The Stelly Plan: Estimated Aggregate Fiscal Impact

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The Stelly Plan

Act 51 and Act 88 of the 2002 Regular Legislative Session enacted significant changes to the state personal income tax and general sales tax, respectively. These provisions were adopted by the electorate on November 5, 2002, and became effective January 1, 2003, and have been commonly referred to as the Stelly Plan.

Act 51 modified taxable income brackets and eliminated the state deduction for federal itemized deductions in excess of the federal standard deduction. These provisions became applicable to the 2003 tax year, and the new tax schedule of rates and brackets was established as the maximum such schedule in the State Constitution. While some taxpayers actually received a reduction in their state tax liability, overall state income tax liabilities and tax collections were increased by these provisions. Act 88 capped the state sales tax rate at 2% on sales of food for home consumption and residential electric, gas, and water utilities beginning January 1, 2003. As of July 1, 2003 the state sales tax would not apply at all to these sales. Prescription drugs were also included in these limitations, but these items had not been subjected to state sales tax since fiscal year 1990. The effect of these provisions has been to decrease state sales tax collections.

Income Tax Provisions

(A) Taxable Income Rate & Bracket - Single

	Pre-Stelly (2002)	Post-Stelly (2003)
2%	$0 - $10,000	$0 - $12,500
4%	$10,000 - $50,000	$12,500 - $25,000
6%	over $50,000	over $25,000

Taxable Income Rate & Bracket – Joint

	Pre-Stelly (2002)	Post-Stelly (2003)
2%	$0 - $20,000	$0 - $25,000
4%	$20,000 - $100,000	$25,000 - $50,000
6%	over $100,000	over $50,000

(B) Excess Itemized Deduction

Pre-Stelly (2002)	Post-Stelly (2003)
57.5%	0%

Note that (a) the tax rates have not been changed, (b) the bottom bracket has actually been widened, resulting in a reduction of tax liability on a portion of income, and (c) in 2002 the excess itemized deduction was in its third year of limitation (50% allowed in 2000 and 2001; 65% to have been allowed in 2003, and 100% in 2004 had the Stelly provisions not passed the electorate and had limitations not been renewed by the legislature).

Sales Tax Provisions

Food For Home and Residential Utilities Tax Rate

Pre-Stelly (2002)	Post-Stelly (2003)
4% through June 2002	2% from January 2003
3.9% from July 2002	0% from July 2003

Note, that had the Stelly provisions not passed the electorate, sales of food for home and residential utilities would have been subject to a 3.9% tax rate through June 2003, a 3.8% tax rate through June 2004, and a 1% tax rate after that unless additional levies were renewed by the legislature.

Observed Revenue Effects

While it is still too early to obtain detailed tax return data and estimated consumer expenditure data for 2003, changes in aggregate personal income tax and general sales tax collections have been observed. These changes are described here and then an estimate of the amounts attributable to the Stelly Plan is presented.

Personal Income Tax

Beginning in 2003, personal income tax withholdings increased significantly. Along with the changes to taxable income brackets and excess itemized deductions, Act 51 repealed the withholding methods provided in R.S. 47:112(B) and (C), and authorized the Department of Revenue to promulgate withholding tables. The withholding methods that were repealed had last been amended in 1984. The Department promulgated new withholding tables and calculation methods that increased typical withholding amounts significantly more than what would have been required to implement only the Stelly changes. For example, withholding increases for a variety of income levels ranged from 1.2 to 4.2 times larger than tax liability increases attributable strictly to the Stelly changes for those same income levels. In some cases, withholdings increased even for income levels that would ultimately receive a tax liability reduction under the Stelly changes. Thus, some of the “sticker-shock” associated with the Stelly changes is a result of these withholding changes.

Some of this shock was then alleviated somewhat when tax year 2003 returns were filed in the winter and spring of 2004. At that point, refunds of excess tax payments were generated. Income tax refunds in the tax season of 2004 (January extending through July this year) have been 29% higher than in the same period of 2003.

Payments with returns also surged, but this occurred primarily beginning with receipts of 2004 as taxpayers filed returns for the 2003 tax year, the first full year of the Stelly changes. These payments were associated with income not subject to withholding, the elimination of the remaining amount of excess itemized deductions, federal tax reductions that reduce the state deduction for federal income tax paid, and any other events or situations that influence income tax liabilities.

General Sales Tax

While the sales tax reductions contained in the Stelly Plan are difficult to notice by individuals, aggregate sales tax collections have been reduced by the Stelly changes. Beginning with receipts in 2003, general sales tax collections began to accelerate their decline as 2% of tax rate was eliminated on food for home and residential utility sales on January 1, 2003 (the second half of the 2003 fiscal year). That decline became even steeper as the remaining 1.9% tax rate was eliminated beginning with sales in July 2003. In addition to the Stelly tax change, the Department also changed the affected tax base, effective July 2003, by administratively redefining certain convenience foods as food for home preparation and consumption. These items were fully taxable, and without this change, would have remained fully taxable even under the Stelly provisions. This means that some of the drop in sales tax in FY04 is due to this action by the Department and not strictly to the Stelly changes.

Estimated Value of Revenue Effects

In both cases, the income tax and sales tax effects that are strictly attributable to the Stelly changes alone are mixed in with the collections data overall. Those aggregate collections are affected by a myriad of influences and events aside from the specific changes imposed by the Stelly Plan. Estimates of the tax collection amounts attributable to the Stelly changes alone were developed through econometric models of the income tax and the sales tax that are used to forecast the overall collections from those taxes. These models use standard linear regression techniques to relate tax collections to the economy, other events or forces, and tax changes such as those imposed by the Stelly Plan. Estimates of these relationships are generated along with a variety of other statistics utilized to assess the efficacy of the models. Estimates, in millions of dollars, of the changes in tax collections associated with the Stelly Plan are presented below.

Estimated Aggregate Impacts of the Stelly Plan

	Income Tax	Sales Tax	Net Effect
FY03	\$32.0	<\$51.9>	<\$19.9>
FY04	\$235.3	<\$222.8>	\$12.5

Note that portions of both the income tax increase and the sales tax decrease resulting from the Stelly Plan occur at the same time that other events are affecting these taxes. The Department of Revenue implemented greater income tax withholdings than required by the Stelly Plan in January 2003, and redefined some convenience foods as food for home preparation and consumption in July 2003. In addition, current law required the tax rate on business utilities and other transactions to drop from 3.9% to 3.8% in July 2003. The statistical models cannot readily isolate different effects occurring simultaneously and, adjustments were made to the statistical estimates of the shifts in the two aggregate tax collection data series to arrive at the estimated impacts of the Stelly Plan alone.

On the basis of withholdings for tax year 2002, 54% of the withholding increases are estimated to be required to satisfy the Stelly Plan income tax liability increases, while all of the estimated increase in payments with returns is attributable to the Stelly Plan (economic growth and federal tax effects are separately controlled for). The estimate of the first phase of the Stelly Plan sales tax reduction, effective January 1, 2003, was used as the basis for the estimate of the second phase reduction, effective July 1, 2003, after applying the economic growth utilized by the model as a whole. The residual sales tax loss is attributable to the convenience food redefinition and the tax rate drop on business utilities and other transactions.

As shown above, the Stelly Plan resulted in an estimated \$19.9 million net revenue loss in FY03, and an estimated \$12.5 million net revenue gain in FY04. In subsequent periods, it is expected that the greater average growth of the income tax relative to the sales tax will result in net revenue gains to the state as a result of the Stelly Plan.