

Arkansas: Options for Tax Reform

Presentation to the Arkansas Tax Reform
and Relief Task Force
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TOPICS OF DISCUSSION

- Tax Reform: General Overview
- Tax Reform: Suggested Reforms
 - Individual Income Tax Reforms
 - Corporate Income Tax Reforms
 - Tax Exemptions
 - Taxes on Capital
- Tax Reform: State Business Tax Climate Index

TAX REFORM

GENERAL OVERVIEW

- We've talked at length about the need for Arkansas to reform its tax code.
 - Emphasis should be placed on lowering the cost of capital, to encourage economic growth.
- Arkansas is falling behind by standing still. Just this year, Georgia, Iowa, Missouri, and Kentucky have passed comprehensive tax reforms.
- It's also important to balance revenue availability with any reforms.

TAX REFORM

GENERAL OVERVIEW

- As we've discussed over the last several months, Arkansas's focus should be on several key areas:
 - Lowering the individual income tax rate
 - Lowering the corporate income tax rate
 - Reforming the corporate income tax base
 - Eliminating sales tax exemptions
 - Repealing taxes on capital

TAX REFORM

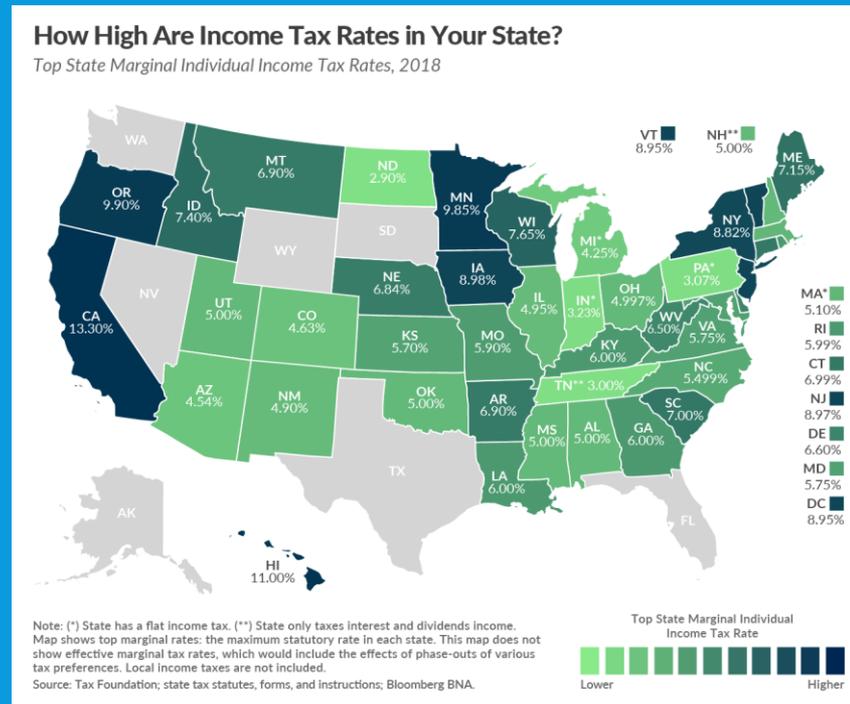
GENERAL OVERVIEW

- I've been asked to outline a \$200 million net tax cut to the task force.
- I've developed my proposal based on the needed areas of reform and the current task force proposals being considered.
- If starting from scratch, my proposals would have looked slightly different, largely due to sales tax exemption reform.

TAX REFORM

SUGGESTED REFORMS

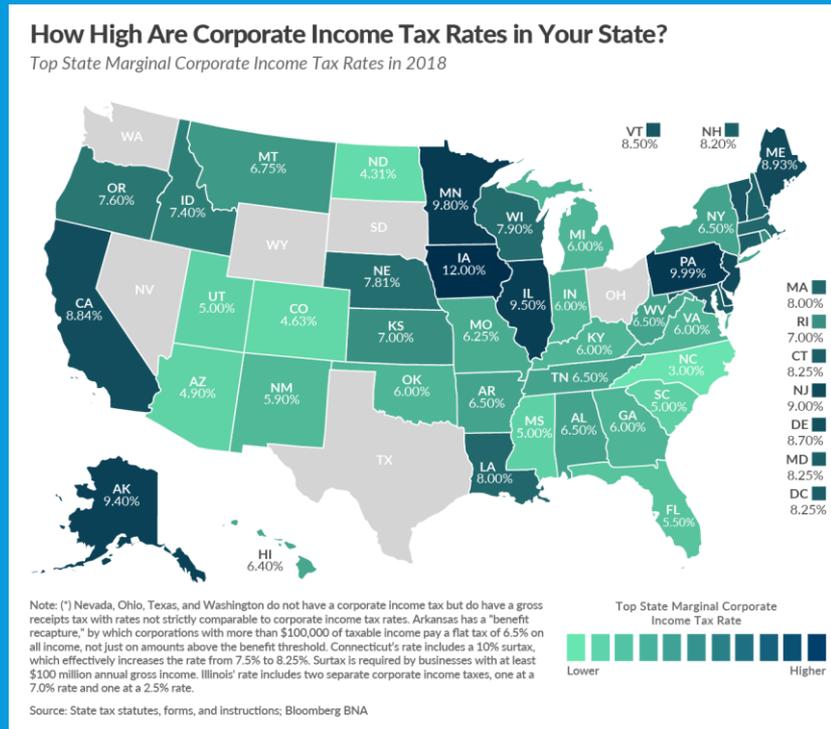
- Individual Income Tax
 - Goal should be to lower the top marginal rate to at least 6 percent.
 - It would bring the state much closer in line to neighboring states.



TAX REFORM

SUGGESTED REFORMS

- Corporate Income Tax
 - Goal should be to lower the top marginal rate to at least 6 percent.
 - It would bring the state much closer in line to neighboring states.



TAX REFORM

SUGGESTED REFORMS

- Corporate Income Tax
 - Reforms to the corporate income tax base are needed as well.
 - The task force should repeal Arkansas's throwback rule, conform NOLs to the federal government, and move to single sales factor.

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SUGGESTED REFORMS

- Tax Exemptions
 - The task force should repeal the following tax exemptions that are still open to consideration
 - Coin-operated car washes (sales tax)
 - Magazine exemption (sales tax)
 - Political contributions (income tax)

TAX REFORM

SUGGESTED REFORMS

- Taxes on Capital
 - Additionally, the task force should consider repealing two taxes on capital.
 - Repeal the franchise tax.
 - Repeal the inventory tax.

TAX REFORM

SUGGESTED REFORMS

- Total Revenue Impact
 - This package of reform would cost approximately \$375 million, based on DF&A analysis of the individual proposals.
 - However, there will be interaction impacts, such as the move to single sales factor, repealing throwback rule, and lowering the corporate income tax.
 - The complete package should be estimated by DF&A.
 - Once, the full impact is understood, a few actions can be taken to minimize the revenue impact, namely using tax triggers and prioritizing reforms.

TAX REFORM

SUGGESTED REFORMS

- Tax Phaseins
 - Revenues traditionally grow year-over-year as the economy grows.
 - An important strategy to mitigate revenue impacts is to phase in the reforms over a series of years.
 - Arkansas has done this in many cases, such as the 2017 individual income tax cuts, which don't go into effect until 2019.

TAX REFORM

SUGGESTED REFORMS

- Tax Triggers
 - Second, tax triggers are a helpful way to manage revenue availability.
 - Tax triggers have been used extensively in more than a dozen states in recent years.
 - These examples have demonstrated what to do and what not to do.

TAX REFORM

SUGGESTED REFORMS

- Tax Triggers
 - There are several key components to include when designing a properly constructed tax trigger.
 - Any tax cuts should be triggered based on revenue, not spending, growth.
 - Need to consider what measure of revenue. Tax collections, general revenues, etc.
 - Also, generally want to build in some natural growth, such as population growth plus inflation.
 - Triggers can also be combined with tax phaseouts.
 - They can help accelerate reforms.

TAX REFORM

SUGGESTED REFORMS

- Then, the key is determining what to implement first and what to do via phasein and trigger.
- Given the revenue target, I would prioritize the tax cuts as such.
 - Individual income: Cut top rate to 6.5 percent
 - Corporate income: Single sales factor, repeal throwback, and expand NOLs.
 - Repeal aforementioned exemptions
 - Repeal the franchise and inventory taxes.
 - And then use tax triggers to lower the individual and corporate income tax rates to 5.9 percent.

TAX REFORM

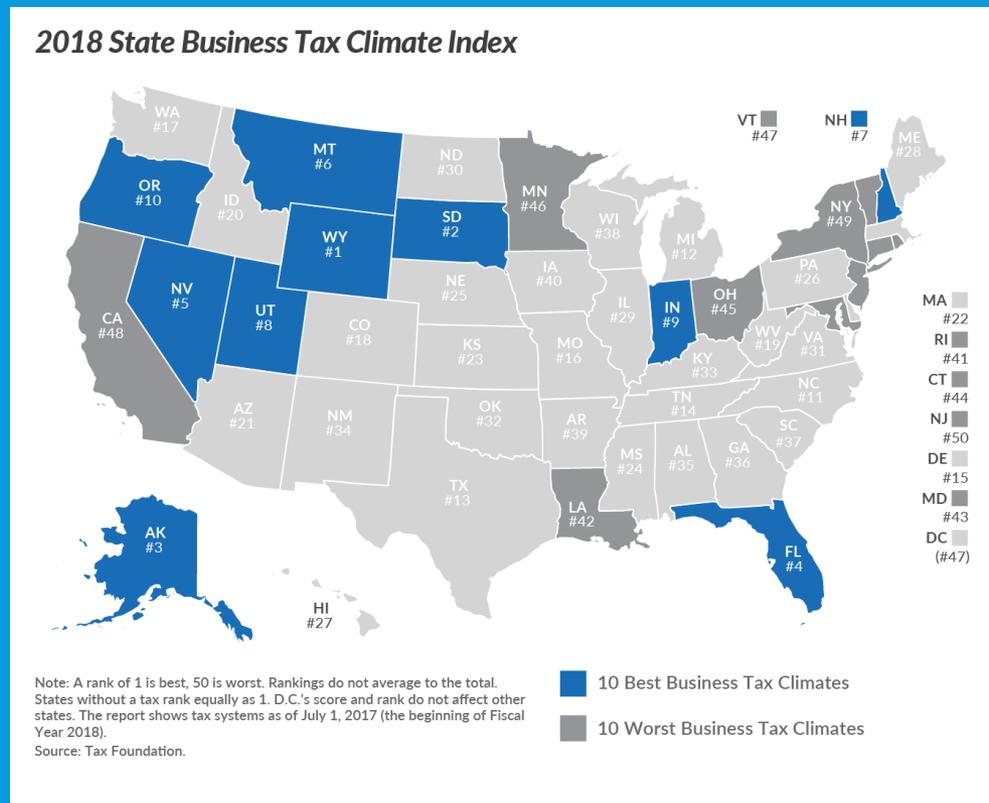
STATE BUSINESS TAX CLIMATE INDEX

- State Business Tax Climate Index
 - We've run projected results based on the tax plan that I've outline above through the State Business Tax Climate Index.
 - Corporate and individual income tax rate cuts to 5.9 percent
 - Repeal throwback rule, expand NOLs, move to single sales factor
 - Overall score moves from 39th to 36th
 - Corporate from 39th to 26th
 - Individual from 30th to 29th
 - If we add franchise and inventory tax repeal, even more dramatic movements.
 - Overall moves from 39th to 31st
 - Property moves from 22nd to 7th

TAX REFORM

STATE BUSINESS TAX CLIMATE INDEX

- Moving Arkansas to 31st would dramatically improve the state's tax structure, particularly its corporate and property tax structure.



CONCLUSION

- Questions?
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