SUMMARY OF PROPOSAL #18
for consideration by the
ARKANSAS TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE

TOPIC: **To Study the Implementation of Tax Triggers Using the Revenue Stabilization Act**

<u>Summary of Proposal for Consideration</u>

To study potential mechanisms to create a tax trigger using the Revenue Stabilization Act (RSA) to fund potential tax triggers. This proposal would ensure that categories A, B, and C are fully funded as required by the RSA. A new fund would be created under the RSA where surplus funds would be allocated from the RSA after categories A, B and C were fully funded. If the study demonstrates that it is feasible to use the RSA to fund future tax triggers, the surplus funds allocated to the new fund would be utilized to fund future income tax cuts that would be triggered by parameters established by the General Assembly.

<u>Fiscal Analysis</u>

According to the Department of Finance and Administration, the proposal would be revenue neutral because the tax triggers would be dependent on funding that was allocated from a new fund created within the RSA. While this does not have a direct revenue impact in a traditional sense, the department provided the following information as an example of how using the RSA to evaluate triggers for the purpose of income tax reduction might function:

- **First** – The target rate reduction would be identified, for example, reducing the top marginal rate for taxpayers making over $75,000 from 6.9% to 6%.
- **Second** – The amount of revenue required for this tax cut would be identified, for example $180 million to totally enact.
- **Third** – A bill would be passed authorizing the tax cuts in an incremental manner. The bill would identify the amount spent on essential governmental services, such as $5.5 billion. The bill would designate a specified amount, such as $40 million, to be set aside to a specified fund for the purpose of the income tax cuts each year of the biennium. The bill would contain a provision that would index the $5.5 billion to inflation, ensuring that essential governmental services are not disproportionately reduced.
- **Fourth** – The RSA at the end of each session would be drafted to specify the $40 million to be a "C" category funding to be deposited in a holding account, with a condition transferring the money to the Long Term Reserve Fund, or similar fund, upon designation of full funding by the Chief Fiscal Officer of the State (CFO).
- **Fifth** – At the end of the following fiscal year, the CFO would certify whether revenue had been sufficient to fund the "C" appropriation of $40 million. If so, the CFO would be authorized to reduce the specified tax rate based on this "excess" funding, while if not, the specified rate would not be reduced. If the

full $40 million in funding is met, the conditional trigger then sends the $40 million to the Long Term Reserve or other similar fund.

- **Sixth** – The CFO would also certify how much remained to meet the intent of the original bill, reducing the specified rate to its target.

The process would repeat each biennium until the targeted rate had been met, requiring a new amendment each biennium so there is no constitutional challenge to one General Assembly binding a subsequent General Assembly. The specific targets, and incremental implementation, should avoid any constitutional challenges for delegation of authority. The process protects the essential government services by having them funded first, in "A" and "B" priorities, while clearly designating the amount and rate of the income tax reduction sought. Indexing the base amount of governmental services to inflation protects those services without endangering the income tax cuts at the same time. In the absence of sufficient funding or receding revenues, the income tax cut would not force a reduction in essential services because of the delayed trigger in the incremental rates.

Legal Analysis

Background

Arkansas currently does not use tax triggers.

Potential Legal Issues

None.

Other States

- Iowa: The tax bill that Iowa passed earlier this month includes a trigger for additional tax reductions and changes beginning January 1, 2023, if the following conditions are met: The net general fund revenues for the fiscal year ending June 30, 2022, is equal to or exceeds both $8,314,600,000 and 104% of the net general fund revenues for the fiscal year ending June 30, 2021. If the conditions are not met for the 2023 tax year, then the changes will take effect January 1 following the first fiscal year for which both of the conditions are met (changing the relevant dates to apply to the relevant years).

- Louisiana: No tax trigger.

- Mississippi: No tax trigger.

- Missouri: Personal Income Tax Reduction (MO St. § 143.011)
    - Benchmark: Net general revenue collected in the previous fiscal year exceeds the highest amount of net general revenue collected in any of past three (3) fiscal years by at least $150 million.

    - Detail: Missouri enacted a schedule of incremental individual income tax reductions designed to reduce the top marginal rate from 6% to 5.5% over five (5) or more years. If the revenue trigger is met, the top rate will be reduced by 0.1% per year, beginning on or after 2017. The first reduction will be delayed at least one (1) year because the state's budget director has certified that revenue targets were not met.

- Oklahoma: Personal Income Tax Reduction (68 OK St. § 2355.1)
    - Benchmark: Projections adequate to reduce rates on revenue-neutral basis based on at least 4% general revenue growth
    - Detail: Oklahoma passed a two-step tax cut that scheduled a reduction in the state's top income tax rate from 5.25% to 5% and then again from 5% to 4.85% if the revenue projection requirements were satisfied. Oklahoma's top marginal rate was decreased to 5% based upon the tax trigger. However, Oklahoma repealed the tax triggers in 2017 to end the two-step tax cut.

- Tennessee: No tax trigger.

- Texas: No tax trigger.