

# Department of Finance and Administration

## Legislative Impact Statement

**Bill: HB1434**

**Bill Subtitle: TO REDUCE THE TAX BURDEN ON ALL ARKANSAS TAXPAYERS; TO AMEND THE INCOME TAX IMPOSED ON INDIVIDUALS, TRUSTS, AND ESTATES; TO ALLOW AN EARNED INCOME TAX CREDIT; AND TO DECLARE AN EMERGENCY.**

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### Basic Change :

**Sponsor: Rep. Love**

HB1434 amends the income tax tables and rates and provides reductions for individuals, trusts, and estate taxpayers in the middle and upper income tax tables. The middle income tax highest rate is reduced from 6.0% to 5.9% and the top marginal income tax rate for the upper tax table is reduced from 6.9% to 6.6%. The upper income tax table is also simplified to four rates. For the 2020 tax year, the tax tables would be the following:

#### **Lower Income Table - Taxable Income of less than \$22,200**

\$0 to	\$4,499	0%
\$4,500 to	\$8,899	2.0%
\$8,900 to	\$13,399	3.0%
\$13,400 to	\$22,199	3.4%

#### **Middle Income Table - Taxable Income of \$22,200 to \$79,300**

\$0 to	\$4,499	.75%
\$4,500 to	\$8,899	2.5%
\$8,900 to	\$13,399	3.5%
\$13,400 to	\$22,199	4.5%
\$22,200 to	\$37,199	5.0%
\$37,200 to	\$79,300	5.9%

#### **Upper Income Table - Taxable Income of more than \$79,300**

\$0 to	\$4,000	2.0%
\$4,001 to	\$8,000	4.0%
\$8,001 to	\$79,300	5.9%
\$79,301 and above		6.6%

Additionally, beginning on January 1, 2021 HB1434 would provide a refundable income tax credit in the amount equal to 5% of the federal Earned Income Tax Credit (EITC) as it existed on January 1, 2019.

### Revenue Impact :

Reduction of top rate in middle income tax table to 5.9% and 6.6% in upper income table effective for 2020 and following tax years:

**FY2020** - \$25.6 Million Reduction in State General Revenue

**FY2021** - \$51.2 Million Reduction in State General Revenue

**FY2022** - \$51.2 Million Reduction in State General Revenue

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5% Earned Income Tax Credit:

**FY2021** - \$38.4 Million Reduction in State General Revenue

**FY2022** - \$38.4 Million Reduction in State General Revenue

Total Net Revenue Impact:

**FY2020** - \$25.6 Million Reduction in State General Revenue

**FY2021** - \$89.6 Million Reduction in State General Revenue

**FY2022** - \$89.6 Million Reduction in State General Revenue

[ Revenue Impact for reduction of top rates for middle income table (5.9%) and upper income table (6.6%) have already been enacted for the 2020 and following tax years under Act 182 of 2019. ]

### **Taxpayer Impact :**

Approximately 579,000 taxpayers with net taxable incomes greater than \$38,200 will receive a decrease in income tax due with the income tax table and rate changes effective tax year 2020. However, this reduction is already

Approximately 287,000 taxpayers that receive the federal EITC will receive a reduction in tax and/or refundable credit effective tax year 2021.

### **Resources Required :**

Reducing the income tax rates and creating a state earned income tax credit will require updating computer programs, tax forms, and instructions

The Department of Finance and Administration (DFA) will be required to annually notify taxpayers of their potential eligibility for the credit. This will require additional funds for generating the letter, printing, and mailing. Based on IRS data from tax year 2017, approximately 287,000 taxpayers would need to be notified each year. Postage for the notification would cost approximately \$140,000.

Additional auditor(s) would be required to process changes from the IRS on auditing of the Earned Income Tax Credit with an annual cost of at least \$110,000.

### **Time Required :**

Adequate time is provided for implementation.

### **Procedural Changes :**

An update of computer programs, tax forms and instructions will be required. DFA employees will need to be educated as well as the tax community.

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### Other Comments :

There is a potential for an increase in fraudulent claims. The Treasury Inspector General for Tax Administration estimated on April 27, 2016 that 23% - 27% of the federal EITC payments are issued improperly. This percentage translates into \$12.3 to \$17.7 billion federal payments that were issued improperly. Taxpayers fraudulently claiming the credit may also file more Arkansas state paper returns that will not have to go through IRS checks and verification for the federal credit. The bill does not require an apportionment of the credit for non-residents, creating the possibility that non-residents will receive credits that exceed income earned in Arkansas.

### Legal Analysis :

HB1434 amends the income tax tables in § 26-51-201 for individuals, trusts, and estates. All changes to the income tax tables would be effective for tax years beginning on or after January 1, 2020. All three tax tables as well as the bracket adjustments of § 26-51-201(10) are updated to reflect prior inflation adjustments that have occurred through the 2018 tax year.

The 6.0% top income tax rate in the middle income table in § 26-51-201(7) would be reduced to 5.9%. The bill does not make any amendments to the tax rates in the lower income table. The top income tax rate for the lower income table would remain at 3.4%. The six upper income table tax rates of 0.9%, 2.5%, 3.5%, 4.5%, 6%, and 6.9% would be replaced with the following four rates: 2%, 4%, 5.9%, and 6.6%. The top rate of 6.6% would apply to individuals with net income of \$79,301 or more.

The bill retains the bracket adjustments in § 26-51-201(10) for individuals with net income of more than \$79,300 but less than \$84,600. HB1434 would repeal § 26-51-201(e), which contained a trigger for reduced income tax rates based upon collections from out-of-state sellers.

HB1434 also creates a refundable earned income tax credit (EITC) for Arkansas taxpayers in an amount equal to five percent (5%) of the credit allowed to a taxpayer under the federal EITC, effective for tax years beginning January 1, 2021. The federal EITC is a refundable income tax credit for low to moderate income working individuals and families, based on the taxpayer's income level and number of qualifying children, as calculated under Internal Revenue Code § 32.

The Department of Finance and Administration (DFA) would be limited in its ability to administer the EITC and would be required to rely upon federal determinations of eligibility and information including the error rate for the federal EITC. The bill does not require an apportionment of the credit for non-residents, creating the possibility that non-residents will receive credits that exceed income earned in Arkansas and will create the possibility of non-residents filing to obtain refunds when they have no Arkansas source income.

The requirement for DFA to notify potentially eligible recipients could increase the administrative complexity and cost for DFA. It is unclear whether DFA would be required to notify all Arkansas taxpayers or only Arkansas taxpayers who qualified for the federal EITC.