



State of Arkansas Tax Relief and Reform Legislative Task Force

State Tax Structures and Recent State Tax Actions

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Discussion Topics

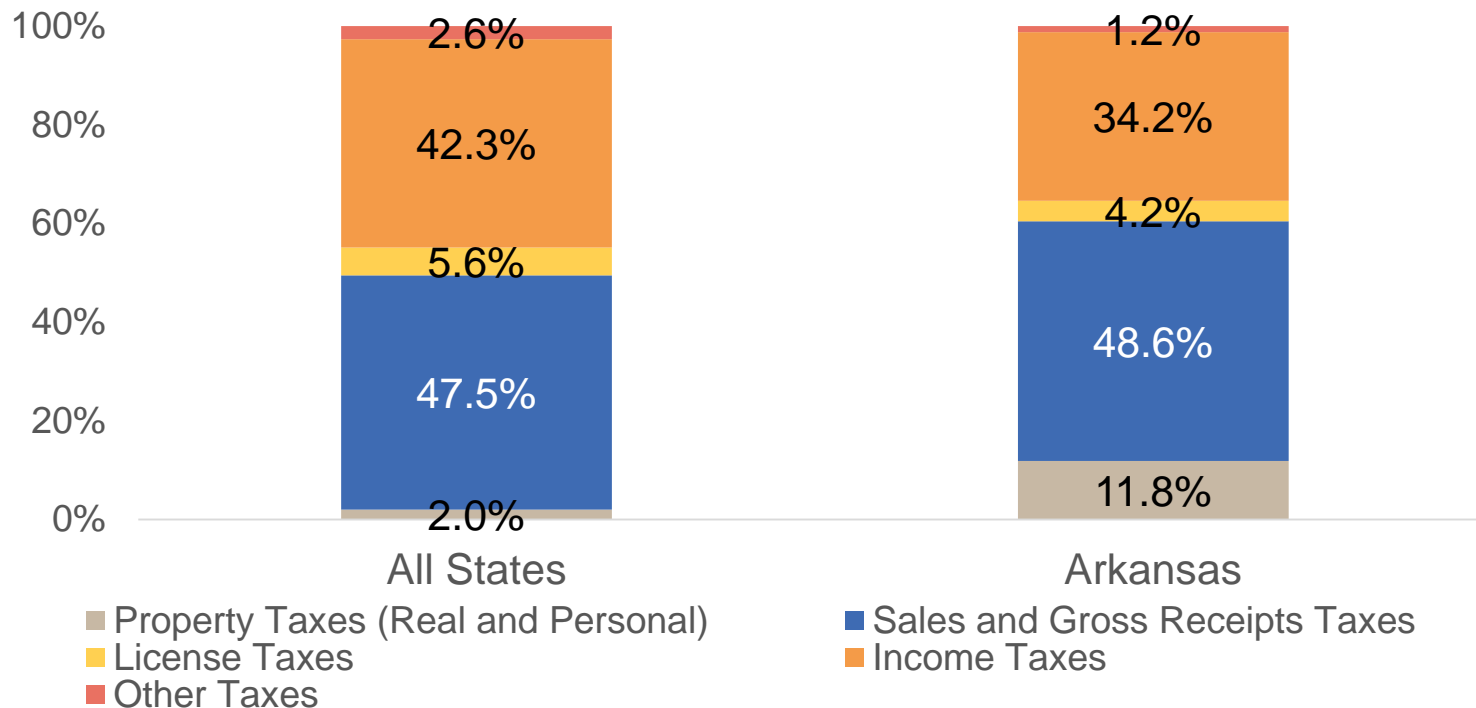
- Arkansas' Tax Structure in Comparison to Benchmark States
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Arkansas' Tax Structure in Comparison to Benchmark States



State Tax Revenues by Tax Category, 2016



- **“Other Taxes”** include death and gift, severance, documentary and stock transfer, and other taxes not elsewhere classified.
- **“License Taxes”** include alcoholic beverages, public utilities, motor vehicles, motor vehicle operators, corporations in general, hunting and fishing, amusements, occupation and businesses, and other license taxes.



State Tax Structures Overview

- All but five states have a broad-based consumption tax (state sales, business privilege and/or general excise tax)
 - None of the five is a benchmark state (Alaska, Delaware, Montana, New Hampshire, Oregon)
- Nine states do not have a broad-based state income tax
 - Two are benchmark states (Tennessee and Texas)
 - Tennessee (as well as New Hampshire taxes dividends and interest income only)
- Four states do not have a broad-based corporate tax
 - None are benchmark states (Nevada, South Dakota, Washington, Wyoming)
 - Several impose gross receipts/franchise types of taxes as their primary method (such as Ohio and Texas)

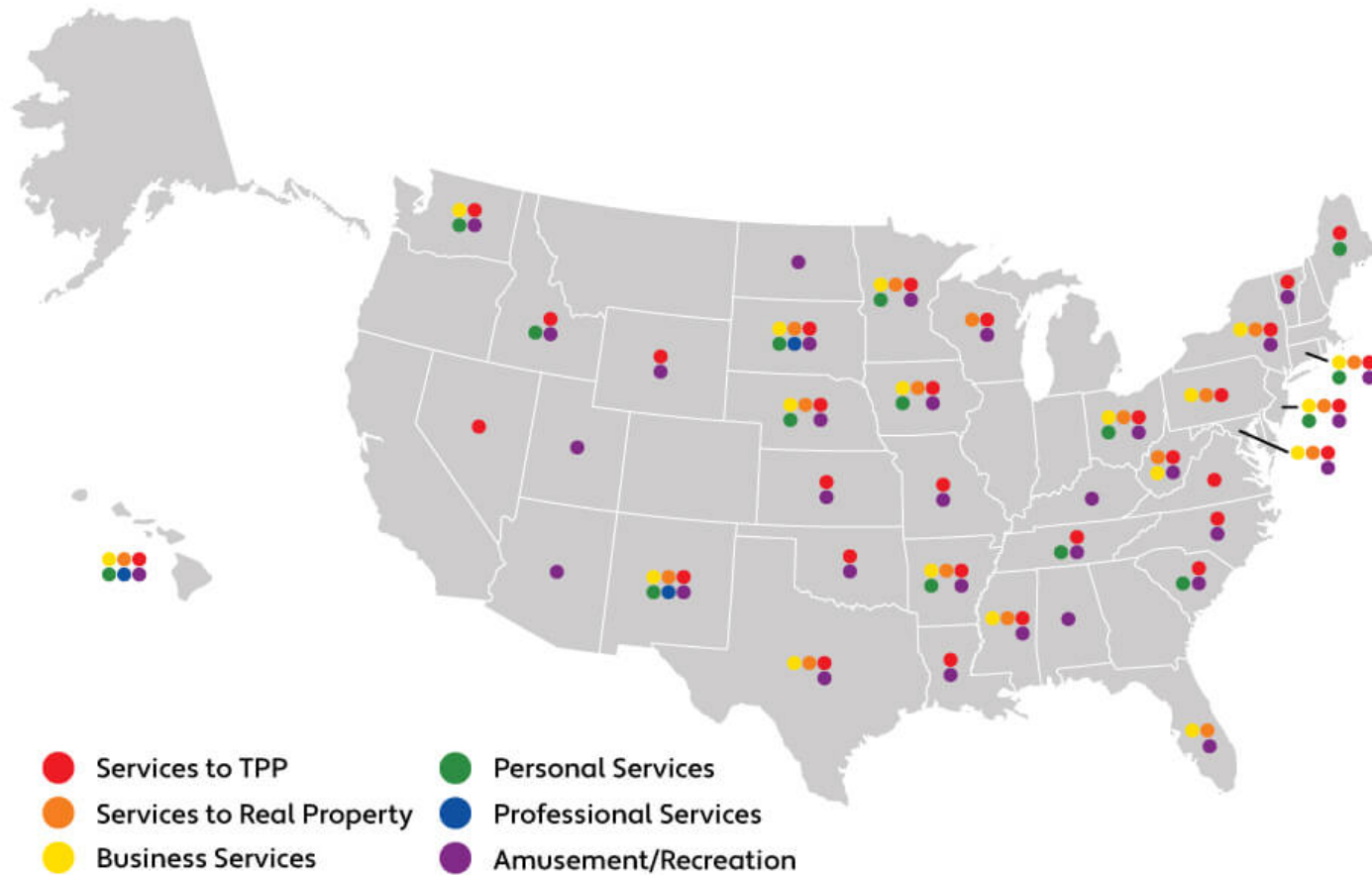


State Sales Tax Rates

	State Tax Rate	Average Local Tax Rate	Combined State & Average Local Sales Tax Rate	Max Local Tax Rate
Alabama	4.00%	5.03%	9.03%	7.00%
Missouri	4.225%	3.74%	7.970%	5.00%
Oklahoma	4.50%	4.36%	8.86%	2.25%
Louisiana	5.00%	5.02%	10.02%	7.00%
Nebraska	5.50%	1.40%	6.90%	2.00%
Iowa	6.00%	0.80%	6.80%	1.00%
Texas	6.25%	1.92%	8.17%	2.00%
Kansas	6.50%	2.18%	8.68%	4.00%
Arkansas	6.50%	2.84%	9.34%	5.125%
Mississippi	7.00%	0.07%	7.07%	1.00%
Tennessee	7.00%	2.45%	9.45%	2.75%
Median	4.23%	4.36%	8.86%	5.00%
Average	4.24%	4.38%	8.62%	4.75%
Rank	8 of 11	5 of 11	6 of 11	7 of 11



State Taxation of Services





Comparable State Treatment of Common Exemptions

State	State Sales Tax Rate	Groceries	Clothing	Prescription Medication	Non-Prescription Medication	Gasoline
Arkansas	6.5%	1.5%*	Taxable	Exempt	Taxable	Exempt
Alabama	4.0%	Taxable	Taxable	Exempt	Taxable	Exempt
Iowa	6.0%	Exempt	Taxable	Exempt	Taxable	Exempt
Kansas	6.5%	Taxable	Taxable	Exempt	Taxable	Exempt
Louisiana	5%**	Exempt	Taxable	Exempt	Taxable	Exempt
Mississippi	7.0%	Taxable	Taxable	Exempt	Taxable	Exempt
Missouri	4.225%	1.225%*	Taxable	Exempt	Taxable	Exempt
Nebraska	5.5%	Exempt	Taxable	Exempt	Taxable	Exempt
Oklahoma	4.5%	Taxable	Taxable	Exempt	Taxable	Exempt
Tennessee	7.0%	5.0%*	Taxable	Exempt	Taxable	Exempt
Texas	6.25%	Exempt	Taxable	Exempt	Exempt	Exempt

* Food sales subject to local taxes.

** Louisiana sales tax rate will decrease to 4% effective 7/1/18.



State Individual Income Tax Comparisons

- Eight states have a flat tax rate
 - None are benchmark states (Colorado, Illinois, Indiana, Massachusetts, Michigan, North Carolina, Pennsylvania, Utah)
 - Flat rates range from 3.07 percent (Pennsylvania) to 5.499 percent (North Carolina)
 - Average is 4.47 percent, median is 4.79 percent
- Remaining states have a progressive tax with income brackets
 - Brackets range from 3 to 10, with an average of 5.7 brackets and a median of 6
 - Six states each have 3, 4 and 6 brackets (most common)
 - Several states have compressed brackets, such as Alabama (\$500 lowest to \$3,001 highest), Mississippi (\$5,000 to \$10,001), Missouri (\$1,000 to \$9,001), Oklahoma (\$1,000 to \$7,200)



State Individual Income Taxes, Benchmark States

State	Tax Rate Lowest	Tax Rate Highest	Number of Brackets	Income Bracket Lowest	Income Bracket Highest	Inflation Adjusted
Arkansas	0.9%	6.9%	6	\$4,299	\$35,100	Yes
Alabama*	2.0%	5.0%	3	\$500	\$3,001	No
Iowa*	0.36%	8.98	9	\$1,573	\$70,785	Yes
Kansas**	2.9%	5.2%	3	\$15,000	\$30,000	No
Louisiana	2.0%	6.0%	3	\$12,500	\$50,001	No
Mississippi	3.0%	5.0%	3	\$5,000	\$10,001	No
Missouri	1.5%	6.0%	10	\$1,000	\$9,001	No
Nebraska	2.46%	6.84%	4	\$3,090	\$29,830	Yes
Oklahoma	0.5%	5.0%	6	\$1,000	\$7,200	No
Tennessee***	4.0%	4.0%				No
Texas	No State Income Tax					

* Federal taxes are fully deductible for state tax purposes, which significantly reduces effective tax rates

** Kansas tax rates are scheduled to increase to 3.1% and 5.7% for tax years 2018.

***Tennessee income tax is on Dividends and Interest Income only



State Corporate Income Tax Comparisons

- Most states have a flat rate (31 states)
 - Range is from low of 3.0 percent (North Carolina) to high of 9.99 percent (Pennsylvania)
 - Average rate is 6.76 percent, median rate is 6.5 percent, most common rates are 6 and 6.5 percent (four states each)
- Remaining states have a progressive tax with income brackets
 - Most remaining states have either 2 or 3 brackets, with one state each having 5, 6 and 10 brackets
 - A few states have compressed brackets, such as Mississippi (\$5,000 to \$10,001), North Dakota (\$25,000 to \$50,001), Vermont \$10,000 to \$25,000)
 - Four states allow federal taxes to be deductible (Alabama, Iowa, Louisiana, Missouri)



State Corporate Income Taxes, Benchmark States

State	Tax Rate Lowest	Tax Rate Highest	Number of Brackets	Income Bracket Lowest	Income Bracket Highest	Federal Taxes Deductible
Arkansas	1.0%	6.5%	6	\$3,000	\$100,001	No
Alabama	6.5%	6.5%	1	Flat Rate		Yes
Iowa	6.0%	12.0%	4	\$25,000	\$250,001	Yes
Kansas	4.0%	4.0%	1	Flat Rate		No
Louisiana	4.0%	8.0%	5	\$25,000	\$200,001	Yes
Mississippi	3.0%	5.0%	3	\$5,000	\$10,001	No
Missouri	6.25%	6.25%	1	Flat Rate		Yes
Nebraska	5.58%	7.81%	2	\$100,000	\$100,000	Yes
Oklahoma	6.0%	6.0%	1	Flat Rate		No
Tennessee	6.5%	6.5%	1	Flat Rate		No
Texas	Franchise tax imposed on various entities at differing rates					



Apportionment of State Corporate Income

- Traditional method (sales, property and payroll equally weighted) is now only used in eight states
- Most common method is to apportion solely on the sales factor (20 states)
- Arkansas is one of nine states that double weight sales while also using property and payroll in its formula
- Other formulas are also used:
 - Choice between single sales factor or double weighted sales (four states)
 - Triple weighted sales (one state), quadruple weighted sales (one state)
 - 80 percent sales, 10 percent property and payroll (one state)



Apportionment of State Corporate Income— Benchmark States

- Traditional three factor (sales, property and payroll equally weighted): Kansas, Louisiana, Missouri, Oklahoma
- Double weighted sales: Alabama, Arkansas
- Triple weighted sales: Tennessee
- Single sales factor: Iowa, Nebraska, Texas
- Other: Mississippi (different apportionment formulas based on specific type of business; a single sales factor formula is required if no specific business formula is specified)



State Tax Actions Overview



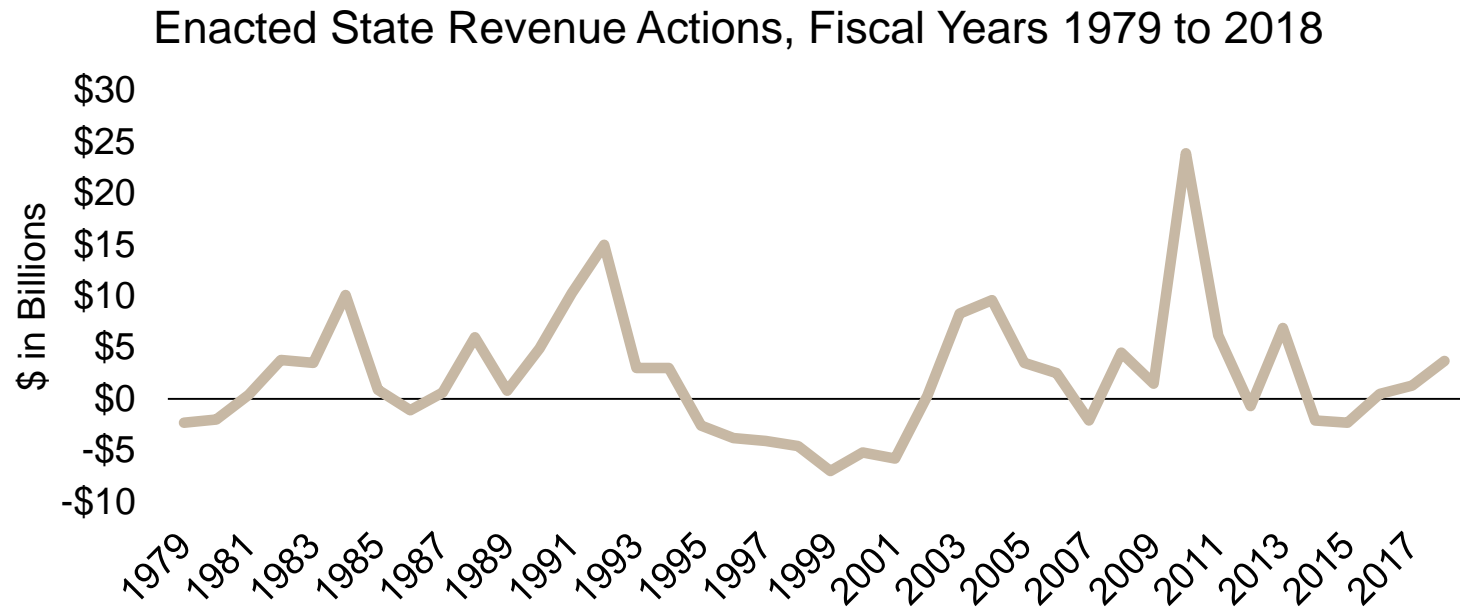
State Tax Actions Overview

- Since 2008, 18 states have cut their individual income taxes and 15 states have reduced their corporate income taxes – while several others have fundamentally remade their tax codes.
- While some states serve as models for reform, others serve as cautionary tales.
- Common ‘best practices’ of successful state reforms include:
 - A commitment to broad bases and low rates
 - Structuring tax codes to avoid picking winners and losers within the economy
 - Raising revenue without unnecessarily influencing economic decision-making



State Tax Actions Overview

- Generally, state tax actions respond to economic trends and revenue needs.
- Nationwide, state governors recommended a net increase in taxes and fees for FY2018 of \$3.7 billion.
 - Governors in 15 states proposed net tax and fee increases totaling \$4.9 billion, while governors in 12 states proposed net decreases totaling \$1.2 billion.



Source: NASBO Fiscal Survey of States (Spring 2017)



Kansas



Kansas Tax Reform

- In 2012, Governor Brownback recommended cutting income taxes across the board.
 - The top income tax rate was reduced from 6.45 percent to 4.9 percent.
 - For some businesses (partnerships, LLCs, s-corps and sole proprietorships), the tax rate was cut to 0.0 percent.
- In 2013, another tax cut was initiated, which would have reduced the top rate for wage income by an additional 1.0 percent by 2018.

Source: Brookings Institution: The Kansas Tax Cut Experiment (July 2017); What the Kansas About-Face Means (June 2017)



Subsequent Kansas Tax Changes

- Facing a \$400 million budget deficit in FY2016, the State approved the following measures:
 - An **income tax** package that slowed the scheduled rate cuts and repealed itemized deductions (except those for charitable contributions, mortgage interest and property taxes paid), a projected tax increase projected at \$149.8 million.
 - An increase in the **sales and use tax** rate from 6.15 percent to 6.5 percent (a projected tax increase of \$164.2 million).
 - An increase in the **cigarette tax** rate by \$0.50 per pack (a projected tax increase of \$40.4 million).
- In 2017, the Legislature voted to raise the top individual income tax rate to 5.7 percent and ended the special treatment of business income.
 - These income tax increases are projected to raise an additional \$1.2 billion between FY2018 and FY2019.

Source: NCSL State Tax Actions Database; High Places Public Radio (May 2017)



Oklahoma



Recent Oklahoma Tax Changes

■ Individual Income Tax Reduction Triggers

- In 2014, the State passed a two-step tax cut that scheduled a reduction in the state's top income tax rate from 5.25 percent to 5.0 percent in January 2016 if the December 2014 revenue estimate for FY2016 was higher than the February 2013 estimate for FY2014.
- By December 2014, the State estimated a \$300 million budget deficit for FY2016; however, since FY2016 revenue estimate was higher than the FY2014 estimate, the trigger was pulled, and the top income tax rate was reduced to 5.0 percent, which reduced revenue by \$100 million.
- In 2017, faced with continued deficits, the State repealed the trigger that would have reduced the rate from 5.0 percent to 4.85 percent.



Oklahoma Tax Changes to Close 2017 Budget Gap

- Facing a \$1.3 billion budget deficit for FY2017, the State increased revenue by nearly \$270 million:
 - Earned income tax credit no longer refundable (\$29 million in 2017).
 - “Double deduction” for state income tax payers eliminated (\$90 million annually).
 - Total credit available for low-producing oil wells capped at \$12.5 million (\$120 million).
 - Annual tax credit cap of \$25 million placed on Investment and New Jobs Tax Credit, effective for tax years 2016-2018 (\$14 million).
 - New license plate fee (\$18.5 million).
- Revenue-generating ideas considered but not adopted included a \$1.50 per pack cigarette tax.

Source: Tax Foundation – Oklahoma Closes Historic Budget Gap (May 31, 2016)



Oklahoma Tax Changes to Close 2018 Budget Gap

- Facing a \$900 million budget deficit for FY2018, the State increased revenue by nearly \$500 million:
 - \$1.50 per pack fee on cigarettes (\$214 million).
 - A 1.25 percent use tax on vehicle purchases (\$111 million).
 - Elimination of several gross production tax breaks and rebates for wells drilled before FY2015 (\$138 million).
- Subsequent lawsuits challenged the revenue-raising measures.
 - The Oklahoma Supreme Court nullified the \$1.50 fee on cigarettes and ruled that the legislature failed to follow constitutional requirements for revenue-raising measures and tax increases.
 - As a result of the Supreme Court's decision, the legislature convened a special session to pass a new budget, which adjourned on November 17th.
 - The Governor vetoed all but five sections of the bill, and it is possible that a new special session will be called.



Louisiana



Recent Louisiana Tax Changes

- For FY2016, the State reduced selected corporate income tax credits, deductions and exclusions by 28 percent (\$153 million).
- For FY2017, tax increases totaling \$1.6 billion were put in place as part of an effort to address a \$2 billion budget deficit.
 - **Sales tax** rate was increased by one percent, from 4 to 5 percent.
 - Most exemptions and exclusions eliminated
 - Expected to raise \$1.2 billion annually
 - Set to expire on June 30, 2018
- The changes resulted in a 27.4 percent increase in sales tax collections and a 65.6 percent increase in corporate income tax collections.



Recent Louisiana Tax Changes

- Other significant changes for FY2017 include:
 - **Premium tax** increase on HMOs
 - \$187 million in FY2017, \$124 million in subsequent years
 - **Corporate franchise tax** base expanded
 - \$10 million in FY2017 and about \$90 million in subsequent years
 - **Inventory tax credit** limitation
 - \$74 million in FY 2017, increasing in subsequent years
 - **Cigarette tax** increased by \$0.22, from \$0.86 to \$1.08 per pack
 - \$46 million annually
 - **Alcohol excise tax** increases
 - \$19 million annually

Source: Louisiana Legislative Fiscal Office, Fiscal Highlights, Fiscal Year 2015-2016 and 2016-2017



Indiana



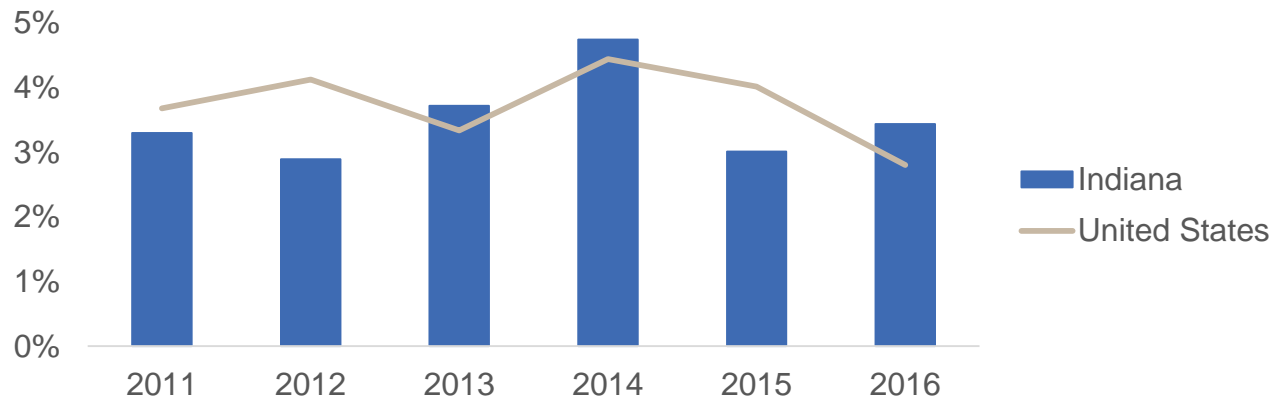
Recent Indiana Tax Changes

- \$3.5 billion (2015-2022) tax cut package impacted several tax categories.
 - 2013: State's flat **individual income tax** rate reduced from 3.40 percent to 3.23 percent over 2 years (\$2.0 billion).
 - 2013: **Inheritance tax** and **dormant estate tax** repealed (-\$620 million).
 - 2014: **Corporate tax** rate lowered from 6.5 percent to 4.9 percent by 2021 (-\$700 million).
 - 2014: **Financial institutions tax** reduced from 6.5 percent to 4.9 percent by 2021 (-\$195 million).
 - 2017: 10-cent **gas tax** increase and new **vehicle registration fees** for highway and bridge maintenance (+\$1.2 billion by 2025).
- Budget remained balanced throughout tax cuts, mostly by keeping state's spending growth rate below inflation.

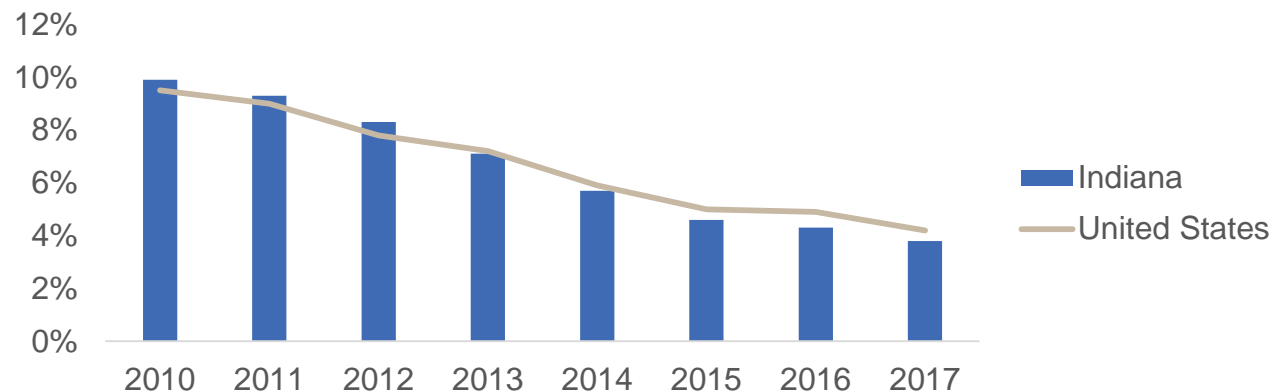


Recent Indiana Economic and Demographic Trends

- State GDP growth outpaced national average in 2013, 2014 and 2016.



- Unemployment rate 3.8 percent as of September 2017.



Sources: Bureau of Economic Analysis – Annual Change in GDP by State; Bureau of Labor Statistics - Local Area Unemployment Statistics (Seasonally adjusted as of September 2017)



North Carolina



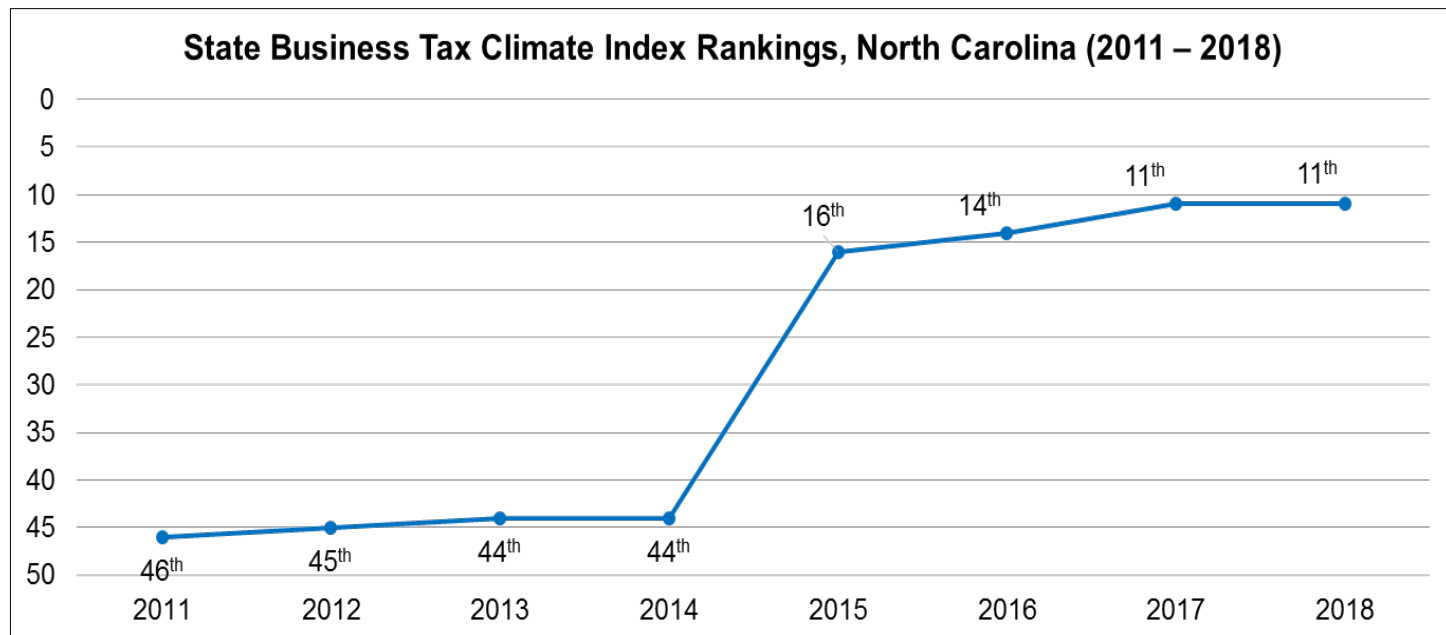
Recent North Carolina Tax Changes

- Starting in 2013, North Carolina made broad-based tax structure changes:
 - 2013: The state's two-bracket **personal income tax** of 6.0 and 7.75 percent was reduced to a single-rate of 5.8 percent in 2013 (-\$108.4 million), and then further reduced to 5.75 percent by 2015. (-\$60 million).
 - 2013: The **corporate income tax** was reduced from 6.9 percent to 6 percent in 2014 (-\$50.1 million), and then to 5.0 percent in 2015. (-\$70 million). Today it is 3.0 percent
 - 2013: applied a combined general **sales tax rate** of 7 percent to electricity (+\$417.1 million) and piped natural gas (+\$102.3 million), increasing state tax revenue.
 - 2013: repealed the **estate tax**. (-\$52 million in FY 2014)
 - 2015: Expanded **sales tax base** to include service charges on repairs, maintenance and installation of tangible personal property (+\$44.5 million in FY 2016; +\$159.5 million in FY 2017)
 - 2015: Adopted **personal income tax** package – lowered personal income tax rate from 5.75% to 5.499 percent, beginning in 2017 (-\$117.3 million). This rate will be further reduced to 5.35% in January 2019 due to legislation passed in the 2017 session.



Impact of North Carolina Reform Efforts

- Prior to 2013, North Carolina had a relatively high tax burden in comparison to its neighbors.
- State tax changes have improved its 'tax climate' rankings according to the Tax Foundation:



Source: Tax Foundation, *North Carolina Illustrated: A Visual Guide to Tax Reform* (November 5, 2015);
Tax Foundation, *State Business Tax Climate Index*



Impact of North Carolina Reform Efforts

- Even while making tax reductions, North Carolina has had a substantial budget surplus for the past three years:
 - FY 2015 – \$447 million surplus
 - FY 2016 – \$430 million surplus
 - FY 2017 – projected to end with \$581 million surplus (2.5 percent growth above projections).
- Budget office estimates economic gains will provide close to \$1.5 billion over the next two fiscal years.

Source: Tax Foundation: North Carolina Set to Post Another Large Budget Surplus (May 8, 2017)



Questions and Discussion



Appendices



Significant 2016 Tax Actions

- 17 states made net reductions to personal income taxes; 6 states raised them.
- Indiana reported the largest tax decrease with a net reduction in revenues of 2.3 percent as a result of phasing in personal and corporate income tax reductions that were originally enacted during the 2013 legislative session.
- Sales and Use and Health Care-related taxes experienced the largest increases due to sales tax actions in Louisiana and South Dakota sales tax actions, and net increases in health care taxes are driven by California's introduction of a tax on Managed Care Organization providers, which raised \$1.1 billion in new revenue.

Net State Tax Changes by Type of Tax

Type of Tax	Dollars (in millions)
Personal Income	-\$884.3
Corporate Income	-\$736.7
Sales and Use	\$788.6
Health Care	\$1,348.8
Tobacco	\$1,008.2
Alcoholic Beverage	\$18.2
Motor Fuel	\$923.3
Miscellaneous	-\$125.3
Net Change	\$2,340.8

Source: NCSL, 2016: State Tax Actions, July 2, 2017



Specific Tax Categories Affected

2016 Tax Changes by Type of Tax (in millions of dollars)

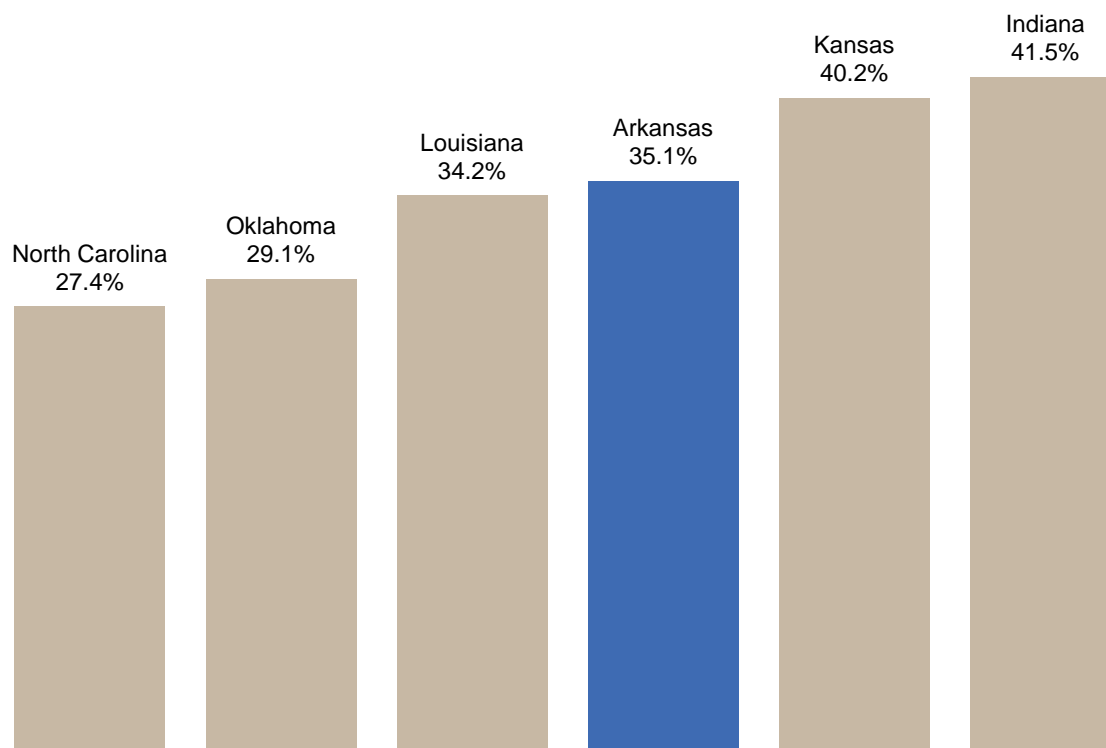
	Personal Income	Corporate Income	Sales & Use	Health Care	Tobacco	Alcoholic Beverage	Motor	Misc.	Total
Oklahoma	\$110.1	\$9.1	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$51.8	\$171.0
Louisiana	\$17.0	\$84.6	\$1,167.5	\$244.0	\$46.0	\$19.2	\$0.0	\$13.3	\$1,591.6
Arkansas	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Kansas	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
North Carolina	-\$145.0	\$0.0	\$19.8	\$0.0	\$0.0	\$0.0	\$0.0	\$1.6	-\$123.6
Indiana	-\$212.8	-\$199.9	\$6.4	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	-\$406.3

Source: NCSL, 2016: State Tax Actions, July 2, 2017



Sales Tax

Sales Tax Percentage of Total Tax Collections, 2016





Sales Tax Rates Rate Comparison

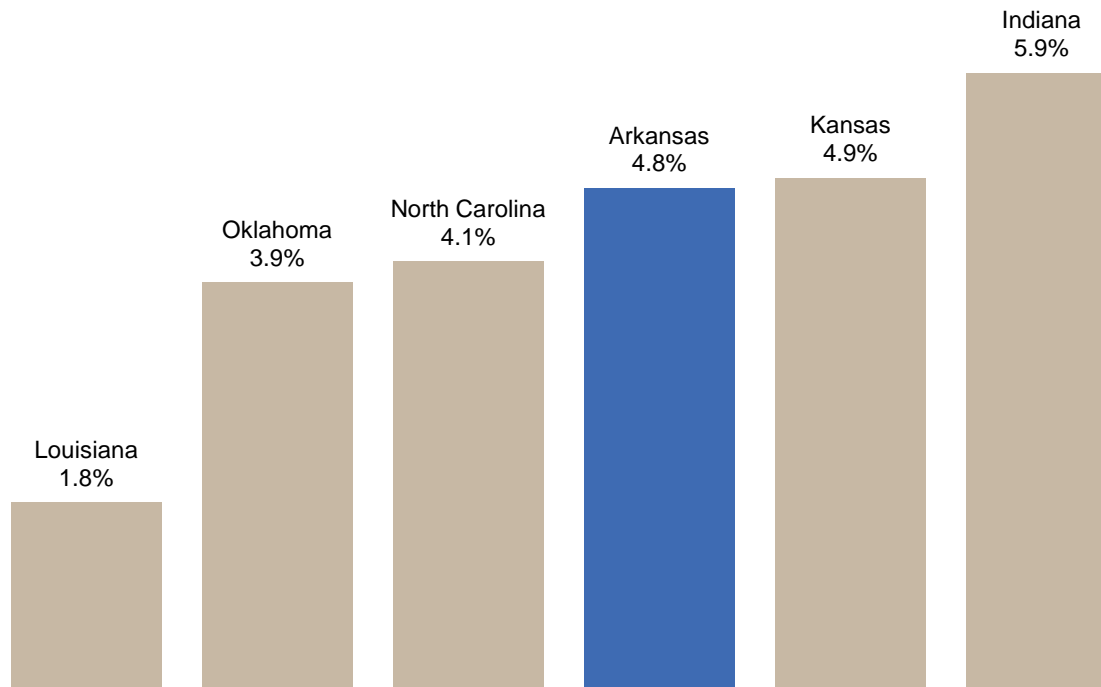
State	Sales Tax
Indiana	7.00%
Arkansas	6.50%
Kansas	6.50%
Louisiana	5.00%
North Carolina	4.75%
Oklahoma	4.50%

Source: Tax Foundation



Corporate Income Tax

Corporate Income Tax Percentage of Total Tax Collections, 2016



Source: Federation of Tax Administrators



Corporate Income Tax Rate Comparison

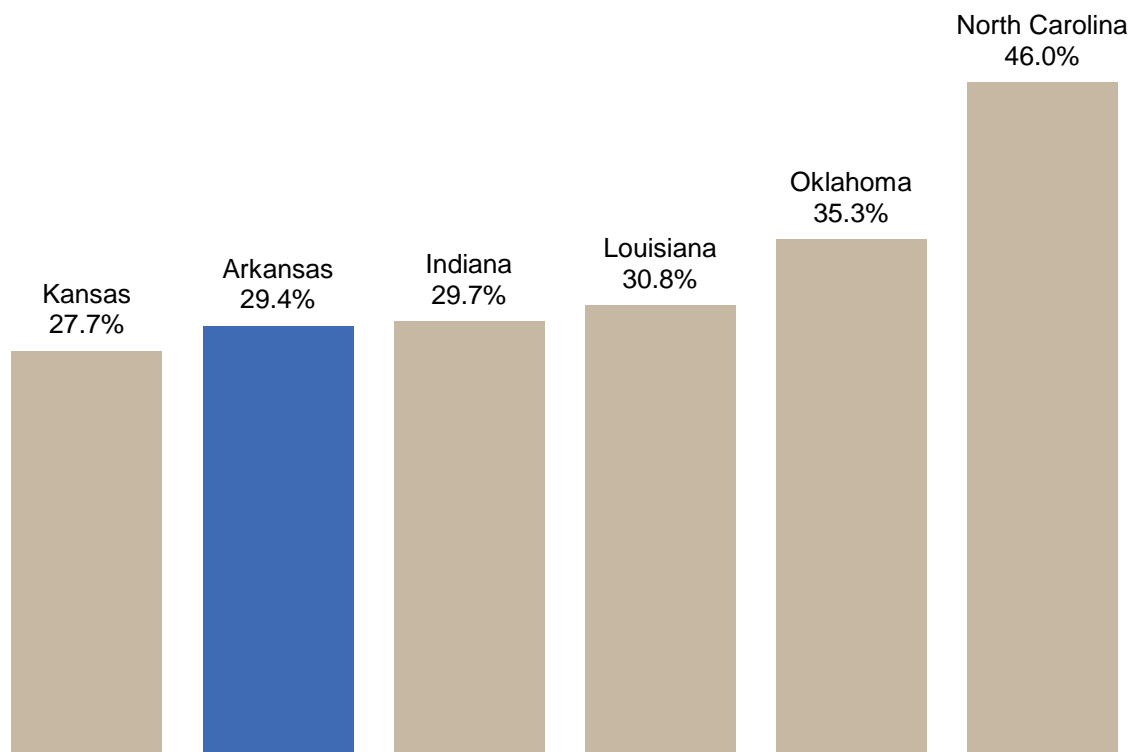
State	Corporate Income Tax Rate	
	Low	High
Louisiana	4.0%	8.0%
Arkansas	1.0%	6.5%
Indiana	6.0%	6.0%
Oklahoma	6.0%	6.0%
Kansas	4.0%	4.0%
North Carolina	3.0%	3.0%

Source: Federation of Tax Administrators



Personal Income Tax

Personal Income Tax Percentage of Total Tax Collections, 2016



Source: Federation of Tax Administrators



Personal Income Tax Rate Comparison

Individual Income Tax Rate					
	Low Rate	High Rate	Number of Brackets	Low Bracket	High Bracket
Arkansas	0.9%	6.9%	6	\$4,299	\$35,100
Louisiana	2.0%	6.0%	3	\$12,500	\$50,001
North Carolina	5.5%	5.5%	1	Flat rate	Flat rate
Oklahoma	0.5%	5.0%	6	\$1,000	\$7,200
Kansas	2.7%	4.6%	2	\$15,000	
Indiana	3.2%	3.2%	1	Flat rate	Flat rate

Source: Federation of Tax Administrators