Don't Give Up on Pease

States Can Decouple from Recent Federal Tax Cuts for Wealthy Itemizers

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INSTITUTE ON TAXATION AND ECONOMIC POLICY

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About ITEP

Founded in 1980, the Institute on Taxation and Economic Policy (ITEP) is a non-profit, non-partisan research organization, based in Washington, DC, that focuses on federal and state tax policy. ITEP's mission is to inform policymakers and the public of the effects of current and proposed tax policies on tax fairness, government budgets, and sound economic policy. Among its many publications on state and local tax policy are *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States* and *The ITEP Guide to Fair State and Local Taxes.* ITEP's full body of research is available at www.itepnet.org.

Introduction

In 2011, thirty one states and the District of Columbia allow a group of income tax breaks known as "itemized deductions" (Figure 1). Itemized deductions are designed to help defray a wide variety of personal expenditures that affect a taxpayer's ability to pay taxes, including charitable contributions, extraordinary medical expenses, mortgage interest payments and state and local taxes. These deductions cost states billions of dollars each year while providing little or no benefit to the middle- and low-income families hit hardest by the lingering economic downturn.

Figure 1: 31 States and DC Generally Follow Federal Rules for Itemized Deductions
Alabama, Arizona, Arkansas, California, Colorado, Delaware, District of Columbia, Georgia, Hawaii, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Mexico, New York, North Carolina, North Dakota, Oklahoma, Oregon, South Carolina, Utah, Vermont, Virginia & Wisconsin

The so-called Bush tax cuts enacted in 2001 at the behest of President George Bush and extended in late 2010 for tax years 2011 and 2012 under President Barack Obama are most widely known for cutting the top income tax rate to 35 percent. But they also quietly repealed the "Pease" disallowance — a provision named after its Congressional sponsor — that reduces the cost and regressivity of certain itemized deductions by limiting their value by up to 80 percent for the very best-off taxpayers. Pease gradually disappeared between 2006 and 2009, with full repeal coming into effect for the first time in 2010. Before the first round of the Bush tax cuts were enacted in 2001, every state with itemized deductions other than California had adopted the federal Pease disallowance—which means that these states saw their version of Pease disappear as the Bush tax cuts were gradually phased-in.

The tax compromise package passed at the end of 2010 extended the repeal of Pease for an additional two years — into 2011 and 2012. This federal tax cut will likely be passed through to most state tax laws, reducing state income tax collections in the 31 states allowing federal itemized deductions by more than $2 billion annually (California is the exception, since it has its own stand-alone disallowance provision similar to Pease). As a result, many of the wealthiest taxpayers in those states will receive automatic state tax cuts over the next two years. Fortunately, state lawmakers can "decouple" from this provision of the tax compromise package by creating their own limits on the value of itemized deductions (See Appendix I for state-by-state estimates of decoupling from the Federal Pease repeal in tax year 2011).

Recommendation

ITEP's 2010 report: *"Writing Off" Tax Giveaways: How States Can Help Balance Their Budgets by Reforming or Repealing Itemized Deductions* presented estimates of the yield and tax fairness impact of five different approaches to itemized deduction reform, each of which could raise significant revenue to fund vital public services:

- Repeal itemized deductions entirely
- Cap the total value of itemized deductions
- Convert itemized and the standard deduction to a credit
- Enact stand-alone phaseouts or disallowance rules
- Decouple from the federal Pease repeal

The most straightforward of these options is to "decouple" from the recent federal tax change that extended the repeal of the Pease provision through 2011 and 2012. This could be done by enacting a law specifying that the state's itemized deduction phaseout will follow federal law as of January 1, 2001—before the Bush tax cuts were enacted. In 2011, this would mean that taxpayers with adjusted gross income (AGI) over $171,500 ($85,550 for single filers) would lose some of their itemized deductions. This approach is relatively simple in that it relies on pre-existing federal rules, but it also would have a relatively small impact on state revenues. Overall, state income tax revenues would typically increase by 0.5 to 1.5 percent if lawmakers decoupled from the federal tax change. However, in a time when every dollar counts, it would be wise for lawmakers to consider such a move. In general, this approach would increase state taxes for less than four percent of a state's residents. For example, decoupling from Pease repeal in the tax compromise package in Iowa would raise state income tax revenue by approximately 0.7 percent and would impact 2.4 percent of the state's wealthiest taxpayers.

Itemized deductions are under fire

Half a dozen states have recently passed legislation to pare back or repeal upper-income tax breaks for everything from charitable contributions to mortgage interest, The outright repeal of itemized deductions in Rhode Island in 2010 has been the most significant of those efforts by far. Itemized deduction reform at the state and federal level continues to gain traction in 2011. Recent bipartisan national fiscal commissions have recommended reducing or eliminating specific federal itemized deductions as an important step toward improving the federal tax code. State tax commissions in Vermont and Georgia recommended repealing all itemized deductions and Hawaii lawmakers are moving towards capping the value of itemized deductions in their state. These important reforms will make tax systems fairer and more sustainable at a time when they are badly in need of such changes. Itemized deductions are costly, "upside-down" subsidies for the best-off taxpayers, offering little or no benefit for many low- and middle-income families.

Implementation

States differ in how they choose to go about incorporating federal tax policy changes into their own tax codes. Thirteen of the states allowing federal itemized deductions are automatic or "moving date" conformity states, meaning that changes in federal tax law automatically apply to the state tax code as they occur. Of the remaining states where this is an issue, eighteen are fixed-date conformity states conforming to the federal tax code as of a specific date (Figure 2). In these states, lawmakers routinely review federal tax changes and make decisions about whether or not to conform or decouple from individual items. Until such a review takes place, these states are not subject to the new itemized deduction disallowance rules, however, Arizona and a few other fixed-date conformity states have already updated their state tax codes to the federal tax compromise package. In either case, lawmakers in each state impacted by federal tax changes can make the decision to decouple from those they find unfavorable.

Figure 2: IRC Conformity Types in States Allowing Federal Itemized Deductions
Fixed-Date Conformity
Arizona, Arkansas, California, District of Columbia, Georgia, Hawaii, Idaho, Iowa, Kentucky, Maine, Minnesota, Nebraska, North Carolina, Oregon, South Carolina, Vermont, Virginia, Wisconsin
Automatic or "Moving Date" Conformity
Alabama, Colorado, Delaware, Kansas, Louisian, Maryland, Missouri, Montana, New Mexico, New York, North Dakota, Oklahoma, Utah
Other
Mississippi

Conclusion

With continued budget deficits being the reality for most states in 2011, state policymakers around the nation are searching for solutions to close these gaps. Itemized deductions are costly, inequitable, and ineffective, depriving states of billions of dollars in needed funds and making state income taxes less fair. Until January 1, 2010, Pease played a small but important role in making those deductions less costly and less unfair. At the very least, lawmakers in those states allowing federal itemized deductions should consider reinstating this provision.

Appendix I: Detailed State-by-State Estimates

All estimates are based on projected 2011 income levels.

ALABAMA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $16,000	$16,000 – $26,000	$26,000 – $46,000	$46,000 – $77,000	$77,000 – $147,000	$147,000 – $365,000	$365,000 – Or More
Average Income in Group	$ 11,000	$ 21,000	$ 35,000	$ 59,000	$ 101,000	$ 204,000	$ 940,000
Tax Change as % Income	—	—	—	—	—	0.01%	0.1%
Average Tax Change	—	—	—	—	—	+23	+810

State Tax Change ($1,000)	+19,000
% Revenue Increase	0.7%
% Taxpayers w/Tax Increase	2.2%

ARIZONA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $20,000	$20,000 – $32,000	$32,000 – $49,000	$49,000 – $78,000	$78,000 – $152,000	$152,000 – $350,000	$350,000 – Or More
Average Income in Group	$ 12,000	$ 26,000	$ 40,000	$ 62,000	$ 103,000	$ 217,000	$ 1,061,000
Tax Change as % Income	—	—	—	—	—	0.02%	0.1%
Average Tax Change	—	—	—	—	—	+33	+843

State Tax Change ($1,000)	+27,000
% Revenue Increase	1.0%
% Taxpayers w/Tax Increase	2.7%

ARKANSAS

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $16,000	$16,000 – $28,000	$28,000 – $46,000	$46,000 – $73,000	$73,000 – $144,000	$144,000 – $355,000	$355,000 – Or More
Average Income in Group	$ 10,000	$ 22,000	$ 36,000	$ 59,000	$ 95,000	$ 203,000	$ 835,000
Tax Change as % Income	—	—	—	—	—	0.01%	0.1%
Average Tax Change	—	—	—	—	—	+25	+892

State Tax Change ($1,000)	+13,000
% Revenue Increase	0.6%
% Taxpayers w/Tax Increase	1.8%

CALIFORNIA

***Decoupling from Pease was not modeled in California because the state's stand-alone phaseout is already decoupled from the Federal Pease Repeal.**

COLORADO

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $20,000	$20,000 – $38,000	$38,000 – $57,000	$57,000 – $98,000	$98,000 – $189,000	$189,000 – $484,000	$484,000 – Or More
Average Income in Group	$ 12,000	$ 28,000	$ 47,000	$ 74,000	$ 128,000	$ 278,000	$ 1,420,000
Tax Change as % Income	—	—	—	—	—	0.03%	0.1%
Average Tax Change	—	—	—	—	—	+70	+1,195

State Tax Change ($1,000)	+26,000
% Revenue Increase	0.6%
% Taxpayers w/Tax Increase	3.8%

DELAWARE

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $19,000	$19,000 – $34,000	$34,000 – $55,000	$55,000 – $90,000	$90,000 – $164,000	$164,000 – $373,000	$373,000 – Or More
Average Income in Group	$ 11,000	$ 25,000	$ 44,000	$ 71,000	$ 116,000	$ 236,000	$ 1,173,000
Tax Change as % Income	—	—	—	—	—	0.02%	0.1%
Average Tax Change	—	—	—	—	—	+51	+1,490

State Tax Change ($1,000)	+8,000
% Revenue Increase	0.9%
% Taxpayers w/Tax Increase	2.9%

DISTRICT OF COLUMBIA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $23,000	$23,000 – $40,000	$40,000 – $63,000	$63,000 – $108,000	$108,000 – $268,000	$268,000 – $1,120,000	$1,120,000 – Or More
Average Income in Group	$ 14,000	$ 31,000	$ 54,000	$ 84,000	$ 161,000	$ 463,000	$ 2,484,000
Tax Change as % Income	—	—	—	—	0.01%	0.1%	0.2%
Average Tax Change	—	—	—	—	+22	+411	+4,215

State Tax Change ($1,000)	+18,000
% Revenue Increase	1.3%
% Taxpayers w/Tax Increase	7.9%

GEORGIA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $15,000	$15,000 – $28,000	$28,000 – $46,000	$46,000 – $76,000	$76,000 – $156,000	$156,000 – $382,000	$382,000 – Or More
Average Income in Group	$ 10,000	$ 21,000	$ 36,000	$ 60,000	$ 104,000	$ 225,000	$ 999,000
Tax Change as % Income	—	—	—	—	—	0.03%	0.1%
Average Tax Change	—	—	—	—	—	+58	+1,079

State Tax Change ($1,000)	+57,000
% Revenue Increase	0.7%
% Taxpayers w/Tax Increase	2.9%

HAWAII

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $19,000	$19,000 – $36,000	$36,000 – $52,000	$52,000 – $88,000	$88,000 – $174,000	$174,000 – $372,000	$372,000 – Or More
Average Income in Group	$ 12,000	$ 27,000	$ 44,000	$ 69,000	$ 121,000	$ 237,000	$ 901,000
Tax Change as % Income	—	—	—	—	—	0.03%	0.2%
Average Tax Change	—	—	—	—	—	+75	+1,629

State Tax Change ($1,000)	+12,000
% Revenue Increase	0.8%
% Taxpayers w/Tax Increase	2.6%

IDAHO

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $18,000	$18,000 – $32,000	$32,000 – $50,000	$50,000 – $77,000	$77,000 – $140,000	$140,000 – $359,000	$359,000 – Or More
Average Income in Group	$ 11,000	$ 24,000	$ 40,000	$ 61,000	$ 98,000	$ 206,000	$ 957,000
Tax Change as % Income	—	—	—	—	—	0.02%	0.1%
Average Tax Change	—	—	—	—	—	+34	+1,099

State Tax Change ($1,000)	+8,000
% Revenue Increase	0.7%
% Taxpayers w/Tax Increase	1.8%

IOWA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $21,000	$21,000 – $39,000	$39,000 – $58,000	$58,000 – $87,000	$87,000 – $149,000	$149,000 – $363,000	$363,000 – Or More
Average Income in Group	$ 12,000	$ 30,000	$ 48,000	$ 71,000	$ 109,000	$ 206,000	$ 871,000
Tax Change as % Income	—	—	—	—	—	0.02%	0.1%
Average Tax Change	—	—	—	—	—	+46	+1,228

State Tax Change ($1,000)	+19,000
% Revenue Increase	0.7%
% Taxpayers w/Tax Increase	2.4%

KANSAS

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $20,000	$20,000 – $35,000	$35,000 – $57,000	$57,000 – $90,000	$90,000 – $165,000	$165,000 – $400,000	$400,000 – Or More
Average Income in Group	$ 11,000	$ 28,000	$ 46,000	$ 73,000	$ 116,000	$ 237,000	$ 1,054,000
Tax Change as % Income	—	—	—	—	—	0.03%	0.1%
Average Tax Change	—	—	—	—	—	+68	+1,214

State Tax Change ($1,000)	+19,000
% Revenue Increase	0.7%
% Taxpayers w/Tax Increase	3.2%

KENTUCKY

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $16,000	$16,000 – $30,000	$30,000 – $48,000	$48,000 – $78,000	$78,000 – $139,000	$139,000 – $322,000	$322,000 – Or More
Average Income in Group	$ 10,000	$ 23,000	$ 38,000	$ 61,000	$ 99,000	$ 195,000	$ 802,000
Tax Change as % Income	—	—	—	—	—	0.01%	0.1%
Average Tax Change	—	—	—	—	—	+22	+799

State Tax Change ($1,000)	+17,000
% Revenue Increase	0.5%
% Taxpayers w/Tax Increase	2.0%

LOUISIANA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $16,000	$16,000 – $31,000	$31,000 – $49,000	$49,000 – $86,000	$86,000 – $169,000	$169,000 – $424,000	$424,000 – Or More
Average Income in Group	$ 11,000	$ 23,000	$ 40,000	$ 64,000	$ 116,000	$ 241,000	$ 1,121,000
Tax Change as % Income	—	—	—	—	—	0.02%	0.1%
Average Tax Change	—	—	—	—	—	+52	+1,135

State Tax Change ($1,000)	+26,000
% Revenue Increase	1.0%
% Taxpayers w/Tax Increase	4.8%

MAINE

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $19,000	$19,000 – $33,000	$33,000 – $51,000	$51,000 – $81,000	$81,000 – $149,000	$149,000 – $358,000	$358,000 – Or More
Average Income in Group	$ 13,000	$ 26,000	$ 42,000	$ 65,000	$ 104,000	$ 209,000	$ 780,000
Tax Change as % Income	—	—	—	—	—	0.02%	0.1%
Average Tax Change	—	—	—	—	—	+41	+1,128

State Tax Change ($1,000)	+8,000
% Revenue Increase	0.6%
% Taxpayers w/Tax Increase	2.4%

MARYLAND

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $23,000	$23,000 – $42,000	$42,000 – $66,000	$66,000 – $108,000	$108,000 – $209,000	$209,000 – $464,000	$464,000 – Or More
Average Income in Group	$ 13,000	$ 32,000	$ 53,000	$ 85,000	$ 145,000	$ 297,000	$ 1,388,000
Tax Change as % Income	—	—	—	—	—	0.1%	0.2%
Average Tax Change	—	—	—	—	—	+97	+1,131

State Tax Change ($1,000)	+84,000
% Revenue Increase	0.8%
% Taxpayers w/Tax Increase	6.0%

MINNESOTA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $23,000	$23,000 – $40,000	$40,000 – $61,000	$61,000 – $93,000	$93,000 – $181,000	$181,000 – $428,000	$428,000 – Or More
Average Income in Group	$ 13,000	$ 31,000	$ 51,000	$ 75,000	$ 122,000	$ 264,000	$ 1,249,000
Tax Change as % Income	—	—	—	—	—	0.05%	0.1%
Average Tax Change	—	—	—	—	—	+125	+1,781

State Tax Change ($1,000)	+57,000
% Revenue Increase	0.8%
% Taxpayers w/Tax Increase	4.0%

MISSISSIPPI

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $23,000	$23,000 – $42,000	$42,000 – $66,000	$66,000 – $108,000	$108,000 – $209,000	$209,000 – $464,000	$464,000 – Or More
Average Income in Group	$ 9,000	$ 19,000	$ 32,000	$ 55,000	$ 93,000	$ 179,000	$ 713,000
Tax Change as % Income	—	—	—	—	—	0.0%	0.1%
Average Tax Change	—	—	—	—	—	+7	+494

State Tax Change ($1,000)	+7,000
% Revenue Increase	0.5%
% Taxpayers w/Tax Increase	1.5%

MISSOURI

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $17,000	$17,000 – $32,000	$32,000 – $50,000	$50,000 – $80,000	$80,000 – $151,000	$151,000 – $375,000	$375,000 – Or More
Average Income in Group	$ 11,000	$ 24,000	$ 40,000	$ 65,000	$ 105,000	$ 216,000	$ 1,020,000
Tax Change as % Income	—	—	—	—	—	0.02%	0.1%
Average Tax Change	—	—	—	—	—	+44	+1,108

State Tax Change ($1,000)	+41,000
% Revenue Increase	0.8%
% Taxpayers w/Tax Increase	2.8%

MONTANA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $17,000	$17,000 – $32,000	$32,000 – $49,000	$49,000 – $80,000	$80,000 – $143,000	$143,000 – $389,000	$389,000 – Or More
Average Income in Group	$ 10,000	$ 24,000	$ 39,000	$ 62,000	$ 103,000	$ 219,000	$ 906,000
Tax Change as % Income	—	—	—	—	—	0.02%	0.1%
Average Tax Change	—	—	—	—	—	+44	+921

State Tax Change ($1,000)	+5,000
% Revenue Increase	0.6%
% Taxpayers w/Tax Increase	2.4%

NEBRASKA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $20,000	$20,000 – $36,000	$36,000 – $57,000	$57,000 – $88,000	$88,000 – $156,000	$156,000 – $355,000	$355,000 – Or More
Average Income in Group	$ 12,000	$ 28,000	$ 46,000	$ 70,000	$ 113,000	$ 221,000	$ 1,090,000
Tax Change as % Income	—	—	—	—	—	0.02%	0.1%
Average Tax Change	—	—	—	—	—	+44	+1,211

State Tax Change ($1,000)	+11,000
% Revenue Increase	0.7%
% Taxpayers w/Tax Increase	2.5%

NEW MEXICO

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $18,000	$18,000 – $31,000	$31,000 – $50,000	$50,000 – $82,000	$82,000 – $156,000	$156,000 – $388,000	$388,000 – Or More
Average Income in Group	$ 11,000	$ 25,000	$ 39,000	$ 64,000	$ 109,000	$ 219,000	$ 844,000
Tax Change as % Income	—	—	—	—	—	—	0.1%
Average Tax Change	—	—	—	—	—	—	+577

State Tax Change ($1,000)	+6,000
% Revenue Increase	0.6%
% Taxpayers w/Tax Increase	2.9%

NEW YORK

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $17,000	$17,000 – $33,000	$33,000 – $54,000	$54,000 – $92,000	$92,000 – $199,000	$199,000 – $569,000	$569,000 – Or More
Average Income in Group	$ 11,000	$ 24,000	$ 43,000	$ 71,000	$ 128,000	$ 308,000	$ 2,211,000
Tax Change as % Income	—	—	—	—	—	0.03%	0.01%
Average Tax Change	—	—	—	—	+1	+81	+161

State Tax Change ($1,000)	+46,000
% Revenue Increase	0.1%
% Taxpayers w/Tax Increase	3.7%

Notes: Decoupling from Pease was modeled with the current NY phaseout rules in addition to Pease.

NORTH CAROLINA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $17,000	$17,000 – $30,000	$30,000 – $48,000	$48,000 – $77,000	$77,000 – $157,000	$157,000 – $363,000	$363,000 – Or More
Average Income in Group	$ 11,000	$ 23,000	$ 38,000	$ 62,000	$ 104,000	$ 221,000	$ 912,000
Tax Change as % Income	—	—	—	—	—	0.03%	0.1%
Average Tax Change	—	—	—	—	—	+58	+1,269

State Tax Change ($1,000)	+65,000
% Revenue Increase	0.7%
% Taxpayers w/Tax Increase	2.7%

NORTH DAKOTA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $24,000	$24,000 – $40,000	$40,000 – $71,000	$71,000 – $96,000	$96,000 – $180,000	$180,000 – $414,000	$414,000 – Or More
Average Income in Group	$ 15,000	$ 31,000	$ 52,000	$ 81,000	$ 123,000	$ 244,000	$ 1,030,000
Tax Change as % Income	—	—	—	—	—	0.01%	0.1%
Average Tax Change	—	—	—	—	—	+30	+752

State Tax Change ($1,000)	+3,000
% Revenue Increase	0.8%
% Taxpayers w/Tax Increase	2.7%

OKLAHOMA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $17,000	$17,000 – $30,000	$30,000 – $49,000	$49,000 – $82,000	$82,000 – $164,000	$164,000 – $357,000	$357,000 – Or More
Average Income in Group	$ 10,000	$ 22,000	$ 39,000	$ 63,000	$ 108,000	$ 223,000	$ 1,115,000
Tax Change as % Income	—	—	—	—	—	0.01%	0.1%
Average Tax Change	—	—	—	—	—	+29	+926

State Tax Change ($1,000)	+17,000
% Revenue Increase	0.7%
% Taxpayers w/Tax Increase	2.3%

OREGON

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $18,000	$18,000 – $31,000	$31,000 – $52,000	$52,000 – $83,000	$83,000 – $162,000	$162,000 – $365,000	$365,000 – Or More
Average Income in Group	$ 11,000	$ 25,000	$ 41,000	$ 65,000	$ 109,000	$ 227,000	$ 911,000
Tax Change as % Income	—	—	—	—	—	0.03%	0.2%
Average Tax Change	—	—	—	—	—	+72	+1,727

State Tax Change ($1,000)	+33,000
% Revenue Increase	0.6%
% Taxpayers w/Tax Increase	2.4%

SOUTH CAROLINA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $17,000	$17,000 – $27,000	$27,000 – $44,000	$44,000 – $74,000	$74,000 – $143,000	$143,000 – $331,000	$331,000 – Or More
Average Income in Group	$ 10,000	$ 22,000	$ 35,000	$ 57,000	$ 97,000	$ 201,000	$ 811,000
Tax Change as % Income	—	—	—	—	—	0.01%	0.1%
Average Tax Change	—	—	—	—	—	+30	+850

State Tax Change ($1,000)	+20,000
% Revenue Increase	0.7%
% Taxpayers w/Tax Increase	2.0%

UTAH

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $20,000	$20,000 – $34,000	$34,000 – $55,000	$55,000 – $86,000	$86,000 – $167,000	$167,000 – $381,000	$381,000 – Or More
Average Income in Group	$ 12,000	$ 27,000	$ 44,000	$ 69,000	$ 114,000	$ 231,000	$ 1,127,000
Tax Change as % Income	—	—	—	—	—	0.01%	0.0%
Average Tax Change	—	—	—	—	—	+22	+72

State Tax Change ($1,000)	+2,000
% Revenue Increase	0.1%
% Taxpayers w/Tax Increase	1.3%

Notes: Decoupling from Pease in Utah was modeled with the state's current credit structure.

VERMONT

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $20,000	$20,000 – $36,000	$36,000 – $55,000	$55,000 – $87,000	$87,000 – $161,000	$161,000 – $353,000	$353,000 – Or More
Average Income in Group	$ 12,000	$ 28,000	$ 45,000	$ 67,000	$ 112,000	$ 228,000	$ 919,000
Tax Change as % Income	—	—	—	—	—	0.03%	0.1%
Average Tax Change	—	—	—	—	—	+76	+1,360

State Tax Change ($1,000)	+5,000
% Revenue Increase	1.0%
% Taxpayers w/Tax Increase	3.0%

VIRGINIA

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $20,000	$20,000 – $37,000	$37,000 – $61,000	$61,000 – $102,000	$102,000 – $206,000	$206,000 – $466,000	$466,000 – Or More
Average Income in Group	$ 12,000	$ 28,000	$ 48,000	$ 79,000	$ 139,000	$ 285,000	$ 1,276,000
Tax Change as % Income	—	—	—	—	—	0.05%	0.1%
Average Tax Change	—	—	—	—	—	+128	+1,362

State Tax Change ($1,000)	+72,000
% Revenue Increase	0.7%
% Taxpayers w/Tax Increase	5.5%

WISCONSIN

2011 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $20,000	$20,000 – $36,000	$36,000 – $57,000	$57,000 – $85,000	$85,000 – $154,000	$154,000 – $351,000	$351,000 – Or More
Average Income in Group	$ 13,000	$ 28,000	$ 45,000	$ 70,000	$ 108,000	$ 211,000	$ 988,000
Tax Change as % Income	—	—	—	—	—	0.02%	0.1%
Average Tax Change	—	—	—	—	—	+32	+807

State Tax Change ($1,000)	+25,000
% Revenue Increase	0.4%
% Taxpayers w/Tax Increase	0.0%

Notes: Decoupling from Pease in Wisconsin was modeled with the state's current credit structure.

Source: Institute on Taxation and Economic Policy Microsimulation Tax Model, March 2011

Appendix II: The ITEP Microsimulation Model

The Institute on Taxation and Economic Policy (ITEP) has engaged in research on tax issues since 1980. Since 1996 ITEP has used a *microsimulation tax model* to conduct research on federal, state, and local tax systems. A microsimulation model uses a large sample of tax returns and other data to estimate the impact of tax systems and tax proposals on actual taxpayers at different income levels. This is the same type of tax model used on the federal level by the U.S. Treasury Department, the Congressional Joint Committee on Taxation, and the Congressional Budget Office, as well as by many state revenue departments. A properly constructed microsimulation model can provide accurate estimates of revenue yield and tax incidence by income group.

ITEP's microsimulation model relies on one of the largest databases of tax returns and supplementary data in existence, encompassing close to 750,000 records. This database is based on federal tax returns, with statistically valid samples from every state and the District of Columbia. The database is augmented with a sampling of records from the U.S. Decennial Census "five percent sample" (which contains a random sample of five percent of all census forms received by the Census Bureau); the Census data are statistically matched with the tax return records. The data on these records is then extrapolated to subsequent years using federal tax micro and tabular data, Census Bureau Current Population Survey micro and tabular data, and other widely respected data sources.

These, and other, data are used by the ITEP model's four modules: Personal Income Tax, Property Tax, Consumption Tax and Business Tax. These modules calculate tax liability on a record-by-record basis and sum the results to provide revenue and tax incidence estimates. (A complete description and methodology for the ITEP model is available on request.)

The ITEP model has the unique capability of analyzing all major taxes for every state and the District of Columbia. In 2009, the ITEP model was used to produce the study *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*. *Who Pays?* shows the distributional impact, by income level, of all major state and local taxes for each of the 50 states. It has been used by many state revenue departments and legislative fiscal offices since its publication.

The ITEP Model is also unique in its ability to forecast the effect of both federal and state tax changes on taxpayers in a given state. This capability is especially important in analyzing the impact of proposed tax changes that affect people on multiple levels. For example, proposals for federal tax reform often impact state tax collections. Similarly, proposals to change state tax structures, such as the bills under discussion today, can affect the federal taxes paid by a state's residents in ways that can drastically affect the overall incidence of these proposals.

A more detailed description of the ITEP Microsimulation Tax Model can be found at www.itepnet.org.