EXHIBIT D

Arkansas Income Tax Policy

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INSTITUTE ON TAXATION &
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Overview

- Follow-up Sales Tax Discussion
  - Taxing Groceries at 6.5% vs. 1.5%
  - Offsetting Options
- Why Income Tax Matters
  - Sustainability
  - Relationship to economic growth
  - Tax Fairness
- Specific Reform Ideas for Arkansas

Taxing Food & Credits

Offer a Targeted Credit instead of a Broad Exemption

- Grocery exemption cost approximately $249 million in 2018

- Exemption vs. Refundable Credit:
  - Lost tax revenues
  - Targeting
  - Volatility
  - Administrative costs

Impact of Taxing Groceries at 6.5%

Impact of Increasing Sales Tax Rate on Food from 1.5 to 6.5% in Arkansas
2018

2018 Income Groups	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than						Or More
Average Income in Group	$ 13,000	$ 28,000	$ 42,000	$ 67,000	$ 116,000	$ 268,000	$ 1,280,000
Tax Change as % of Income	+0.6%	+0.5%	+0.4%	+0.3%	+0.2%	+0.1%	+0.04%
Average Tax Change	+76	+129	+162	+208	+266	+371	+527
Share of In-State Tax Change	9%	15%	18%	24%	23%	8%	3%

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Credit Options

Credits Designed to Offset Sales Tax/Taxes on Food

State	Description of Credit
AZ	Refundable "Increased Excise Tax Credit" for low-income taxpayers of all ages
HI	"Refundable Food/Excise Tax Credit" for taxpayers with FAGI below $50,000. In 2016, eligibility changed for single taxpayers to $30,000 FAGI
ID	Refundable "Grocery Credit" to all families regardless of income. The credit is $100 per family member. Elderly taxpayers receive an extra $10 per filer
KS	Targeted, nonrefundable food sales tax credit to families with income below $30,615 with at least one dependent or who are over 55 years of age; the maximum credit is $125 per exemption
ME	Targeted, refundable Sales Tax Fairness Credit to low- and middle-income families dependent on family size and income; the maximum credit is $225
NM	Refundable "Low Income Comprehensive Tax Rebate" for all low-income taxpayers
OK	Refundable "Credit/Refund of Sales Tax" for low-income taxpayers of all ages

Some Possible Offsetting Credits

Option 1: Hold Harmless Bottom 20% of Taxpayers

The Kansas Food Sales Tax Refund (2010)

Only taxpayers over 55, taxpayers with children under 18, and disabled taxpayers are eligible.

Income Level	Refund
$0 to $17,500	$90 per person
$17,500 to $35,000	$45 per person
$35,000 or more	no refund

Some Possible Offsetting Credits

Option 1: Hold Harmless Bottom 20% of Taxpayers

Kansas Food Sales Tax Refund

$52 million

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $21,000	$21,000 – $33,000	$33,000 – $52,000	$52,000 – $85,000	$85,000 – $179,000	$179,000 – $486,000	$486,000 – Or More
Average Income in Group	$13,000	$28,000	$42,000	$67,000	$116,000	$268,000	$1,280,000
KS Based Grocery Credit							
Tax Change as % of Income	–0.7%	–0.2%	–0.04%	–0.01%	–0%	–0%	–0%
Average Tax Change	–84	–60	–19	–5	—	—	—
Combined with Impact of Taxing Groceries							
Tax Change as % of Income	–0.1%	+0.2%	+0.3%	+0.3%	+0.2%	+0.1%	+0.04%
Average Tax Change	–8	+69	+143	+203	+266	+371	+527

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Some Possible Offsetting Credits

Taxpayers whose SNAP food purchases are exempt from the food tax still pay sales taxes on a significant portion of their food expenses

	1 Adult	1 Adult, 1 Kid	1 Adult, 2 Kids	1 Adult, 3 Kids
Annual Food Expenses	$ 2,986	$ 4,394	$ 6,613	$ 8,777
Monthly Food Expenses	$ 249	$ 366	$ 551	$ 731
Average SNAP Benefit	$ 110	$ 220	$ 330	$ 440
Difference	$ 139	$ 146	$ 221	$ 291

	2 Adults	2 Adults, 1 Kid	2 Adults, 2 Kids	2 Adults, 3 Kids
Annual Food Expenses	$ 5,474	$ 6,807	$ 8,786	$ 10,702
Monthly	$ 456	$ 567	$ 732	$ 892
Average SNAP Benefit	$ 220	$ 330	$ 440	$ 550
Difference	$ 236	$ 237	$ 292	$ 342

From: Living Wage Calucator, http://livingwage.mit.edu/states/05; and CBPP Arkansas SNAP Factsheet, https://www.cbpp.org/sites/default/files/atoms/files/snap_factsheet_arkansas.pdf

Some Possible Offsetting Credits

Option 2: Hold Harmless Bottom 40% of Taxpayers

The Hawaii Food / Excise Tax Credit (2013)	
Income Level	**Refundable Credit (per person)**
$0 to $5,000	$85
$5,000 to $10,000	$75
$10,000 to $15,000	$65
$15,000 to $20,000	$55
$20,000 to $30,000	$45
$30,000 to $40,000	$35
$40,000 to $50,000	$25
$50,000 or more	no refund

Some Possible Offsetting Credits

Option 2: Hold Harmless Bottom 40% of Taxpayers

Hawaii Food/Excise Tax Credit

$121 million

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $21,000	$21,000 – $33,000	$33,000 – $52,000	$52,000 – $85,000	$85,000 – $179,000	$179,000 – $486,000	$486,000 – Or More
Average Income in Group	$13,000	$28,000	$42,000	$67,000	$116,000	$268,000	$1,280,000
HI Based Grocery Credit							
Tax Change as % of Income	–1.4%	–0.4%	–0.2%	–0.02%	–0%	–0%	–0%
Average Tax Change	–175	–125	–93	–15	—	—	—
Combined with Impact of Taxing Groceries							
Tax Change as % of Income	–0.8%	+0.01%	+0.2%	+0.3%	+0.2%	+0.1%	+0.04%
Average Tax Change	–99	+4	+69	+193	+266	+371	+527

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Some Possible Offsetting Credits

Option 3: Hold Harmless Bottom 60% of Taxpayers

$50 per person refundable credit

Incomes ‹ $75,000

Some Possible Offsetting Credits

Option 3: Hold Harmless Bottom 60% of Taxpayers

$50 per person credit if income <$75,000

$162 million

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $21,000	$21,000 – $33,000	$33,000 – $52,000	$52,000 – $85,000	$85,000 – $179,000	$179,000 – $486,000	$486,000 – Or More
Average Income in Group	$13,000	$28,000	$42,000	$67,000	$116,000	$268,000	$1,280,000
$50 Per Person Grocery Credit							
Tax Change as % of Income	–1.0%	–0.5%	–0.4%	–0.2%	–0%	–0%	–0%
Average Tax Change	–130	–140	–179	–125	—	—	—
Combined with Impact of Taxing Groceries							
Tax Change as % of Income	–0.4%	–0.04%	–0.04%	+0.1%	+0.2%	+0.1%	+0.04%
Average Tax Change	–54	–11	–17	+83	+266	+371	+527

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Some Possible Offsetting Credits

Option 4: Enact 10% Refundable EITC

(holds bottom 40% harmless)

Arkansas Refundable EITC @ 10% of Federal

$76 million

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $21,000	$21,000 – $33,000	$33,000 – $52,000	$52,000 – $85,000	$85,000 – $179,000	$179,000 – $486,000	$486,000 – Or More
Average Income in Group	$13,000	$28,000	$42,000	$67,000	$116,000	$268,000	$1,280,000
Enact Refundable State EITC at 10% of Federal							
Tax Change as % of Income	–0.8%	–0.5%	–0.1%	—	—	—	—
Average Tax Change	–98	–125	–57	—	—	—	—
Combined Changes							
Tax Change as % of Income	–0.2%	–0.0%	+0.3%	+0.3%	+0.2%	+0.1%	+0.04%
Average Tax Change	–22	+4	+105	+208	+266	+371	+527

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Income Tax

Why Income Taxes Matter: Sustainability

- Sustainability
  - Revenue stream grows at the same pace as the services it is intended to fund; and over the long-run, both grow along with the economy.

- To achieve, tax systems must be responsive to broad economic developments that affect the tax base

Why Income Taxes Matter: Sustainability

- Economic developments of note
  - Sales tax
    - Consumption moving to more services, new types of goods
    - Taxes haven't kept up and face difficult political forces when trying to modernize
  - Property tax
    - Legal constraints
    - Since not sensitive to ability to pay, lower taxpayer tolerance for growing levies over time
  - Gas tax
    - Stagnant gas tax rates
    - Increased fuel efficiency

Why Income Taxes Matter: Sustainability

- Economic developments of note, cont'd
  - Income Tax
    - Income growth
    - Disparate income growth across income groups over the past 40 years

Why Income Taxes Matter: Sustainability

- Income tax—especially progressive income taxes—are most responsive to this important economic trend
  - Income tax yields grow as income does
  - Progressive income taxes allow lawmakers to differentiate tax burden among those whose incomes are growing at slower and faster rates
- Over the long term, progressive income taxes are the most reliable revenue source available to states, displaying more robust growth than sales, property, or excise taxes

What About Volatility?

- Volatility
- What is it?
  - Change in tax yields from year to year (growing or falling)
- Why does it happen?
  - Usually in response to changes in the business cycle: tax collections increase rapidly when the economy grows, and grow more slowly when the economy slows down

What About Volatility?

- Why it matters
  - Tax revenues are how state and local governments pay for the public services they provide each year
  - The cost of providing these services tends to grow at least with inflation
  - If the cost of public investments such as education, transportation and healthcare grows each year, lawmakers will be left scrambling when tax revenues actually decline, as has happened in many states during the recent recession

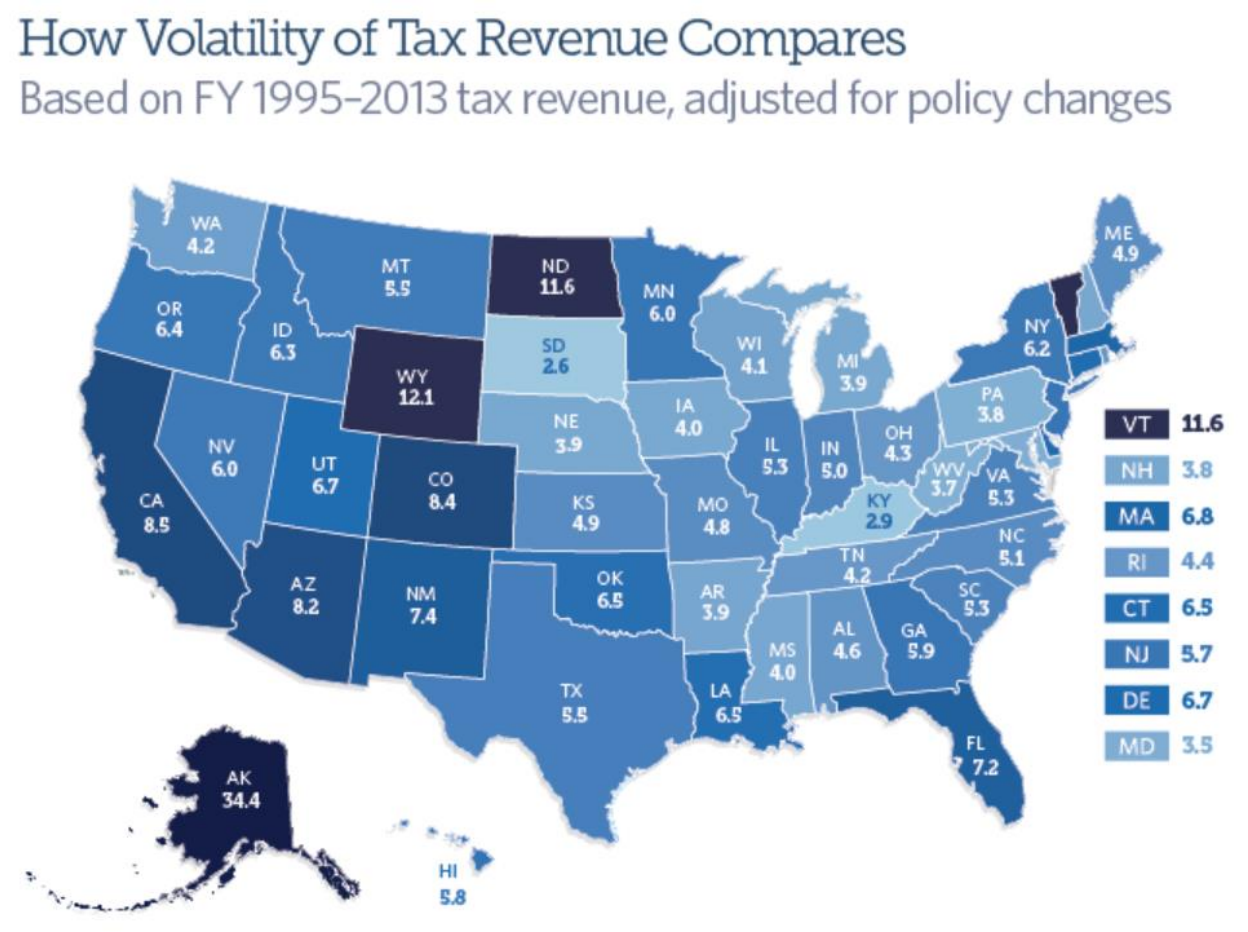
What About Volatility?

- What factors determine volatility?
  - Volatility of individual tax streams often outside of policymakers' control
    - State economic factors: the mix of industry, natural resources, workforce, and population growth
    - Federal budget changes
    - Unforeseen events, such as natural disasters

What About Volatility?

- What factors determine volatility?
  - Relative reliance on each tax types
    - From FY 1995-2013, corporate income tax and severance tax on oil and minerals consistently were more volatile than other major state taxes (personal income and sales of goods and services)
  - Mix of taxes
    - Diversification

What About Volatility?



What About Volatility?

- Are income taxes more volatile than other major tax sources?
  - Short-term volatility effects all major tax sources levied by states
    - In recent years, states have seen a downturn in everything from the sales tax to gambling revenues to corporate income taxes
  - Academic research casts doubt on the conventional wisdom that income taxes are more volatile than sales taxes
  - PEW Study
    - Personal income tax fluctuated more than any other type of tax in only 9 of the 41 states that levy it (less than 22%)

What About Volatility?

- Is volatility a deal breaker?
  - There is a fundamental tradeoff between short-term volatility and long-term growth—the price of making your tax system less volatile is usually a diminished capacity to fund public investments in the long run
  - Over the long term, progressive income taxes are the most reliable revenue source available to states, displaying more robust growth in the long run than sales, property or excise taxes
  - Volatility complicates the already difficult tasks of revenue forecasting and budgeting, yet it is not inherently bad

What About Volatility?

- What can be done to mitigate volatility?
  - Sensible fiscal management strategies available to mitigate the impact of volatility
  - Best hedge is better planning
    - Improve roads and bridges, pay down debt, or build up reserves during high-receipt times
    - Harness good growth years to cushion the lean years by using a rainy day fund (deposit surplus revenue during prosperous times to be drawn upon in times of need)
  - Expand the base of other taxes
    - Leaves states less vulnerable to economic downturns and the revenue fluctuations they induce

Why Income Taxes Matter: Supporting Economic Growth

- A sustainable revenue stream made possible by an income tax pays for state services that are vital to economic growth, like education, public safety, the courts, and transportation infrastructure

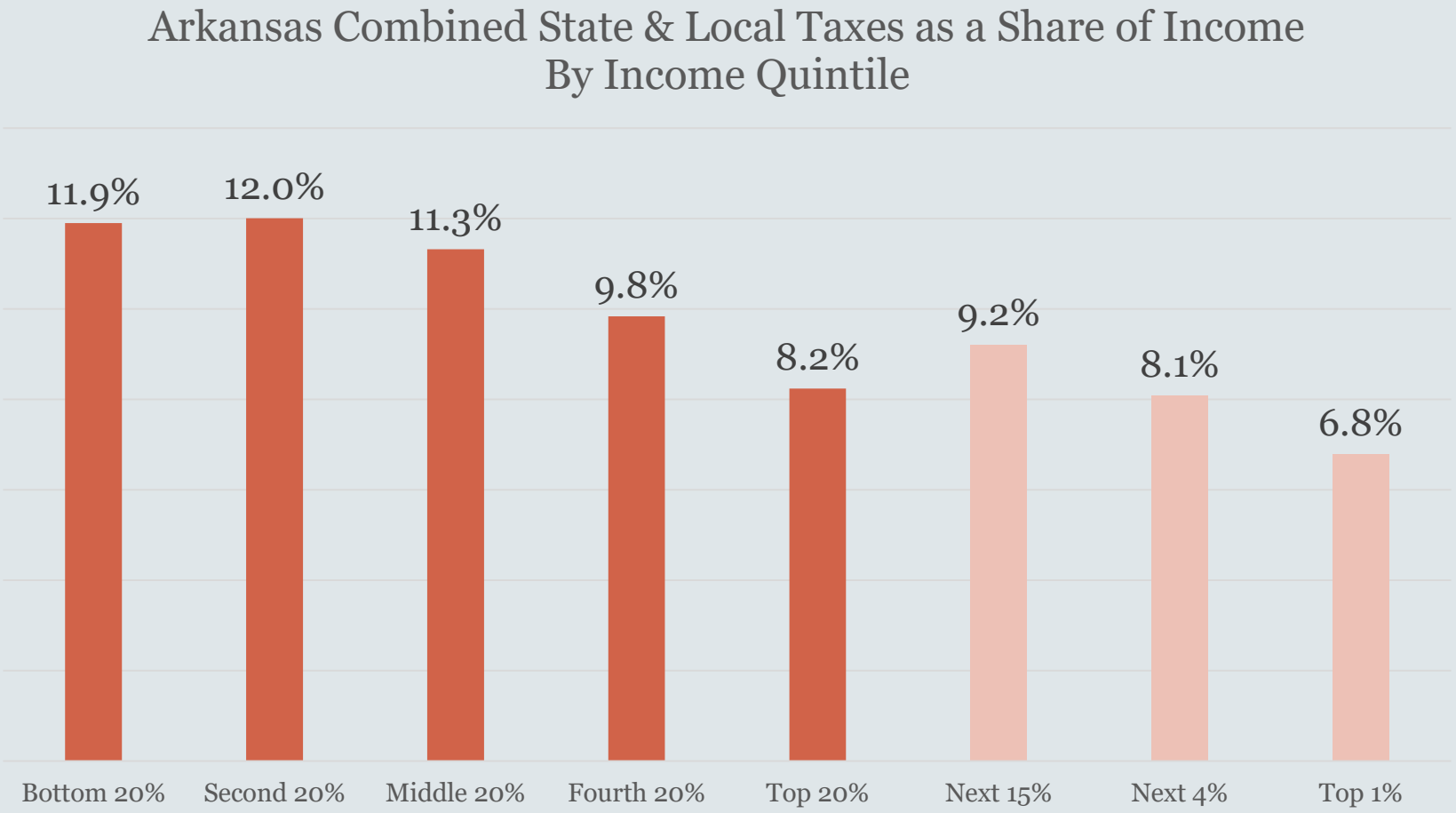
Why Income Taxes Matter: Supporting Economic Growth

- Evidence that investments in public goods matter:
  - Statistical research: Many empirical studies find positive correlation between quality of education and infrastructure (especially) and rate of state economic growth and growth in high-paying jobs
  - Business executives: Most surveys of business executives about what's important in their location decisions find quality of local labor force and infrastructure more influential than taxes/tax incentives
  - "Creative class": Growing body of research finding that fastest growing cities are those where highly-educated workforce is concentrated. They want good schools, parks, low crime, etc.

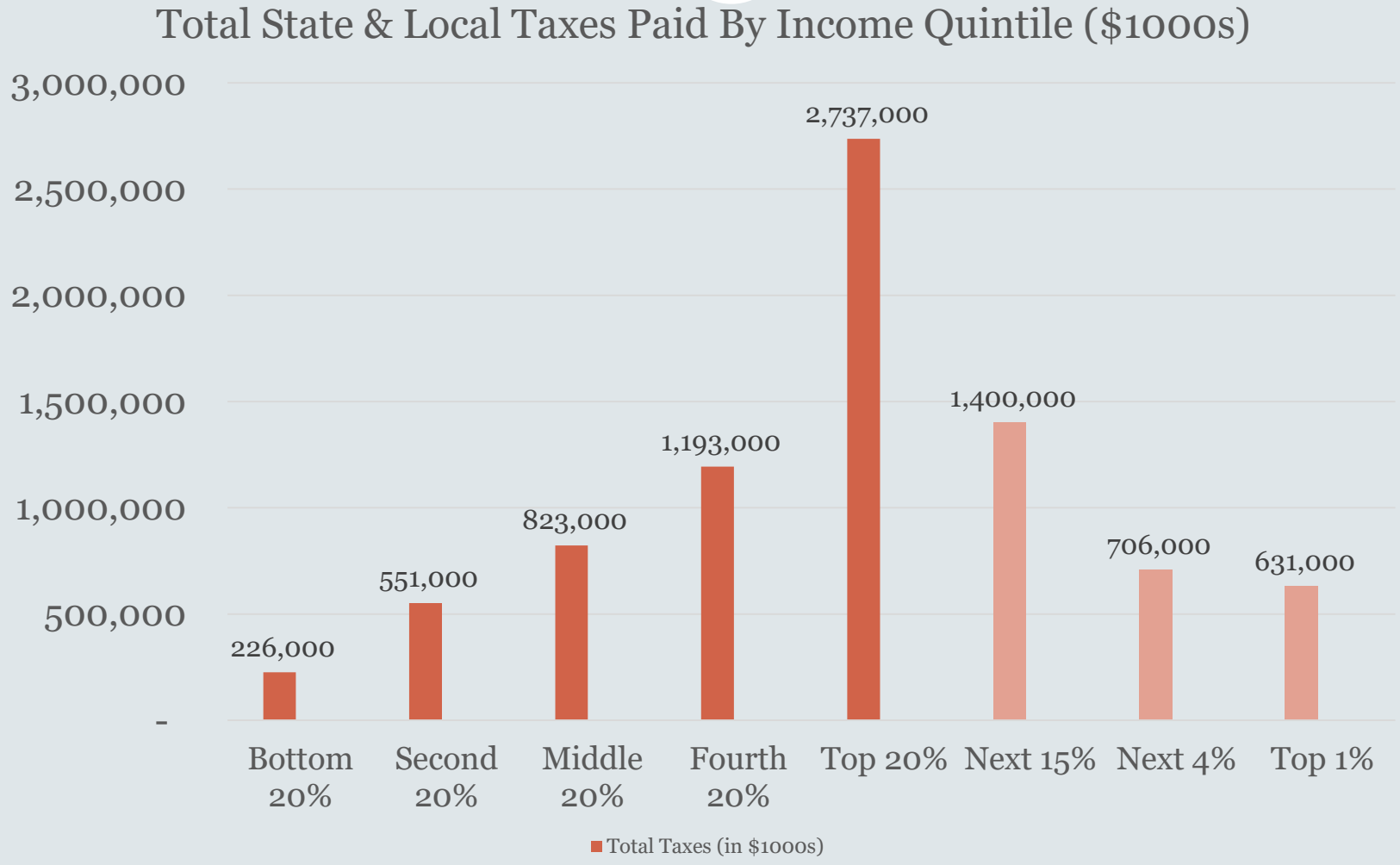
Why Income Taxes Matter: Tax Fairness

- State & local taxes are regressive
  - Make up a larger share of income for low- and middle-income families
- Conceptualizing tax fairness

Conceptualizing Tax Fairness: Relative Impact on Individual Taxpayer



Conceptualizing Tax Fairness: Total Taxes Paid in $s by Income Group



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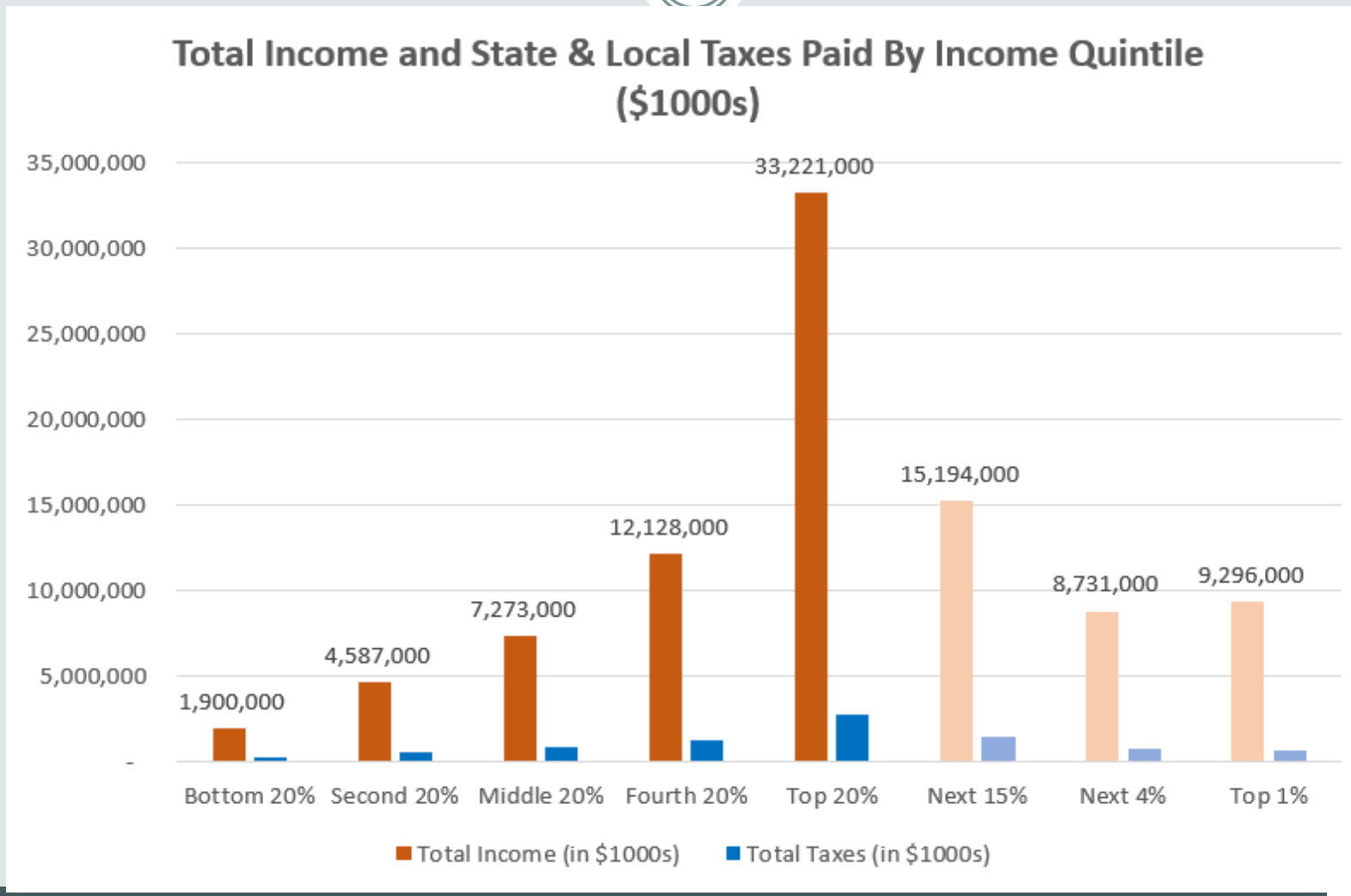
Conceptualizing Tax Fairness: Total Taxes Paid vs. Total Income by Income Group



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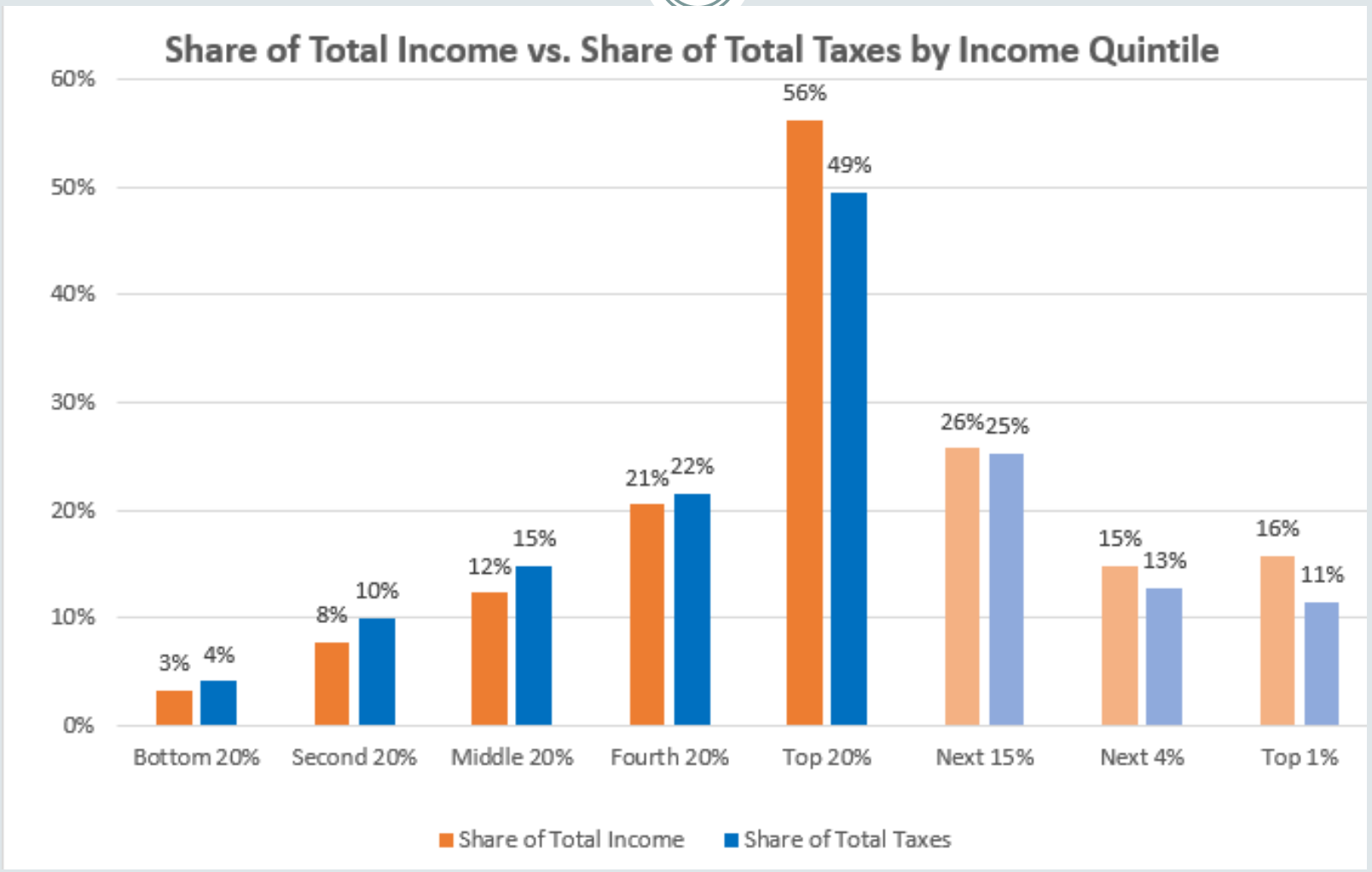
Conceptualizing Tax Fairness: % Total Income vs. % Total Taxes Paid by Income Group



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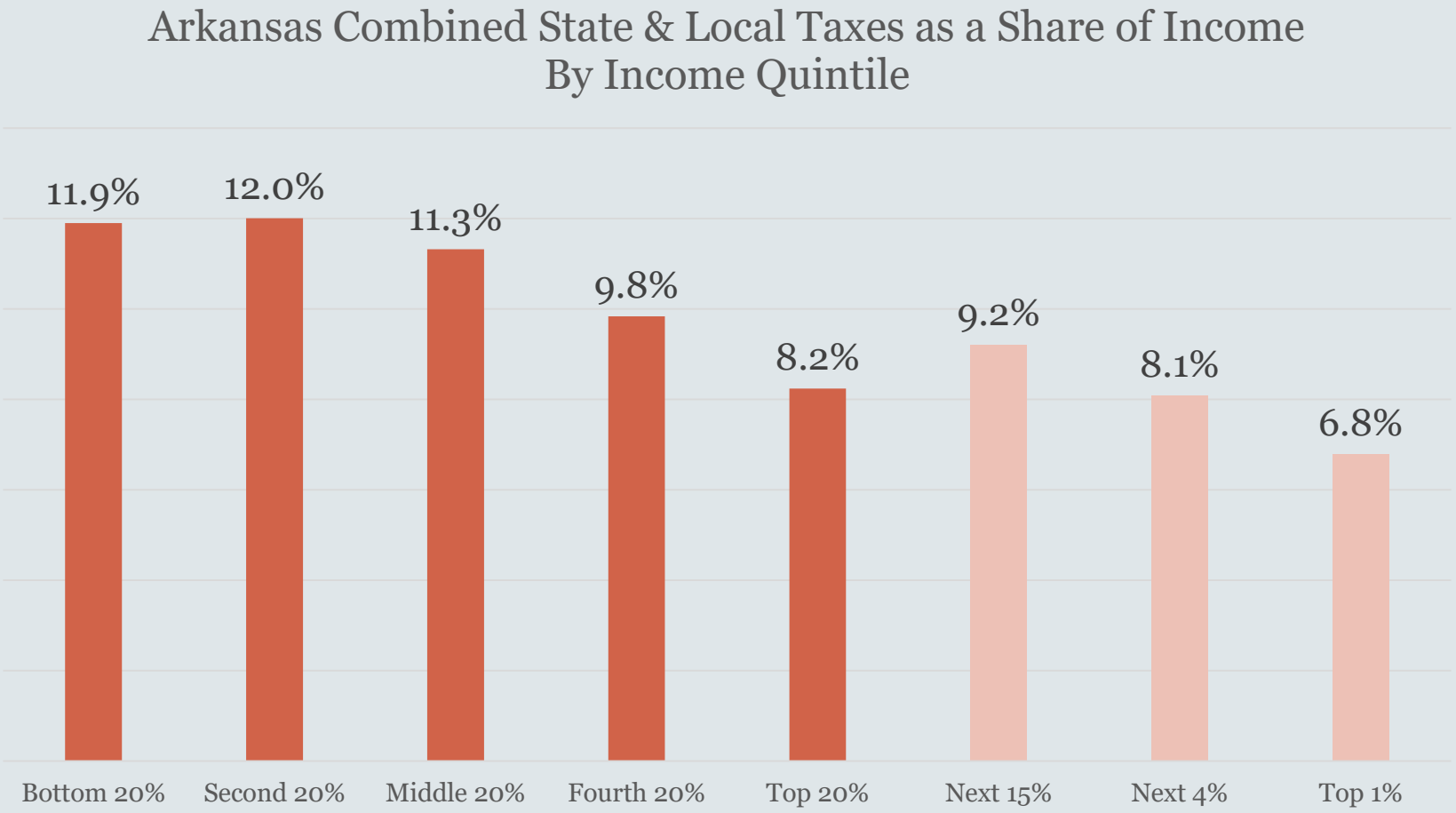
Conceptualizing Tax Fairness: Relative Impact on Individual Taxpayer



Why Income Taxes Matter: Tax Fairness

- Regressivity
  - Sales and excise taxes are regressive because consumption makes up a much larger share of income for poor and middle-class taxpayers
  - Property taxes are regressive since homes and vehicles are usually the only types of property subject to tax, and the only types of property typically owned by individuals and families in the lower half of the income distribution
  - A personal income tax is simply the only major revenue source available to states that can meaningfully mitigate the regressivity of sales, excise, and property taxes

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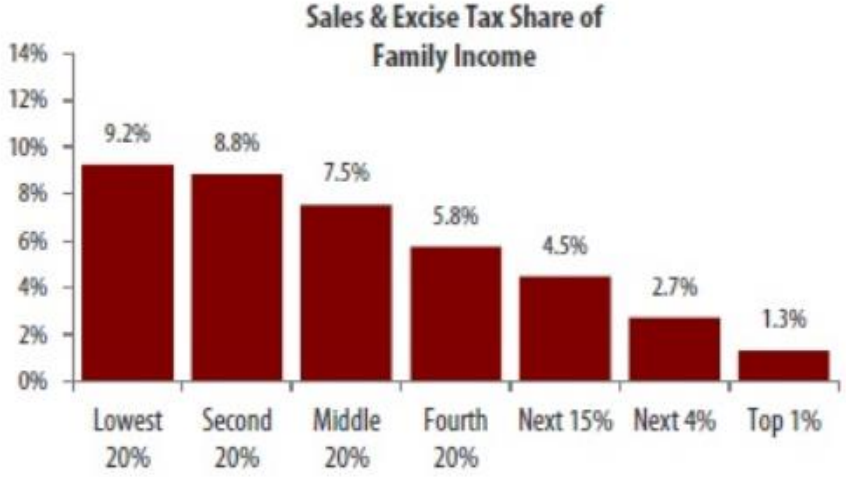

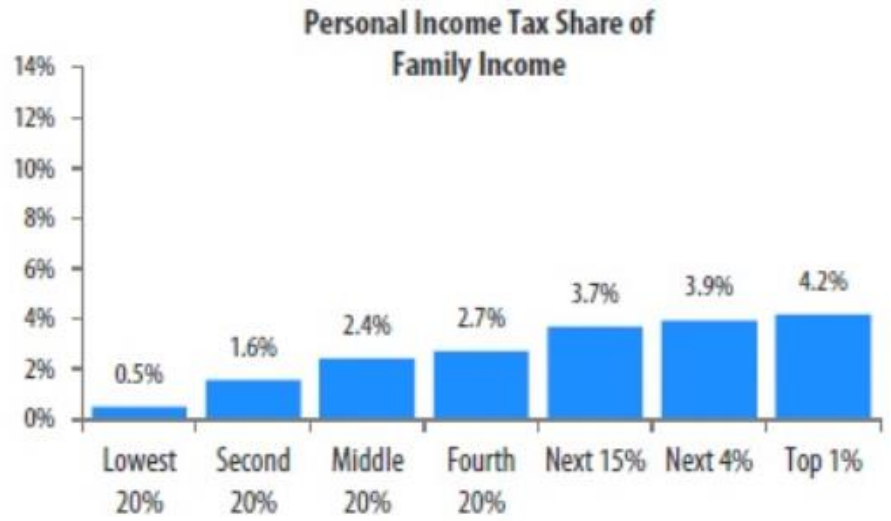

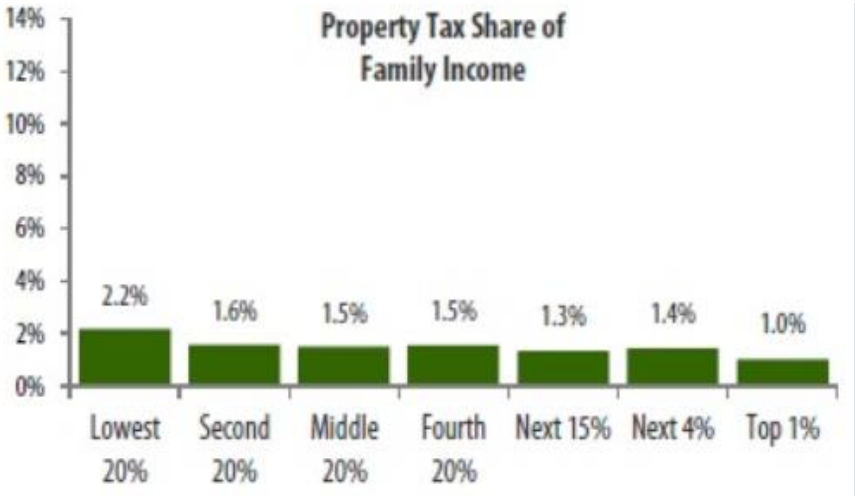

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Income Inequality Index

Appendix B: ITEP's Tax Inequality Index

Rank	State	Index	Lowest 20%	Middle 60%	Top 1%	Ratio of Poorest 20% to Top 1%	Ratio of Middle 60% to Top 1%
1	Washington	–12.6%	16.8%	10.1%	2.4%	687%	412%
2	Florida	–9.5%	12.9%	8.3%	1.9%	664%	429%
3	Texas	–8.5%	12.5%	8.8%	2.9%	433%	307%
4	South Dakota	–8.4%	11.3%	7.9%	1.8%	619%	431%
5	Illinois	–8.1%	13.2%	10.9%	4.6%	289%	238%
6	Pennsylvania	–7.3%	12.0%	10.1%	4.2%	286%	241%
7	Tennessee	–7.3%	10.9%	8.4%	3.0%	366%	280%
8	Arizona	–7.1%	12.5%	9.5%	4.6%	272%	207%
9	Kansas	–6.9%	11.1%	9.2%	3.6%	310%	258%
10	Indiana	–6.6%	12.0%	10.6%	5.2%	231%	204%
11	Arkansas	–6.4%	11.9%	11.1%	5.6%	212%	197%

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Highest Taxes on the Poor

The 10 States with the Highest Taxes on the Poor

State	Taxes Paid by Bottom 20%
Washington	16.8%
Hawaii	13.4%
Illinois	13.2%
Florida	12.9%
Rhode Island	12.5%
Arizona	12.5%
Texas	12.5%
Indiana	12.0%
Pennsylvania	12.0%
Arkansas	11.9%

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Why Income Taxes Matter: Tax Fairness

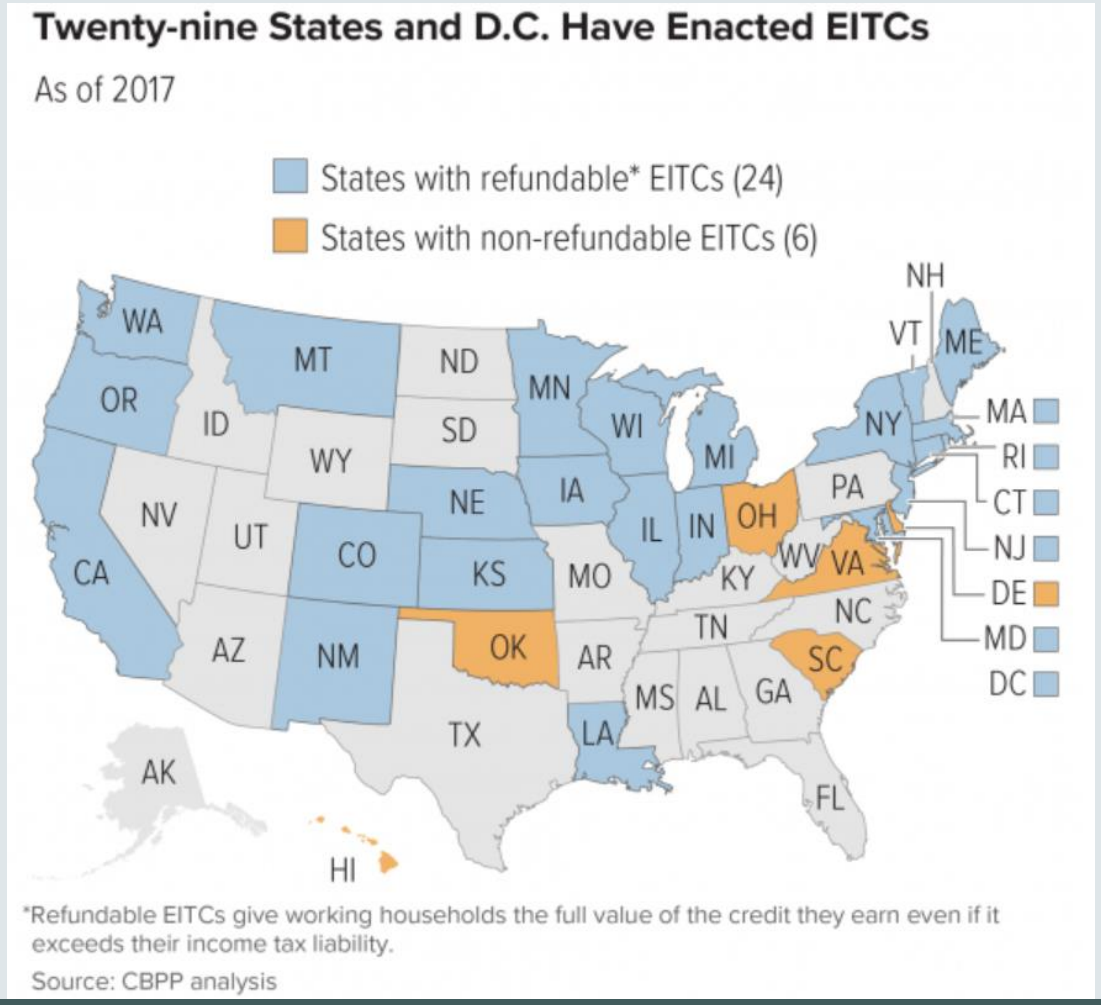
- Characteristics of income taxes that are progressive
  - A graduated rate structure that applies lower tax rates to lower-income families
  - Use of refundable tax credits to off set the impact of other regressive taxes
  - Fair treatment of different types of income: wages, salaries, capital

Recommended Reforms

Improvements to AR Income Tax: Enact State EITC

- Enact a refundable state Earned Income Tax Credit
  - States EITCs a standard feature of a modern income tax (29 states and DC)
  - Effects
    - Encourages work
    - Leads to better child development, education, and earnings outcomes
    - Tool for offsetting regressivity of other state taxes
- Refundability
  - Rebate, not wealth redistribution
  - Easier than trying to administer in the check-out line at grocery store

Earned Income Tax Credits (EITC) in the States



EITC Options

2018 Income	Lowest 20%	Second 20%	Middle 20%
Income Range	Less than $21,000	$21,000 – $33,000	$33,000 – $52,000
Average Income in Group	$13,000	$28,000	$42,000

% Taxpayers w/Cut
21%

EITC Options: Percent of Federal

10% Refundable Credit			
Tax Change as % of Income	–0.7%	–0.4%	–0.2%
% with Income Tax Cut	43%	32%	27%
Avg. Tax Cut for Those w/Cut	–197	–344	–263
Share of Tax Cut	30%	39%	25%

State Tax Change ($1000)
–76,000

15% Refundable Credit			
Tax Change as % of Income	–1.0%	–0.6%	–0.3%
% with Income Tax Cut	43%	32%	27%
Avg. Tax Cut for Those w/Cut	–302	–525	–404
Share of Tax Cut	30%	39%	25%

State Tax Change ($1000)
–115,000

30% Refundable Credit			
Tax Change as % of Income	–2.1%	–1.2%	–0.5%
% with Income Tax Cut	43%	32%	28%
Avg. Tax Cut for Those w/Cut	–616	–1,068	–818
Share of Tax Cut	30%	39%	26%

State Tax Change ($1000)
–235,000

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Improvements to AR Income Tax: Repeal Exclusion for Capital Gains

- Special tax break that favor investors' capital gains income over the wages and salaries earned by working families
  - Vast majority of gains recognized by the wealthiest
    - 72% of benefit of CG exclusion in Arkansas realized by top 1% (incomes >$486,000)
- Exacerbates regressivity
- Already receive preferential treatment at federal level

Improvements to AR Income Tax: Repeal Exclusion for Capital Gains

- Flawed strategy for promoting economic growth
  - General state capital gains tax breaks are unlikely to benefit that state's economy, since any new investment encouraged by the break could take place anywhere in the United States or the world
- Recent changes
  - Expansion in Arizona and Arkansas
  - Elimination in Rhode Island
  - Reductions in Vermont and Wisconsin

Improvements to AR Income Tax: Repeal Exclusion for Capital Gains

- Incidence Analysis from repeal of AR exclusion for long-term capital gains

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $21,000	$21,000 – $33,000	$33,000 – $52,000	$52,000 – $85,000	$85,000 – $179,000	$179,000 – $486,000	$486,000 – Or More
Average Income in Group	$13,000	$28,000	$42,000	$67,000	$116,000	$268,000	$1,280,000
Repeal Capital Gains Exclusion							
Tax Change as % of Income	—	—	—	+0.01%	+0.04%	+0.1%	+0.4%
Average Tax Change	—	—	—	+4	+42	+323	+5,119
% with Income Tax Increase	—	—	—	5%	14%	36%	43%
Avg. Tax Increase for Those w/Increase	—	—	—	+91	+295	+904	+11,778
Share of Tax Increase	—	—	—	1%	9%	18%	72%

State Tax Change ($1000)
+98,000

% Taxpayers w/Increase
6%

Note: Doesn't include estimate for cost of exclusion for capital gains >$10 million

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Improvements to AR Income Tax: Maintain Progressivity of Graduated Rate Structure

- Top rate cuts increase regressivity of current tax system
  - Cutting top income tax rate from 6.9% to 6.0% for taxable incomes ›$75,000 results in a $168 million tax cut for 7% of Arkansans—those entirely in the top 20%
  - Average value of cut for those with cut ranges from $542 - $7,368

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $21,000	$21,000 – $33,000	$33,000 – $52,000	$52,000 – $85,000	$85,000 – $179,000	$179,000 – $486,000	$486,000 – Or More
Average Income in Group	$13,000	$28,000	$42,000	$67,000	$116,000	$268,000	$1,280,000
Cut Top Rate from 6.9% to 6% for Taxable Incomes >$75,000							
Tax Change as % of Income	—	—	—	—	-0.1%	-0.4%	-0.5%
Average Tax Change	—	—	—	—	-106	-1,021	-6,587
% with Income Tax Cut	—	—	—	—	20%	88%	89%
Avg. Tax Cut for Those w/Cut	—	—	—	—	-542	-1,160	-7,368
Share of Tax Cut	—	—	—	—	13%	33%	54%

State Tax Change ($1000)
-168,000

% Taxpayers w/Cut
7%

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Improvements to AR Income Tax: Maintain Progressivity of Graduated Rate Structure

- Compare to 2017 "Low Income" Rate Cut for perspective…
  - Our estimates show $41 million tax cut with average tax cut of $41 for the target beneficiaries with incomes under $21,000

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $21,000	$21,000 – $33,000	$33,000 – $52,000	$52,000 – $85,000	$85,000 – $179,000	$179,000 – $486,000	$486,000 – Or More
Average Income in Group	$13,000	$28,000	$42,000	$67,000	$116,000	$268,000	$1,280,000
2017 "Low-Income" Tax Cut							
Tax Change as % of Income	–0.1%	–0.1%	–0.1%	–0.1%	–0.03%	–0.02%	—
Average Tax Change	–8	–23	–29	–55	–34	–47	—
Avg. Tax Cut for Those w/Cut	–41	–41	–40	–67	–42	–79	—
Share of Tax Cut	5%	15%	19%	37%	17%	6%	—

State Tax Change ($1000)
–41,000

Improvements to AR Income Tax: Maintain Progressivity from Graduated Rate Structure

- Moderate slightly by combining top rate cut with elimination of capital gains exclusion
  - Brings the top 20% tax cut down to $81 million from $168 million

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than $21,000	$21,000 – $33,000	$33,000 – $52,000	$52,000 – $85,000	$85,000 – $179,000	$179,000 – $486,000	$486,000 – Or More
Average Income in Group	$13,000	$28,000	$42,000	$67,000	$116,000	$268,000	$1,280,000
Cut Top Rate from 6.9% to 6% for Taxable Incomes >$75,000 & Eliminate Capital Gains Exclusion							
Tax Change as % of Income	—	—	—	—	–0.1%	–0.3%	–0.2%
Average Tax Change	—	—	—	—	–65	–733	–2,132
% with Income Tax Cut	—	—	—	—	19%	84%	82%
Avg. Tax Cut for Those w/Cut	—	—	—	—	–521	–1,082	–3,115
Share of Tax Cut	—	—	—	—	20%	47%	34%

State Tax Change ($1000)
–81,000

% Taxpayers w/Cut
7%

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Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Income taxes (corporate and personal) popular targets among proponents of tax cuts
- Thinking behind it? Theoretical predictions:
  - Demand-side: With fewer taxes, businesses will hire more people, invest in new facilities; individuals will spend more on goods and services that indirectly provide employment and income to the businesses/people furnishing them.
  - Supply-side: Changes incentives businesses have to make an investment/create a job/locate to a particular state and the incentives individuals have to work/live in a state

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Problems with the demand-side argument
  - Every dollar cut for a business or household is one dollar in taxes raised on someone else or a dollar matched in spending cuts—money that is more likely to have been spent within the local economy
    - Previous spenders of state payments have to take it out of local economy immediately while recipient may not inject it immediately at all
    - Save or spend on out of state expenses
    - Invest in out of state pay bonuses, dividends

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Theoretically, supply-side benefits are supposed to offset negative demand-side effects of tax cuts
  - Tip the balance towards investment/jobs that wouldn't otherwise have happened at all: Tax cuts increase profitability of business investments, thus incentive to make them; can turn marginally-unprofitable investment into a marginally profitable one
  - Shift location of a business or investment and associated jobs into the state
  - Induce individuals to reside in one state rather than another (indirect impact on economic development due to shift in location of household spending)

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Difficulties facing the supply-side argument in practice?
  - Cutting taxes for businesses
    - State and local taxes paid by corporations make up a small share of total expenses (2-4%). Even substantial cuts won't move the needle much on profitability
    - Business investment responds primarily to anticipated demand for products, not small cut in tax expense or marginal rate
    - Taxes aren't a disincentive for hiring since wages are already fully deductible
    - Relocating is costly, rare, and makes up a tiny share of net job growth

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Difficulties facing the supply-side argument in practice, cont'd
  - Cutting taxes for businesses
    - Job growth among states based on ability to support start-ups that develop innovative technologies, products or business models and that grow rapidly (Facebook/Google/Amazon)
    - Tax cuts don't help these businesses takeoff because they earn little in any profit in the early years (money goes into R&D, marketing, etc.)
    - Lots of other things important to location decisions
      - Businesses: Distance to suppliers/customers; skill level of workforce; road quality
      - Households: Climate, school quality, distance to family/relatives/jobs

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Difficulties facing the supply-side argument in practice, cont'd
  - Cutting personal income taxes for individuals
    - Most people don't own businesses and most small and startups don't earn enough profit to get much from PIT cuts
    - Most small businesses don't employ anyone other than themselves and don't have any intention of ever doing so (not job creators)
    - PIT cuts don't attract entrepreneurs—they almost never move before starting their business. They start where they live, have local relationships, know the market, where industry is already clustered
    - Cutting family/friend ties is painful. New houses costly. New job hunting difficult and risky

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- What does the research show?
  - Relationship between state tax levels and state economic performance has been studied extensively by economists
  - People on both sides of the debate can point to well-done studies by reputable economists published in peer reviewed journals supporting the assertion that relative state tax levels do and don't affect relative rates of economic growth, job creation, etc.
    - **Results aren't robust**; several replications of widely-cited earlier studies have completed undermined them
    - **Results are contradictory**; one study will find CIT matters and PIT doesn't, and the next will find exactly the opposite
  - **The weight of academic research concludes that state and local tax levels have, at most, a small impact on relative rates of state economic performance**

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- What does the research show?
  - Business taxation
    - Considerable statistical research supports the conclusion that business tax cuts don' have ***major impact*** on state economic performance
    - Bartik's summary of the literature
      - 10% cut in total business taxes required to produce 2-3% boost in long-run (15-20 years) economic output and jobs, assuming quality of public services needed by business doesn't decline (have to offset by raising taxes on households instead of just cutting services)
      - Effects = $20,000 per job paying less than $40,000 (large subsidy)
      - 20-50% of jobs go to in-migrants instead of residents; 80% in the long-term go to in-migrants (who need roads, sewers, schools)
      - Significant revenue loss for small number of jobs

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- What does the research show?
  - Personal income tax
    - Don't have same robust statistical summary of literature
    - Proponents of tax cuts can cite a couple of studies that find some inverse relationship between state PIT level and economic performance, but the majority find none

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Key Takeaways
  - Theoretically-possible positive incentive effects of cutting business taxes and PITs are so small that in short run they are not powerful enough to overcome negative impact on growth of reducing state spending to finance tax cut; net combined effect on state economic growth likely to be negative
  - Across-the-board tax cuts are not a cost-effective means of stimulating state economic growth/job creation
  - Preserving high-quality state and local services needed by businesses, especially education and infrastructure, should still be the primary economic growth strategy for states to pursue

Avoid Costly Cuts that Don't Improve Economic Growth & Cripple State Budgets

- Key Takeaways, cont'd
  - If states are going to use more narrow tax incentives to stimulate economic growth, they really can't afford for them to take a form that isn't directly conditioned on in-state investment (e.g., capital gains tax cuts, single sales factor, and domestic production deduction conformity are misguided)

The Trigger Temptation

- Dangers of "triggered" tax cuts
  - Are based on inadequate information about projected revenues and spending
    - Need multi-year forecasts on cost of cuts when take effect and cost of services to responsibly evaluate impact
    - Best forecasts can't predict change in state needs, citizen preferences, and lawmaker priorities
  - Can take effect even during economic downturns or at other times when revenues are particularly needed
    - If based on achieving model revenue growth in a single year, cuts can take effect as soon as state's economy starts recovering despite being below pre-recession levels

The Trigger Temptation

- Dangers of "triggered" tax cuts, cont'd
  - Typically fail to account for state fiscal needs
    - Cuts triggered in most states even if recent revenue growth not enough to offset inflation, population growth, or other factors that affect cost of current services
    - Don't account for need to maintain adequate reserves for fiscal emergencies

The Trigger Temptation

- Dangers of "triggered" tax cuts, cont'd
  - Offer no meaningful benefits compared with deferring action on tax cuts until closer to the implementation date, when policymakers will know more about whether they are affordable
    - Benefits from knowing future tax rates likely quite limited when it comes to state taxes
      - State tax rates are low to begin with and unlikely to tip investment decisions
      - Most enacted in recent years involve personal income tax, and only a small minority of income tax payers are business owners making significant capital decisions

The Trigger Temptation

- Dangers of "triggered" tax cuts, cont'd
  - Enable policymakers to claim credit for cutting taxes while avoiding accountability for the consequences
    - Enacting an income tax cut with a future effective date — whether or not a trigger is attached — effectively acknowledges that the cut is not affordable now
    - Irresponsible to take political credit for approving the tax cuts, even if taxpayers won't actually benefit for years, and gamble that the cuts will turn out *not* to harm public services or the state's financial stability down the road
    - Lawmakers who agree to cut state revenues without knowing whether the cuts will be affordable abdicate their responsibility to prudently manage state finances, often at significant cost to the state's future

The Trigger Temptation

- Alternative to triggers
  - If you really want to cut taxes, figure out how to pay for it now and take responsibility for its consequences (fiscally and politically)

Lessons from Kansas

- Kansas Gov. Brownback and legislators enacted a nearly $800 million personal income tax cut
  - Exempted all pass through income from PIT
  - Repealed low-income tax credits
  - Reduced tax rate structure from three brackets to two and lowered rates.
  - Later hiked sales and cigarette taxes

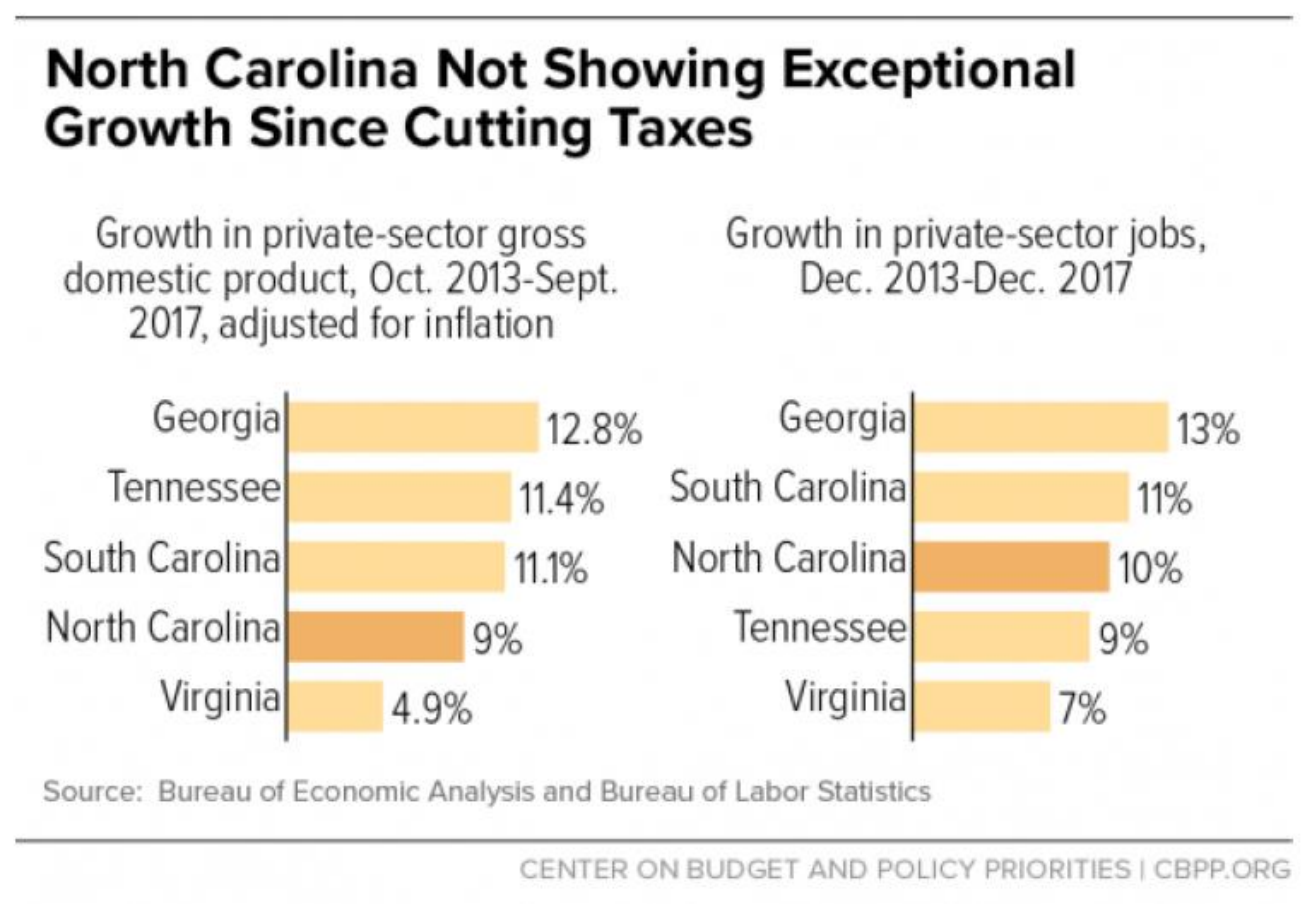
Impact of Kansas Tax Changes Between 2012 and 2015

	Lowest	Second	Middle	Fourth	Next	Next	
2015 Income Group	20%	20%	20%	20%	15%	4%	Top 1%
Tax Change as % Income	1.5%	0.2%	-0.1%	-0.4%	-0.7%	-1.2%	-1.9%
Average Tax Change	$197	$66	-$29	-$316	-$983	-$3,587	-$24,632

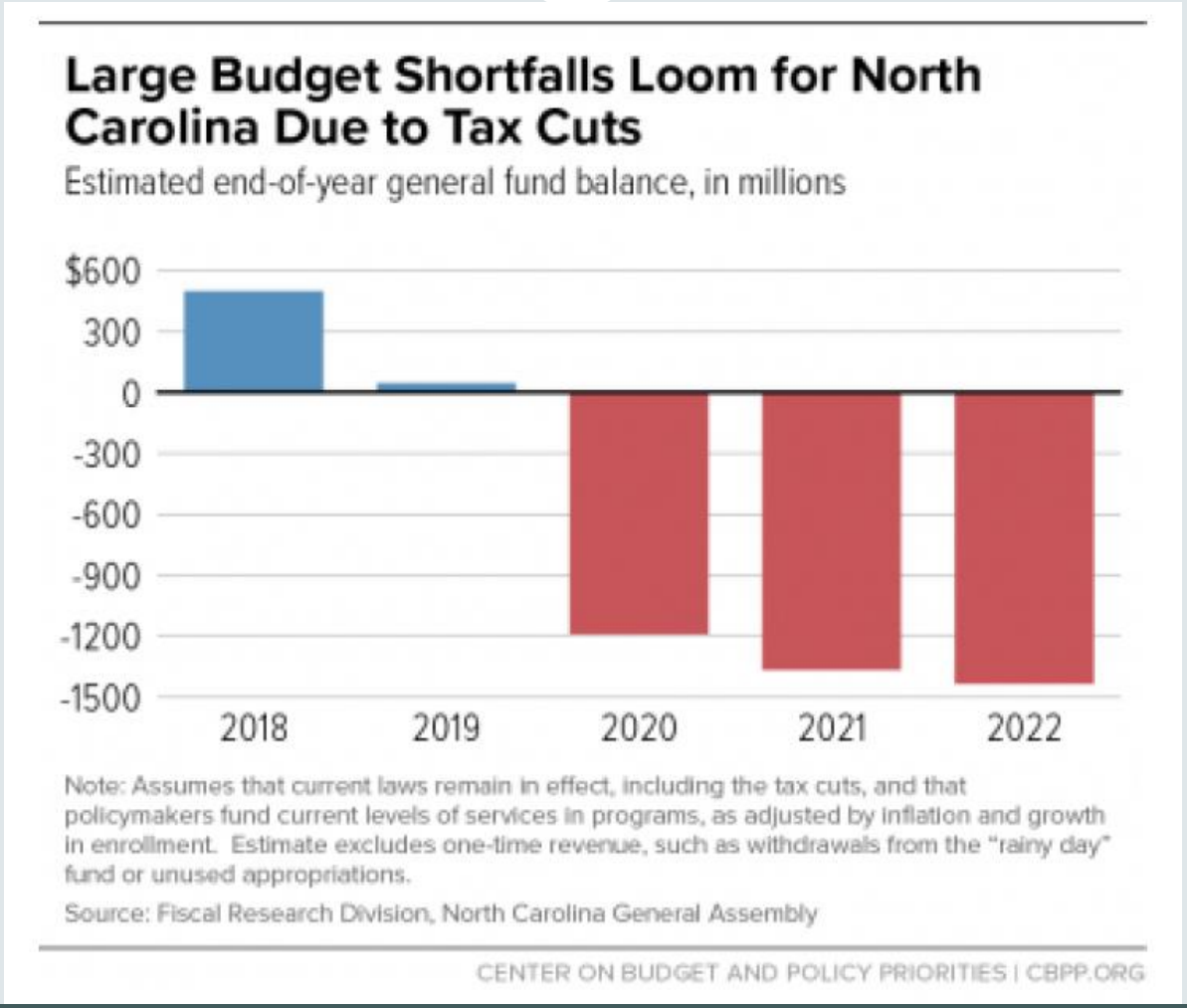
Lessons from North Carolina

- Hoped for economic gains haven't happened
  - Before 2014 cuts, NC outpaced nation and performed in line with neighboring states even with highest income tax rates in the region (and higher rates than today).
  - Since 2014 cuts, lagging GA & SC in GDP and private sector job growth and lagging nation's growth
- The budget crisis is coming

Lessons from North Carolina



Lessons from North Carolina



Summary

- Income tax important tool for revenue sustainability and thus funding public investments essential to economic growth (education, infrastructure)
- Income tax is the only major tax source that can improve tax fairness
  - Tools: EITC, maintain graduated rates, tax capital gains income same as other income
- Volatility can be managed
- Figure out how to pay for tax cuts now
- Narrowly tailored tax cuts should be conditioned on in-state investment

Questions?

Thank you for your time and attention!

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About the ITEP Microsimulation Model

- A **tax incidence model**. Built in 1994-1996, but still evolving in 2016
- Designed to:
  - Predict the distributional effect of proposed tax changes on taxpayers at different income levels
  - Predict the revenue gain (loss) from proposed tax changes
  - Estimate the impact of current state and local taxes in all 50 states
  - Measure the interaction between state and federal tax changes
- Employs the same technology used by the US Treasury, Congressional Joint Committee on Taxation, Congressional Budget Office, and some state departments of revenue (e.g. TX, MN, ME)
- Consists of four basic modules: **personal income tax, property tax, consumption tax, and business tax**

Data Sources