# The Effect of Changes in Tax Policy on Indiana Families

## Indiana Family Impact Seminars

## Briefing Report


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## Purpose, Presenters and Publications

**Family Impact Seminars have been well received by federal policymakers in Washington, DC, and Indiana is one of several states to sponsor such seminars for state policymakers. Family Impact Seminars provide state-of-the-art research on current family issues for state legislators and their aides, Governor's Office staff, state agency representatives, educators, and service providers. One of the best ways to help individuals is by strengthening their families. Therefore, the Family Impact Seminars speakers analyze the consequences an issue, policy or program may have for families.**

**The seminars provide objective, nonpartisan information on current issues and do not lobby for particular policies. Seminar participants discuss policy options and identify common ground where it exists.**

*The Effect of Changes in Tax Policy on Indiana Families* is the fifth in a continuing series designed to bring a family focus to policymaking. The topic was chosen by the very legislators these seminars are intended to inform. This year's topic focuses on how the changes in tax laws made during the previous legislative session will affect Hoosier families, with an emphasis on low-income families. This fifth seminar features the following speakers:


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**The Effect of Changes in Tax Policy on Indiana Families**

Each seminar is accompanied by an in-depth briefing report that summarizes the latest research on a topic and identifies policy options from across the political spectrum. This Briefing report consists of the speakers' slides and their notes as they were presented to the Legislature.

Table of Contents

# Introduction to the 2003 Family Impact Seminar Briefing Report:
# It is Different This Year!

If you have received Family Impact Seminar briefing reports from us in prior years, you will notice that this year's report looks quite different. The speakers at this year's seminar came prepared with extensive slide sets that definitely were worth thousands of words! So we decided to present their slides, accompanied by brief annotations, in our briefing report. The slide sets also are available electronically - simply download the pdf file from the Policymakers section of the Publications page at: www.cfs.purdue.edu/CFF/publications.html .

We hope that this information is useful to you in your deliberations, and we look forward to continuing to provide educational seminars and briefing reports in the future.

**Copies of this 2003 Briefing Report may be downloaded from the Center for Families Website, www.cfs.purdue.edu/CFF/publications.html. Earlier Briefing Reports may be obtained from The Center for Families at Purdue University, (765) 494 – 8573.**

# A Checklist for Assessing the Impact of Policies and Programs on Families

The first step in developing family-friendly policies is to ask the right questions:

- What can government and community institutions do to enhance the family's capacity to help itself and others?
- What effect does (or will) this policy (or proposed program) have for families? Will it help or hurt, strengthen or weaken family life?

These questions sound simple, but they can be difficult to answer.

The Family Criteria (Ad Hoc) Task Force of the Consortium of Family Organizations (COFO) developed a checklist to assess the intended and unintended consequences of policies and programs on family stability, family relationships, and family responsibilities. The checklist includes six basic principles. These principles serve as the criteria for evaluating policies and programs for sensitivity to and support of families. Each principle is accompanied by a series of family impact questions.

The principles are not rank ordered and sometimes they conflict with each other, requiring trade-offs. Cost effectiveness also must be considered. Some questions are value-neutral and others incorporate specific values. People may not always agree on these values, so sometimes the questions will require rephrasing. This tool, however, reflects a broad nonpartisan consensus, and it can be useful to people across the political spectrum.

*For the questions that apply to your policy or program, record the impact on family well-being.*

## Principle 1. Family support and responsibilities.

Policies and programs should aim to support and supplement family functioning and provide substitute services only as a last resort.

Does the proposal or program:

- support and supplement parents' and other family members' ability to carry out their responsibilities?
- provide incentives for other persons to take over family functioning when doing so may not be necessary?
- set unrealistic expectations for families to assume financial and/or caregiving responsibilities for dependent, seriously ill, or disabled family members?
- enforce absent parents' obligations to provide financial support for their children?

## Principle 2. Family membership and stability.

Whenever possible, policies and programs should encourage and reinforce marital, parental, and family commitment and stability, especially when children are involved. Intervention in family membership and living arrangements is usually justified only to protect family members from serious harm or at the request of the family itself.

Does the policy or program:

- provide incentives or disincentives to marry, separate, or divorce?
- provide incentives or disincentives to give birth to, foster, or adopt children?
- strengthen marital commitment or parental obligations?
- use appropriate criteria to justify removal of a child or adult from the family?
- allocate resources to help keep the marriage or family together when this is the appropriate goal?
- recognize that major changes in family relationships such as divorce or adoption are processes that extend over time and require continuing support and attention?

## Principle 3. Family involvement and interdependence.

Policies and programs must recognize the interdependence of family relationships, the strength and persistence of family ties and obligations, and the wealth of resources that families can mobilize to help their members.

To what extent does the policy or program:

- ❖ recognize the reciprocal influence of family needs on individual needs, and the influence of individual needs on family needs?
- ❖ recognize the complexity and responsibilities involved in caring for family members with special needs (e.g., physically or mentally disabled, or chronically ill)?
- ❖ involve immediate and extended family members in working toward a solution?
- ❖ acknowledge the power and persistence of family ties, even when they are problematic or destructive?
- ❖ build on informal social support networks (such as community/neighborhood organizations, religious communities) that are essential to families' lives?
- ❖ respect family decisions about the division of labor?
- ❖ address issues of power inequity in families?
- ❖ ensure perspectives of all family members are represented?
- ❖ assess and balance the competing needs, rights, and interests of various family members?
- ❖ protect the rights and safety of families while respecting parents' rights and family integrity?

## Principle 4. Family partnership and empowerment.

Policies and programs must encourage individuals and their close family members to collaborate as partners with program professionals in delivery of services to an individual. In addition, parent and family representatives are an essential resource in policy development, program planning, and evaluation.

In what specific ways does the policy or program:

- ❖ provide full information and a range of choices to families?
- ❖ respect family autonomy and allow families to make their own decisions? On what principles are family autonomy breached and program staff allowed to intervene and make decisions?
- ❖ encourage professionals to work in collaboration with the families of their clients, patients, or students?
- ❖ take into account the family's need to coordinate the multiple services they may require and integrate well with other programs and services that the families use?
- ❖ make services easily accessible to families in terms of location, operating hours, and easy-to-use application and intake forms?
- ❖ prevent participating families from being devalued, stigmatized, or subjected to humiliating circumstances?
- ❖ involve parents and family representatives in policy and program development, implementation, and evaluation?

## Principle 5. Family diversity.

Families come in many forms and configurations, and policies and programs must take into account their varying effects on different types of families. Policies and programs must acknowledge and value the diversity of family life and not discriminate against or penalize families solely for reasons of structure, roles, cultural values, or life stage.

How does the policy or program:

- affect various types of families?
- acknowledge intergenerational relationships and responsibilities among family members?
- provide good justification for targeting only certain family types, for example, only employed parents or single parents? Does it discriminate against or penalize other types of families for insufficient reason?
- identify and respect the different values, attitudes, and behavior of families from various racial, ethnic, religious, cultural, and geographic backgrounds that are relevant to program effectiveness?

## Principle 6. Support of vulnerable families.

Families in greatest economic and social need, as well as those determined to be most vulnerable to breakdown, should be included in government policies and programs.

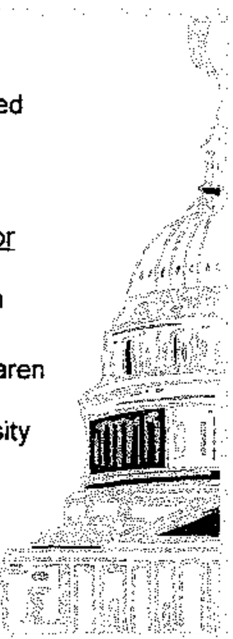
Does the policy or program:

- identify and publicly support services for families in the most extreme economic or social need?
- give support to families who are most vulnerable to breakdown and have the fewest resources?
- target efforts and resources toward preventing family problems before they become serious crises or chronic situations?

Adapted from Ooms, T. (1995). Taking families seriously as an essential policy tool. Paper prepared for an expert meeting on Family Impact in Leuven, Belgium.

The first version of this checklist was published by Ooms, T., & Preister, S. (Eds., 1988). A strategy for strengthening families: Using family criteria in policymaking and program evaluation. Washington DC: Family Impact Seminar.

The checklist and the papers are available from Karen Bogenschneider and Jessica Mills of the Policy Institute for Family Impact Seminars at the University of Wisconsin-Madison/Extension, 120 Human Ecology, 1300 Linden Drive, Madison, WI, 53706; phone (608) 263-2353; FAX (608) 262-5335; http//sohe.wisc.edu/familyimpact.



# Prospects for Indiana Families

Indiana Family Impact Seminar

Presentation by

Charles Warren, Ph.D.
January 8, 2003

## Prospects for Indiana Families

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## Indiana's Families

- Family Structure
- Incomes
- Wages
- Family Budgets
- Families in Need
- Findings

This presentation attempts to provide a snapshot of Indiana families, and should provide a context for the presentations on Indiana taxes that follow.

First we will look at a summary of data from the 2000 Census on:

family structure
incomes
wages
family budgets
and families in need

The central question is: How are Hoosier families doing?

## People and Families

### Indiana's People & Households

- 2000 Census = 6,080,485 Hoosiers
- 5.9 million in households (97% of Total population)
- Over 2.3 million households

The 2000 Census estimated Indiana's population at just over 6 million people.
5.9 million Hoosiers live in households – 97 percent of the total- and there are 2.3 million households.
A "household" is all the persons who occupy a housing unit. They need not be related or part of the same family. (A family consists only of those persons related by marriage, birth or adoption.)

### Indiana is more diverse!

Population change, 1990 to 2000, Up 9.7%

- Whites: ↑ 6%
- Blacks: ↑ 18%
- Hispanics: ↑ 117%
- Asians: ↑ 55%

We can also see that Indiana is becoming more diverse!

While total population increased by 9.7%, Whites gained only 6%
Blacks increased by 18%
Hispanics, still only 3.5% of the population, grew by 118%
and Asians, only 1% of the total, increased by 55%

## Indiana Families, 2000

- All families -- 1.6 million
- Married couples families -- 1.25 million
- Married couples w/ children -- 556,000
- Single mothers -- 160,000
- Single fathers -- 51,400

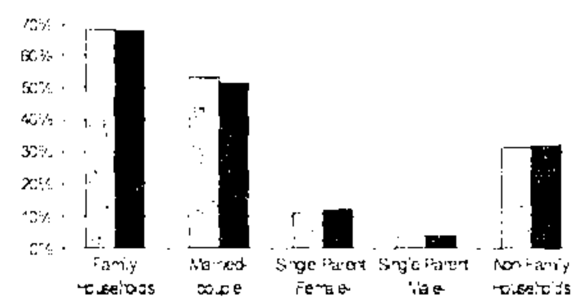
There are 2.3 million households in Indiana.

Of those households, 1.6 million are families; of those families, 1.25 million are married couples. Of those married couples 556,000 have children.

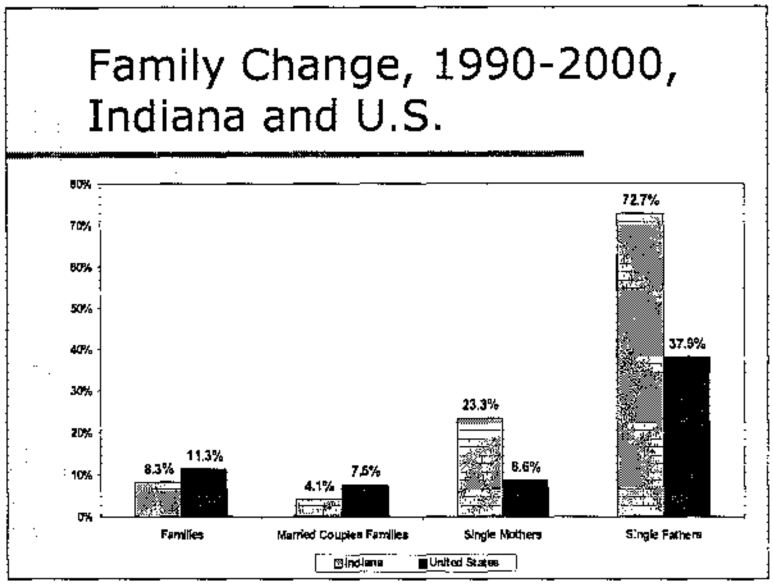
-- So, married couples living with their children represent just 35% of all families, and only 24% of all households.

160,000 families are headed by single mothers and 51,400 are headed by single fathers.

## Type of Households, Indiana and U.S.




| | Family Households | Married-couple | Single Parent Female | Single Parent Male | Non-Family Households |
|---|---|---|---|---|---|
| % Households Indiana | 68.6% | 53.6% | 11.1% | 3.9% | 31.4% |
| % Households U.S. | 68.1% | 51.7% | 12.2% | 4.2% | 31.9% |




The number of families in Indiana increased by 8.3% from 1990 to 2000; a slower growth rate than the U.S. increase of 11.3%.

Married couples families grew only by 4.1%, compared to a 7.5% U.S. increase.

Single mothers increased dramatically, up 23 percent, compared to a much smaller increase of 8.6% in the U.S. Single fathers grew even more sharply, up by 72 percent!

## Hoosier Incomes

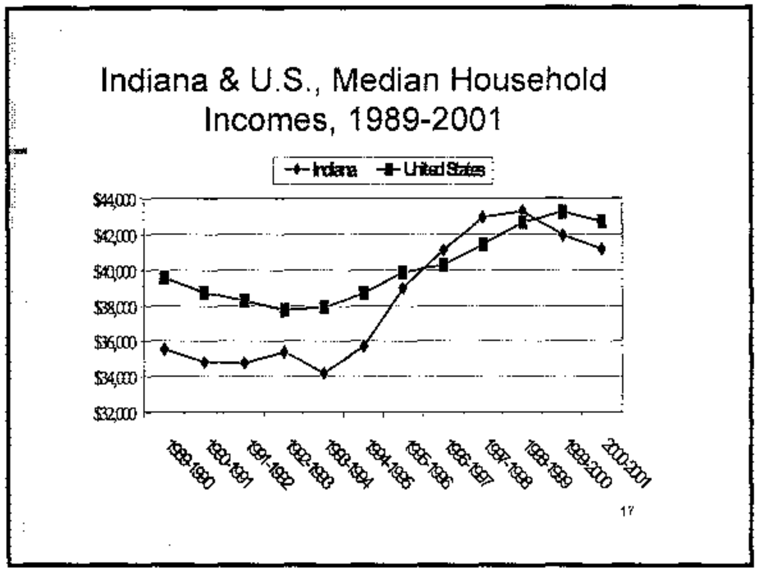
### Indiana Median Household Income

- $41,192* ranks 30th
- Lowest of Great Lakes States
- Declined by 4.8% since 1998

*2000-2001, 2 year average, U.S. Census Bureau

Now, let's look at the Indiana Median Household Income:

In 2000-2001 the median household income was $41,192, which ranks Indiana 30th among the 50 states.




Moreover, the Indiana Median Household Income is the lowest among the Great Lakes states, and has declined by almost 5% since 1998.

## Median Family Income: Indiana, 2000

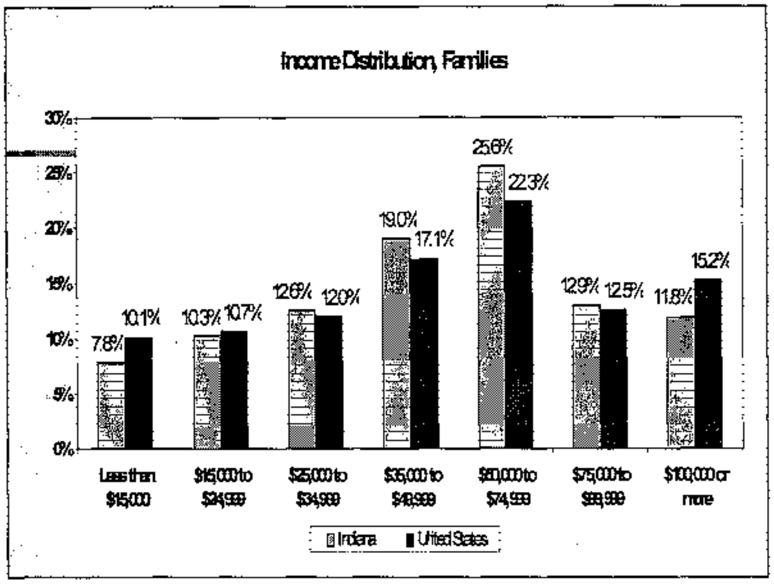
- $50,261, ranks 21st
- Slightly above U.S. average of $50,046
- IN ranks 5th of 6 Great Lakes States
  - MN, IL, MI, WI, IN, OH

Indiana Median Family Income is

$50, 261, which ranks Indiana much higher, at 21st among the states.

-- Could that be due to many more two-income families?

Median family income is slightly above the U.S. average, but Indiana ranks only 5th of the six Great Lakes states.




**Indiana is a Middle Income State**.

Almost 45% of Indiana families have incomes between $35,000 and $75,000; this compares to 39.4% in the U.S. as a whole.

Yet, Indiana has fewer families in the lowest income categories:
-- 7.8% below $15,000, compared to 10% in the U.S.

And, fewer in the highest income categories:
-- Almost 12% with incomes above $100,000, compared to 15% in the U.S.

## IN: A Middle-Income State

- Almost 45% of Indiana families with incomes between $35,000 and $75,000
  - Compares to 39% in U.S.
- Fewer families than U.S. in lowest income and highest income categories.

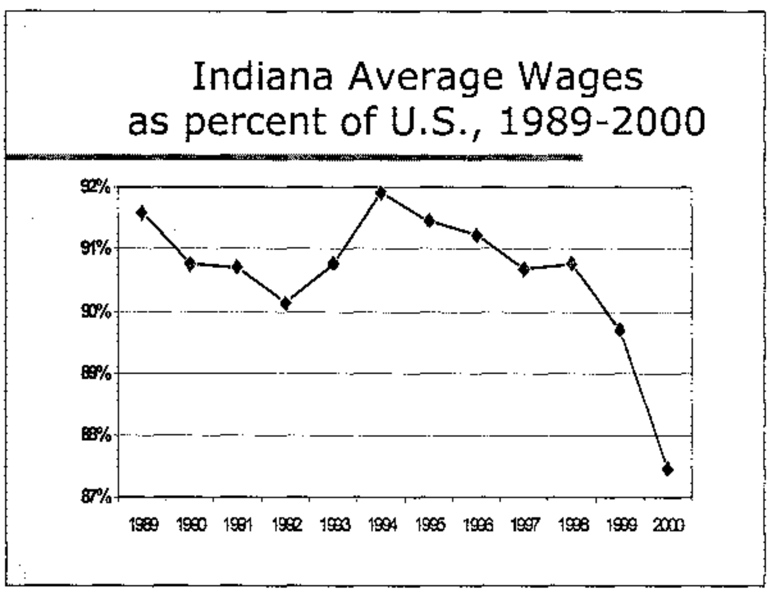
## Indiana Wages

### Indiana Wages Declining

- 2000, Indiana average wages were 87.5% of U.S.
- 1989, IN wages 91.6% of U.S.
- Indiana average wages rank 28th among 50 states
- Indianapolis MSA average wages were 99% of U.S. (2000)

Indiana wages are declining!

In 2000, Indiana average wages were 87.5% of U.S. average wages.
In 1989, Hoosier wages were almost 92% of U.S.
Indiana average wages rank the state 28th.
Average wages in the Indianapolis MSA are almost equal to the U.S. average.
Average wages in non-metropolitan counties of Indiana are only 77% of the U.S.
Chart, 1989 to 2000.

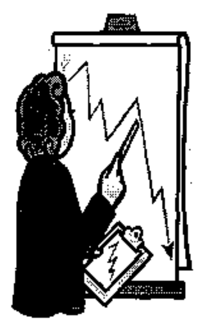


## Why are Wages Declining?

- Changing economy: shift from manufacturing to services
  - Jan. 1990 to Jan. 2002 -17,000 fewer manufacturing jobs; 232,000 more service sector jobs.
- IN Job growth in lower wage industries
  - 1989 to 2000, 74% of jobs created in Industries with average wages below $35,000.
  - In U.S., only 66% of jobs

## Wages of Indiana Women

- Indiana women earn 68% of Hoosier males (full-time, median earnings)
- Indiana women earn 93% of U.S. women's median earnings
- Wage gap between Indiana men and women among largest in nation



Wages of Indiana Women

In Indiana women only earn 68% of what Indiana men earn!
This statistic compares both sexes-- full-time workers' median earnings.
Indiana women earn only 68% of the wages U.S. women earn.
The wage gap between Indiana men and women is among the largest in the nation. Only two states – Utah and Wyoming – had wider gaps.

There are lots of reasons for the difference, but one is educational attainment; higher education equals higher earnings:
18 percent of Indiana women have a bachelor's degree or higher, compared to 22 percent of Indiana males and 23 percent of U.S. women.

## Median Earnings, IN & U.S.
full-time, year-round workers

| | Indiana | United States |
|---|---|---|
| Male | $37,055 | $37,057 |
| Female | **$25,252** | $27,194 |

Here are the Median Earnings for Hoosier males and females in Indiana and the U.S.

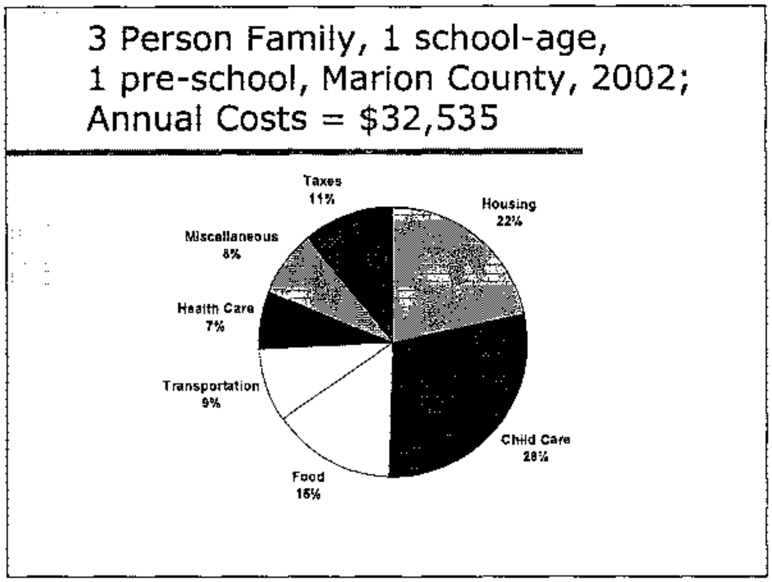
Indiana females earn a median wage of $25,252. Imagine the difficulty faced by single mothers in supporting their families.

# Family Budgets

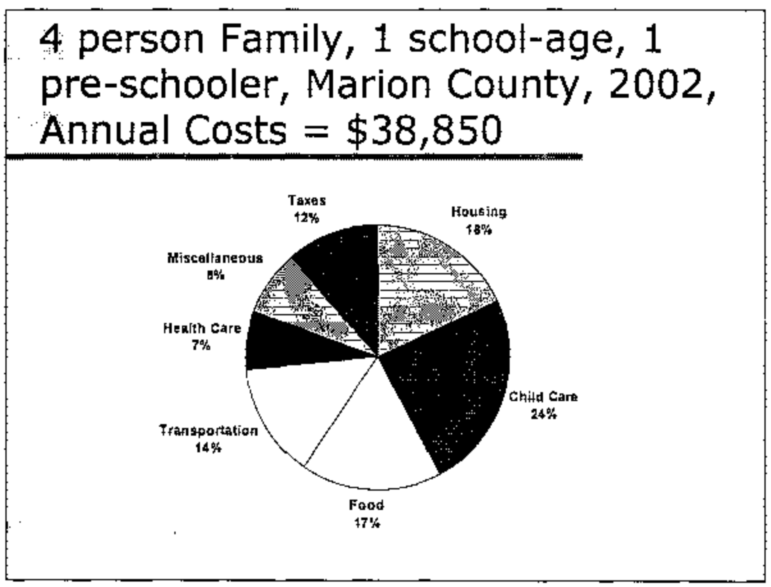
How much does it take to get by in Indiana?

The Self-Sufficiency Standard, ICHHI, 2002

Let me tell you about the Self-Sufficiency Standard. This data is from 2002.
A new report is to be to be published this month (January, 2003) by the Indiana Coalition for Housing and Homeless Issues.




The Self Sufficiency Report contains data for all Indiana counties. This chart shows bottom-up budgeting – what does each budget item cost, e.g., housing, food, taxes, etc.




In Marion County:
A 3 person family's annual costs of basic needs is $32,535
4 person family's annual costs of basic needs is $38,850

For both families, child care constitutes largest percentage of family budgets.

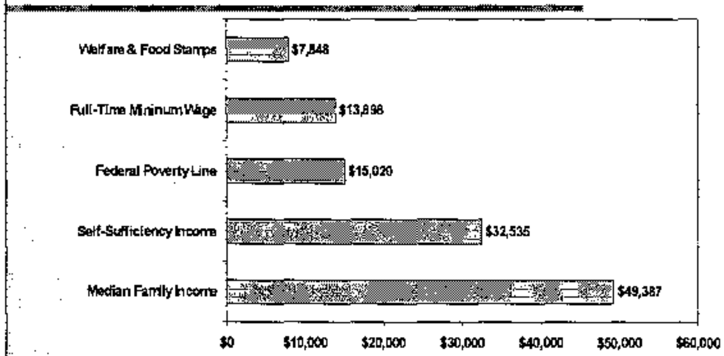
For the Marion County family of three, taxes (net) are 10.7% of their budget. For the Marion County family of four, taxes are 11.5% percent of their budget. Taxes are the largest expense category after child care, housing and food. Here is the breakdown for families in Marion Counties.

## Self-Sufficiency Standard, Marion County, 2002

| Monthly Costs | Family of 3 | Family of 4 |
|---|---|---|
| Housing | $588 | $588 |
| Child Care | $783 | $783 |
| Food | $403 | $554 |
| Transportation | $234 | $450 |
| Health Care | $193 | $230 |
| Miscellaneous | $220 | $260 |
| Net Taxes | $291 | $373 |
| Total | $2,712 | $3,238 |

## Self-Sufficiency Standard compared to other benchmarks

Marion County, 3 person family, 2002




Let us compare the Self-sufficiency Standard to Comparison to other Annual Income benchmarks:

a. A Welfare and Food Stamps Family receives $7,848.
b. A Family with one worker full-time at minimum wage earns $13,898.
c. The Federal poverty line for a family of three is $15,020.
d. The Self-sufficiency standard is $32,535.
e. and the Median Family income in Marion County is $49,387.

## % Families with incomes less than $35,000; U.S. & Great Lakes States

| | |
|---|---|
| United States | 32.8% |
| Ohio | 31.7% |
| Indiana | 30.7% |
| Michigan | 29.2% |
| Illinois | 27.8% |
| Wisconsin | 27.2% |
| Minnesota | 24.6% |

Who are the working poor?
Families with earned incomes below $35,000.

Almost 31% of Indiana families are working poor.
-- that is slightly below U.S. percentage of 32.8%
--but that is a high percentage among Great Lakes States; only Ohio's is larger.

## % Families with incomes less than $35,000; Selected Indiana Counties

| | |
|---|---|
| Hamilton | 11.6% |
| Allen | 28.1% |
| Tippecanoe | 29.1% |
| Marion | 32.8% |
| Vanderburgh | 33.7% |
| Vigo | 39.5% |
| Crawford | 45.4% |

In Indiana, at 45%, Crawford County has the highest percentage of families earning $35,000 or less.

Hamilton County has the lowest, at only 11.6%.

## Indiana Families in Need

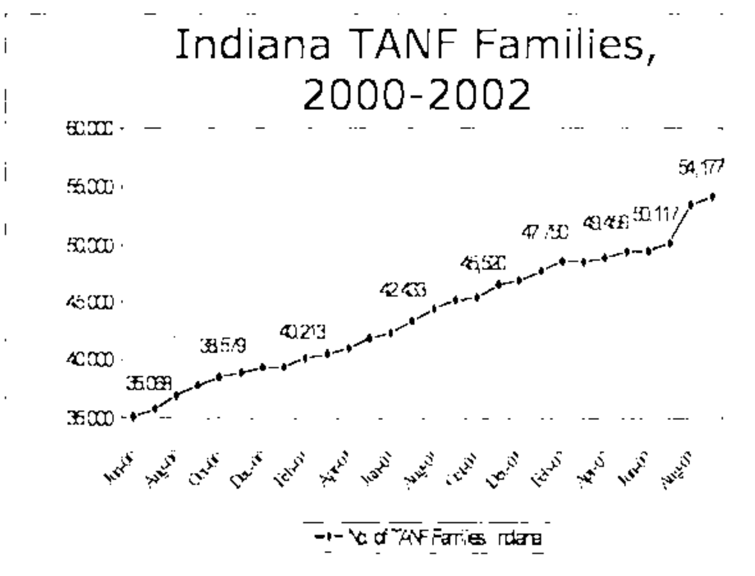
### Indiana Families in Need

- Working Poor
  - 494,000 families w/ incomes <$35,000
  - 31% of all families
- Poverty
  - 108,000 families
  - 180,000 children

*Source: 2000 Census*

Many Indiana Families are in Need:

494,000 families fall into the "working poor" category of incomes below $35,000.
108,000 families in Indiana have incomes below federal poverty line.
180,000 children in Indiana live in poverty.




Over 54,000 Hoosier families are on TANF.
Almost 180,000 households are receiving food stamps – a total of 430,000 individuals.
The Indiana TANF rolls fell 53% from 1994 to 2000, but have now increased by 55 % from June 2000 to September 2002.

## Summary: Findings

### Findings: Indiana Families

- Households & family types still similar to U.S.
- But, family structure changing
  - Single mothers & fathers increasing faster than U.S.
  - Married couples share of families declining

### Findings: Incomes

- Median household income declined by 5% since 1998.
- Median family income at U.S. average, but among lowest in Great Lakes.
- Indiana – A middle-income state; fewer poor, fewer wealthy.

## Findings: Wages

- Indiana Average wages on the decline.
- Job quality is deteriorating.
- Wages of Indiana women are low and far below men's.

## Findings: Poor families

- Self-Sufficiency Income now at low to mid- $30,000s.
- 31% of families are "working poor"
- TANF rolls increasing
- Indiana poverty rate up

# Tax Restructuring, Reassessment and Indiana Household Tax Payments

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# Tax Restructuring, Reassessment and Indiana Household Tax Payments

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The year 2003 will see the biggest changes in Indiana state and local taxation in at least 30 years. Reassessment will change property tax bills more than usual, because the courts have ordered that new assessments be done using market values. Tax restructuring, passed in June 2002, will change sales taxes, individual income taxes, corporate income taxes, cigarette taxes and gasoline taxes, as well as offer significant new property tax relief. How will Indiana households fare in the face of these changes?

This study uses a computer model to apply these tax changes to a series of average households with different characteristics to measure the overall effects on household tax bills. The model takes into account characteristics such as household members who are older than 65 or the number of parents and children in families at different income levels. Thus, the model allows us to view a "snapshot" of what the tax burden is like for a specific kind of family.

## Who?

- Incomes $15,000 to $150,000
- Household sizes 1, 2 and 4
- Homeowners and Renters
- Under Age 65 and Over Age 65
- Smokers and non-smokers

The household tax incidence model includes 36 households with the following characteristics. Each household has one of six income levels: $15,000, $25,000, $50,000, $75,000, $100,000 and $150,000. Each household has one, two or four members. The four-member household is assumed to have two children. Households are either renters or homeowners. If they are homeowners, we assume that the value of the home increases with income. The two-person household can have its members be under age 65, or age 65 and over. The adults in the household may be smokers or non-smokers. Data from the U.S. Department of Labor's Consumer Expenditure Survey is used to determine the spending levels on goods and services by households with each of these characteristics.

## Property Tax Reassessment

- Assessed values to market value
  - Assessment ratio from 48.1% to 100%
  - Increase by a factor of 2.1
- Gross tax rates fall
  - From $3.37 per $100 AV to $2.26 per $100 AV
  - Decline by one-third

In 1998 the Indiana Supreme Court found Indiana's property assessment rules to be unconstitutional. As a result, the current reassessment will be done on a market value basis, that is, based on predicted selling prices. Under the old rules, the average Indiana house was assessed at about 48.1% of its market value. Under market value assessment, property will be assessed at 100% of market value. The assessed value of the average house, then, will increase by a factor of 2.1. Keep in mind, however, that Indiana's state property tax controls prevent the tax levy – the amount of revenue collected – from rising in proportion to assessed values. This means that the tax rate will fall, because lower rates will be required to raise a given levy from the increased assessments. On the average across the state, the property tax rate is expected to fall from $3.37 per $100 assessed value to $2.26 per $100 assessed value, a decline of about one-third. With assessments doubling but rates falling by only a third, household tax payments would rise substantially (by about 33% for the average homeowner). Nonetheless, several provisions of tax restructuring will offset this potential tax hike.

## Tax Restructuring

- Sales tax increase from 5% to 6%
- Cigarette tax increase from 15.5 cents to 55.5 cents per pack
- Gasoline tax increase from 15 cents to 18 cents per gallon

Tax restructuring was designed to provide funds for property tax relief, and to partially close the state budget gap resulting from the recession. The legislature passed about $1.5 billion in tax increases. More than half of this increase comes from the one-cent rise in the sales tax rate, from 5% to 6%. The sales tax hike took effect on December 1, 2002. The cigarette tax was increased from 15.5 cents to 55.5 cents per pack on July 1, 2002. The gasoline tax increased from 15 cents to 18 cents per gallon on January 1, 2003. An additional increase in riverboat gaming taxes is not considered in this study.

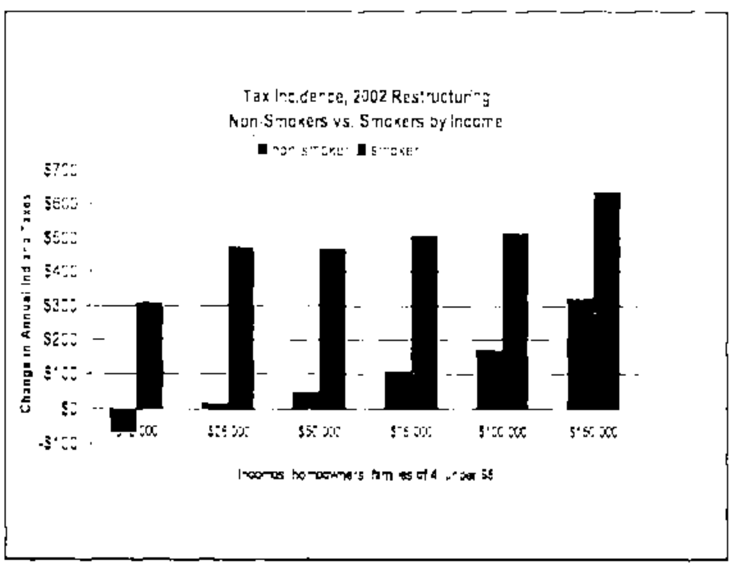
About $500 million from this tax hike will be added to the state budget, with the remaining one billion dollars to be used to fund tax cuts. Two changes were made in individual income taxes. The renters deduction was increased from $2,000 to $2,500. At the 3.4% state income tax rate, this will save renters an added $17, more if the renter lives in a county with a local income tax. Indiana's earned income credit was calculated with a $12,000 maximum income. It will be revised for the 2004 tax year to be 6% of the Federal earned income credit. Households with two children are eligible for this credit at incomes up to $34,000, meaning the new Indiana credit is much more generous than the

old. Most of the tax relief offsets property taxes, however. The state will remove 60% of the school general fund from the property tax, to be replaced by state aid. The existing property tax replacement credit (PTRC) will be revised.

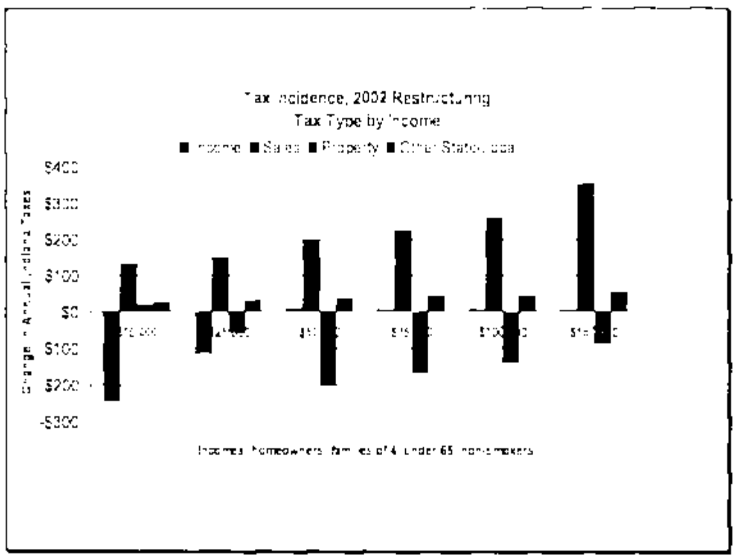
## Tax Restructuring

- Renters income tax deduction from $2000 to $2,500
- Indiana Earned Income Credit to 6% of Federal credit
- School PTRC, 60% of school general fund
- Revised existing PTRC, applies only to real property
  - Combined PTRC about 30% of tax bills
- Homestead credit from 10% to 20%
- Homestead exemption from $6,000 to $35,000

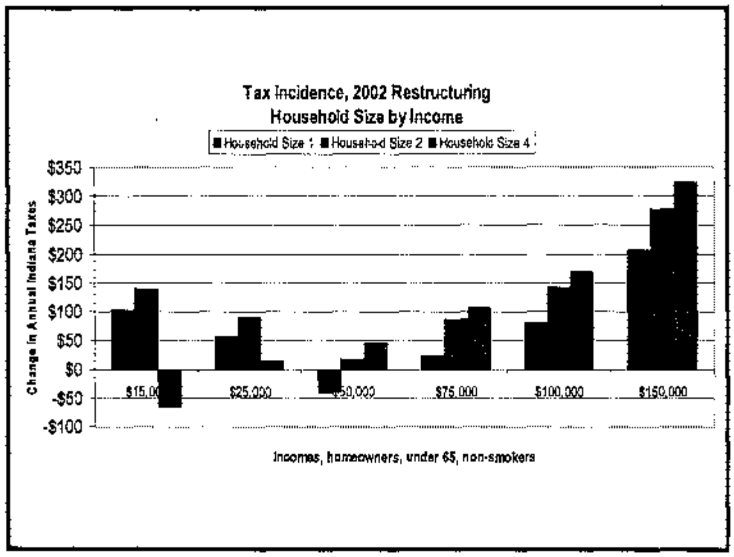
Combined, these two credits will reduce property taxes about 30%, compared to 14% under the current PTRC program. The homestead credit will rise to 20% from 10%, and this is applied to homeowner tax bills after they are calculated. The homestead exemption will subtract $35,000 from the assessed value of homes, rather than $6,000. (Note: the recent discovery that the homestead credit has been overpaid for the past 17 years is not included in this study. Homestead credit payments will likely be reduced by about 40% if the correct rules are used). But what influences tax incidence the most?



What matters most for tax incidence under reassessment and restructuring is whether or not the adults in the household smoke. Based on Indiana survey data and cigarette revenue collections, it is estimated that the average Indiana smoker smokes one and a third packs a day. About a quarter of Hoosiers smoke. If both adults smoke in a four person, $50,000, home-owning household, their tax payments will rise by almost $500 under reassessment and restructuring. A non-smoking household with the same characteristics would see a tax hike of about $50. The rest of the tax comparisons made in this study will assume that the members of the households are non-smokers.

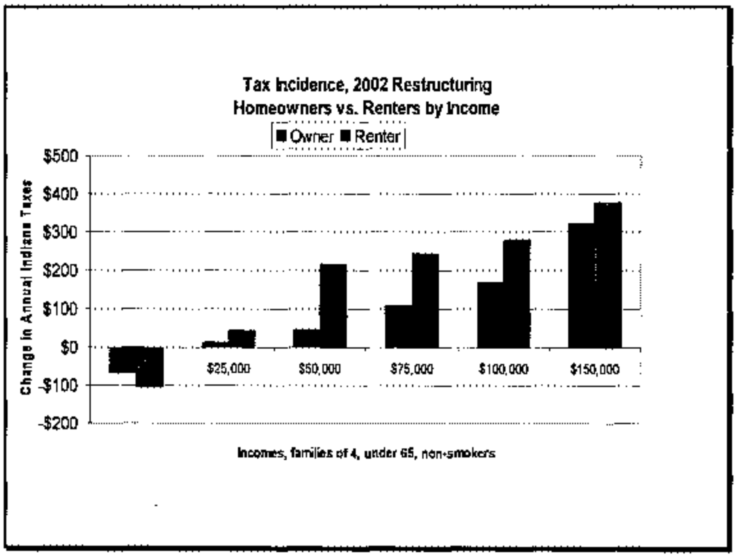



This chart divides the tax changes into four components, by tax type. The first bar shows changes in income tax payments for a family of four, homeowner, under age 65, non-smokers, by income level. The households with incomes of $15,000 and $25,000 are eligible for the new Indiana earned income credit. They were not eligible for the old credit. This reduces their income tax payment (in fact, they receive refunds greater than their tax liabilities). There are no significant changes in individual income tax payments for households with higher incomes. Sales taxes increase for every household, more for those with higher incomes because they spend more on taxable goods. Note, however, that the $130 sales tax hike probably hurts the lowest income household more than the bigger $350 hike hurts the highest income household. As a share of income, the lower income households see bigger sales tax increases. The sales tax is often called regressive for this reason. Property taxes decline most for the middle-income homeowners. The "other state/local" tax bar represents only the gasoline tax (since these households are non-smokers). Households pay added gasoline tax based on the amount of gasoline they buy. Higher income households buy more.

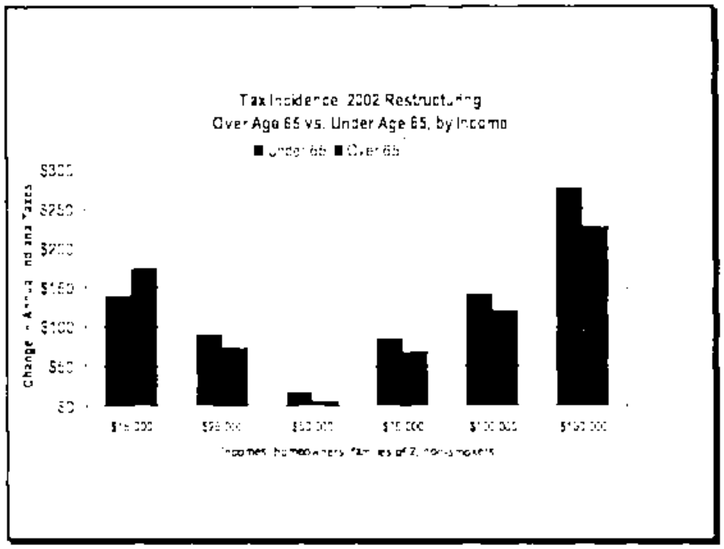



Here we see the overall changes in tax payments by income and household size. Lower income households with four people, including two children, are eligible for the new earned income credit, and so see overall tax cuts (at $15,000) or small tax increases (at $25,000). The other households pay more as incomes increase, mostly because of rising sales tax payments. For households with incomes $50,000 and over, bigger households see bigger tax hikes. This is because a family of four with a particular income will spend more than a one or two-person household with the same income. More spending means more sales tax payments. For one and two-person households, not eligible for the earned income credit, the chart shows a U-shape. The household with $50,000 income has the

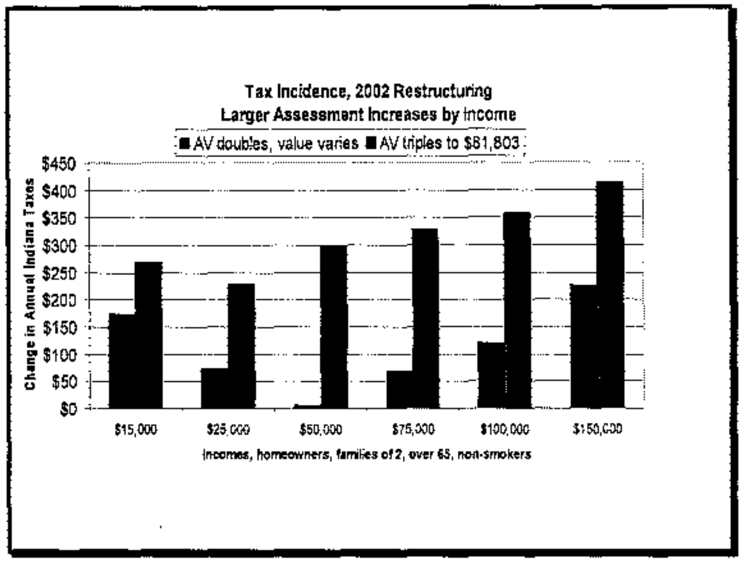
smallest tax hike, those with lower or higher incomes see bigger tax hikes. The reason for this is a quirk in the homestead exemption. This exemption subtracts $35,000 from the assessed value of homes, up to 50% of the home's assessed value. The homeowners in this model with incomes of $15,000 and $25,000 own homes assessed at less than $70,000, so they cannot take full advantage of the exemption. Their property taxes are not cut as much. Upper-income homeowners have houses with much higher assessments. The $35,000 exemption is relatively insignificant for their overall tax bills. The middle-income homeowner can take full advantage of the exemption, and it reduces the home assessments by a large percentage. This household sees the greatest benefit from this tax break, and so sees the smallest overall tax hike.




Most of the tax relief provided by restructuring was aimed at reducing the property taxes of homeowners. It is no surprise, then, that renters do not fare as well. Households with incomes $25,000 and up see bigger tax hikes if they are renters. At the lowest income level, the value of the increased renters income tax deduction is greater than the small tax benefit homeowners receive from the $35,000 homestead exemption (capped at 50% of value). Both are eligible for the new earned income credit. The lowest income renters see bigger tax cuts than the lowest income homeowners.




In general, households 65 years old and older see smaller tax hikes than those under age 65. This is because a larger share of older people's spending is on medical care and drugs, which are not sales taxable. A larger share of their spending is not subject to the higher sales tax, so their sales tax increases are smaller. However, at the lowest income level, households over age 65 see bigger tax increases. Homeowners with incomes this low are eligible for the over-65 property exemption. The exemption subtracts up to $6,000 from the taxable value of the home. Tax restructuring did not increase this exemption, however. With the fall in the property tax rate due to reassessment, the exemption is worth less than it was under the old higher rates. The decline in the value of this exemption is enough to offset the lower sales tax bills of over-65 households with the lowest incomes.




A concern with reassessment is that older homeowners on fixed incomes, with older houses, will see particularly large tax increases. It appears that this concern is appropriate. Here it is assumed that all households over age 65 own houses assessed at about $82,000, the value of the $50,000 income family home. It is also assumed that this is an older house, which, under the old assessment rules, was valued at about $27,000. Older houses under the old assessment rules were valued less than newer houses, even if they had the same market value. This will not be true under the new rules. This means that the assessments of older homes will increase more than the assessments of newer homes. Here it is assumed that older home assessments will triple. Under these conditions, all households see tax increases of at least $275, and each household sees an increase higher than under the usual doubling of assessments.

## Incidence Results

- Smoking matters most—smokers pay a lot more added tax
- Higher income households spend more, pay more in added sales taxes
- But low income households pay more in added sales taxes as a share of their incomes
- Bigger households pay more added sales tax
- New Indiana earned income credit is more generous than the old credit, which cuts taxes of lower income households, especially those with children

## Incidence Results

- $35,000 Homestead Deduction has a cap at 50% of assessed value, so owners of mid-valued homes benefit most
- Most tax relief went to property owners, so renters pay more added tax
- Higher renters income tax deduction means lower income renters see bigger tax cuts than lower income homeowners

## Incidence Results

- Medical care and drugs are not sales taxable, so most older households pay less added tax
- Size of the over-65 property tax deduction did not increase, so lower income households over age 65 pay more added tax
- Low income households over age 65 with older homes could see sizable tax increases, because of bigger assessment increases

These tables summarize the findings of this study. In general, lower income non-smoking households with children benefit from reassessment and restructuring, because of the new, more generous Indiana earned income credit. These households may see tax cuts; most others see tax increases. Smokers in particular see large tax hikes. Otherwise, the smallest tax increases appear to go to middle income homeowners, mostly because they can take full advantage of property tax relief, and the relief is significant relative to the values of their houses.

## The Distributional Impact of the Indiana Tax System: Past, Present & Future

**Michael Mazerov,**
**Center on Budget & Policy Priorities**
**Family Impact Seminar**
**Indianapolis, January 8, 2003**

## Objectives

- **Put the level of Indiana's taxes in national perspective**
- **Put the distribution of Indiana's taxes in national perspective**
- **Highlight Indiana's tax treatment of low-income families**
- **Draw implications for future changes in tax policy**

## Indiana is a low- tax state

Combined state/local taxes as share of total personal income (FY2000)

- Indiana: 10.2%
- U.S. average: 10.8%

Indiana ranks 39th out of 50 states

- Highest: New York — 13.9%
- Lowest: New Hampshire — 8.3%

Tax collections data used to prepare all rankings reported here are collected by the U.S. Census Bureau and published in the "Government Finances" series. FY2000 is the most recent year for which such data are available.

## State/Local Taxes as Share of State Personal Income, FY00

| | | Indiana's Rank |
|---|---|---|
| Indiana | 10.2% | |
| Neighbors | 10.7% | Lowest of 5 |
| Great Lakes | 11.0% | Lowest of 6 |
| Industrial | 10.6% | Lowest of 6 |
| High-tech | 10.6% | 2nd lowest of 7 |
| "Competitors" | 10.6% | 6th lowest of 21 |
| All | 10.8% | 12th lowest of 50 |

"Neighbors" are IN, IL, KY, MI, OH.
"Great Lakes" are IN, IL, MI, MN, OH, WI
"Industrial" are IN, IL, MI, NJ, OH, PA
"High-tech" are IN, CA, MA, MN, NC, TX, WA
"Competitors" are all of the above plus AR, CT, FL, IA, ME, MO

## State/Local Taxes as Share of State Personal Income, FY00

**Indiana's low <u>combined</u> state and local tax level reflects varying rankings for "Big Three" taxes**

- **Sales tax**
- **Income tax**
- **Property tax**

## State/Local Sales Taxes as Share of State Personal Income, FY00

| | | Indiana's Rank |
|---|---|---|
| Indiana | 2.2% | |
| Neighbors | 2.3% | 2nd lowest of 5 |
| Great Lakes | 2.3% | 2nd lowest of 6 |
| Industrial | 2.1% | 3rd highest of 6 |
| High-tech | 2.8% | 3rd lowest of 7 |
| "Competitors" | 2.7% | 6th lowest of 21 |
| All | 2.7% | 10th lowest of 45 |

Note, of course, that this ranking was calculated before the recent increase in the sales tax rate from 5% to 6%

## State/Local Income Taxes as Share of State Personal Income, FY00

| | | Indiana's Rank |
|---|---|---|
| Indiana | 2.7% | |
| Neighbors | 2.8% | 2nd lowest of 5 |
| Great Lakes | 2.9% | 2nd lowest of 6 |
| Industrial | 2.6% | 3rd highest of 6 |
| High-tech | 2.6% | 2nd lowest of 7 |
| "Competitors" | 2.4% | middle of 21 |
| All | 2.6% | 18th lowest of 41 |

The lower reliance on the income tax of "high tech" states than of Indiana shown in this slide is significantly distorted by fact that Texas, a very large state, does not have an income tax. Among "high tech" states WITH an income tax, Indiana ranks lowest in reliance on that tax.

## State/Local Property Taxes as Share of State Personal Income, FY00

| | | Indiana's Rank |
|---|---|---|
| Indiana | 3.5% | |
| Neighbors | 3.3% | 2nd highest of 5 |
| Great Lakes | 3.4% | 3rd highest of 6 |
| Industrial | 3.5% | 3rd highest of 6 |
| High-tech | 2.9% | highest of 7 |
| "Competitors" | 3.1% | 6th highest of 21 |
| All | 3.1% | 13th highest of 50 |

## Level and Mix of Indiana Taxes As of FY2000

- Low-tax state overall
- Below-average reliance on sales tax
- Above-average reliance on property tax
- Average reliance on income tax

## Indiana's Taxes: Low for Everyone?

- While Indiana's taxes are relatively low overall, this can't be said of taxes on low-income Hoosiers
- According to new *Who Pays?* study by Inst. For Taxation & Econ. Policy (ITEP), 20% of (non-elderly) Indiana households with lowest incomes devote 11.7% of income to paying state/local taxes

*Who Pays?* is available at http://www.itepnet.org/whopays.htm

## Indiana's Taxes: Low for Everyone?

11.7% of income devoted to paying state & local taxes is 13th-heaviest burden among 50 states for bottom 20% of income distribution

- heaviest: WA (17.6% of income)
- lightest: AL (3.8% of income)

This estimate does incorporate 2002 tax changes (e.g., expanded EITC)

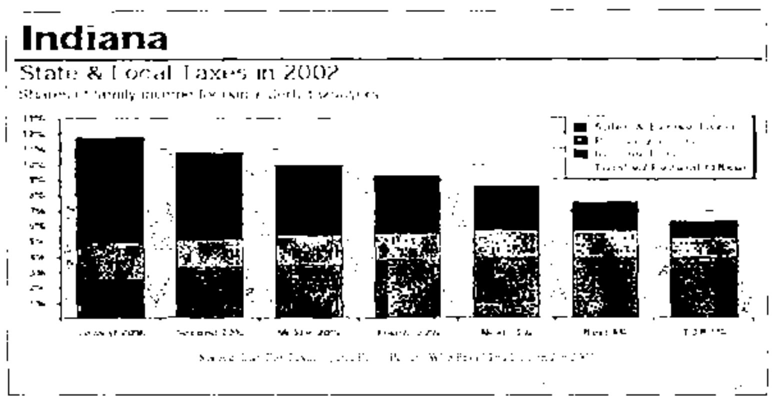
Source: ITEP, *Who Pays?* "EITC" refers to the Earned Income Tax Credit.

## Indiana's Taxes: Regressive

A tax — or an entire tax system — is "regressive" when lower-income taxpayers devote a greater share of their income to paying the tax(es) than do higher-income taxpayers

Indiana's tax system — like that of all but 8 states — is regressive.

## Indiana's Taxes: Regressive




As ITEP's data indicate, the 20% of households with the lowest incomes must devote 11.7 percent of their incomes to IN state/local taxes, while the top 1% of households devote just 6.3 percent of their incomes to taxes. The 60 percent of households in the middle of the income distribution devote 10.0% of their incomes to IN state/local taxes.

## Indiana's Taxes: Among the [illegible] Regressive

**6.3% : 11.7% ratio of share of income devoted to s/l taxes by top 1% of households as compared to bottom 20%**

**Is the 15th$^{th}$ lowest ratio among all 50 states**

**By this measure, Indiana has the 15$^{th}$ most regressive state/local tax structure in the country**

## Q: Why does Indiana have a regressive tax system?

**Answer:**

**Indiana's personal income tax**

- **Is barely progressive, and**
- **Is not sufficiently progressive to significantly counteract the regressivity of sales, property, and sin taxes.**

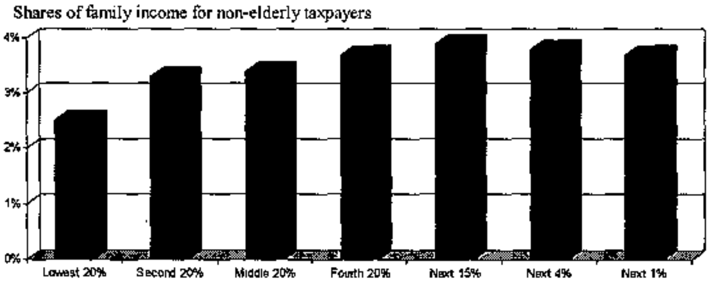
It was shown above that Indiana relies on the personal income tax somewhat more than most states. So it is the structure of the personal income tax rather than a low level of reliance on this tax that contributes to the regressivity of Indiana's overall tax structure.

## Progressivity of the Indiana Income Tax

**INDIANA**

State & Local Personal Income Tax in 2002

Shares of family income for non-elderly taxpayers




Source: Inst. For Taxation and Econ. Policy, Who Pays? 2nd Edition Jan 2003

The top 1% of Indiana families devoted an average of 3.7 percent of income to Indiana state and local income taxes, barely more than the bottom 20% of families, who devoted an average of 2.5 percent of income to personal income taxes.

The 60 percent of households in the middle of the income distribution paid an average of 2.9 percent of income in Indiana s/l income taxes

## Progressivity of the Indiana Income Tax

**Indiana's Personal Income Tax (PIT) is 2nd least progressive of all 41 broad-based state PITs**

**This is true even after 2002 expansion of earned income tax credit (EITC)**

**Only 5 of these 41 states (AL, IL, LA, ND, PA) place lower PIT burdens on highest-income households than does IN**

Source: ITEP, *Who Pays?*

## Progressivity of the Indiana Income Tax

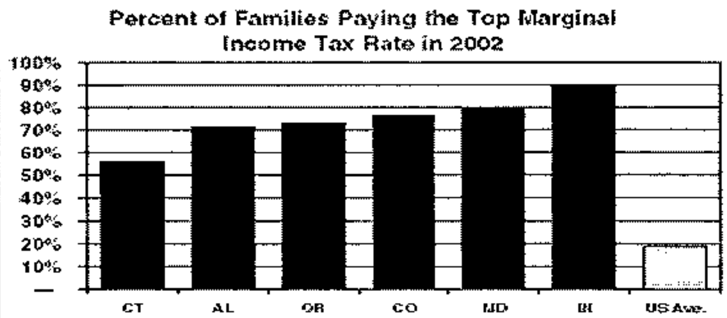
**35 states have progressive bracket structures like federal PIT**

**Only 6 states have flat-rate PITs like Indiana's (CO, IL, IN, MA, MI, PA)**

**Some states with flat rates have higher personal exemptions & standard deductions than Indiana, so tax effectively is somewhat more progressive**

A progressive bracket structure is one in which higher segments of income are taxed at higher rates, for example, income between $0 and $10,000 is taxed at 3%, income between $10,000 and $20,000 is taxed at 4%, etc..

## Progressivity of the Indiana Income Tax




Source: Inst. For Taxation and Econ. Policy, Who Pays? 2nd Edition Jan 2003

The top marginal rate is the highest income tax rate imposed on any segment of income. Even though Indiana has a flat rate income tax, not all families pay at that rate; some families that file a return pay at a 0% rate (because their incomes are too low to have a tax liability) and some receive refundable EITCs.

## Indiana Income Taxes and the Poor: Half Full or Half Empty?

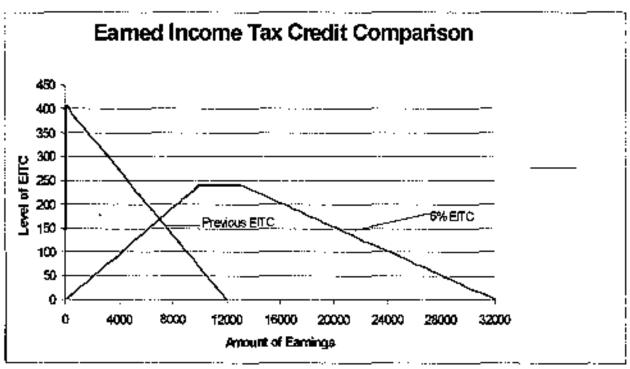
- **In recent years, Indiana has substantially reduced income tax burden on poor**
  - **Increased extra dependent exemption from $500 to $1500**
  - **Enacted earned-income deduction, converted to refundable credit, then expanded credit effective 1/1/03 by piggybacking on federal EITC**

## Indiana Earned Income Tax Credit

**6% of federal EITC, effective with 2003 tax year**

**Refundable, so credit in excess of PIT liability partially offsets sales and property tax liability of low-income households <u>with earnings</u>.**

## Indiana Earned Income Tax Credit




Under the old EITC, families with earnings above $12,000 received no credit. The piggybacking of the Indiana EITC onto the federal EITC will enable families with earnings of up to $32,000 to receive some amount of credit.

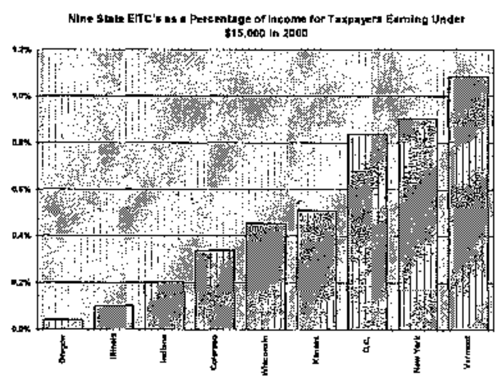
## Indiana Income Taxes and the Poor: Half Full or Half Empty?

**Even had more generous 2003 (6%) EITC been in effect in tax year 2001:**

- **Only 9 states would have begun imposing state income tax at lower income level than IN's $13,800 (2-parent family of 4)**
- **IN would have imposed $200 PIT on family with $18,104 poverty-level income (12th highest among states)**
- **IN would have imposed $411 PIT on family with 125% of poverty level income, $22,630 (11th highest among states).**

Source: Center on Budget and Policy Priorities annual report on state income tax treatment of low-income families. The most recent report deals with 2001 income taxes.

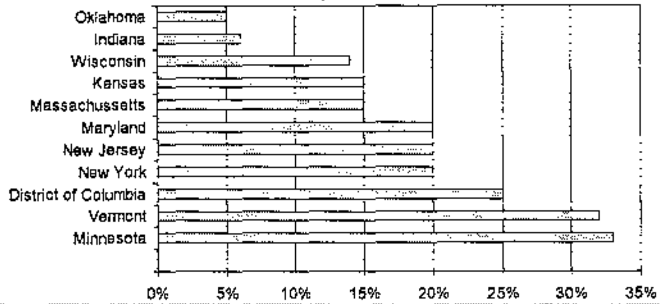
## Not All State EITCs Are Created Equal




Source: Inst. For Taxation and Econ. Policy, Who Pays? 2nd Edition Jan 2003

## Not All State EITCs Are Created Equal

**Refundable State Earned Income Tax Credits as Share of Federal EITC, Tax Year 2003**




## Indiana Sales Tax

**Of 45 states with sales tax, IN's absorbed 10th-lowest share of personal income (2000)**

**Low reliance due to**

- **Relatively low rate (until recent increase)**
- **No local sales taxes**
- **Narrow "base" (goods/services subject to tax); 18th most narrow base in 2001 (Source: Prof. John Mikesell, IU)**

## Sales taxes are not deductible for federal tax purposes

**Property and income taxes are deductible on federal tax returns for those who itemize**

**Below-average reliance on sales tax and above-average reliance on income & property taxes maximizes federal tax savings for Indiana itemizers, reduces net cost of Indiana taxes for Indiana citizens**

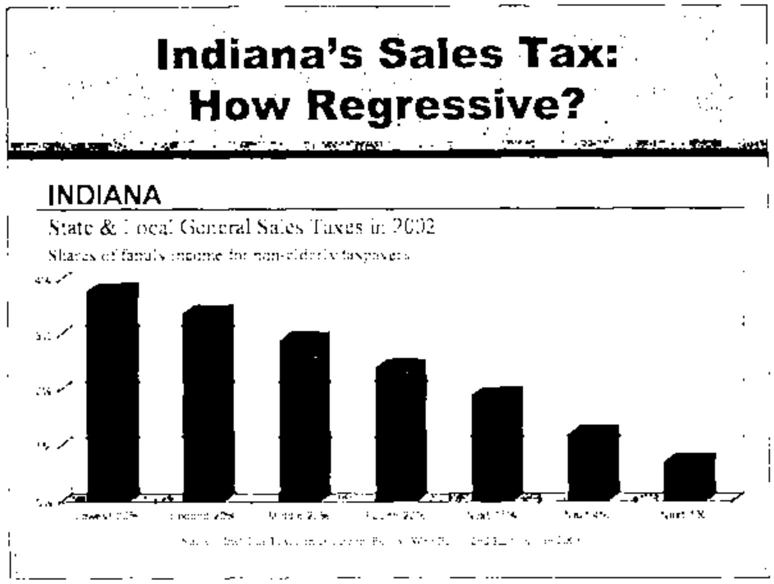
## Sales Taxes Are Regressive

- Sales taxes inherently regressive: upper-income households save rather than consume larger shares of income
- Relatively low reliance on sales tax helped counteract low progressivity of Indiana's income tax – preventing highly regressive tax system from being even more so

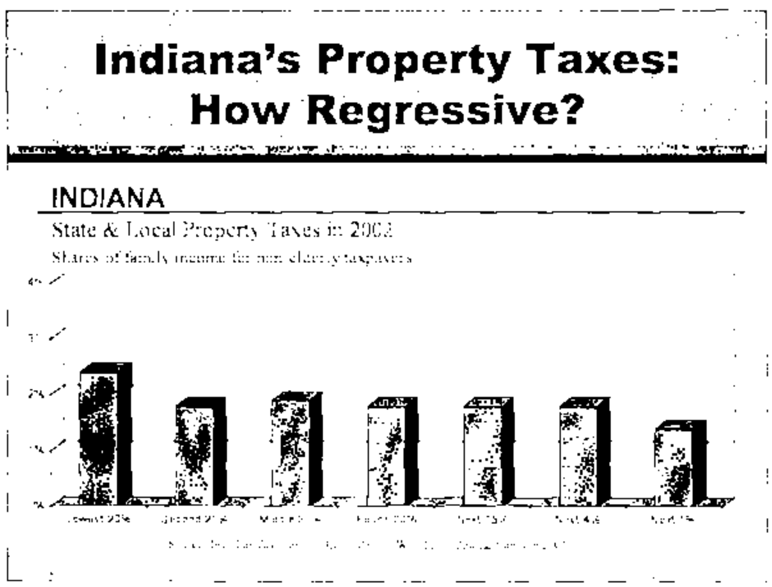
## Indiana's Sales Tax: How Regressive?

- Indiana has mitigated regressivity of sales tax by exempting food – which represents a large share of income for low- and moderate-income families
- By not taxing services – many of which are disproportionately bought by upper-income families – Indiana has foregone opportunity to reduce regressivity of its sales tax
  - As of 1996, IN taxed only 22 of 164 services; only 6 of 45 states with sales taxes taxed fewer services

See: Federation of Tax Administrators, *Sales Taxation of Services, 1996 Update.*
Available at http://www.taxadmin.org/fta/pub/services/services.html




The bottom 20% of Indiana families devote 3.8% of income to paying state sales taxes; the top 1% devote just 0.7% of income. The chart does incorporate the effect of the recent increase in the sales tax rate.




The bottom 20% of Indiana families devote 2.4% of income to paying property taxes; the top 1% devote just 1.4% of income to paying this tax. The property tax is regressive, although not as regressive as the sales tax. Again, note that this chart incorporates policy changes that were enacted last year to mitigate the regressivity of the property tax, such as the increased homestead exemption.

## Indiana's Property Taxes: How Regressive?

**Indiana property taxes are well below average among all states in their regressivity**

- **Ratio of property tax share of income for bottom 20% of households to property tax share of income for top 1% of households is about 1.7 : 1**
- **This ratio lower in Indiana than in all but 15 states**

The fact that the property tax is not as regressive in Indiana as it is in other states is attributable to the broader array of property tax relief policies in effect in the state.

## Indiana's Property Taxes: How Regressive?

**Indiana property taxes are much less regressive than Indiana sales taxes**

- **Bottom 20% of households devote 1.7 times as great a share of their incomes to property taxes than do the top 1% of households**
- **Bottom 20% of households devote 6.8 times as great a share of their incomes to sales taxes than do the top 1% of households**

## Trading Higher Sales Taxes for Lower Property Taxes (2002)

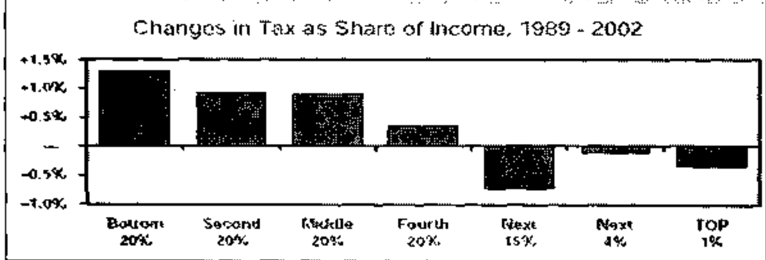
**So, by choosing to fund property tax relief with 1¢ sales tax increase rather than income tax increase:**

**Indiana made tax system more regressive**

**Indiana ensured that more of Hoosiers' aggregate incomes would flow to federal Treasury rather than be spent and re-spent in Indiana**

Recall that sales tax payments are not deductible from the federal income tax, while state income tax and local property tax payments are deductible. Using sales tax revenues to reduce property taxes substituted a non-deductible tax for a deductible tax, meaning that Hoosiers will have higher aggregate federal income tax liabilities. This represents a drain of income out of Indiana.

## Over the last decade, Indiana's taxes have become more regressive




| | Bottom 20% | Second 20% | Middle 20% | Fourth 20% | Top 20%: Next 15% | Top 20%: Next 4% | Top 20%: TOP 1% |
|---|---|---|---|---|---|---|---|
| Sales & Excise | [illegible] | +0.4% | [illegible] | +0.2% | [illegible] | [illegible] | [illegible] |
| Property | [illegible] | [illegible] | [illegible] | +0.2% | [illegible] | [illegible] | [illegible] |
| Income | −0.0% | +0.2% | +0.1% | +0.2% | +0.2% | +0.2% | +0.2% |
| Federal Offset | −0.0% | −0.6% | −0.1% | −0.2% | −0.3% | −0.3% | −0.5% |
| Overall Change | +1.3% | +0.9% | +0.9% | +0.4% | −0.7% | −0.1% | −0.3% |

Source: ITEP, Who Pays? Last year's increase in sales and cigarette taxes more than offset all of the income and property tax relief provided to low- and moderate-income families over the last decade. The bottom 20% of families end 2002 devoting 1.3 percent more of their incomes to state and local taxes than they did in 1989.

## Conclusions and Policy Options (I)

Indiana already has one of the more regressive state/local tax systems in U.S.

Recent tax policy has made it more so, on balance

Increasing EITC has not offset higher sales tax for many families with earnings, let alone families without (e.g., retirees)

## Conclusions and Policy Options (II)

Indiana could further mitigate regressive impact of recent sales tax increase by enacting refundable income tax credits

- tied to estimated sales tax liability of low-income households
- non-income-tax filers should be eligible
- could phase out as income increases
- 5 states have somewhat similar credits

## Conclusions and Policy Options (III)

If sales taxes must be increased further to address budget shortfall, IN could mitigate impact on low-income families by

Forgoing further increases in sales tax rate

Enacting refundable credits to offset impact

## Conclusions and Policy Options (IV)

If sales taxes must be increased further to address budget shortfall, IN could mitigate impact on low-income families by

Broadening sales tax base to encompass goods and services disproportionately purchased by upper-income households

- Financial planners, health club memberships
- Purchases from Internet affiliates of retail stores

## Conclusions and Policy Options (V)

Further tax increases to address budget shortfall could focus on income tax, particularly on upper incomes

State income tax burdens on affluent families in IN among lowest in country

IN only flat-rate state able to enact progressive rates without constitutional amendment

? 1/3 of any income tax increase on affluent will be offset by reduced federal income tax liability through federal deductibility

## Conclusions and Policy Options (VI)

- Eliminating income tax burdens on families below poverty line should have high-priority claim on any future tax relief when state's fiscal condition improves
- Indiana state government needs in-house ability to analyze distributional impact of tax policy changes

It is unfortunate that the major restructuring of Indiana's tax system last year was undertaken with very little information made available to policymakers or the public about the overall distributional impact of the changes. See: Michael Mazerov, *Developing the Capacity to Analyze the Distributional Impact of State and Local Taxes,* Center on Budget and Policy Priorities, January 2002.
Available at http://www.cbpp.org/1-15-02sfp2.htm.