Tax Credits

Executive Summary

Federal, state and local tax revenue fund a range of public goods and services, including education, healthcare, and infrastructure. Policies that reduce the amount of taxes owed by a taxpayer (e.g., credits, deductions, exemptions) are expected to decrease government revenue while incentivizing immediate private spending and investment. In contrast to tax deductions and exemptions, which reduce the assessed tax liability, tax credits are directly subtracted from the amount of taxes owed. In many cases, tax credits are targeted to low- and middle-income individuals and households. They can also be used to incentivize taxpayers to invest in high-need projects, government programs, or philanthropic services.

Eligible Missouri taxpayers may access tax credits related to property (e.g., Missouri Property Tax Credit), individual income (e.g., Federal Earned Income Tax Credit) and/or corporate income (e.g. Missouri Meat Processing Facility Investment Tax Credit). Several proposed bills during the 2021 session would increase the availability of tax credits in each of these areas, although the estimated impact of each credit will vary based on affected population, whether the credit impacts state or local tax revenue, and the maximum value of tax credits that can be awarded.

Highlights

- Many tax credits are designed to target tax relief to specific individuals, such as seniors or low-income taxpayers with dependents. Circuit breaker tax credits and refundable tax credits preferentially aid low-income individuals.
- Tax credits can also be used to incentivize individuals or businesses to invest in high-need projects or philanthropic causes.
- A significant portion of state-generated revenue depends on income tax collection. Local governments, however, rely more heavily on property taxes.
- Residential and commercial property tax credits offset costs for homeowners, renters and businesses, but decrease the available funding for public services that depend heavily on locally-generated revenue (e.g., education, public safety).
- Income tax credits are typically used to incentivize economic development and charitable donations by reducing the income tax liability of eligible individuals and businesses and the funds available for federal/state budgets.

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Limitations

- There is continued debate over the extent to which tax incentives such as tax credits stimulate the economy. The relative costs and benefits are also influenced by the time frame considered (e.g., short-term spending increases vs. long-term revenue reduction).
- Because estimates rely on averages (e.g., average income, average property value) and often lack specificity about the regional distribution of qualified individuals, it is difficult to estimate the extent to which specific tax credits will impact state/local revenue.

Tax Credit Overview

Tax credits reduce the amount of property or income tax that a household or business owes. In addition to federal tax credits, state and local governments may offer tax credits to individuals and/or businesses. Many tax credits are designed to incentivize individuals or businesses to invest in economic development (or recovery) projects or philanthropic services.[2] Some tax credits specifically target tax relief to groups of taxpayers, such as seniors or low-income citizens with dependents.[3,4] Despite these benefits, tax credits ultimately reduce the total revenue generated by federal, state and local governments, which may have particularly costly long-term consequences.

Refundable tax credits extend beyond tax liability and result in a taxpayer refund whereas nonrefundable tax credits stop at the tax liability (or zero) and do not result in a refund check. While most tax credits are nonrefundable, some tax credits are fully (e.g., Earned Income Tax Credit) or partially (e.g., American Opportunity Tax Credit) refundable. Low- and middle-income taxpayers with a tax liability lower than the allowable maximum cannot recover the full value of the tax credit unless the credit is refundable.[4,5]

Property Tax Credits

Residential and commercial property tax credits offset costs for homeowners, renters and businesses.[6] Because property taxes are a major source of revenue for local governments, tax credit programs are expected to reduce funding for public services that heavily rely on local property tax revenue (e.g., education, public safety).[7] High-income taxpayers are most likely to benefit from property tax credits, with the exception of "circuit breaker" property taxes.[3,8] Circuit breakers connect property tax liability to taxpayer ability to pay by specifically reducing property taxes for individuals whose property tax exceeds a certain threshold (usually some percentage of taxpayer income).[8] Unlike many income tax credits, taxpayers are typically required to complete an additional application to receive the tax credit; therefore, not all eligible individuals will complete the required form (and renewals, if required). State-level information about property tax credits and additional deductions/exemptions that were available as of 2019 can be accessed at the Lincoln Institute of Land Policy & George Washington Institute of Public Policy Property Tax Database.

Residential property tax credits

Many states/localities offer residential property tax credits to make it easier for individuals who depend on fixed income (e.g., seniors, individuals with disabilities) to remain in their homes.[9,10] As of 2019, eighteen states and the District of Columbia offered circuit breaker tax credits, only one of which did not apply to renters.[8] Some states and localities offer additional residential property tax credits, including an automatic school levy tax credit on taxable property in Wisconsin and an agricultural homestead credit in Minnesota.

Missouri: Senior citizens and 100% disabled individuals can claim the Missouri Property Tax Credit (up to $750 for renters or $1,100 for homeowners). The value of the tax credit is calculated based on income and the amount of taxes owed or rent paid. In FY20, total redemptions of this credit were valued at $88.7 million. Slightly more than half of the individuals who claim this circuit breaker tax credit are renters (~94,000 renters out of 178,518 total taxpayers in 2017).[11]

Commercial property tax credits

Residential property tax credits can be offset by changes to commercial property taxes. Commercial property tax credits are typically part of broader economic packages used to incentivize businesses to modernize equipment or operate/headquarter in a particular region.[1] In some cases, counties can opt-in to state-level tax credits on real and/or personal tangible property. For example, localities in Maryland can choose whether or not to offer a property tax credit for specific commercial waterfront properties.

Missouri*:* Under the Missouri Works program, businesses can receive tax credits based on the cost of purchasing specific types of personal property (e.g., equipment) for qualified projects.

Income Tax Credits

Income tax credits reduce the income tax liability of eligible individuals and businesses, and provide financial assistance to specific populations, but reduce federal and state government revenue. There are several income tax credits that can be claimed at the federal and state level.

Individual income tax credits

Earned Income Tax Credit (EITC): The most claimed individual income tax credit is the federal Earned Income Tax Credit. The EITC is intended to bolster the economic security of low-income working families, especially those with children. The amount of tax credit is determined mostly by income level, marital status and number of dependent children. State EITCs provide an additional benefit to the federal credit for low-income taxpayers by reducing their state income tax liability. Thirty states have implemented their own EITC; Missouri does not have a state EITC.[12] State EITCs mirror the federal EITC eligibility with slight differences between states. There are many documented benefits to having a state EITC which include helping low-income families pay for necessities, encouraging individuals to work, improved educational outcomes for low-income children, and increased lifetime earnings for children of low-income families.[13-15]

Education Credits: Education credits help with the cost of higher education by reducing the amount of tax owed on an individual's tax return. The American Opportunity Tax Credit (AOTC) and Lifetime Learning Credit (LLC) are two commonly claimed tax credits. The AOTC is for qualified education expenses paid for an eligible student for the first four years of higher education. The credit is worth up to $2,500 per eligible student. The LLC is similar, however, there is no limit on the number of years this credit can be claimed and is worth up to $2,000 per tax return.[16]

Miscellaneous Credits: The Missouri Department of Revenue currently advertises over fifty miscellaneous tax credits, many of which are individual income tax credits (e.g., donate to a domestic violence shelter and claim income tax credit). For example, individuals who adopt a child with special needs are eligible for the Special Needs Adoption Tax Credit. The US government offers nonrefundable residential energy tax credits (Form 5695) up to a lifetime limit of $500 to incentivize energy-efficient improvements.

Corporate income tax credits

The federal government and states typically offer corporate tax credits to promote investment in new property/equipment, "qualified" research & development, and incentives to create and maintain jobs in the state.[17] Corporate income tax credits can generate revenue loss to the state and long-lasting impacts. Corporations can qualify for tax income credits on the basis of meeting the program's criteria. The Work Opportunity Tax Credit (WOTC) is a federal and a Missouri state level tax credit for employers that hire those who face significant barriers to employment; these targeted groups include veterans, ex-felons, those who are participants of supplemental assistance programs, long-term unemployed individuals, and summer youths. The maximum credit received is dependent upon the number of individuals hired and from which target group. For most targeted groups, the maximum federal benefit is $2,400 for each employee, however, some businesses can receive up to $9,600 per employee; this includes employing a disabled veteran who was unemployed six month prior to employment or long-term family assistance program participants.[18]

Missouri: There are additional tax credits for corporations specific to Missouri. The Missouri Works Program includes a tax credit for new and existing businesses that create and retain jobs in the state. The Meat Processing Facility Investment Tax Program is tax credit for meat processing modernization or expansion at their meat processing facility. The tax credit is 25% of the modernization or expansion costs, with a maximum of $75,000 per year.

Tax Credits Proposed in 2021

For a complete list of new tax credits (or expansions of existing tax credits) proposed in 2021, please see **Supplementary Table 1**.

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