OREGON CENTER FOR PUBLIC POLICY

204 N. First St., Suite C • PO Box 7 • Silverton, OR 97381 • www.ocpp.org • 503-873-1201 • fax 503-873-1947

Executive Summary

October 16, 2000

How Would Expanding Oregon's Deduction for Federal Income Taxes Paid Affect Elderly Oregonians?

A Distributional Analysis of Ballot Measures 88 and 91

Oregon is one of nine states that allow taxpayers to claim federal income taxes paid as a deduction on personal income tax forms. Oregon taxpayers can deduct up to $3,000 of federal personal income tax on their Oregon tax returns. There are two initiatives proposing changes to this structure. Measure 88 would increase the deduction of federal income taxes from $3,000 to $5,000. Measure 91 would allow Oregonians to deduct all of their federal personal income tax. This analysis assesses the impact of these two initiatives on elderly taxpayers at different income levels.

Distributional Effects of Measure 91:

- More than three out of every four dollars (78 percent) cut from taxes of the elderly would go to the wealthiest six percent (6 percent) of elderly Oregon residents—those with incomes over $100,000.
- The average tax cut awarded to these wealthiest of Oregon's elderly would be over $4,000.
- Those earning $50,000 or less comprise 73 percent of elderly taxpayers. They would receive only one percent (1%) of the tax cut created by this measure, and would enjoy on average a $4 tax cut.
- Only about four percent of this group would receive any state income tax cut at all.
- Of the entire elderly population, three out of every four will receive no benefit from Measure 91.

Distributional Effects of Measure 88:

- The lowest-income 73 percent of elderly Oregonians (those earning $50,000 or less per year) would receive only 5 percent of the tax cut from Measure 88, and their average tax cut would be $3.
- The best-off six percent (6%) of Oregonians over 65 would receive thirty percent of the Measure 88 benefit.
- As with Measure 91, three out of four elderly Oregonians would receive no tax cut at all from the Measure 88 change.

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A Distributional Analysis of Ballot Measures 88 and 91

Oregon is one of nine states that allow taxpayers to claim federal income taxes paid as a deduction on personal income tax forms. Under current law, taxpayers may deduct all state income taxes when calculating federal income tax liability. In addition, Oregon taxpayers can deduct up to $3,000 of federal personal income tax on their Oregon tax returns. There are two initiatives proposing changes to this structure. Measure 88 would increase the deduction of federal income taxes from $3,000 to $5,000. Measure 91 would allow Oregonians to deduct all of their federal personal income tax.[1] This analysis assesses the impact of these two initiatives on elderly taxpayers at different income levels.[2]

Distributional Effects of Measure 91

Measure 91 would allow Oregonians to deduct the entire amount they pay in federal income taxes from their taxable income on their Oregon tax returns. Figure 1 shows the distributional consequences for elderly Oregonians. More than three out of every four dollars (78 percent) cut from taxes of the elderly would go to the wealthiest six percent of elderly Oregon residents—those with incomes over $100,000. The average tax cut awarded to these wealthiest of Oregon's elderly would be over $4,000.

Those earning $50,000 or less comprise 73 percent of elderly taxpayers. They would receive only one percent of the tax cut created by this measure, and would receive a $4 tax cut, on average. However, only about four percent of this group would receive any state income tax cut at all. Of the entire elderly population, three out of every four will receive no benefit from Measure 91's removal of the $3,000 limit and creation of a double deduction for tax liability.[3]

Distributional Effects of Measure 88

Measure 88, referred to the voters by the Oregon Legislature in 1999, would raise the cap on deducting federal taxes from $3,000 to $5,000. Figure 1 shows that, while the distribution of the tax cuts from such a change would be less regressive than Measure 91, this tax cut would also disproportionately benefit higher-income Oregonians and would fail to give tax relief to most elderly Oregonians.

The lowest-income 73 percent of elderly Oregonians (those earning $50,000 or less per year) would receive only 5 percent of the tax cut from the Measure 88 change, and their average tax cut would be $3. The wealthiest six percent of Oregonians over 65 would receive thirty percent of the Measure 88 benefit. As with Measure 91, three out of four elderly Oregonians would receive no tax cut at all from the Measure 88 change.

Figure 1. Tax Cuts to Elderly Individuals, Ballot Measures 88 and 91

		Measure 88 ($5,000 limit)		Measure 91 (unlimited deduction)		
Income Group	**% of Elderly Individuals and Couples**	**Average Tax Cut**	**% of Total Tax Cut**	**Average Tax Cut**	**% of Total Tax Cut**	**Percent With Tax Cut**
Less than $25,000	46%	$0	0%	$0	0%	0%
$25,000-$50,000	27%	$7	5%	$10	1%	10%
$50,000-$75,000	15%	$98	40%	$180	8%	73%
$75,000-$100,000	6%	$171	26%	$748	13%	96%
Over $100,000	6%	$177	30%	$4,107	78%	97%
Addendum: All Under $50,000	73%	$3	5%	$4	1%	4%

Source: ITEP Microsimulation Tax Model, October 5, 2000

The Effects of Measure 91 on All Taxpayers

Figure 2 shows the distribution of the Measure 91 tax cut among *all* Oregon taxpayers. Among all taxpayers, the wealthiest one percent of Oregonians, whose average income is about $790,000 per year, would receive an average tax cut of over $16,000, or 29 percent of their income tax liability. Middle income Oregonians (the 20 percent of Oregonians in the middle of the income distribution) would receive only 1.5 percent of the total tax cut—an average reduction of $28. This reduction represents just two percent of the average amount of income taxes paid by middle income taxpayers.

The poorest 40 percent of Oregonians—those earning less than $26,000 in 2000—would receive virtually no benefit from the proposal.

Figure 2. Effect of Eliminating the Cap on Deductibility of Federal Income Taxes: Oregon Residents by Income Group, 1999

Income Group	Tax Cuts as % of Income	Average Tax Cut	Percent of Total Tax Cut	Tax Cut as % of Income Taxes
Lowest 20%	0.0%	$0	0%	0.0%
Second 20%	0.0%	$1	0%	0.1%
Middle 20%	0.1%	$28	1%	2.0%
Fourth 20%	0.3%	$158	8%	6.1%
Next 15%	0.7%	$598	24%	12.6%
Next 4%	1.3%	$2,288	24%	20.8%
Next 1%	2.1%	$16,627	43%	29.1%
Addendum: Lowest 99%	0.5%	$222	57%	10.40%

Source: ITEP Microsimulation Tax Model, September 2000

The Effects of Measure 88 on All Taxpayers

Figure 3 shows the distributional effects of increasing the cap on the federal income tax deduction from the current $3,000 to $5,000 as proposed by Measure 88. This tax cut also disproportionately benefits higher-income Oregonians.

The lowest-income 60 percent of Oregonians would receive only 9 percent of the tax cut from this proposal. The wealthiest 20 percent of Oregonians would receive over half of the benefit. Moreover, the five percent of the population with incomes in excess of $124,000 would realize a full 15 percent of the tax break from this proposal.

Figure 3. Effect of Increasing the Cap on Deductibility of Federal Income Taxes to $5,000: Oregon Residents by Income Group, 2000

Income Group	Tax Cuts as % of Income	Average Tax Cut	Percent of Total Tax Cut
Lowest 20%	0.0%	$0	0%
Second 20%	0.0%	$1	0%
Middle 20%	0.1%	$25	9%
Fourth 20%	0.2%	$99	34%
Next 15%	0.2%	$158	42%
Next 4%	0.1%	$181	12%
Next 1%	0.0%	$184	3%

Source: ITEP Microsimulation Tax Model, September 2000

Measure 91's Impact on Marginal Tax Rates

An alternative way to achieve the tax cuts contained in Measure 91 would be to selectively reduce the marginal tax rates (the percentage of each additional dollar of income paid in taxes) of upper-income taxpayers. In other words, if Measure 91 were to pass, it would have the same effect as enacting sizeable reductions in the marginal rates of upper-income taxpayers. The new marginal rate structure resulting from Measure 91 is contained in Figure 4.

Figure 4. New Oregon Marginal Tax Rates on Families of Four Created by Measure 91

Oregon Taxable Income	Marginal Tax Rate
$0-4,700	5%
$4,700-11,800	7%
$11,800-22,200	9%
$22,200-53,800	7.70%
$53,800-97,500	6.50%
$97,500-136,500	6.20%
$136,5000-217,000	5.80%
Above $217,000	5.40%

*Assumes standard deduction for federal and Oregon taxes.

Source: ITEP Microsimulation Tax Model, September, 2000.

The structure of this tax rate schedule is unusual. The highest marginal tax rate is for taxpayers with incomes between $11,800 and $22,200. From that point the marginal tax rate slowly declines. Such a tax rate schedule is considered regressive because people at higher incomes pay a lower tax rate. For example, someone with an income of $200,000 would be in the 5.8 percent bracket, while someone with an income of $50,000 would be in the 7.7 percent bracket.

Note that Figure 4 applies to married couples filing joint returns with two dependents who take the standard deduction, and it assumes income for federal and Oregon purposes is taxed in the same way (which is true of most forms of income). The exact income brackets vary for differing deduction amounts, filing statuses, family sizes and some types of income. The pattern and rates do not, however, change significantly.

Conclusion

Nine states allow an income tax deduction for federal taxes paid (Alabama, Iowa, Louisiana, Missouri, Montana, North Dakota, Oklahoma, Oregon, and Utah), and only three states (Alabama, Iowa, and Louisiana) allow taxpayers to deduct the full amount of their federal income tax liability. When fully implemented, expanding this deduction would carry a substantial price tag—eliminating the cap entirely would cost more than $750 million annually, while increasing the cap would cost over $120 million annually[4] and would deliver no tax relief to most elderly Oregonians. The vast majority of elderly Oregonians would be completely unaffected by an increase in the federal tax deduction because the amount of federal income taxes they pay is less than $3,000.

The skewed distribution of the tax cuts under these proposals is due to the fact that wealthier people pay more in federal personal income taxes. Low- and middle-income taxpayers whose federal income tax is $3,000 or less would receive no benefit from the proposals because they are already deducting their entire federal personal income tax liability under current law. Upper-income taxpayers, for whom the $3,000 they currently deduct constitutes a substantial portion of their federal tax liability, would receive some benefit. The wealthiest Oregonians, for whom the $3,000 maximum deduction is a small share of their federal personal income tax liability, would realize enormous tax cuts if the full amount is deductible.

It is telling that the measures' sponsors singled out the federal income tax for special treatment under these proposals. The federal personal income tax is based on the well established principle of taxation based on ability to pay; , the federal income tax is progressive.[5] In fact, it is the most progressive major tax on individuals—the tax that takes the most from high-income relative to middle- and low-income taxpayers. Because the federal income tax is based on ability to pay, the deductions created by Measures 88 and 91 give a disproportionate benefit to the wealthiest taxpayers.

Most Americans actually pay less in federal personal income taxes than in other federal taxes such as the regressive excise and payroll taxes. For the 92 percent of Americans who earned less than $100,000 in 1999, the federal personal income tax represented only 38 percent of total federal taxes paid.[6] Thus, Measures 88 and 91, by increasing the deduction for the federal personal income tax, target their benefits to the most affluent Oregonians.

Endnotes:

[1] Because federal law provides a deduction for all state income taxes for federal income tax purposes, Measure 91 would create a "double deduction" of tax liability. Moreover, Measures 88 and 91 will increase federal income taxes for those taxpayers who itemize deductions on their federal income tax returns and who benefit from the state income tax cuts created by the measures.

[2] For the purposes of this analysis, elderly Oregon taxpayers include all families and individuals in which at least one filer is over 65 years old.

[3] The percent of elderly Oregon taxpayers who will receive a tax cut is the cumulative total of the percent of each income quintile (20%) who will receive a tax cut multiplied by the percent of elderly individuals and couples (i.e., none of the elderly in the first quintile; 2.7 percent of the elderly from the second quintile; 10.95 percent of the elderly from the third quintile; 5.76 percent of the elderly from the fourth quintile, and 5.82 percent of the elderly from the fifth quintile).

[4] "Initiative Petition #10: Full Deductibility for Federal Income Taxes," Legislative Revenue Office Research Report Number 4-00, June 22, 2000, and Revenue Impact of Proposed Legislation, 1999 Regular Session, SB 535b Revenue Impact Update, Legislative Revenue Office Document #5745, September 7, 2000.

[5] The concept of taxation based on ability to pay, or progressive taxation, is not new. Adam Smith, the "father" of modern capitalism, in *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), wrote "The subjects of every state ought to contribute toward the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state [As Henry Home (Lord Kames) has written, a goal of taxation should be to] 'remedy inequality of riches as much as possible, by relieving the poor and burdening the rich.'"

[6] "Tax and Income Shares in 1999 According to the Joint Committee on Taxation," available at http://www.ctj.org/pdf/gop10p2.pdf.