersey, Oklahoma, Virginia, and West Virginia set their no-tax floors below the poverty level for both families of three and four.[33]

Low-Income Credits

Another strategy available to states for increasing income tax thresholds and reducing income taxes on low-income families is to provide income tax credits specifically for low-income taxpayers. A tax credit is a fixed amount subtracted directly from an individual's tax liability. Credits available only to low-income taxpayers are thus a targeted and efficient way of increasing the tax threshold and reducing the tax liability for low-income families. Credits that are

[33] In Iowa, while the no-tax floor is below the poverty level, families of three or four with two children pay no tax at the poverty level due to other credits.

refundable — that is, credits for which the taxpayer receives the entire value even if the credit amount exceeds the amount of taxes owed — can also serve to offset the burden of other state and local taxes and supplement wages for families at low income levels.

For tax year 1999, some form of low-income credit is used in 21 states.[34] Eleven states have an Earned Income Tax Credit (EITC) based on the federal EITC. States with low-income credits other than the EITC in 1999 include Arizona, Connecticut, the District of Columbia, Georgia, Hawaii, Indiana, Kentucky, Maine, New Mexico, and Pennsylvania.[35] Maryland, Massachusetts, and New York have both EITCs and other low-income credits. In some cases, these credits are simply a flat amount per dependent or household member. Arizona, for example, has a $40 credit per household member for low- and moderate-income families. Other states have credits that equal a percentage of the tax liability, with the percentage based on income. Three states — the District of Columbia, Maine, and Pennsylvania — have low-income credits that act very much like no-tax floors. For example, Pennsylvania families of four with income below a set level — $26,000 for a family of four in 1999 — qualify for a "tax forgiveness" credit equal to 100 percent of their tax bill. The percentage of tax forgiven by the credit declines sharply as family income rises; a family of four with income over $28,250 receives no credit.

Colorado, Iowa, Kansas, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, and Wisconsin had state earned income tax credits (EITC) in 1999. State EITCs modeled on the federal EITC provide a credit to low- and moderate-income working families with children and to very low-income individuals and couples who are not caring for children in the home. The credit amount is determined by the family's earnings and number of children. Eight of the state EITCs presently available are refundable.[36] Like the federal EITC, which is among the most effective government programs in lifting children out of poverty, these refundable credits serve to supplement the earnings of these families, offset the burden of other taxes, and complement efforts to help families make the transition from welfare to work.[37]

In recent years, state EITCs have enjoyed growing popularity. Ten of the 11 state EITCs have been adopted since passage of the federal Tax Reform Act of 1986, which eliminated federal income tax liabilities for poor families. State EITCs can easily be piggybacked on the federal EITC by adopting federal eligibility criteria and expressing the state EITC as a percentage of the

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[34] Arkansas allows low-income taxpayers to pay a reduced amount based on a "low-income tax table"; this reduction is similar in its effect to a credit.

[35] The Indiana credit is called an Earned Income Tax Credit but is quite different in its structure from the federal EITC and other state EITCs.

[36] Maryland offers both a refundable and a non-refundable EITC.

[37] For further discussion of the effectiveness of the federal EITC, see *Strengths of the Safety Net*, Center on Budget and Policy Priorities, March 1998.

federal EITC. Appendix I summarizes the structure of state EITCs in the 11 states that use them.[38]

Other Design Issues

Personal exemptions, credits and standard deductions are often set at a fixed dollar amount which can only be increased through specific actions by state lawmakers. In some 16 states, however, personal exemptions, personal credits, and/or standard deductions for tax year 1999 are indexed for inflation.[39] For federal taxes, these amounts are adjusted automatically each year to account for the effects of inflation. In this way, the value of the exemption, credit, or deduction is maintained. In seven of the 16 states with indexing, the indexing results from the state's beginning the income calculation with federal taxable income or federal tax liability.[40] Both the federal taxable income line and federal tax liability line on the federal income tax return reflect the subtraction from adjusted gross income of federally-allowed personal exemptions and standard deductions.

The value of personal exemptions, personal credits, and standard deductions failed to increase with inflation last year in eight of the 20 states with tax thresholds below the poverty level in 1999 for families of four. So, while the costs faced by poor families increased and were reflected in a higher poverty level, the income tax threshold did not also increase. One way to partially address this problem is to index personal exemptions or standard deductions to inflation so that they will automatically increase as the cost of living increases.[41]

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[38] For further information on state EITC programs, see *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty*, 1999 Edition, Center on Budget and Policy Priorities, November 1999.

[39] The sixteen states were California, Colorado, Idaho, Iowa, Maine, Michigan, Minnesota, Missouri, Nebraska, New Mexico, North Dakota, Oregon, Rhode Island, South Carolina, Utah, and Vermont. Nebraska and Ohio will begin indexing their personal exemptions in 2000, and Wisconsin will begin indexing its standard deduction in 2000.

[40] The seven states that adopt indexing of their personal exemptions and standard deductions by starting their income tax calculations with federal taxable income or federal tax liability were Colorado, Idaho, Minnesota, North Dakota, Rhode Island, South Carolina, and Vermont. Five states — Maine, Missouri, Nebraska, New Mexico, and Utah — also set their personal exemptions and/or standard deductions to the federal level, even though they do not start their calculations with federal taxable income or federal tax liability. The remaining four states that index their personal exemptions, personal credits, and/or standard deductions — California, Iowa, Michigan, and Oregon — do so through state-specific rules.

[41] North Carolina, for example, does not automatically adjust its income tax code for inflation. As a result, its threshold is not scheduled to rise above its current level of $17,000. Due to cost-of-living adjustments, the federal poverty line for a family of four increased from $16,660 in 1998 to $17,028 in 1999. In the absence of legislative action to increase its threshold, North Carolina once again taxed families with earnings at the poverty line in 1999 after having had a threshold above the poverty line in 1998.

Income Tax Rate Reductions Are Often of Small Benefit to Low-Income Taxpayers

Many of the states that have not yet removed state income taxes from poor families have not made it a priority to do so. Most state economies expanded through the 1990s and most states experienced robust fiscal conditions. As a result, more than 30 states enacted significant personal income tax cuts in the last five years. But many of the states with the largest income tax cuts in recent years chose to cut top tax rates or cut all tax rates in ways that provide a disproportionate benefit to higher-income taxpayers. Eight of the states — Delaware, Hawaii, Michigan, New Jersey, Ohio, Oklahoma, Oregon, and Utah — that have enacted personal income tax rate cuts in recent years still have income tax thresholds below the poverty line.[42]

Rate cuts would appear to benefit all taxpayers regardless of income. However, the benefit for low-income taxpayers of an income tax rate reduction is generally very small.

- A number of state income tax systems use graduated income tax rate structures with higher rates for high-income taxpayers. Some states have focused in recent years on reducing the top income tax rate; such actions disproportionately benefit high-income taxpayers.

- Even if a rate reduction is made across-the-board, reducing the rate for each tax bracket, it provides a larger dollar benefit for high-income taxpayers than for low-income taxpayers. For example, consider a state with an income tax with a flat rate of five percent and exemptions and deductions that total $10,000 for a family of four. A rate reduction from five percent to 4.5 percent would reduce the taxes of a family earning $20,000 by only $50. The same rate cut would reduce the taxes of a family earning $100,000 by $450 — nine times more than the cut for the lower income taxpayer. Moreover, the lower-income family's reduction amounts to 0.25 percent of its income, while the wealthier family's taxes are cut by 0.45 percent of income.

- In addition, as this report shows, many states exempt their lowest-income residents from the personal income tax. Residents that pay no income tax, of course, will receive no benefit from a rate reduction.

California is an example of a state where a reduction in tax rates provided no tax relief for low-income taxpayers. In 1995, California had eight graduated tax brackets. The top two brackets were tax rates of 10 percent and 11 percent, which applied to married filers with taxable income over $220,000. These top two brackets, which had been instituted in 1991 as a temporary rather than permanent feature of the tax code, were eliminated in 1996. As a result, the marginal tax rate for taxpayers with incomes above $220,000 dropped to 9.3 percent. While this provided

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[42] New Jersey's threshold for a family of four with two children will be above the poverty line in 2000 as a result of increases to the state's no-tax floor adopted in 1999.

a substantial tax cut for high-income taxpayers in the state and cost the state over $700 million in revenue, it provided no tax relief for poor taxpayers.[43]

Even a rate reduction targeted to lower-income taxpayers may not result in significant tax relief. New Jersey enacted a substantial rate cut that was phased in starting in 1994. New Jersey has a graduated income tax with five brackets. The rate reduction enacted was larger for the lowest income brackets than for the upper brackets. The rate for taxable income of less than $20,000 was lowered by 30 percent from 2.0 percent to 1.4 percent. A family of four earning $15,000 had their taxes reduced by $60 as a result of the rate cut, while the taxes of a family earning $150,000 were reduced by over $1,300. Despite the rate reductions, a family of four at the poverty line owed $168 in New Jersey income taxes in 1999.

New Jersey has recently begun to address this problem. In 1999, the state enacted an increase in its no-tax floor. This will exempt poor families from the income tax beginning in tax year 2000.

Rate reductions are among the least efficient ways to relieve the tax burdens of the working poor. Changes in personal exemptions, standard deductions, tax credits or no-tax floors are far better choices for providing tax relief to those most in need of it at a modest cost.

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[43] California has subsequently cut income taxes in ways other than rate reductions, but those cuts have not benefitted low-income taxpayers either.

V. Conclusion

Many low-income working families face a heavy state and local tax burden. Eliminating state income taxes on the poor can help prevent taxing these families deeper into poverty. Relieving tax burdens on low-income working families can also improve their ability to remain self-sufficient. Although progress is being made in relieving the burden of income taxes on poor families, nearly half the states with income taxes still require two-parent families of four and single-parent families of three with income at the poverty level to pay income taxes. Even families with minimum-wage income that falls far below the poverty line are required to pay income taxes in a significant number of states.

It is not necessary for states to impose income taxes on poor families. A majority of states have already eliminated the tax burden on poor families. There are many ways to structure a state income tax to do so. Most of the 22 states that do not tax poor families of three or four allow relatively large deductions from income for all taxpayers through personal and dependent exemptions and the standard deduction. Some 28 states have adopted additional measures that target relief on low-income families.

The relatively good fiscal condition that many states have enjoyed in recent years has led to the adoption of income tax cuts in many states. Many states have used this opportunity to reduce taxes on working-poor families, thereby making it easier for low-wage workers to support their families — particularly important policy in the late 1990s as rising numbers of welfare recipients enter the workforce. In states that still tax the poor, the opportunity remains open for states to make changes in their income tax provisions that will relieve tax burdens on poor families — both in the interest of fairness and in order to further the objective of allowing parents who work to support their families adequately.

Appendix I
State Earned Income Tax Credits in 1999

In 1999, eleven states had state earned income tax credits. State EITCs are tax credits for low-income working families that are based on the federal EITC. This table displays four major features of the EITC in each state:

- Whether the credit is refundable, that is, whether the full amount of the credit could be received even if it exceeded the amount of state income tax owed. The federal EITC is refundable.
- The percentage of the federal EITC at which the credit is set.
- Whether the credit is adjusted for family size beyond the adjustment in the federal EITC. The federal EITC benefit structure distinguishes only between families with one child and those with more than one child.
- Whether workers without qualifying children who qualify for the federal EITC are eligible to receive the state credit.

State Earned Income Tax Credits in Tax Year 1999

State	Percentage of Federal Credit	Workers Without Qualifying Children Eligible?
Refundable credits:		
Colorado[a]	8.5%	Yes
Kansas	10%	Yes
Maryland[b]	10% (rising to 15% in 2001)	No
Massachusetts	10% (rising to 15% in 2001)	Yes
Minnesota	15% — no qualifying children 15% to 46% — families with children[c]	Yes
New York	20% (rising to 25% in 2001)	Yes
Vermont	25%	Yes
Wisconsin	4% — one child 14% — two children 43% — three children	No
Non-refundable credits:		
Iowa	6.5%	Yes
Oregon	5%	Yes
Rhode Island	26.5%[d]	Yes

Notes.
[a] Colorado's EITC is contingent on the availability of sufficient revenue.
[b] A Maryland taxpayer may claim either the refundable credit or a non-refundable EITC equal to 50% of the federal credit.
[c] Minnesota's credit for families with children, unlike the other credits shown in this table, is not expressly structured as a percentage of the federal credit. Depending on income level, the credit may range from 15 percent to 46 percent of the federal credit.
[d] Rhode Island's credit is phasing down to 25 percent of the federal credit over five years as part of an overall reduction in the state income tax.