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Georgia May Be the First State to Cap Income Taxes

It's up to voters this November, but other states have enacted similar moves only to encounter financial problems later.

BY LIZ FARMER | OCTOBER 6, 2014



Senate President Pro Tempore David Shafer, center, touts the measure as a way to cement Georgia's status as a low-tax state. *AP/David Goldman*

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ELECTION 2014: *This article is part of our coverage of ballot measures to watch.*

Georgia appears on the verge of removing a valuable financial tool for the state -- and it's leaving the ultimate decision to voters.

The question on November's ballot asks voters if they want to place a cap on the state's income tax. (The state's top rate is 6 percent.) Perhaps not surprisingly, the idea has strong popular support -- a poll conducted at the end of August by Georgia-based polling company Sand Mountain Communications showed 57 percent of voters support the idea. Even more convincing, the cap has majority support across all age groups, men and women and both major parties.

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To some policy watchers, that's a problem. For one, the average voter may not be thinking about her state's ability to weather the next financial downturn. And once it's enshrined in the constitution, removing a cap will be difficult to do.

"You're taking it out of the legislators' hands and as policy option -- as a practical matter -- you're saying in any kind of short term period we can't respond to recessions," said Don Boyd, senior fellow at the Rockefeller Institute of Government in Albany, N.Y. Without the ability to raise the income tax in response to dipping revenues, he added, the state would likely turn to cuts in big spending areas like infrastructure, education and Medicaid. "They will have foreclosed on the Number One tool in their tool box."

Proponents, led by Republican Senate President Pro Tempore David Shafer, tout the measure as a way to cement Georgia's status as a low-tax state. "It makes it clear that our income tax rate is not going up," he told a local radio station after the Senate approved the measure. "It helps increase our competitiveness by pointing out to businesses making expansion decisions that, while other states could increase their rates tomorrow, our rates are constitutionally capped."

Others have supported the pro-business argument. University of Georgia Professor Jeffrey Dorfman has argued the cap is a way to establish credibility with businesses, noting it might help steer some companies and jobs to Georgia from neighboring states.

Indeed, the Peach State tends to be at a disadvantage when compared with its immediate neighbors: It shares a border with Florida, which doesn't tax income at all; Alabama, which has a 5 percent tax rate; and Tennessee, which only applies its 6 percent tax rate to investment income. Its remaining neighbor, South Carolina, has a 7 percent top income tax rate. But compared with the rest of the country, Georgia's income tax rate ranks squarely in the middle of states. And when looking at its business tax climate as measured annually by the Tax Foundation, it ranks in the middle of its neighbors. Georgia ranks 32nd -- below Florida (5th), Tennessee (15th) and Alabama (21st) and above South Carolina (37th) and North Carolina (44th). The State Business Tax Climate Index compares states in five areas of taxation that impact business: corporate taxes, individual income taxes, sales taxes, unemployment insurance taxes, and taxes on property, including residential and commercial property.

Although Georgia would be the first state to enshrine an income tax cap in its constitution, other states have enacted similar moves only to encounter problems much later. Illinois' constitution mandates a flat tax and in the 1990s, voters amended it to say that individual income tax and corporate income tax must maintain a certain ratio to each other. That means that neither can be

raised or lowered without the other, making policy changes extremely difficult. This summer, ratings agencies warned Illinois of a credit rating downgrade after the state failed to extend an income tax hike in its 2015 budget. Instead, Illinois relied on one-time fixes to plug its budget deficit.

California in the late 1970s passed Proposition 13, which responded to soaring property values by capping the property tax rate -- the prime funding source of public schools. The Golden State went from being ranked fifth among the states in per-pupil spending during the 1950s and '60s, to the mid-40s by the 1990s. Prop. 13 also required a two-thirds approval of any other tax increases -- meaning that not only were local governments shifting to relying on money from income tax collected by the state, it was even more difficult to eek more out of that revenue stream. By 2009, the state was so hamstrung in its taxing ability, it was staring down the barrel of a \$21 billion budget deficit.

Tax Foundation Economist Liz Malm said a better policy move for Georgia would be to lower its income tax instead of capping it. "I don't see them raising it in the future anyway because they're already higher than most of its neighbors," she said.

In fact, Georgia's income tax rate hasn't increased since the 1980s. Additionally, if the measure is approved by voters, it's no guarantee that their overall tax burdens will remain low. Georgia may be forced to make up the difference elsewhere, like in its sales tax. At 6.99 percent, Georgia boasts one of the lowest sales tax rates in the South. That could change.

"It's like a water balloon," said Boyd. "You squeeze it in one place and it bulges out in another."

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