

## Oklahoma Policy Institute

## THE "TAX CUT" BAIT AND SWITCH

*HOW AVERAGE OKLAHOMANS COULD BE COLLATERAL DAMAGE IN THE ASSAULT ON TAX CREDITS*

**By Gene Perry**

As they ponder plans to cut Oklahoma's top income tax rate, most lawmakers admit the state cannot afford a cut without eliminating many other tax breaks. They emphasize that we should close loopholes for corporate "special-interests." Yet as details of their plans emerge, we've discovered that the biggest cost would fall not on special-interests, but on hundreds of thousands of low- and moderate-income taxpayers, seniors, and families with children. These families would lose a host of broad and effective state tax breaks to make way for income tax cuts that primarily benefit wealthier households.

The at-risk credits include the Earned Income Tax Credit (EITC), Sales Tax Relief Credit, and Child Tax Credit/Child Care Tax Credit. These credits help families to make ends meet and enable thousands of men and women to stay in the job market. They encourage work, strengthen families, and boost the economy. This issue brief explains how the broad-based credits work and why Oklahoma should preserve them.



*Tax Cuts*

# Ending Broad-Based Credits Would Shift Taxes Onto the Most Vulnerable

1 in 2

Oklahomans would pay more in the first year under plans based on Laffer/OCPA proposals.<sup>1</sup>

1 in 3

Oklahomans would pay more taxes in the first year under Governor Fallin's plan.<sup>1</sup>

1 in 2

Oklahomans would pay more under the plan based on the tax reform task force proposal.<sup>1</sup>

Three major tax plans have been taken up by the Legislature this year. Two bills, SB 1571 and HB 3038, are based on a proposal from the Oklahoma Council of Public Affairs (OCPA) to cut the top 5.25 percent income tax rate by more than half next year and then phase it out over ten years. These plans would eliminate nearly every deduction and credit designed to help seniors and families with modest incomes, as well as the standard deduction and personal exemption available to all Oklahomans.

A proposal from Governor Fallin, put into legislation in the House (HB 3061), would also eliminate most deductions and credits. The Governor's plan would reduce the number of tax brackets to three from the current six, with a top rate of 3.5 percent.

A Senate plan (SB 1623), based on recommendations from the Legislature's tax reform task force, would reduce the current top rate by half a percentage point and eliminate about 40 credits, exemptions, and deductions, including those important for low- and moderate-income taxpayers. Unlike the OCPA and Fallin plans, which would cost up to \$1 billion in the first year alone, this bill would neither reduce nor add to state revenue.

***All three plans would shift more taxes onto low and moderate-income families by eliminating broad-based tax preferences, including the Earned Income Tax Credit, Sales Tax Relief Credit, and Child Tax Credit.***

## Broad-Based Credits are Important for a Balanced Tax System

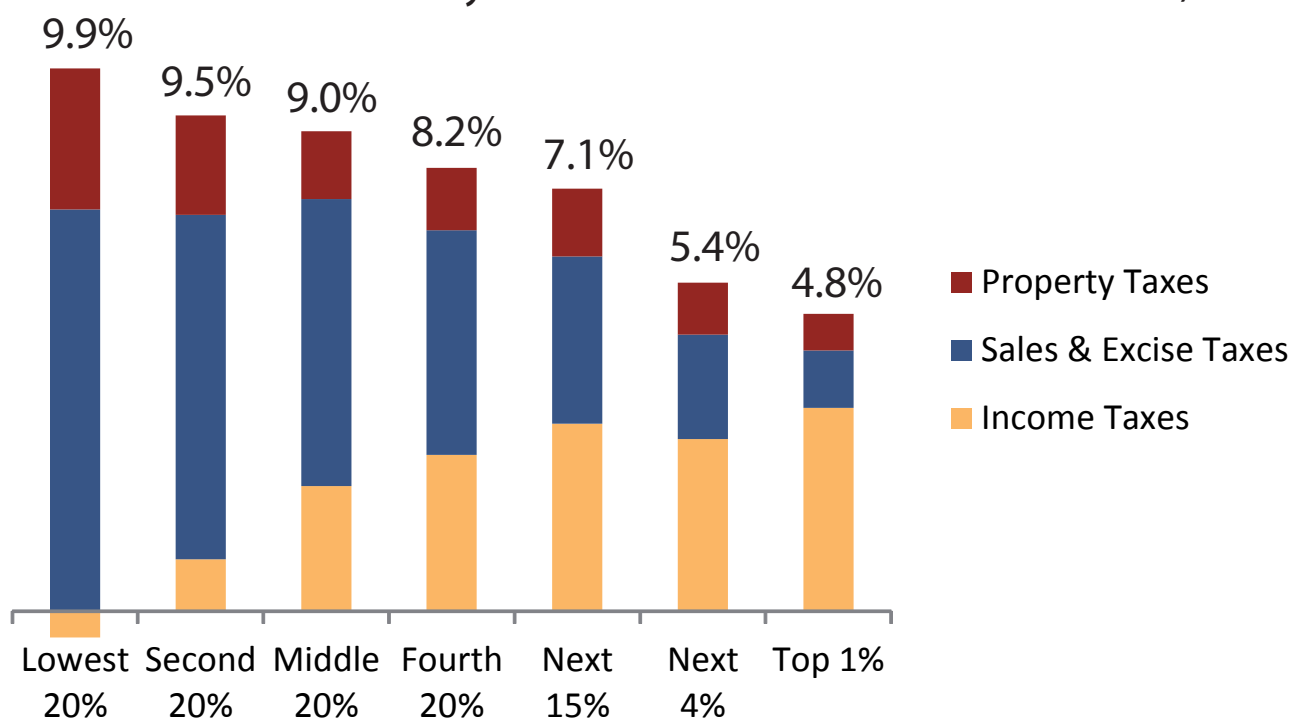
Those seeking to do away with broad-based credits have claimed that it is not fair for a taxpayer to “profit” from filing an income tax return, since some of the credits allow low-income households that have limited or no tax liability to receive a tax “refund.” However, that argument ignores the impact of other taxes paid by these households.

All Oklahomans help support schools, roads and other core public services. They pay sales taxes, property taxes on their homes or indirectly when they rent, and motor vehicle taxes. Oklahoma’s state and local taxes actually take a higher share of income from poor families than from middle-class families, and they take a higher share from middle class families than from the wealthiest households. The broad-based credits only partially alleviate this imbalance.

In addition, even Oklahomans who do not pay income taxes in a given year have likely paid them in the past or will pay them in the future. These include seniors who paid during their working years, students and young workers at the beginning of their careers, and new parents who may reduce working hours to care for children.

By providing certain credits, we acknowledge that Oklahomans need varying levels of assistance at different stages in their lives. We use tax credits to reward previous work or to provide a strong foundation for future prosperity.

### Share of Income Paid by Oklahomans in State & Local Taxes, 2007



Source: Institute on Taxation and Economic Policy. 2009. “Who Pays? A Distributional Analysis of the Tax Systems in All 50 States.” <http://www.itepnet.org/whopays3.pdf>

# Broad-Based Credits Encourage Work, Strengthen Families & Boost the Economy

**TARGETED ASSISTANCE:** Oklahoma's most important credits are designed specifically to encourage work (EITC), support basic nutrition (Sales Tax Relief Credit), and strengthen families with children (Child Tax Credit). These types of credits have lifted millions out of poverty nationwide. They provide just enough breathing room in a family budget to ensure that basic needs are met and that other forms of assistance aren't necessary.

**BOOSTING THE ECONOMY:** Low- and moderate-income families are most likely to spend locally on food, clothing, and other necessities, so almost every dollar spent on the tax credits multiplies throughout local economies. For instance, many families use EITC refunds to buy cars so they can more easily find or keep a job.<sup>2</sup>

**\$1.58**

**Economic activity generated by each dollar spent on the EITC, according to a study by the City of San Antonio.<sup>3</sup>**

**STRENGTHENING FAMILIES:** About half of the families receiving credits spend their tax refunds on basic needs like rent, food, and medicine. Another quarter pay credit card bills—most built up from buying those same basic necessities. The last quarter, who can afford to invest some of the income, primarily use it for education and job training to advance their careers, or for their children's or grandchildren's education.<sup>4</sup>

# Earned Income Tax Credit

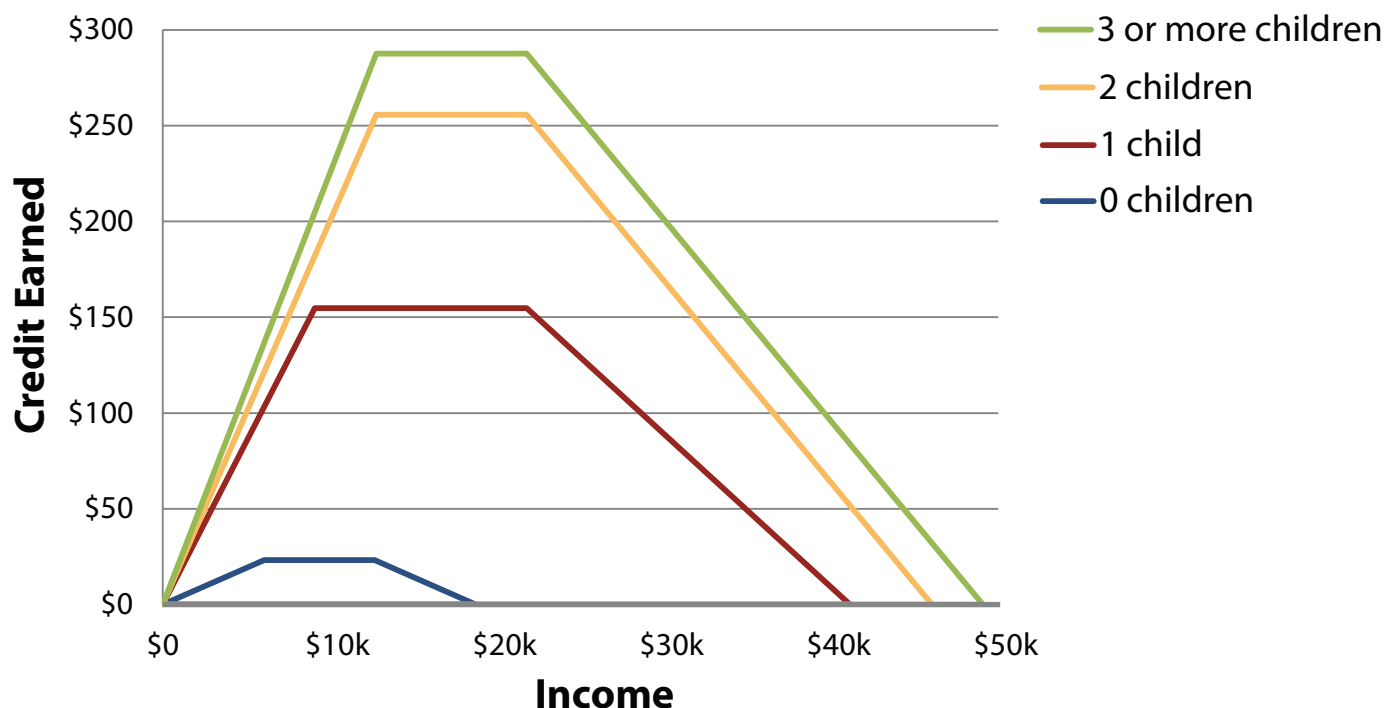
*“The best anti-poverty, the best pro-family, the best job-creation measure to come out of Congress.”*

That’s how President Reagan described the federal Earned Income Tax Credit (EITC),<sup>5</sup> which he also worked to expand during his administration.

## Earned Income Tax Credit Facts

- The EITC encourages and rewards work. The credit grows with each dollar of earnings until it reaches its maximum value. This creates an incentive for Oklahomans to leave welfare for work and for low-wage workers to increase their hours.
- The EITC is the largest poverty fighting program in the United States. It lifted 5.4 million people above the poverty-line in 2010, including 3.0 million children.<sup>6</sup>
- Oklahoma is one of 24 states with a state-level EITC. It was created in 2001 under Republican Governor Frank Keating. Oklahoma’s EITC supplements the federal credit by an additional 5 percent.
- The Oklahoma EITC was claimed on 307,253 tax returns in 2009, for an average benefit of about \$104.<sup>7</sup>

State EITC Earned by Oklahoma Families in 2011



Source: Tax Policy Center, “Earned Income Tax Credit Parameters,” adjusted to show 5 percent Oklahoma credit.

## Sales Tax Relief Credit

Oklahoma is one of only seven states that imposes a sales tax on groceries at the full rate. Most states have reduced or eliminated taxes on this basic necessity that eats up a substantial portion of a low-income family's budget. To reduce this burden, Oklahoma created the Sales Tax Relief Credit.

### Sales Tax Relief Credit Facts



- In 2009, the credit was claimed on almost one-third (32.3 percent) of all Oklahoma tax returns, and it benefited more than 1 million Oklahomans.<sup>8</sup>
- The credit provides \$40 per person to households with a dependent child, senior, or disabled resident who earn less than \$50,000. Households without dependents can receive the credit if they make \$20,000 or less.
- The need in Oklahoma is very high. From 2008-10, about one in six Oklahoma households (16.4 percent) experienced food insecurity. This means that at some time during the year, they were unable to get enough food for their families. This was the 6th highest rate in the nation.

***Without the sales tax relief credit, Oklahoma would join Mississippi and Alabama as the only states that provide no offset of any kind for taxes on groceries.***



# Child Tax Credit/Child Care Tax Credit



The child credit and child care credit provide important flexibility and support for families with children. The credits allow parents to pay for child care so they can work or look for work. They also reduce taxes for stay-at-home parents and those who care for dependent elders or people with disabilities.

## Child Tax Credit Facts

- In 2009, the federal child tax credit kept approximately 2.3 million people out of poverty, including about 1.3 million children.<sup>10</sup>
- The credit is one of the broadest and is available to households with incomes up to \$100,000. In 2009, it was claimed on 362,470 Oklahoma returns for an average benefit of about \$80.<sup>11</sup>
- The state child care tax credit can be claimed for 20 percent of the federal credit for child care expenses, up to a maximum of \$420. Families also have the option to instead receive 5 percent of the federal child tax credit of \$1,000 per child, so those who don't pay out of pocket for child care can still benefit. Most qualifying Oklahoma families take the child tax credit.

## Broad-Based Tax Credits At A Glance

### Earned Income Tax Credit

**WHO IT HELPS:** The EITC benefits childless Oklahoma families making less than \$18,740, one-child families making less than \$41,132, two-child families making less than \$46,044, and three-or-more-child families making less than \$49,078.

**HOW IT HELPS:** In order to encourage and reward work, the credit grows with each dollar of earnings until it reaches its maximum value, and then phases out gradually. Oklahoma's provides an additional five percent of the federal Earned Income Tax Credit. In 2009, the state EITC was claimed on 307,253 Oklahoma tax returns for a total of \$31.9M and an average benefit of about \$104.

### Sales Tax Relief Credit

**WHO IT HELPS:** The Sales Tax Relief Credit goes to families with a dependent child, senior, or person with disability making up to \$50,000, or others making up to \$20,000.

**HOW IT HELPS:** The credit provides \$40 per person in a household. It is meant to offset the sales tax on groceries, since Oklahoma is one of the few states that taxes groceries at the full rate. The Sales Tax Relief Credit was claimed on 520,746 Oklahoma tax returns in 2009, and it provided a total of \$43.2M in tax relief to more than 1 million Oklahomans.

### Child Tax Credit/Child Care Tax Credit

**WHO IT HELPS:** The Child Tax Credit and Child Care Tax Credit benefit families who are supporting children and make up to \$100,000.

**HOW IT HELPS:** Oklahoma's child care credit can be claimed for 20 percent of the federal credit for child care expenses, up to a maximum of \$420. Families may instead receive 5 percent of the federal child tax credit of \$1,000 per child, so those who don't pay out of pocket for child care can still benefit. Most qualifying Oklahoma families choose the child tax credit. In 2009, it was claimed on 362,470 Oklahoma returns for a total of \$29.0 M, which works out to an average benefit of about \$80.



## References

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