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THE IMPACT OF STATE INCOME TAXES ON LOW-INCOME FAMILIES IN 2005

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Summary

Poor families in many states face substantial state income tax liability for the 2005 tax year. In 19 of the 42 states that levy income taxes, two-parent families of four with incomes below the federal poverty line are liable for income tax. In 16 of the 42 states, poor single-parent families of three pay income tax. And 31 of these states collect taxes from two-parent families of four with incomes just above the poverty line.

Some states levy income tax on working families in severe poverty. In **Alabama**, families with two children owe income tax when their earnings reach \$4,600. This amount is less than one-third of the 2005 federal poverty line for one-parent families of three (\$15,577), and less than one-quarter of the poverty line for two-parent families of four (\$19,961). **Alabama** plus six other states — **Hawaii, Indiana, Louisiana, Michigan, Montana, and West Virginia** — tax the incomes of three- or four-person families earning less than three-quarters of the poverty line.

In some states, families living in poverty face income tax bills of several hundred dollars. A two-parent family of four in **Alabama** with income at the poverty line owes \$538 in income tax, while such a family in **Hawaii** owes \$470 and in **Arkansas** \$406. Such amounts can make a big difference to a family struggling to escape poverty. Other states levying tax of \$200 or more on families with poverty-level incomes include **Indiana, Michigan, Montana, Oregon, Virginia, and West Virginia**.

Some states have achieved progress in improving their income-tax treatment of the poor, but others have not. Between 2004 and 2005, **Kentucky, Montana, Ohio, the District of Columbia, and Rhode Island** implemented policies that reduce the income tax liability of poor families. The *number* of states that tax poor families, however, has increased since 2004. Since the early 1990s, the number of states that tax poor two-parent families of four has declined from 24 to 19, but in

¹ Additional data analysis for this report was provided by David Bradley, Julie Gathers, Karen Lyons, Michael Mazerov, Elizabeth C. McNichol, Ifie Okwuje, and Sara Williams.

Methodology

This report takes into account income tax provisions that are broadly available to low-income families and that are not intended to offset some other tax. It does not take into account tax credits or deductions that benefit only families with certain expenses, nor does it take into account provisions that are intended explicitly to offset taxes other than the income tax. For instance, it does not include the impact of tax provisions that are available only to families with out-of-pocket child care expenses or specific housing costs, because not all families face such costs. It also does not take into account sales tax credits, property tax “circuitbreakers,” and similar provisions, because this analysis does not attempt to gauge the impact of those taxes — only of income taxes.

Alabama, Arkansas, Iowa, Louisiana, Mississippi, Virginia, and West Virginia poor families’ tax liability has increased, even after accounting for inflation. The reason for these tax increases is that provisions designed to protect low-income families from taxation — including standard deductions, personal exemptions and low-income credits — have not been increased to keep up with inflation.

Taxing the incomes of working-poor families runs counter to the efforts of policymakers across the political spectrum to help families work their way out of poverty. The federal government has exempted such families from the income tax since the mid-1980s, and a majority of states now do so as well.

Eliminating state income taxes on working families with poverty-level incomes gives 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 taxes on poor families can make a meaningful contribution toward “making work pay.” Several states — including Alabama and Hawaii — are considering measures in their current legislative sessions that would considerably improve their income-tax treatment of the poor.

States seeking to reduce or eliminate income taxes on low-income families can choose from an array of mechanisms to do so. These mechanisms include state Earned Income Tax Credits (EITCs) and other low-income tax credits, no-tax floors, and personal exemptions and standard deductions that are adequate to shield poverty-level income from taxation. Some states go beyond exempting poor families from income tax by making their EITCs or other low-income credits refundable. These policies mean a lot to a family struggling to escape poverty, but they are relatively inexpensive to states, since these families have little income to tax.

Despite some progress, there remains much to do before state income taxes adequately protect and assist families working to escape poverty.

State Income Taxation of the Poor in 2005

This analysis assesses the impact of each state’s income tax in 2005 on poor and near-poor families with children.² (Forty-two states, counting the **District of Columbia** as a state, levy broad-

² For a more detailed analysis of the changes that individual states have made to their income taxes affecting low-income families since the early 1990s, the reasons why such changes are important, and the ways other states can implement

based income taxes.) Two family types are used as models for assessing taxes' impact: a married couple with two dependent children, and a single parent with two dependent children.³ The analysis focuses on two measures: the lowest income level at which state residents are required to pay income tax, and the tax due at various poverty and near-poverty income levels.

A benchmark used throughout this analysis is the federal poverty line — an estimate prepared by the federal government of the minimum financial resources an American family needs. The Census Bureau's preliminary estimates of the poverty line for 2005 are \$15,577 for a family of three and \$19,961 for a family of four.⁴

Many States Continue to Levy Substantial Income Taxes on Poor Families in 2005

The Tax Threshold

One important measure of the impact of taxes on poor families is the income tax threshold — the point at which, as a family's income rises, it first begins to owe income tax. Tables 1A and 1B show the thresholds for a single parent with two children and for a married couple with two children, respectively.

- In 16 states, the income tax threshold for a single-parent family of three is less than the \$15,577 poverty line, meaning that families living in poverty must pay state income tax. In the remaining 26 states with income taxes, the threshold is above the poverty line; in those states, poor families pay no income tax or receive a refund.
- In 19 states, the threshold for a two-parent family of four is below the \$19,961 poverty line for such a family. In the remaining 23 states with income taxes, the threshold is above the poverty line.
- **Alabama's** thresholds are by far the lowest in the country — at \$4,600, they are about half those of the next lowest state. **Alabama** taxes single-parent families of three earning less than one third of the poverty line, and two-parent families of four earning less than one quarter of the poverty line. (For 2004, **Kentucky** also taxed extremely poor families, but for 2005 it implemented a low-income tax credit that raises its thresholds considerably, leaving **Alabama's** income tax alone in taxing the extremely poor.)
- Seven states — **Alabama, Hawaii, Indiana, Louisiana, Michigan, Montana, and West Virginia** — tax families of three or four earning less than three-quarters of the federal poverty line: \$11,683 for a family of three and \$14,971 for a family of four.

such changes, see the forthcoming Center on Budget and Policy Priorities report, *State Income Tax Burdens on Low-Income Families in 2005: Assessing the Burden and Opportunities for Relief*, to be released in spring 2006.

³ The married couple is assumed to take filing status Married Filing Jointly on its federal and state tax forms, while the single parent is assumed to file as a Head of Household. Each family is assumed to have one worker.

⁴ Specifically, this report uses the Census Bureau's preliminary estimates of the weighted poverty thresholds, available at <http://www.census.gov/hhes/www/poverty/threshld/05prelim.html>.

Why Does This Report Focus on the Income Tax — A Tax That Is Arguably the Fairest State Tax?

In most states, poor families pay more in consumption taxes, such as sales and gasoline taxes, than they do in income taxes. They also pay substantial amounts of property taxes and other taxes and fees. Why then does this report focus on the burden of state income taxes on poor families?

First, the income tax is a major component of state tax systems, making up 33 percent of total state tax revenue nationally, according to the Census Bureau. Thus, the design of a state's income tax has a major effect on the overall fairness of the state's tax system.

Second, because information on the taxpayer's income is available at the time the income tax is levied, it is administratively easier for states to target income tax relief to poor families than it is to provide sales or property tax relief to those families. For example, sales tax is generally 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. As a result, the great majority of the low-income tax relief enacted at the state level in the last decade has been administered through the income tax.

Third, families trying to work their way out of poverty often face an effective tax on every additional dollar earned in the form of lost benefits such as income support, food stamps, Medicaid, or housing assistance. Income taxes on poor families can exacerbate this problem and send a negative message about the extent to which increased earnings can improve family well-being.

This report emphasizes that many states' income taxes leave considerable room for improvement. But it is important to recognize that a state tax system that includes an income tax — even one with a relatively low income threshold — typically serves low-income families better than a state tax system that does not include an income tax at all. 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 non-income taxes tend to place a higher overall tax burden on the poor than on high-income families. Seven states with sales taxes — Florida, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming — do not appear in this report because they do not levy income taxes. Their heavy reliance on the sales tax renders their tax systems very burdensome for low-income families. Conversely, three states with income taxes but no general sales tax — Delaware, Montana, and Oregon — are shown in this report to impose above-average income tax burdens on the poor, despite some recent improvement. While there is room for further improvement in this aspect of their income taxes, these three states still have less regressive tax systems overall than the average state because they do not levy general sales taxes.

- Six states — **Alabama, Hawaii, Illinois, Montana, Oregon** and **West Virginia** — tax families of three with full-time minimum wage earnings.⁵
- The state with the highest threshold is **California**, where the threshold is \$40,500 for a family of three and \$42,700 for a family of four — more than twice the poverty lines for families of those sizes.

⁵ Calculations are based on the minimum wage in effect in each state in 2005, which in fifteen states exceeded the federal minimum wage of \$10,712 per year for a full-time worker. Among the six states listed here, Hawaii, Illinois, and Oregon have enacted minimum wages above the federal level. In Illinois and Oregon, a single-parent family of three earning \$10,712 would not pay income tax. "Full-time" is assumed to be 40 hours per week, 52 weeks per year.

Taxes on Poor Families

Several states charge families living in poverty several hundred dollars in income taxes — a substantial amount for a struggling family. Tables 2A, 2B, 3A, and 3B show these amounts.

- The average 2005 tax bill for a family with income at the poverty line in states with below-poverty thresholds is \$145 for a one-parent family of three and \$227 for a two-parent family of four.
- In nine states, the tax bill for a poverty-line family of four exceeds \$200, and in **Alabama** it exceeds \$500. The other states levying tax of \$200 or more on families with poverty-level incomes are **Arkansas, Hawaii, Indiana, Michigan, Montana, Oregon, Virginia, and West Virginia.**
- As noted above, a majority of states do not tax families with poverty-level income.
- Twelve states go further than simply not taxing poor families by offering tax credits that provide refunds to families with income at the poverty line. These credits act as a wage supplement and income support, helping to support families' work efforts and reduce poverty. The amount of refund for families with income at the poverty line is as high as \$1,327 for a family of three in **Vermont** and \$1,540 for a family of four in **Minnesota.**

Taxes on Near-Poor Families

Many families with earnings above the official federal poverty line have difficulty making ends meet. Studies have consistently found that the basic costs of living — food, clothing, housing, transportation, and health care — in most parts of the country exceed the federal poverty line, sometimes substantially.⁶

Federal and state governments recognize the challenges faced by families with incomes slightly above the poverty line and have set eligibility ceilings for some assistance programs, such as energy assistance, school lunch subsidies, and in many states health care subsidies, at 125 percent of the poverty line (\$19,471 for a family of three, \$24,951 for a family of four) or above.

A majority of states, however, continue to levy income tax on families with incomes at 125 percent of the poverty line. Tables 4A and 4B show these amounts.

- Thirty-one states tax two-parent families of four earning 125 percent of the poverty level, with the tax bill exceeding \$500 in nine states — **Alabama, Arkansas, Hawaii, Iowa, Kentucky, Oklahoma, Oregon, Virginia, and West Virginia.**
- Twenty-seven states tax families of three with income at 125 percent of the poverty line.

⁶ See, for example, Sylvia A. Allegretto, *Basic family budgets: Working families' incomes often fail to meet living expenses around the U.S.*, Economic Policy Institute, September 2005.

Can States Afford To Exempt Poor Residents from the Income Tax?

Reducing or eliminating income taxes for low-income families carries with it a “cost” to the state budget, in the form of lost revenue. This cost must be weighed against other demands on a state’s budget and in some years may be deemed unaffordable. But even states that have a large number of poor families, and even states that rely heavily on the income tax for revenue, have found that they can reduce or eliminate such taxes at a reasonable cost to the state treasury.

- *Income Tax Thresholds in Poor States.* Reducing income taxes on poor families can be a greater challenge for states with low median incomes and higher poverty rates than it is for wealthier states, because poorer states generally have more low-income taxpayers and a smaller overall tax base to absorb the loss of revenue. Yet both high-income states and low-income states have been able to exempt poor families from the income tax. Of the 26 states that exempt poor single-parent families of three from income taxation, 12 have median household incomes below the U.S. median according to the U.S. Census Bureau. They include three of the nation’s 10 poorest states, **Kentucky, New Mexico, and Oklahoma.**
- *Income Tax Thresholds in States that Rely Heavily on the Income Tax.* States that rely heavily on income taxes for revenue still can exempt poor families from taxation. Of the 10 states that Census Bureau figures indicate receive their largest share of state and local tax revenue from personal income taxes, seven — **California, Colorado, Maryland, Massachusetts, New York, Virginia, and Wisconsin** — exempt poor families of three from the income tax.

Some States Made Significant Improvements for 2005, But Overall There Was Little Change from the Previous Year

Between 2004 and 2005, a few states made significant improvements in their income-tax treatment of the poor, but looking at the nation as a whole there was little progress. See Tables 5, 6, and 7.

Selected States Improved Between 2004 and 2005

Kentucky, Montana, Ohio, the District of Columbia, and Rhode Island each implemented policy changes in 2005 to reduce income taxes on poor families or to increase poor families’ tax refunds.

- **Kentucky**, which for 2004 levied the highest tax on a family of four at the poverty level (\$652), implemented a low-income credit for 2005 that shields nearly all poor families from paying income tax. As a result, the tax threshold for families of four in **Kentucky** more than tripled from \$5,600 to \$19,400, and the tax liability for such families at the poverty line fell to \$78.⁷ However, the credit does little for families with incomes just above the poverty line:

⁷ Kentucky’s low-income tax credit fully cancels tax liability for families with incomes below the federal poverty guidelines set by the U.S. Department of Health and Human Services for administrative purposes; above those guidelines, it gradually phases out. These guidelines are slightly lower than the poverty threshold for a two-parent family of four used by the Census Bureau for statistical purposes, which is the poverty standard used in this analysis. As a result, Kentucky’s income tax threshold for a two-parent family of four is found in this analysis to fall slightly below the poverty line. The same is true in Virginia.

- **Kentucky's** tax on families of four earning 125 percent of the poverty line remains the highest in the nation in 2005, at \$858.
- In 2005, **Ohio** implemented a major tax cut package, including two provisions that reduce the tax liability of some poor families. The more significant provision for poor families is a tax credit that cancels the income tax liability of very poor Ohioans. As a result, **Ohio's** tax thresholds increased from \$10,500 to \$14,100 for a family of three and from \$13,100 to \$15,400 for a family of four. The second provision is an across-the-board income tax rate cut which primarily benefits wealthy taxpayers but also cuts poor families' marginal tax rates. Nevertheless, the tax that **Ohio** charges a two-parent family of four at the poverty line was relatively unchanged in 2005, increasing from \$154 to \$157. This occurred because the low-income credit only benefits families with incomes significantly below the poverty line and because the rate reduction is offset by the erosion due to inflation of other tax provisions that shield the poor from tax liability.
- **Montana** reduced income tax rates for all taxpayers — including low-income families — in 2005. Although the reduction did not improve **Montana's** threshold, which remains among the nation's lowest, it did reduce taxes paid by families with incomes at the federal poverty line from \$191 to \$143 for a family of three and from \$255 to \$209 for a family of four.
- The **District of Columbia**, which in 2004 was already among the better jurisdictions in its income-tax treatment of the poor, increased its Earned Income Tax Credit in 2005 from 25 percent to 35 percent of the federal EITC. As a result, the **District of Columbia's** tax refund for two-parent families at the poverty line increased from \$213 to \$588.
- **Rhode Island** also augmented its Earned Income Tax Credit in 2005, increasing the refundable portion from 1.25 percent of the federal EITC to 2.5 percent. As a result, its tax refund for families at the poverty line increased from \$51 to \$104 for families of three and from \$42 to \$91 for families of four.

Overall, There Was Little Change Compared To 2004

While a few states improved their income-tax treatment of the poor in 2005, others showed no improvement or in a few cases even increased their taxation of the poor.

- Nineteen states taxed poor two-parent families of four in 2005. This includes all 17 states that did so in 2004,⁸ plus 2 additional states — **Mississippi** and **North Carolina** — whose tax thresholds fell below the poverty line in 2005.
- Sixteen states tax poor single-parent families of three in 2005, the same number as in 2004. Fifteen of these states are the same as in 2004. **Kentucky's** new credit caused it to stop taxing these families, while **North Carolina's** tax threshold fell below the poverty line in 2005.

Another useful measure for evaluating states' progress is the ratio of state income tax thresholds to the poverty line. By this measure, shown in Table 7, income-tax treatment of the poor stagnated or worsened between 2004 and 2005.

⁸ As described above, Kentucky significantly cut — but did not eliminate — taxes on these families.

Future Changes in Income Tax Thresholds

This report shows income tax thresholds for tax year 2005. Under current law, the following changes will take effect in subsequent years. (In addition, legislation is pending in **Alabama** and **Hawaii** that would raise the thresholds there. These proposals are discussed in the Appendix.)

- Beginning in 2006, **Delaware** will offer a nonrefundable Earned Income Tax Credit equal to 20 percent of the federal EITC. As a result, Delaware's threshold will increase further above the poverty line.
- Beginning in 2006, **Virginia** will offer a 20 percent non-refundable EITC that families can choose instead of an existing low-income credit. The change will lift Virginia's threshold for a two-parent family of four above the poverty line.
- **Ohio's** rate cut, described above, will continue to phase in over five years, which will mean small additional tax cuts for each tax year through 2009.
- **Oregon's** EITC will become refundable in 2006 and will increase slightly in 2008, leading to small increases in Oregon's thresholds.

- Twenty-two states — over half of those with income taxes — reduced their tax thresholds as a percent of the poverty line for two-parent families of four. Only 10 states increased their thresholds relative to the poverty line. (The remaining 10 held their thresholds about constant compared to the poverty line.)
- The average threshold of the 42 states with income taxes stayed about the same relative to the poverty line in 2005. The average threshold is 107 percent of the poverty line for 2005, compared to 106 percent in 2004 and 107 percent in 2003.

Why Many States' Thresholds Are Falling Compared to the Poverty Line

In the 22 states where income tax thresholds fell relative to the poverty line since 2004, it was generally not because of explicit policy changes. Rather, tax thresholds fell relative to poverty levels because states failed to update their standard deductions, personal exemptions, and low-income credits to keep up with inflation.⁹ For example, both **Mississippi** and **North Carolina** taxed poor families in 2005 but not 2004, but neither enacted an explicit policy change in the interim. They merely failed to adjust their tax systems to keep up with the rising cost of living. For the same reason, **New Jersey** will begin taxing impoverished two-parent families of four in 2006 unless it increases its tax thresholds.

⁹ The poverty line increases each year to account for the higher cost of food, shelter, and other necessities.

Most States Have Made Substantial Progress since the Early 1990s, While Others Lag Severely Behind

Overall, States' Income-Tax Treatment of the Poor Has Improved Greatly

Since the early 1990s, states generally have improved their income-tax treatment of working poor families. From 1991 to 2005, the number of states levying income tax on poor two-parent families of four decreased from 24 to 19. Over that same span, the average of state tax thresholds increased from 84 percent to 107 percent of the poverty line. And many of the 19 states that still tax poor families have reduced the taxes levied. From 1994 to 2005, the average tax levies fell by 23 percent relative to the poverty line. Tables 5, and 6, and 7 show these changes over time.

A Few States Tax the Incomes of the Poor More Heavily than in the Early 1990s.

A smaller number of states stand out for their lack of progress over the last dozen years in reducing income taxes on the poor.

- **Alabama's** thresholds remain at \$4,600, the lowest in the nation and the same dollar amount it has been since the 1960s. Because the threshold has not changed while the cost of living and the poverty line have increased, between 1991 and 2005 the threshold fell from 33 percent of the poverty line to 23 percent of the poverty line for a family of four.
- In **Connecticut, Mississippi, and West Virginia**, as in **Alabama**, the income tax threshold has fallen compared to the poverty line since 1991. In **Connecticut**, the threshold has fallen over that time from 173 percent to 121 percent of the poverty line.
- Over the last ten years, the **Alabama** income tax on families with poverty-level incomes has risen. The income tax on a family of four with income at the poverty line in 2005 is \$538, compared with \$348 eleven years earlier — a 17 percent increase after adjusting for inflation.
- In **Arkansas, Iowa, Louisiana, Mississippi, Ohio, Virginia, and West Virginia**, as in **Alabama**, the income taxes on families of four with poverty-level incomes have risen since 1994 even after taking inflation into account. As Table 6 shows, the inflation-adjusted increase was 62 percent in **Louisiana**, 44 percent in **Arkansas**, 36 percent in **Virginia**, and 33 percent in **West Virginia**. In **Iowa**, these families' tax liability increased from zero to \$183, the third-highest dollar increase in any state. In each of these states, the reason for the tax increase is that personal exemptions, credits, or other features designed to protect the incomes of low-income families from taxation have eroded due to inflation.

How Can States Reduce Income Taxes on Poor Families?

States have used a variety of mechanisms to reduce income taxes on poor families. Nearly all states offer personal exemptions and/or standard deductions, which reduce the amount of income subject to taxation for all families, including those with low incomes; in a number of states, these provisions by themselves are sufficient to lift the income tax threshold above the poverty line. In addition, many states have enacted provisions targeted to low- and moderate-income families. In

2005, 16 states offered Earned Income Tax Credits based on the federal EITC, which is a tax credit for working-poor families, mostly those with children.¹⁰ Other states offer other types of low-income tax credits, such as New Mexico's "Low-Income Comprehensive Tax Rebate." Finally, a few states have "no-tax floors," which set a dollar level below which families owe no tax but do not affect tax liability for families above that level.

Conclusion

Too many states continue to tax the income of poor families — in some cases, extremely poor families. Improvements in selected states in 2005 were offset by backsliding in others, leading to an overall increase since 2004 in the number of states taxing the poor. The longer trend is brighter — income taxation of poor families has decreased since the early 1990's — but even over that period some states have increased the tax burden on families in poverty. There is a broad range of affordable mechanisms for exempting the poor from the income tax. As Hawaii Governor Linda Lingle said in her 2006 State of the State Address, "the bottom line is that we are collecting income taxes from people who simply can't afford to pay them." A number of states would do well to heed her words.

¹⁰ The 16 states are the District of Columbia, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oklahoma, Oregon, Rhode Island, Vermont, and Wisconsin. Two states, Delaware and Virginia, have passed EITCs that will take effect for 2006. A 19th state, Colorado, has an EITC that is available only in years when certain budgetary conditions are met. The Colorado EITC has been suspended since 2002 and, as the result of a ballot measure passed in 2005, will be likely continue to be suspended through 2011. A full description of current state EITCs and policy issues relating to them may be found in *A Hand Up: How State Earned Income Tax Credits Help Working Families Escape Poverty*, Center on Budget and Policy Priorities, 2006 (forthcoming).

Table 1A. State Income Tax Thresholds for Single-Parent Families of Three, 2005

Rank	State	Threshold
01	Alabama	\$4,600
02	Montana	8,900
03	Hawaii	9,800
04	West Virginia	10,000
05	Michigan	10,800
06	Louisiana	11,000
07	Georgia	12,700
08	Arkansas	13,100
09	Missouri	13,300
10	Illinois	13,400
11	Indiana	13,800
12	Ohio	14,100
13	Oregon	14,200
14	Mississippi	14,400
15	Delaware	14,700
16	North Carolina	15,300
..... Federal Poverty Line		15,577
17	Virginia	15,700
18	Oklahoma	16,000
19	Kentucky	16,100
20	Colorado	16,900
20	Utah	16,900
22	Idaho	17,000
23	Nebraska	17,100
24	North Dakota	17,400
25	Iowa	17,900
26	Connecticut	19,100
27	New Mexico	19,300
28	New Jersey	20,000
29	Arizona	20,100
29	South Carolina	20,100
31	Wisconsin	20,200
32	Maine	22,500
33	District of Columbia	22,900
34	Massachusetts	23,500
35	Kansas	23,900
36	Pennsylvania	25,500
37	New York	26,300
38	Rhode Island	27,700
39	Maryland	28,200
40	Minnesota	28,900
40	Vermont	28,900
42	California	40,500
Average Threshold		\$18,160

Table 1B. State Income Tax Thresholds for Two-Parent Families of Four, 2005

Rank	State	Threshold
01	Alabama	\$4,600
02	West Virginia	10,000
03	Montana	10,800
04	Hawaii	11,500
05	Michigan	14,000
06	Indiana	14,800
07	Illinois	15,349
08	Ohio	15,400
09	Arkansas	15,900
09	Georgia	15,900
11	Louisiana	16,400
12	Missouri	16,700
13	Oregon	16,900
14	Oklahoma	17,200
15	Iowa	18,200
16	Kentucky	19,400
16	North Carolina	19,400
16	Virginia	19,400
19	Mississippi	19,600
..... Federal Poverty Line		19,961
20	New Jersey	20,000
21	Delaware	20,300
22	Colorado	22,800
22	Idaho	22,800
22	Nebraska	22,800
22	New Mexico	22,800
22	Utah	22,800
27	North Dakota	23,300
28	Arizona	23,600
29	District of Columbia	23,900
30	Connecticut	24,100
31	Wisconsin	24,300
32	Massachusetts	25,400
33	Kansas	25,600
34	Maine	25,700
35	South Carolina	27,000
36	New York	29,300
37	Maryland	30,300
38	Rhode Island	30,600
39	Minnesota	31,800
40	Pennsylvania	32,000
41	Vermont	32,200
42	California	42,700
Average Threshold		\$21,360

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 2005 poverty line is a Census Bureau estimate based on the actual 2004 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 2A. State Income Tax at Poverty Line for Single-Parent Families of Three, 2005

Rank	State	Income	Tax
1	Alabama	\$15,577	\$458
2	Hawaii	15,577	373
3	West Virginia	15,577	287
4	Michigan	15,577	186
5	Louisiana	15,577	155
6	Montana	15,577	143
7	Arkansas	15,577	126
8	Oregon	15,577	117
9	Ohio	15,577	90
10	Georgia	15,577	82
11	Illinois	15,577	80
12	Indiana	15,577	77
13	Missouri	15,577	44
14	Delaware	15,577	43
15	Mississippi	15,577	35
16	North Carolina	15,577	21
17	Arizona	15,577	0
17	California	15,577	0
17	Colorado	15,577	0
17	Connecticut	15,577	0
17	Idaho	15,577	0
17	Iowa	15,577	0
17	Kentucky	15,577	0
17	Maine	15,577	0
17	Nebraska	15,577	0
17	North Dakota	15,577	0
17	Pennsylvania	15,577	0
17	South Carolina	15,577	0
17	Utah	15,577	0
17	Virginia	15,577	0
31	Oklahoma	15,577	(17)
32	New Mexico	15,577	(70)
33	Rhode Island	15,577	(104)
34	Wisconsin	15,577	(403)
35	Kansas	15,577	(549)
36	Massachusetts	15,577	(622)
37	Maryland	15,577	(626)
38	New Jersey	15,577	(829)
39	District of Columbia	15,577	(1,047)
40	Minnesota	15,577	(1,100)
41	New York	15,577	(1,121)
42	Vermont	15,577	(1,327)

Source: Center on Budget and Policy Priorities

Table 2B. State Income Tax at Poverty Line for Two-Parent Families of Four, 2005

Rank	State	Income	Tax
1	Alabama	\$19,961	\$538
2	Hawaii	19,961	470
3	Arkansas	19,961	406
4	Virginia	19,961	389
5	West Virginia	19,961	378
6	Oregon	19,961	310
7	Michigan	19,961	232
8	Indiana	19,961	222
9	Montana	19,961	209
10	Iowa	19,961	183
11	Louisiana	19,961	178
12	Illinois	19,961	177
13	Oklahoma	19,961	162
14	Ohio	19,961	157
15	Georgia	19,961	112
16	Kentucky	19,961	78
17	Missouri	19,961	71
18	North Carolina	19,961	39
19	Mississippi	19,961	11
20	Arizona	19,961	0
20	Carolina	19,961	0
20	Colorado	19,961	0
20	Connecticut	19,961	0
20	Delaware	19,961	0
20	Idaho	19,961	0
20	Maine	19,961	0
20	Nebraska	19,961	0
20	North Dakota	19,961	0
20	Pennsylvania	19,961	0
20	South Carolina	19,961	0
20	Utah	19,961	0
32	New Mexico	19,961	(50)
33	Rhode Island	19,961	(91)
34	Wisconsin	19,961	(369)
35	Kansas	19,961	(372)
36	Maryland	19,961	(430)
37	Massachusetts	19,961	(439)
38	District of Columbia	19,961	(588)
39	New Jersey	19,961	(728)
40	New York	19,961	(957)
41	Vermont	19,961	(1,165)
42	Minnesota	19,961	(1,540)

Source: Center on Budget and Policy Priorities

Table 3A. State Income Tax at Minimum Wage for Single-Parent Families of Three, 2005

Rank	State	Income*	Tax
1	Alabama	\$10,712	\$218
2	Hawaii**	13,000	185
3	West Virginia	10,712	143
4	Oregon**	15,080	77
5	Montana	10,712	19
6	Illinois**	13,520	6
7	Arizona	10,712	0
7	Arkansas	10,712	0
7	California**	14,040	0
7	Colorado	10,712	0
7	Connecticut**	14,768	0
7	Delaware**	12,792	0
7	Idaho	10,712	0
7	Iowa	10,712	0
7	Kentucky	10,712	0
7	Louisiana	10,712	0
7	Maine**	13,208	0
7	Michigan	10,712	0
7	Mississippi	10,712	0
7	Missouri	10,712	0
7	Nebraska	10,712	0
7	North Carolina	10,712	0
7	North Dakota	10,712	0
7	Ohio	10,712	0
7	Pennsylvania	10,712	0
7	South Carolina	10,712	0
7	Utah	10,712	0
7	Virginia	10,712	0
29	Georgia	10,712	(24)
30	Indiana	10,712	(97)
31	New Mexico	10,712	(100)
32	Rhode Island**	14,040	(110)
33	Oklahoma	10,712	(152)
34	Wisconsin	11,856	(616)
35	Kansas	10,712	(644)
36	Massachusetts	14,040	(660)
37	Maryland	10,712	(847)
38	New Jersey**	11,232	(880)
39	Minnesota	10,920	(1,095)
40	District of Columbia**	13,728	(1,229)
41	New York**	12,480	(1,320)
42	Vermont**	14,560	(1,394)

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

**These fifteen states had a minimum wage higher than the federal minimum wage in all or part of 2005.

Source: Center on Budget and Policy Priorities

Table 3B. State Income Tax at Minimum Wage for Two-Parent Families of Four, 2005

Rank	State	Income*	Tax
1	Alabama	\$10,712	\$178
2	West Virginia	10,712	83
3	Hawaii**	13,000	50
4	Arizona	10,712	0
4	Arkansas	10,712	0
4	California**	14,040	0
4	Colorado	10,712	0
4	Connecticut**	14,768	0
4	Delaware**	12,792	0
4	Idaho	10,712	0
4	Iowa	10,712	0
4	Kentucky	10,712	0
4	Louisiana	10,712	0
4	Maine**	13,208	0
4	Michigan	10,712	0
4	Mississippi	10,712	0
4	Missouri	10,712	0
4	Montana	10,712	0
4	Nebraska	10,712	0
4	North Carolina	10,712	0
4	North Dakota	10,712	0
4	Ohio	10,712	0
4	Oregon**	15,080	0
4	Pennsylvania	10,712	0
4	South Carolina	10,712	0
4	Utah	10,712	0
4	Virginia	10,712	0
28	Georgia	10,712	(32)
29	Illinois**	13,520	(54)
30	Rhode Island**	14,040	(110)
31	New Mexico	10,712	(130)
32	Indiana	10,712	(131)
33	Oklahoma	10,712	(215)
34	Wisconsin**	11,856	(616)
35	Kansas	10,712	(644)
36	Massachusetts	14,040	(660)
37	Maryland	10,712	(858)
38	New Jersey**	11,232	(880)
39	Minnesota**	10,090	(1,095)
40	District of Columbia**	13,728	(1,229)
41	New York**	12,480	(1,320)
42	Vermont**	14,560	(1,408)

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

**These fifteen states had a minimum wage higher than the federal minimum wage in all or part of 2005.

Source: Center on Budget and Policy Priorities

Table 4A. State Income Tax at 125% of Poverty Line for Single-Parent Families of Three, 2005

Rank	State	Income	Tax
1	Alabama	\$19,471	\$653
2	Hawaii	19,471	612
3	Virginia	19,471	559
4	Oregon	19,471	498
5	Arkansas	19,471	474
6	Kentucky	19,471	464
7	West Virginia	19,471	438
8	Michigan	19,471	338
9	Louisiana	19,471	305
10	Montana	19,471	284
11	Indiana	19,471	259
12	North Carolina	19,471	255
13	Georgia	19,471	248
14	Illinois	19,471	238
15	Delaware	19,471	230
16	Ohio	19,471	204
17	Oklahoma	19,471	203
18	Missouri	19,471	176
19	Utah	19,471	161
20	Iowa	19,471	160
21	Mississippi	19,471	153
22	Colorado	19,471	118
23	Nebraska	19,471	88
24	North Dakota	19,471	54
25	Idaho	19,471	46
26	Connecticut	19,471	4
27	New Mexico	19,471	3
28	Arizona	19,471	0
28	California	19,471	0
28	Maine	19,471	0
28	Pennsylvania	19,471	0
28	South Carolina	19,471	0
33	Wisconsin	19,471	(72)
34	Rhode Island	19,471	(73)
35	Maryland	19,471	(277)
36	Kansas	19,471	(290)
37	Massachusetts	19,471	(325)
38	District of Columbia	19,471	(516)
39	New Jersey	19,471	(665)
40	New York	19,471	(719)
41	Vermont	19,471	(972)
42	Minnesota	19,471	(1,404)

Source: Center on Budget and Policy Priorities

Table 4B. State Income Tax at 125% of Poverty Line for Two-Parent Families of Four, 2005

Rank	State	Income	Tax
1	Kentucky	\$24,951	\$858
2	Oregon	24,951	813
3	Hawaii	24,951	808
4	Alabama	24,951	788
5	Arkansas	24,951	683
6	Virginia	24,951	637
7	Iowa	24,951	624
8	West Virginia	24,951	578
9	Oklahoma	24,951	505
10	Indiana	24,951	455
11	Michigan	24,951	427
12	Montana	24,951	424
13	Illinois	24,951	379
14	Georgia	24,951	373
15	North Carolina	24,951	339
16	Ohio	24,951	332
17	New Jersey	24,951	280
18	Missouri	24,951	279
19	Louisiana	24,951	279
20	Delaware	24,951	228
21	Utah	24,951	178
22	Arizona	24,951	167
23	Mississippi	24,951	164
24	District of Columbia	24,951	155
25	Nebraska	24,951	141
26	Colorado	24,951	100
27	Wisconsin	24,951	54
28	North Dakota	24,951	45
29	New Mexico	24,951	37
30	Idaho	24,951	34
31	Connecticut	24,951	7
32	California	24,951	0
32	Maine	24,951	0
32	Pennsylvania	24,951	0
32	South Carolina	24,951	0
36	Maryland	24,951	(18)
37	Massachusetts	24,951	(34)
38	Kansas	24,951	(39)
39	Rhode Island	24,951	(50)
40	New York	24,951	(441)
41	Vermont	24,951	(751)
42	Minnesota	24,951	(1,077)

Source: Center on Budget and Policy Priorities

Table 5. Tax Threshold for a Family of Four, 1991-2005

State	1991	1994	1997	2000	2003	2004	2005	Change 1991-2004
Alabama	\$4,600	\$4,600	\$4,600	\$4,600	\$4,600	\$4,600	\$4,600	\$0
Arizona	15,000	15,800	20,000	23,600	23,600	23,600	23,600	8,600
Arkansas	10,700	10,700	10,700	15,600	15,500	15,500	15,900	5,200
California	20,900	22,600	23,800	36,800	40,200	41,500	42,700	21,800
Colorado	14,300	16,200	17,500	27,900	21,700	22,100	22,800	8,500
Connecticut	24,100	24,100	24,100	24,100	24,100	24,100	24,100	0
Delaware	8,600	8,600	12,700	20,300	20,300	20,300	20,300	11,700
District of Columbia	14,300	16,200	17,500	18,600	20,700	21,700	23,900	9,600
Georgia	9,000	11,100	13,100	15,300	15,900	15,900	15,900	6,900
Hawaii	6,300	6,300	6,100	11,000	11,500	11,500	11,500	5,200
Idaho	14,300	16,200	17,500	20,100	21,800	22,200	22,800	8,500
Illinois	4,000	4,000	4,000	14,000	15,000	15,200	15,349	11,349
Indiana	4,000	4,000	8,500	9,500	14,400	14,600	14,800	10,800
Iowa	9,000	15,300	16,500	17,400	17,900	18,000	18,200	9,200
Kansas	13,000	13,000	13,000	21,100	24,400	24,700	25,600	12,600
Kentucky	5,000	5,000	5,000	5,400	5,500	5,600	19,400	14,400
Louisiana	11,000	11,000	12,300	13,000	15,600	15,900	16,400	5,400
Maine	14,100	14,800	17,500	23,100	24,600	25,000	25,700	11,600
Maryland	15,800	19,400	22,900	25,200	28,500	29,000	30,300	14,500
Massachusetts	12,000	12,000	17,400	20,600	24,000	24,300	25,400	13,400
Michigan	8,400	8,400	10,000	12,800	13,600	13,600	14,000	5,600
Minnesota	15,500	19,000	21,600	26,800	30,200	30,900	31,800	16,300
Mississippi	15,900	15,900	15,900	19,600	19,600	19,600	19,600	3,700
Missouri	8,900	9,700	10,200	14,100	16,200	16,400	16,700	7,800
Montana	6,600	7,200	8,800	9,500	10,100	10,400	10,800	4,200
Nebraska	14,300	16,200	17,900	18,900	21,700	22,100	22,800	8,500
New Jersey	5,000	7,500	7,500	20,000	20,000	20,000	20,000	15,000
New Mexico	14,300	16,300	17,500	21,000	22,000	22,100	22,800	8,500
New York	14,000	16,900	22,300	23,800	27,700	28,200	29,300	15,300
North Carolina	13,000	13,000	17,000	17,000	18,000	19,400	19,400	6,400
North Dakota	14,700	16,500	18,000	19,000	22,200	22,600	23,300	8,600
Ohio	10,500	10,500	12,000	12,700	12,900	13,100	15,400	4,900
Oklahoma	10,000	10,900	12,200	13,000	16,600	16,800	17,200	7,200
Oregon	10,100	10,900	14,000	14,800	16,000	16,400	16,900	6,800
Pennsylvania	9,800	15,300	20,600	28,000	31,000	32,000	32,000	22,200
Rhode Island	17,400	21,100	24,400	25,900	28,700	29,300	30,600	13,200
South Carolina	14,300	16,800	20,200	21,400	23,200	25,200	27,000	12,700
Utah	12,200	13,600	14,900	15,800	21,700	22,100	22,800	10,600
Vermont	17,400	21,100	24,400	26,800	30,200	30,800	32,200	14,800
Virginia	8,200	8,200	8,200	17,100	18,400	18,900	19,400	11,200
West Virginia	8,000	8,000	10,000	10,000	10,000	10,000	10,000	2,000
Wisconsin	14,400	16,400	17,000	20,700	23,000	23,400	24,300	9,900
Average	\$11,736	\$13,102	\$14,983	\$18,474	\$20,067	\$20,443	\$21,370	\$9,635
Federal Poverty Line	\$13,924	\$15,141	\$16,400	\$16,400	\$18,810	\$19,311	\$19,961	\$6,037
Average as % poverty	84%	87%	91%	113%	107%	106%	107%	23%
Number Above Poverty Line	18	19	21	26	24	25	23	
Number Below Poverty Line	24	23	21	16	18	17	19	

Source: Center on Budget and Policy Priorities

Table 6. State Income Tax at the Poverty Line for Families of Four in States with Below-Poverty Thresholds in 2004

State	1994	2004	2005	Change 94–05	Percent change after inflation, 94–05*
Louisiana	\$83	\$168	\$178	\$95	62%
Arkansas	214	403	406	192	44%
Virginia	217	425	389	172	36%
West Virginia	215	354	378	163	33%
Alabama	348	513	538	190	17%
Ohio	107	154	157	50	11%
Iowa	0	141	183	183	—
Mississippi	0	0	11	11	—
Oklahoma	139	141	162	23	–12%
Hawaii	406	434	470	64	–12%
Montana	211	255	209	(2)	–25%
Georgia	116	89	112	(4)	–27%
Oregon	331	289	310	(21)	–29%
Michigan	301	226	232	(69)	–41%
Indiana	379	215	222	(157)	–55%
Illinois	334	169	177	(157)	–60%
Missouri	147	62	71	(77)	–64%
North Carolina	128	0	39	(90)	–77%
Kentucky	499	652	78	(421)	–88%
Average	\$220	\$247	227	\$8	–21%

Notes: Dollar amounts shown are nominal amounts.
* "Percent change after inflation" shows the percentage change adjusted for the 1.32 percent change in the cost of living from 1994 to 2005 as measured by the Consumer Price Index.

Source: Center on Budget and Policy Priorities

Table 7. Tax Threshold as a Percent of the Federal Poverty Line for a Family of Four, 1991-2005

State	1991	1994	2004	2005	% Point Change 1991-2005	% Point Change 2004-2005
Alabama	33%	30%	24%	23%	-10%	-1%
Arizona	108%	104%	122%	118%	11%	-4%
Arkansas	77%	71%	80%	80%	3%	-1%
California	150%	149%	215%	214%	64%	-1%
Colorado	103%	107%	114%	114%	12%	0%
Connecticut	173%	159%	125%	121%	-52%	-4%
Delaware	62%	57%	105%	102%	40%	-3%
District of Columbia	103%	107%	112%	120%	17%	7%
Georgia	65%	73%	82%	80%	15%	-3%
Hawaii	45%	42%	60%	58%	12%	-2%
Idaho	103%	107%	115%	114%	12%	-1%
Illinois	29%	26%	79%	77%	48%	-2%
Indiana	29%	26%	76%	74%	45%	-1%
Iowa	65%	101%	93%	91%	27%	-2%
Kansas	93%	86%	128%	128%	35%	0%
Kentucky	36%	33%	29%	97%	61%	68%
Louisiana	79%	73%	82%	82%	3%	0%
Maine	101%	98%	129%	129%	27%	-1%
Maryland	113%	128%	150%	152%	38%	2%
Massachusetts	86%	79%	126%	127%	41%	1%
Michigan	60%	55%	70%	70%	10%	0%
Minnesota	111%	125%	160%	159%	48%	-1%
Mississippi	114%	105%	101%	98%	-16%	-3%
Missouri	64%	64%	85%	84%	20%	-1%
Montana	47%	48%	54%	54%	7%	0%
Nebraska	103%	107%	114%	114%	12%	0%
New Jersey	36%	50%	104%	100%	64%	-3%
New Mexico	103%	108%	114%	114%	12%	0%
New York	101%	112%	146%	147%	46%	1%
North Carolina	93%	86%	100%	97%	4%	-3%
North Dakota	106%	109%	117%	117%	11%	0%
Ohio	75%	69%	68%	77%	2%	9%
Oklahoma	72%	72%	87%	86%	14%	-1%
Oregon	73%	72%	85%	85%	12%	0%
Pennsylvania	70%	101%	166%	160%	90%	-5%
Rhode Island	125%	139%	152%	153%	28%	2%
South Carolina	103%	111%	130%	135%	33%	5%
Utah	88%	90%	114%	114%	27%	0%
Vermont	125%	139%	159%	161%	36%	2%
Virginia	59%	54%	98%	97%	38%	-1%
West Virginia	57%	53%	52%	50%	-7%	-2%
Wisconsin	103%	108%	121%	122%	18%	1%
Average	84%	87%	106%	107%	23%	1%

Source: Center on Budget and Policy Priorities

Appendix: The Potential Impact of Proposals in Alabama and Hawaii

The governors of Alabama and Hawaii, as well as leading legislators in each of those states, have introduced bills that would substantially increase income tax thresholds and reduce income taxes paid by low-income families. These proposals are important because, as the body of this report finds, Alabama and Hawaii are among the states with the lowest thresholds and highest taxes on low-income families.

This appendix describes how some of the results of this report would have been different if the changes proposed in Alabama and Hawaii had been in effect in 2005.

Alabama

In Alabama, which has by far the nation's lowest income tax thresholds, several bills have been filed that would reduce income taxes substantially for low-income families.¹¹

- **HB 290.** Proposed by Gov. Bob Riley and introduced by Rep. Jay Love, HB 290 would raise standard deductions and personal exemptions. The bill would phase the changes in over five years, contingent on specific levels of revenue growth. According to the Alabama Legislative Fiscal Office, this bill would cost about \$233 million per year when fully implemented.
- **HB 292.** Introduced by Rep. John Knight, HB 292 would increase standard deductions and personal exemptions to a greater degree than Gov. Riley's proposal and would implement the changes for tax year 2007, with inflation adjustments in each year thereafter. Lost revenue would be offset by repeal of an existing tax deduction for federal income taxes. (This aspect of the bill does not directly affect low-income families, since such families generally do not have federal income tax liability.)¹²
- **HB 578.** Also introduced by Knight, HB 578 would allow families a non-refundable tax credit equal to 12 percent of the federal Earned Income Tax Credit, phased in over three years and contingent on specific levels of revenue growth. According to the Institute on Taxation and Economic Policy (ITEP), this provision would cost about \$84 million per year when fully implemented.

Table A-1 describes how each of these proposals would have affected Alabama's income tax thresholds and taxes paid by working families with incomes at the poverty line if they had been in

¹¹ This list of bills includes those that substantially affect income tax thresholds and that are focused on the personal income tax. Therefore, it excludes bills that have relatively little impact on thresholds. It also excludes bills that deliver a majority of their benefits through taxes other than the income tax, such as sales taxes.

¹² This deduction is enshrined in the Alabama Constitution, so it would require not only legislative approval but also a statewide referendum to eliminate it. HB 292 is worded in such a way that none of its provisions could take effect unless the referendum passed. Neither of the other two bills described in this section trigger such a requirement.

Table A-1: Impact of Proposed Income Tax Changes on Alabama Tax Thresholds and Taxes Paid if Proposals Were Already Fully Implemented in 2005

	Current law	HB 290 – Riley/Love	HB 292 – Knight	HB 578 – Knight
Annual cost compared to current law when fully implemented	—	\$233 million	\$0	\$84 million
Single-parent family of three				
Income tax threshold	\$4,600	\$11,600	\$17,000	\$16,100
Tax at poverty line (\$15,577)	\$458	\$163	\$0	\$0
Threshold rank (1=lowest)	1	6	21 (tie)	18 (tie)
Two-parent family of four				
Income tax threshold	\$4,600	\$15,100	\$22,900	\$18,400
Tax at poverty line (\$19,961)	\$538	\$178	\$0	\$101
Threshold rank (1=lowest)	1	6	26	15

Note: Threshold rank indicates what the ranking would have been in 2005 among the 42 states that levy income taxes had the proposal been in effect and fully implemented.

effect in tax year 2005. The proposals' impacts are for the same two family types that are considered in the body of this report, based on the same assumptions.¹³

Table A-1 also illustrates how Alabama's *ranking* on the measure of income tax thresholds in 2005 would have been different under each of the three proposals.

Of the three proposals analyzed here, HB 292 would have the biggest impact on income tax thresholds, eliminating income taxes fully for families of three and families of four with incomes below the poverty line. Alabama's income tax thresholds would be close to the median state's thresholds in 2005.

HB 578 would have the second-largest impact. It would eliminate income taxes on families of four with poverty-level income and reduce them substantially for families of three. Alabama's rankings would be close to, but still slightly below, the median state's thresholds for 2005.

Under the provisions of HB 290, Gov. Riley's proposal, Alabama's income tax threshold would improve significantly and income taxes levied on families with poverty-level incomes would fall substantially. Measured in comparison to other states' income tax thresholds in 2005, Alabama would remain among the half-dozen states with the lowest thresholds.

¹³ The calculations in this section are based on what the impacts *would have been* if the bills had been fully in effect for tax year 2005, even though in fact their years of full implementation range from 2007 to 2011. This approach has the effect of somewhat understating the benefits of Rep. Knight's two bills, HB292 and HB578, since their provisions are tied to provisions of the federal Internal Revenue Code, which in turn are adjusted on an annual basis for inflation. By contrast, neither the provisions of current law nor the provisions of Gov. Riley's proposed HB290 are indexed for inflation, so thresholds in future years under these options would decline over time relative to the poverty line.

Hawaii

In Hawaii, the 2005 and 2006 legislative sessions have brought a raft of legislative activity aimed at increasing the state's thresholds, which are among the lowest in the nation. The bills employ four mechanisms for decreasing tax liability for the poor: increasing Hawaii's standard deductions; enacting a state Earned Income Tax Credit; enacting a fixed, refundable state credit; and expanding the tax brackets. The legislators advancing these provisions have been joined recently by Gov. Linda Lingle, who in her 2006 State of the State address proposed a comprehensive package aimed at tax relief for the poor.

This analysis focuses on three proposals: a standard deduction increase; an Earned Income Tax Credit, and Gov. Lingle's plan, which combines several elements.

- **Increased standard deductions.** Numerous bills¹⁴ have been introduced during the 2005 and 2006 legislative sessions to increase the standard deductions, which at \$1,650 for a single parent and \$1,900 for a married couple are far below those of most other states. Some of the bills increase the standard deductions modestly, while others raise them to the federal standard deductions: \$7,300 for a single parent and \$10,000 for a married couple. The federal level is the option modeled here. According to ITEP, this provision would cost about \$103 million per year.
- **EITC.** A second group of proposed bills¹⁵ would enact a state Earned Income Tax Credit, generally set at 20 percent of the federal EITC. It is worth noting that the EITC bills that have been introduced would require that the EITC be offset by other credits, so taxpayers would effectively be required to choose between claiming the EITC and the existing low-income tax credit. According to ITEP, this provision would cost \$17.5 million per year.
- **Gov. Lingle's proposal.** The governor's plan includes three permanent provisions that would increase income tax thresholds. Under state law, House Speaker Calvin Say is required to introduce the Governor's proposal, which he did as HB 2413 and HB 2415. The plan would raise Hawaii's standard deductions to 75 percent of the federal standard deductions. Tax brackets would be widened. And a new, \$100-per-person refundable tax credit would be created intended to help with the cost of food and health care services for individuals and families with incomes below \$50,000. This credit could be claimed in addition to existing credits. The Governor's office estimates that this package would cost about \$157 million per year.¹⁶

Table A-2 shows how each of these proposals — had it been effective for tax year 2005 — would have affected Hawaii's income tax thresholds and taxes paid by working families with incomes at the

¹⁴ See, for example, HB 93, HB 276, HB 478, HB 726, HB 1799, HB 2015, HB 2782, HB 2783, SB 97, SB 835, SB 1612, SB 1676, and SB 2568.

¹⁵ See, for example, HB 957, HB 1408, HB 2613, and SB 1410.

¹⁶ The Governor also proposed a one-time means-tested \$150-per-person tax refund for tax year 2006 at a cost of \$128.5 million. This proposal, which has been introduced as HB 2411, is not included in this analysis, since the subject of this analysis is permanent provisions.

Table A-2: Impact of Proposed Income Tax Changes on Hawaii Tax Thresholds and Taxes Paid if Proposals Were Already Fully Implemented in 2005

	Current law	Federal standard deduction	EITC	Gov.'s Plan – HB 2413 & 2415
Annual cost compared to current law when fully implemented	—	\$103 million	\$17.5 million	\$157 million
Single-parent family of three				
Income tax threshold	\$9,800	\$14,500	\$19,700	\$18,900
Tax at poverty line (\$15,577)	\$373	\$82	\$426 refund	\$174 refund
Threshold rank (1=lowest)	3	14	27	25
Two-parent family of four				
Income tax threshold	\$11,500	\$17,100	\$22,200	\$24,800
Tax at poverty line (\$19,961)	\$470	\$74	\$219 refund	\$264 refund
Threshold rank (1=lowest)	4	13	21	31

Note: Threshold rank indicates what the ranking would have been in 2005 among the 42 states that levy income taxes.

poverty line.¹⁷ The proposals' impacts are shown for the same two family types that are considered in the body of this report, based on the same assumptions. Table A-2 also illustrates how Hawaii's *ranking* on the measure of income tax thresholds in 2005 would have been different under each of the proposals.

Of the proposals analyzed here, both the EITC and Gov. Lingle's proposal would be sufficient to move Hawaii's thresholds well above the poverty line, and to guarantee tax refunds to families at the poverty line. Hawaii's income-tax treatment of low-income families would go from being substantially *worse* than that of other states to being *better* than that of most other states. The standard deduction increase as modeled here would also increase the thresholds substantially but would leave thresholds somewhat below the poverty line and lower than those in the majority of other states. (Of course, if the standard deduction increase were combined with other changes — such as an EITC — the impact would be greater.)

There are other significant differences among the proposals. One is the large differences in the amount of lost revenue to the state. Another is the difference in targeting: the governor's proposal would reduce taxes on all or most Hawaii residents, whereas an EITC benefits only families with low and moderate incomes, and nearly all of its benefits accrue to those with children. A third is that the governor's proposed credit is fully refundable to families regardless of family structure or employment status, while the EITC is available only to families with earned income. Fourth, the governor's proposals are not indexed to keep up with inflation; once the new higher thresholds were set, they would begin to deteriorate each year compared to the poverty line — as they do under current law.

¹⁷ The U.S. Department of Human Services, recognizing that the cost of living in Hawaii generally is greater than on the mainland, maintains a different, higher "poverty guideline" for Hawaii. Consistent with the body of this report, however, this analysis uses the U.S. Census Bureau's "poverty threshold" which is the same for all 50 states.