# Expanded Tax Forgiveness Would Soften Impact of PIT Increase

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Governor Ed Rendell has proposed a one-half percent increase in Pennsylvania's personal income tax (PIT) rate from 3.07% to 3.57%. That increase would cost a family at the median income − roughly $50,000 − $4.82 per week in additional taxes for the next three years.

Pennsylvania has the second lowest top income tax rate of 42 states with income taxes. Governor Patrick Quinn of Illinois − which has the lowest top income tax rate in the nation − has proposed an increase in Illinois's rate from 3% to 4.5% this year. In June, he vetoed a legislative budget that failed to increase the state PIT.[i]

Many Pennsylvanians would not be affected by an increase in the personal income tax because of the state's tax forgiveness program. Currently, a working family with three children earning $41,500 or less pays no state income taxes because of the program, which is authorized under the Special Poverty exemption of the state Constitution. Making more working families eligible for tax forgiveness, either by increasing the per child exemption or slowing the phase out of the share of taxes forgiven, could blunt the impact of a PIT increase and still raise revenue to prevent cuts to schools, libraries, hospitals and other public services.

About one in four Pennsylvania households qualifies for Pennsylvania's tax forgiveness program, which allows families at or above the minimum wage and senior citizens to reduce a part or all of their state income tax liability. Eligibility for working families depends on income and number of dependents. A family of four with two working parents earning up to $8.23 per hour each is eligible for tax forgiveness, as is a single parent with two children earning up to $13.34 per hour. Income eligibility increases with the number of children; therefore, larger families with higher incomes remain eligible (See Tables 3 and 4).

**Tax forgiveness utilization is highest in Pennsylvania's rural counties.**
Table 1 lists the percentage of tax returns receiving tax forgiveness by county in Pennsylvania in tax year 2006. More than 30% of all tax filers received tax forgiveness in six Pennsylvania counties: Forest, Cameron, Tioga, Fayette, Venango, and Philadelphia. The share of taxpayers participating in the tax forgiveness program is lowest in Chester, Montgomery, Bucks, Cumberland, and Centre counties, with percentages ranging from 13% to 18%. Across the state, 22.5% of tax filers had their state income tax liability reduced or eliminated.

**Tax forgiveness benefits can be substantial**.
A two-parent family with three children earning $41,500 is eligible for $1,274 in tax forgiveness while a single parent with three children earning $35,000 is eligible for $1,074. Tax forgiveness makes the tax system fairer to families who earn less than the state median income.

**Most senior citizens pay no state income tax in Pennsylvania.**
Social Security and retirement income are not taxed in the Commonwealth. Income from investments, including interest, dividends, and gains from the sale of stock or property, is taxable under Pennsylvania law; however, seniors are able to have taxes on that income forgiven if the taxable income is less than $6,500 for an individual or $13,000 for a couple.

**In the absence of a graduated tax, Pennsylvania lawmakers should consider improvements to the tax forgiveness program.**

Pennsylvania's flat income tax means that moderate-income working families pay the same share of their income in state income taxes as wealthy families who are better able to afford higher tax rates. If Pennsylvania adopted a graduated tax rate, the Commonwealth could maintain or even reduce the tax rate on middle-income families while increasing the rate on upper income families to preserve health care, education, and services for children, seniors and people with disabilities.

**Table 1. Tax Forgiveness by Pennsylvania Counties**

| COUNTY | PERCENTAGE | COUNTY | PERCENTAGE |
|---|---|---|---|
| ADAMS | 20.0% | LACKAWANNA | 24.8% |
| ALLEGHENY | 21.4% | LANCASTER | 20.3% |
| ARMSTRONG | 27.2% | LAWRENCE | 28.6% |
| BEAVER | 25.5% | LEBANON | 22.2% |
| BEDFORD | 28.5% | LEHIGH | 22.7% |
| BERKS | 22.5% | LUZERNE | 25.4% |
| BLAIR | 28.2% | LYCOMING | 27.0% |
| BRADFORD | 29.5% | MCKEAN | 28.6% |
| BUCKS | 14.5% | MERCER | 28.2% |
| BUTLER | 20.2% | MIFFLIN | 29.8% |
| CAMBRIA | 29.8% | MONROE | 22.4% |
| CAMERON | 31.4% | MONTGOMERY | 13.5% |
| CARBON | 24.8% | MONTOUR | 23.9% |
| CENTRE | 18.3% | NORTHAMPTON | 20.2% |
| CHESTER | 13.3% | NORTHUMBERLAND | 27.9% |
| CLARION | 28.5% | PERRY | 21.1% |
| CLEARFIELD | 29.3% | PHILADELPHIA | 31.1% |
| CLINTON | 28.0% | PIKE | 23.1% |
| COLUMBIA | 25.5% | POTTER | 30.7% |
| CRAWFORD | 29.4% | SCHUYLKILL | 25.8% |
| CUMBERLAND | 17.7% | SNYDER | 25.7% |
| DAUPHIN | 21.5% | SOMERSET | 29.3% |
| DELAWARE | 18.3% | SULLIVAN | 30.1% |
| ELK | 24.8% | SUSQUEHANNA | 28.3% |
| ERIE | 26.9% | TIOGA | 31.4% |
| FAYETTE | 31.3% | UNION | 23.7% |
| FOREST | 33.7% | VENANGO | 30.2% |
| FRANKLIN | 22.2% | WARREN | 27.8% |
| FULTON | 23.9% | WASHINGTON | 23.8% |
| GREENE | 29.1% | WAYNE | 27.3% |
| HUNTINGDON | 27.7% | WESTMORELAND | 24.0% |
| INDIANA | 28.0% | WYOMING | 25.4% |
| JEFFERSON | 29.9% | YORK | 19.8% |
| JUNIATA | 26.8% | PENNSYLVANIA | 22.5% |

Source. Pennsylvania Department of Revenue, *2006 Personal Income Tax Statistics*.

**Improving the tax forgiveness program.**
One option to consider is increasing income eligibility for families. As discussed above, tax forgiveness is quite generous for senior citizens. A senior couple can have $100,000 or more in retirement income, earn up to $13,000 in investment income annually, and pay no state income tax. Conversely, a family with two children receives tax forgiveness only to $34,250 in income.

Lawmakers can improve tax forgiveness by increasing the per child exemption from the current $9,500 to $12,000. Under this plan, a two-parent family with two children earning $37,000 would pay no state income tax.

A second option would be to slow the phase down of the program. Currently, a married couple with two children earning $32,000 receives 100% tax forgiveness. Once earnings hit the $32,000 threshold, the share of tax forgiven is reduced by 10% for every $250 in additional income. This means that the same family earning $34,250 gets a 10% tax reduction and a family earning $34,251 pays the full tax of $1,052.

If the phase down were calculated in $500 or $1,000 increments, rather than the current $250, additional families would be able to have some share of their taxes reduced.

**Revising the income calculation for tax forgiveness could make the program changes more revenue neutral.**
The current Tax Forgiveness program uses taxable income to determine program eligibility. Since retirement income is not taxed, seniors with high levels of retirement income may qualify for tax forgiveness if they have less than $6,500 per person in taxable income. Counting a portion of untaxed retirement income to determine eligibility for tax forgiveness could better target the program to those who would most benefit.

For example, changing eligibility to allow seniors with $35,000 in retirement income and $6,500 in taxable income to obtain tax forgiveness would allow at least five out of six of the 800,000 seniors in the program to continue to receive tax forgiveness while freeing up funding for higher per-child exemptions or a slower benefit phase-down. It is important to note that such a test would not tax the retirement benefits received by seniors.

Seniors applying for the state's property tax and rent rebate (PTRR) go through a similar process, and it helps provide program dollars to those most in need. To be eligible for PTRR, seniors may have a maximum of $35,000 in income – including retirement and half of their Social Security benefits.

Table 2 shows the federal taxable income (which includes retirement income and a portion of Social Security – both are untaxed in Pennsylvania) of tax forgiveness recipients. According to calculations developed by the Pennsylvania Department of Revenue, 11% of tax forgiveness recipients in 2005 had federal taxable incomes of $35,000 or more. These taxpayers received $54.5 million, or 17% of the tax forgiveness program benefits that year. While these taxpayers report low incomes on Pennsylvania tax returns, many are much better off. For every one dollar of income that is taxable in Pennsylvania, these taxpayers receive, on average, four dollars in total – due largely to retirement income.

**Table 2. Tax Forgiveness Recipients by Federal Taxable Income, 2005**

| Federal AGI Range | Number of Returns | Pct of Returns | Tax Forgiveness | Pct of Benefits | Ratio of PA Taxable Income to Federal Taxable income |
|---|---|---|---|---|---|
| $0 – 34,999 | 1,184,479 | 89% | $265,607,583 | 83% | 72% |
| $35,000 or more | 142,635 | 11% | 54,507,421 | 17% | 23% |
| TOTAL | 1,327,114 | | $320,115,004 | | |

Source. Pennsylvania Department of Revenue.

**Conclusion**

Since 1989, the tax forgiveness program has reduced taxes for seniors and lower-income working families with children. At a time when a personal income tax increase is the most prudent option for raising needed revenue to fund education, health care, and other core services, strategically expanding the tax forgiveness program could help blunt the impact on our most vulnerable citizens.

**Table 3. Income Eligibility for Tax Forgiveness: Single Taxpayers**

| Single | | | |
|---|---|---|---|
| No Children | $6,500 | $7,750 | $8,750 |
| With Dependent Children | | | |
| 1 | $16,000 | $17,250 | $18,250 |
| | | | |
| 2 | $25,500 | $26,750 | $27,750 |
| | | | |
| 3 | $35,000 | $36,250 | $37,250 |
| | | | |
| Percentage of Tax Forgiveness | 100% | 50% | 10% |

Source. Pennsylvania Department of Revenue, *PA Schedule SP Eligibility Income Tables*.

**Table 4. Income Eligibility for Tax Forgiveness: Married Taxpayers**

| Married | | | |
|---|---|---|---|
| No Children | $13,000 | $14,250 | $15,250 |
| With Dependent Children | | | |
| 1 | $22,500 | $23,750 | $24,750 |
| | | | |
| 2 | $32,000 | $33,250 | $34,250 |
| | | | |
| 3 | $41,500 | $42,750 | $43,750 |
| | | | |
| Percentage of Tax Forgiveness | 100% | 50% | 10% |

Source. Pennsylvania Department of Revenue, *PA Schedule SP Eligibility Income Tables.*

[i] Governor Quinn signed a budget bill on July 16 but said it was "not the final word" and signaled he would continue advocating for a PIT increase. That bill also requires $3.5 billion in borrowing to help fund state worker pensions – a move that prompted Moody's to say it was eyeing a downgrade in the state's bond rating, citing a "history of political unwillingness to provide sufficient funding to structurally balance the budget." *The Chicago Tribune*, July 17. 2009. http://www.chicagotribune.com/news/local/chi-illinois-state-budgetjul17,0,5204234.story