

Arkansas Tax Cut Options

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About ITEP



The Institute on Taxation and Economic Policy (ITEP)

Non-profit

Non-partisan research organization

Federal, state, and local tax policy issues

Mission:

Ensure elected officials, media, and general public have access to accurate, timely, and straightforward information that allows them to understand the effects of current and proposed tax policies with an emphasis on tax-incidence analysis.

Overview



- Lens
- Cautions
- Intended Beneficiaries?
- \$200 Million Tax Cut Options
- ITEP Recommendations

Lens: What Values to Maximize?



Values of Taxation



55

- Adequacy, Sustainability
- Neutrality, Equity
- Simplicity, Transparency
- Competitiveness

Lens for Recommendations



- Adequacy
- Sustainability
- Equity

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't 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

Cautions



Is Now the Time to Cut Taxes?



- State needs adequate taxes to investment in its people and infrastructure
- Looming federal budget cuts
 - Medicare, Medicaid, SNAP, non-defense discretionary funding (transportation and infrastructure, education and training, medical research, child and elder care, environmental protection, other)
 - Loss of federal grants-in-aid to state govts and increase the burden on states to provide services
- Prepared for the next down turn?

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)

The Trigger Temptation



- Dangers of “triggered” tax cuts
 - Design problems
 - ✦ Inadequate information about projected revenues and spending
 - ✦ Inadequate contingencies for economic downturns or other times when revenues are particularly needed
 - ✦ Failure to account for natural growth in the cost of services, demographic changes, inflation, fiscal emergencies
 - 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
 - Enable policymakers to claim credit for cutting taxes while avoiding accountability for the consequences

Beneficiaries



Critical Question



Who?

Setting the Stage: Recent Tax Cuts



- Change in Arkansans' Federal Income Tax Liability Due to Tax Cuts and Jobs Act

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income	Less than	\$22,000 –	\$35,000 –	\$55,000 –	\$89,000 –	\$184,000 –	\$461,000 –
Range	\$22,000	\$35,000	\$55,000	\$89,000	\$184,000	\$461,000	Or More
Average Income in Group	\$13,000	\$29,000	\$43,000	\$69,000	\$119,000	\$270,000	\$1,292,000

Change in Arkansas Residents' Federal Taxes (Personal Income, Corporate, and Estate Tax)							
Tax Change as % of Income	-0.7%	-1.5%	-1.7%	-1.5%	-1.5%	-2.6%	-2.9%
Average Tax Change	-96	-428	-722	-1,014	-1,825	-6,896	-36,820
Share of State's Federal Tax Cut	1%	6%	10%	15%	20%	21%	27%

Federal Tax Change for Arkansas Residents (\$1000)
-1,854,000

Share to Bottom 80%	33%
Share to Top 20%	67%

Source: Institute on Taxation and Economic Policy, 1.2018

Setting the Stage: Recent Arkansas Tax Cuts



Recent Tax Policy Changes

Middle Class Tax Cut (Effective 2016)

State Tax Change (\$1000)
-107,000

Share to bottom 80%	48%
Share to Top 20%	52%

Low Income Tax Cut (Effective 2019)

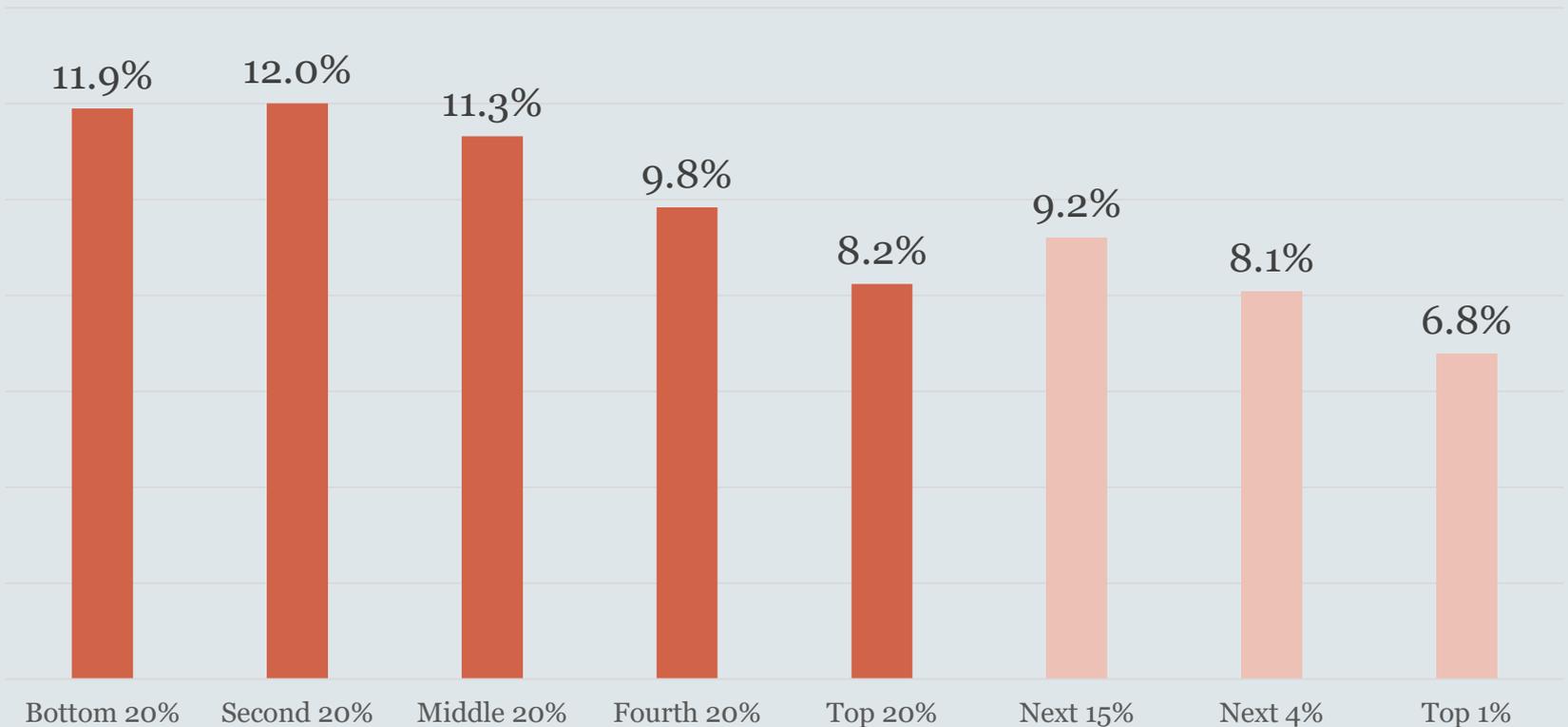
State Tax Change (\$1000)
-42,000

Share to bottom 80%	73%
Share to Top 20%	27%

Baseline: Regressive Tax System



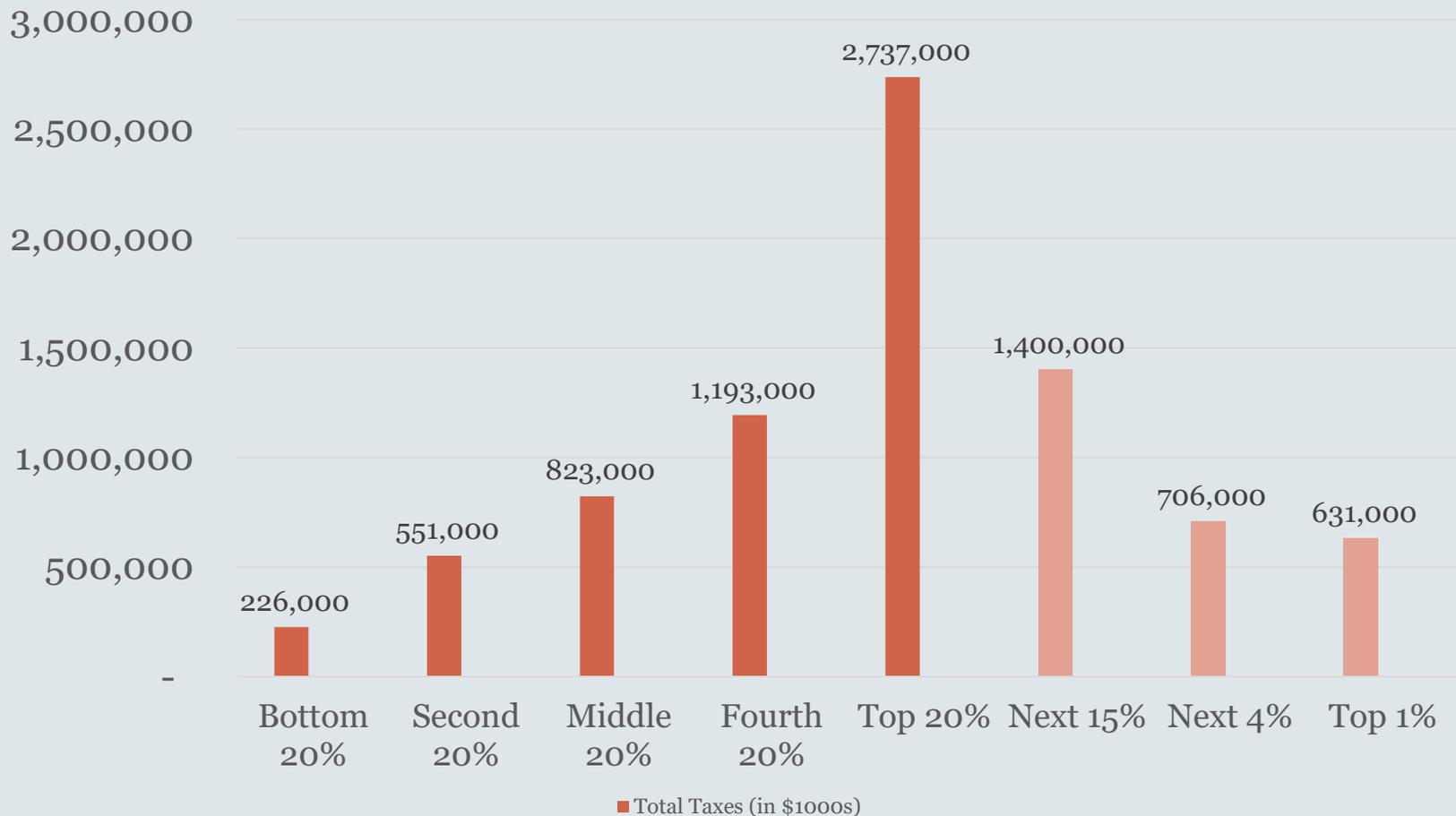
Arkansas Combined State & Local Taxes as a Share of Income
By Income Quintile



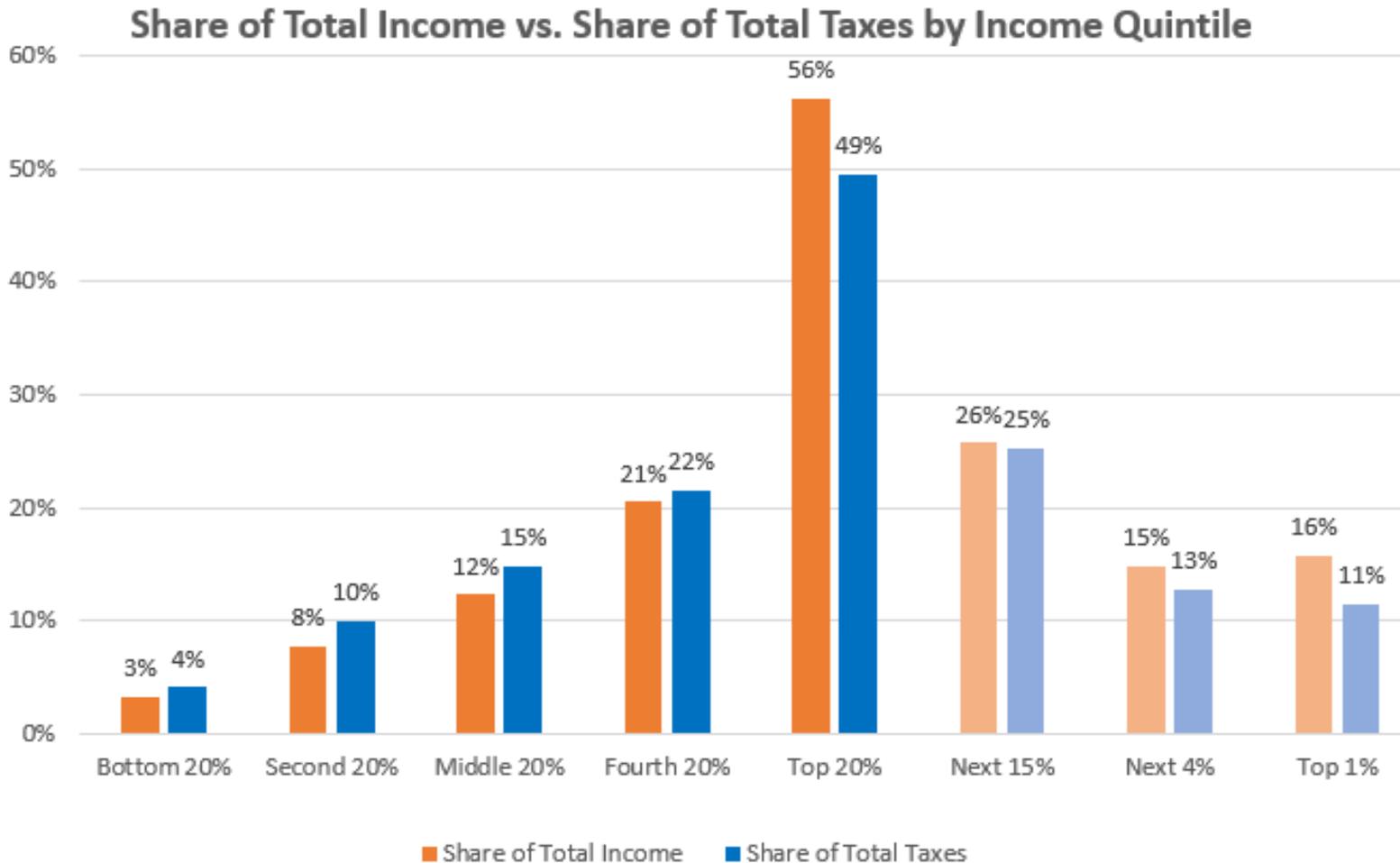
Conceptualizing Tax Fairness: Total Taxes Paid in \$s by Income Group



Total State & Local Taxes Paid By Income Quintile (\$1000s)



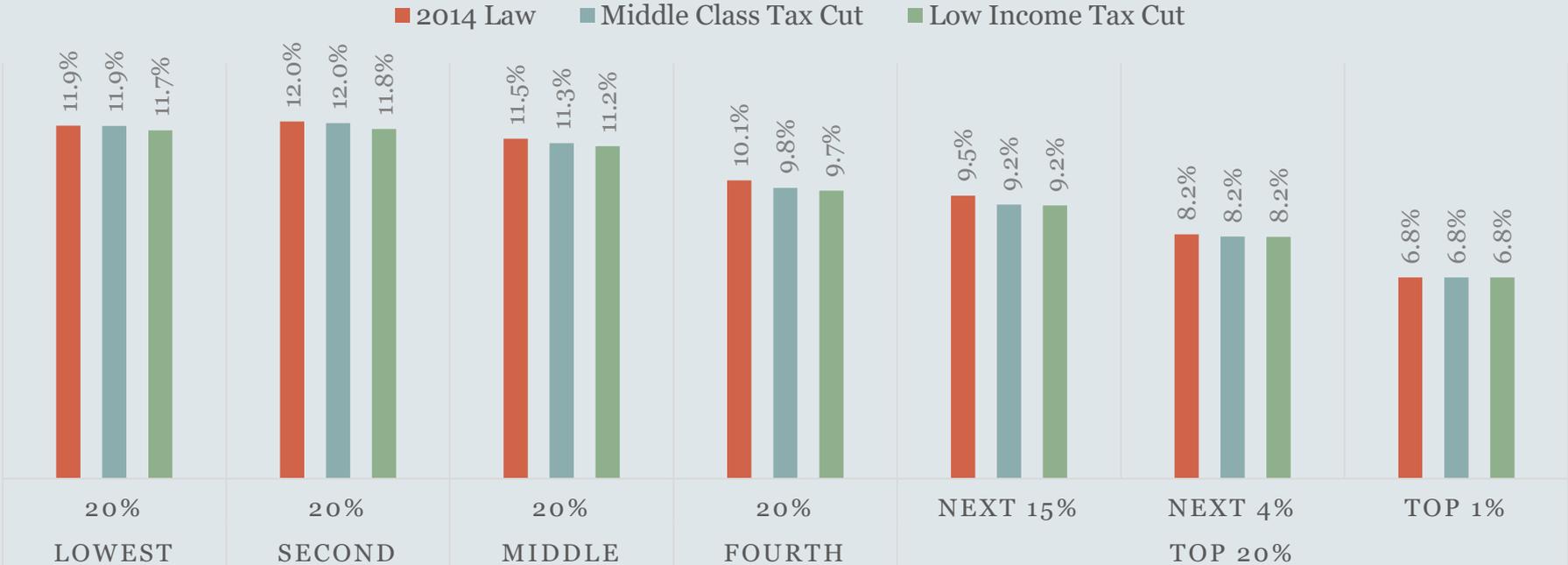
Conceptualizing Tax Fairness: % Total Income vs. % Total Taxes Paid by Income Group



Setting the Stage: Recent Arkansas Tax Cuts



ARKANSAS: CHANGES IN COMBINED STATE & LOCAL TAXES AS A SHARE OF PERSONAL INCOME SINCE 2014



\$200 Million Tax Cut Options



Scenario 1: Personal Income Tax Top Rate Cut



2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,000	\$21,000 – \$35,000	\$35,000 – \$55,000	\$55,000 – \$91,000	\$91,000 – \$190,000	\$190,000 – \$416,000	\$416,000 – Or More
Average Income in Group	\$12,000	\$29,000	\$44,000	\$69,000	\$121,000	\$259,000	\$1,204,000

Scenario 1: Cut Top Rate from 6.9% to 6% for Taxable Incomes >\$75,000							
Tax Change as % of Income	—	—	—	—	-0.1%	-0.3%	-0.6%
Average Tax Change	—	—	—	—	-109	-815	-7,257

% with Income Tax Cut	—	—	—	—	21%	76%	97%
Avg. Tax Cut for Those w/Cut	—	—	—	—	-526	-1,067	-7,506
Share of Tax Cut	—	—	—	—	13%	27%	59%

State Tax Change (\$1000)
-168,000

% Taxpayers w/Cut
7%

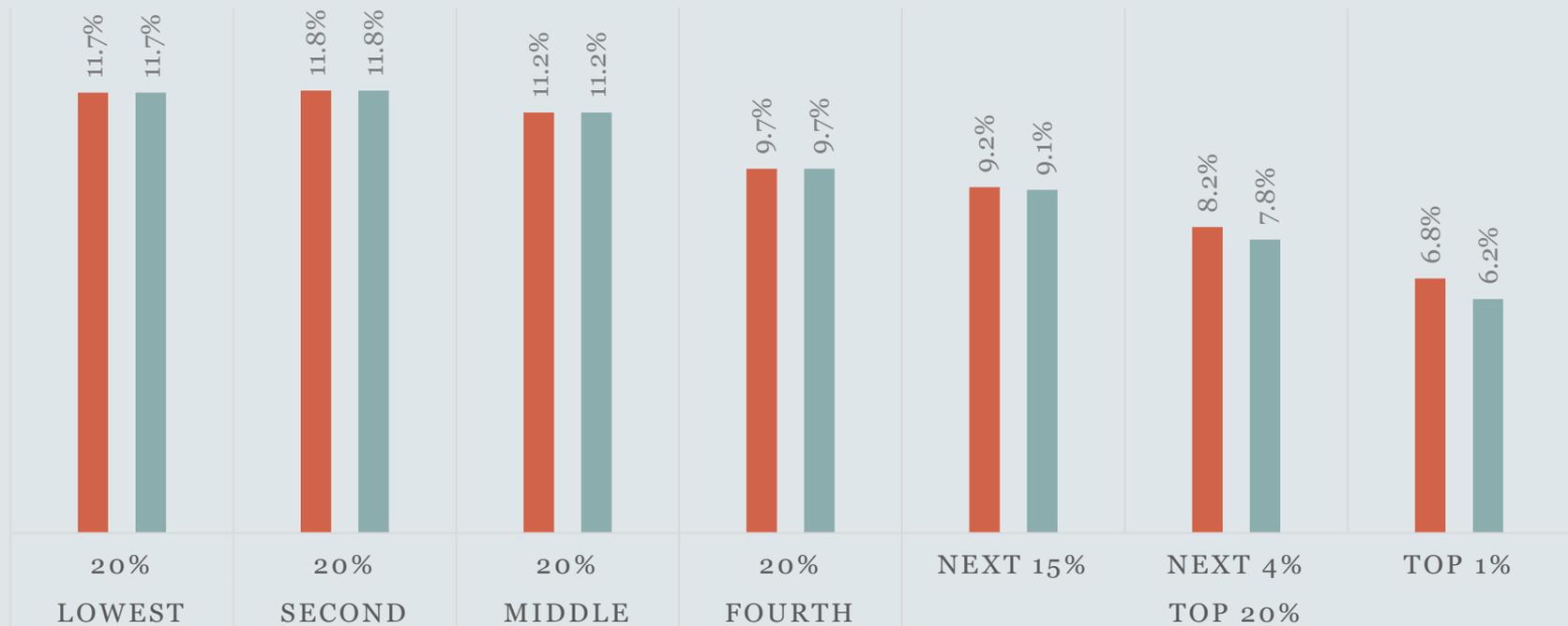
Share to bottom 80%	—
Share to Top 20%	99%

Scenario 1: Personal Income Tax Top Rate Cut



ARKANSAS: EFFECTIVE TAX RATES UNDER CURRENT LAW VS. TOP RATE OF 6.0%

■ Current Law ■ Scenario 1: Top Rate Cut



Scenario 2: 25% Refundable EITC



2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,000	\$21,000 – \$35,000	\$35,000 – \$55,000	\$55,000 – \$91,000	\$91,000 – \$190,000	\$190,000 – \$416,000	\$416,000 – Or More
Average Income in Group	\$12,000	\$29,000	\$44,000	\$69,000	\$121,000	\$259,000	\$1,204,000

Scenario 2: Enact a Refundable EITC at 25% of Federal							
Tax Change as % of Income	-1.6%	-1.1%	-0.4%	—	—	—	—
Average Tax Change	-199	-319	-170	—	—	—	—

% with Income Tax Cut	41%	37%	25%	—	—	—	—
Avg. Tax Cut for Those w/Cut	-482	-873	-677	—	—	—	—
Share of Tax Cut	27%	44%	24%	—	—	—	—

State Tax Change (\$1000)	-200,000
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% Taxpayers w/Cut	21%
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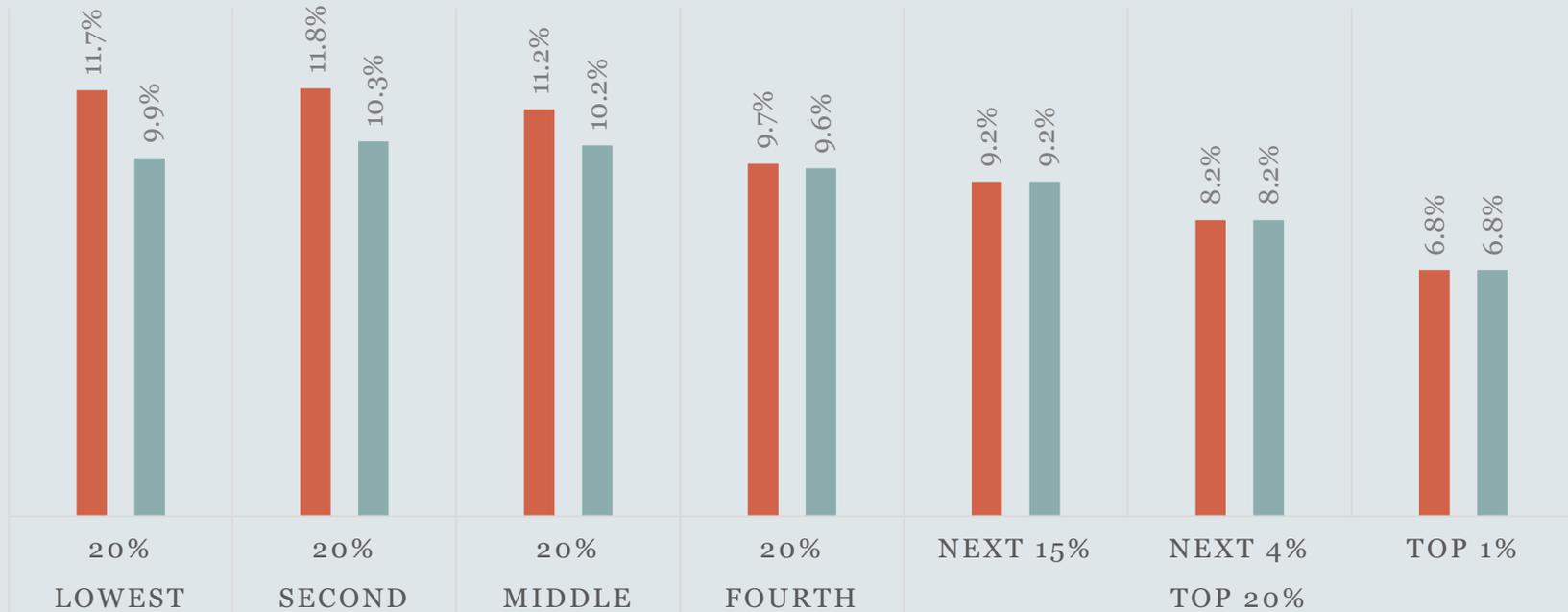
Share to bottom 80%	94%
Share to Top 20%	—

Scenario 2: 25% Refundable EITC



ARKANSAS: EFFECTIVE TAX RATES UNDER CURRENT LAW VS. 25% EITC

■ Current Law ■ Scenario 2: 25% EITC



Scenario 3: 15% Refundable EITC & Double the Standard Deduction



2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,000	\$21,000 – \$35,000	\$35,000 – \$55,000	\$55,000 – \$91,000	\$91,000 – \$190,000	\$190,000 – \$416,000	\$416,000 – Or More
Average Income in Group	\$12,000	\$29,000	\$44,000	\$69,000	\$121,000	\$259,000	\$1,204,000

Scenario 3: Double the Standard Deduction & Enact a Refundable EITC at 15% of Federal							
Tax Change as % of Income	-1.1%	-0.9%	-0.4%	-0.1%	-0.1%	-0.02%	-0.001%
Average Tax Change	-128	-248	-180	-91	-86	-53	-8

State Tax Change (\$1000)
-205,000

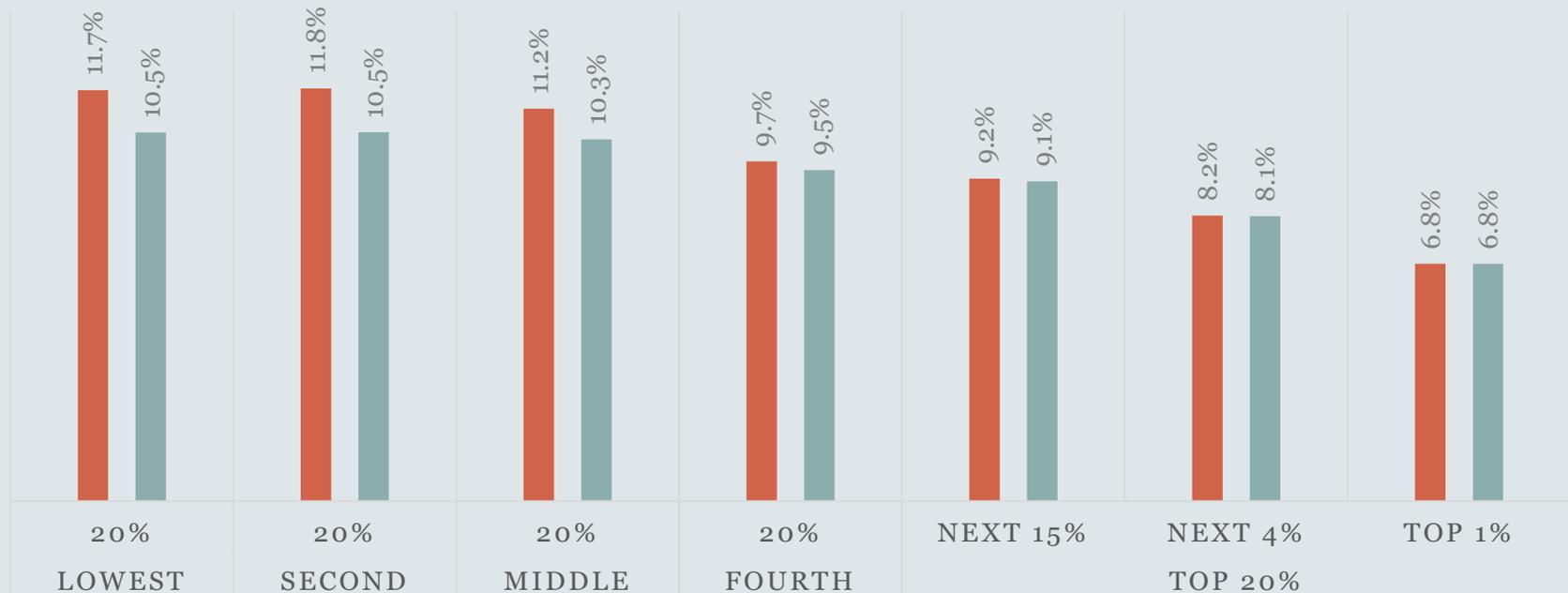
% Taxpayers w/Cut
42%

Scenario 3: 15% Refundable EITC & Double Standard Deduction



ARKANSAS: EFFECTIVE TAX RATES UNDER CURRENT LAW VS. 15% EITC AND DOUBLING STANDARD DEDUCTION

■ Current Law ■ Scenario 3: 15% EITC & Double SD



Scenario 4: 15% Refundable EITC, Cut Top Rate, & Eliminate Capital Gains Exclusion



2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,000	\$21,000 – \$35,000	\$35,000 – \$55,000	\$55,000 – \$91,000	\$91,000 – \$190,000	\$190,000 – \$416,000	\$416,000 – Or More
Average Income in Group	\$12,000	\$29,000	\$44,000	\$69,000	\$121,000	\$259,000	\$1,204,000

Scenario 4: Enact a Refundable EITC at 15 % of Federal, Cut Top Rate from 6.9% to 6% for Taxable Incomes >\$75,000 & Eliminate Capital Gains Exclusion

Tax Change as % of Income	-1.0%	-0.7%	-0.2%	—	-0.1%	-0.2%	-0.2%
Average Tax Change	-119	-189	-99	—	-74	-516	-2,754

State Tax Change (\$1000)
-199,000

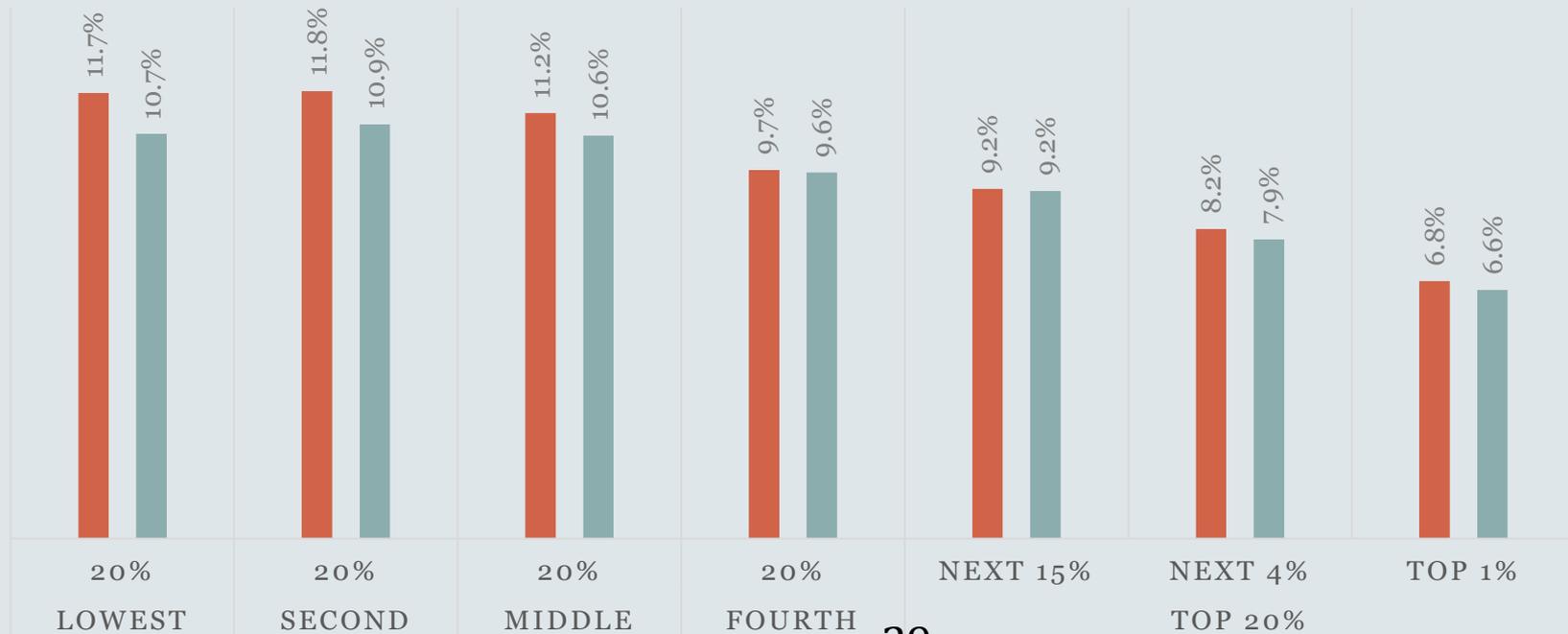
% Taxpayers w/Cut
28%

Scenario 4: 15% Refundable EITC, Cut Top Rate & Eliminate Capital Gains Exclusion



ARKANSAS: EFFECTIVE TAX RATES UNDER CURRENT LAW VS. 15% EITC, 6.0% TOP RATE, NO CAP GAINS EXCLUSION

■ Current Law
 ■ Scenario 4: 15% EITC, Top Rate Cut, & Eliminate Capital Gains Exclusion



Scenario 5: Cut \$200 Million in Corporate Income Tax Liability



2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,000	\$21,000 – \$35,000	\$35,000 – \$55,000	\$55,000 – \$91,000	\$91,000 – \$190,000	\$190,000 – \$416,000	\$416,000 – Or More
Average Income in Group	\$12,000	\$29,000	\$44,000	\$69,000	\$121,000	\$259,000	\$1,204,000

Scenario 5: \$200 Million Cut to Corporate Income Tax							
Tax Change as % of Income	-0.0%	-0.0%	-0.0%	-0.0%	-0.0%	-0.1%	-0.1%
Average Tax Change	-1	-2	-7	-10	-29	-154	-1,263

State Tax Change (\$1000)	-200,000
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% Tax Cut In-State	19%
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Tax Cut to In-State Residents (\$1000)	-37,000
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Compare Average Tax Changes by Income Group



2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,000	\$21,000 – \$35,000	\$35,000 – \$55,000	\$55,000 – \$91,000	\$91,000 – \$190,000	\$190,000 – \$416,000	\$416,000 – Or More
Average Income in Group	\$12,000	\$29,000	\$44,000	\$69,000	\$121,000	\$259,000	\$1,204,000

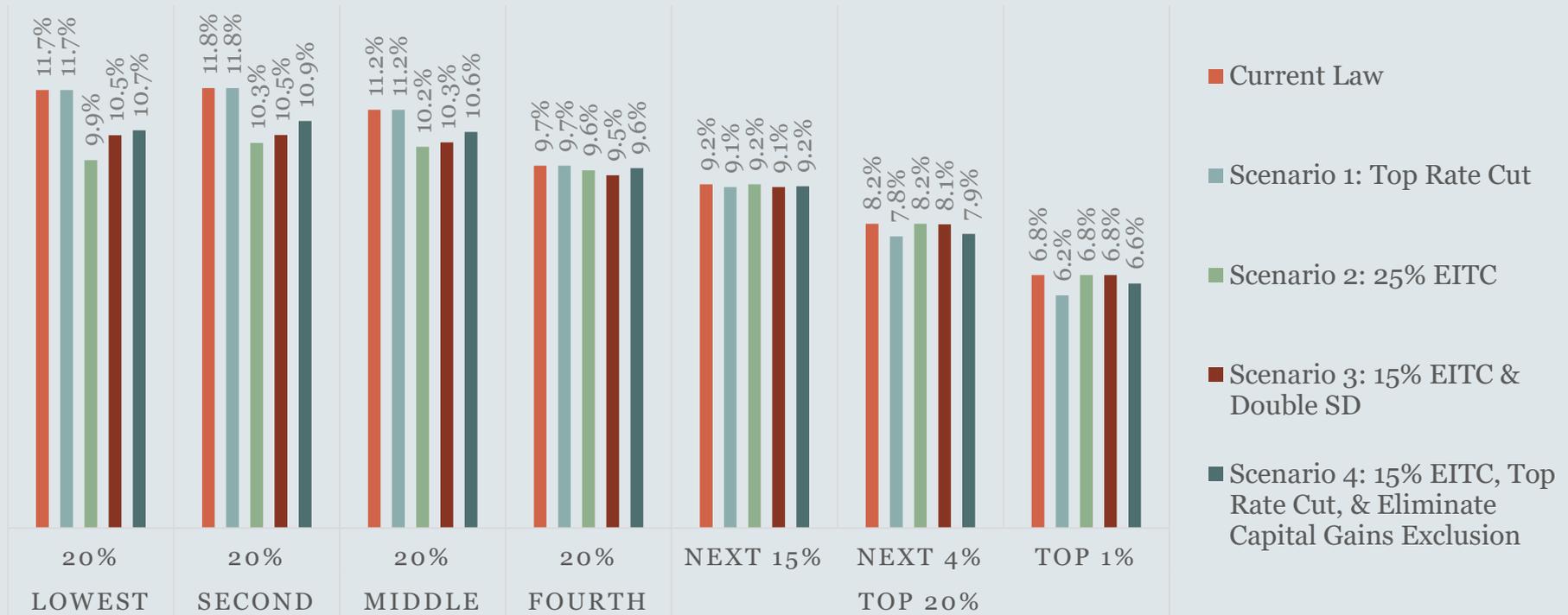
\$200 Million Tax Cut Policy Options

Top Rate Cut	Average Tax Change	—	—	—	—	-109	-815	-7,257
25% Refundable EITC	Average Tax Change	-199	-319	-170	—	—	—	—
Double SD & 15% Refundable EITC	Average Tax Change	-128	-248	-180	-91	-86	-53	-8
Top Rate Cut, Eliminate CG Exclusion, 15% EITC	Average Tax Change	-119	-189	-99	—	-74	-516	-2,754
Corporate Income Tax Cut	Average Tax Change	-1	-2	-7	-10	-29	-154	-1,263

Compare Changes in Effective Tax Rates



ARKANSAS: COMBINED STATE & LOCAL INCOME AS A SHARE OF PERSONAL INCOME UNDER VARIOUS \$200 MILLION TAX CUTS



ITEP Recommendations



Recommendation #1: Avoid Further Eroding Arkansas' Corporate Income Tax



- Trend: states are experiencing a rapid decline in state corporate income tax revenue despite rebounding and even booming bottom lines for many corporations
 - Since our last analysis of these data, in 2014, the state effective corporate tax rate paid by profitable Fortune 500 corporations has declined, dropping from 3.1 percent to 2.9 percent of their U.S. profits.

Recommendation #1: Avoid Further Eroding Arkansas' Corporate Income Tax



- What is driving this trend?
 - A race to the bottom by states providing significant “incentives” for specific companies to relocate or stay put
 - Manipulation of loopholes in state tax systems by corporate accountants
 - Significant cuts in state corporate tax rates
 - Erosion of state corporate tax bases, largely due to ill-advised state-level linkages to the federal system

Recommendation #1: Why It Matters



- Just as working families and individuals benefit from the services that state and local governments provide, so too do corporations
 - State's education system to provide a trained workforce
 - Use a state's transportation system to move their products from one place to another
 - Depend on the state's court system and police to protect their property and business transactions

Recommendation #1: Why It Matters



- While corporations—like individuals—may pay taxes on the purchases they make or on the property they own, they should also pay taxes on the profits they realize, much in the way that people earning a living in the state pay taxes on their income

Recommendation #1: Why It Matters



- Corporate income tax is largely exported to other states.
 - Not targeted relief for Arkansas residents
 - Because most multi-state corporations have shareholders around the country and around the world, the bulk of a state's corporate income tax will ultimately fall on residents of other states and countries
- Essential backstop to the personal income tax.
 - Without the corporate tax, much of the income of wealthier Americans would go entirely untaxed, as individuals could easily shelter their personal income by putting it in a corporate form.

Recommendation #2: Target Cuts to Taxpayers Whose Effective Tax Rates Are Highest Relative To Income



- Target the Bottom
 - Scenario 2: Enact 25% Refundable Earned Income Tax Credit
- Target the Middle and Bottom
 - Scenario 3: Enact 15% Refundable Earned Income Tax Credit and Double the Standard Deduction

Recommendation #2: Target Cuts to Taxpayers Whose Effective Tax Rates Are Highest Relative To Income



2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,000	\$21,000 – \$35,000	\$35,000 – \$55,000	\$55,000 – \$91,000	\$91,000 – \$190,000	\$190,000 – \$416,000	\$416,000 – Or More
Average Income in Group	\$12,000	\$29,000	\$44,000	\$69,000	\$121,000	\$259,000	\$1,204,000

Scenario 2: Enact a Refundable EITC at 25% of Federal

Tax Change as % of Income	-1.6%	-1.1%	-0.4%	—	—	—	—
Average Tax Change	-199	-319	-170	—	—	—	—

% with Income Tax Cut	41%	37%	25%	—	—	—	—
Avg. Tax Cut for Those w/Cut	-482	-873	-677	—	—	—	—
Share of Tax Cut	27%	44%	24%	—	—	—	—

State Tax Change (\$1000)	-200,000
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% Taxpayers w/Cut	21%	Share to bottom 80%	94%
		Share to Top 20%	—

Scenario 3: Double the Standard Deduction & Enact a Refundable EITC at 15% of Federal

Tax Change as % of Income	-1.1%	-0.9%	-0.4%	-0.1%	-0.1%	-0.02%	-0.001%
Average Tax Change	-128	-248	-180	-91	-86	-53	-8

State Tax Change (\$1000)	-205,000
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% Taxpayers w/Cut	42%
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Recommendation #3: Avoid Targeted Tax Cuts that Only Benefit Taxpayers with the Lowest Effective Tax Rates



- What's wrong with a top personal income tax rate cut and corporate income tax cut

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,000	\$21,000 – \$35,000	\$35,000 – \$55,000	\$55,000 – \$91,000	\$91,000 – \$190,000	\$190,000 – \$416,000	\$416,000 – Or More
Average Income in Group	\$12,000	\$29,000	\$44,000	\$69,000	\$121,000	\$259,000	\$1,204,000

Scenario 1: Cut Top Rate from 6.9% to 6% for Taxable Incomes >\$75,000

Tax Change as % of Income	—	—	—	—	-0.1%	-0.3%	-0.6%
Average Tax Change	—	—	—	—	-109	-815	-7,257

% with Income Tax Cut	—	—	—	—	21%	76%	97%
Avg. Tax Cut for Those w/Cut	—	—	—	—	-526	-1,067	-7,506
Share of Tax Cut	—	—	—	—	13%	27%	59%

State Tax Change (\$1000)	-168,000
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% Taxpayers w/Cut	7%	Share to bottom 80%	—
		Share to Top 20%	99%

Scenario 5: \$200 Million Cut to Corporate Income Tax

Tax Change as % of Income	-0.0%	-0.0%	-0.0%	-0.0%	-0.0%	-0.1%	-0.1%
Average Tax Change	-1	-2	-7	-10	-29	-154	-1,263

State Tax Change (\$1000)	-200,000	% Tax Cut In-State	19%
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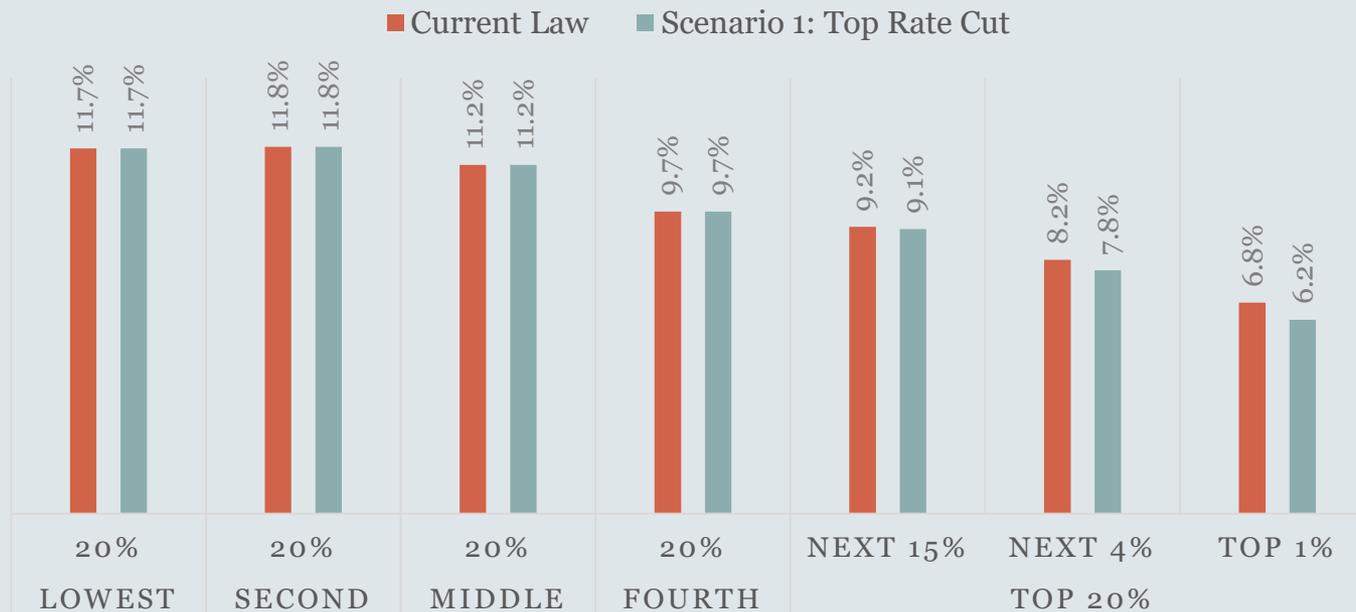
Tax Cut to In-State Residents (\$1000)	-37,000
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Recommendation #3: Avoid Targeted Tax Cuts that Only Benefit Taxpayers with the Lowest Effective Tax Rates



- What's wrong with a top personal income tax rate cut and corporate income tax cut

ARKANSAS: EFFECTIVE TAX RATES UNDER CURRENT LAW VS. TOP RATE OF 6.0%



Recommendation #3: Avoid Targeted Tax Cuts that Only Benefit Taxpayers with the Lowest Effective Tax Rates



- If insistent on cutting taxes for top 20%, moderate the top rate cut by eliminating the exclusion for capital gains income & pair with a targeted tax cut for the bottom

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$21,000	\$21,000 – \$35,000	\$35,000 – \$55,000	\$55,000 – \$91,000	\$91,000 – \$190,000	\$190,000 – \$416,000	\$416,000 – Or More
Average Income in Group	\$12,000	\$29,000	\$44,000	\$69,000	\$121,000	\$259,000	\$1,204,000

Scenario 1: Cut Top Rate from 6.9% to 6% for Taxable Incomes >\$75,000							
Tax Change as % of Income	—	—	—	—	-0.1%	-0.3%	-0.6%
Average Tax Change	—	—	—	—	-109	-815	-7,257

% with Income Tax Cut	—	—	—	—	21%	76%	97%
Avg. Tax Cut for Those w/Cut	—	—	—	—	-526	-1,067	-7,506
Share of Tax Cut	—	—	—	—	13%	27%	59%

State Tax Change (\$1000)	-168,000
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% Taxpayers w/Cut	7%	Share to bottom 80%	—
		Share to Top 20%	99%

Scenario 4: Enact a Refundable EITC at 15 % of Federal, Cut Top Rate from 6.9% to 6% for Taxable Incomes >\$75,000 & Eliminate Capital Gains Exclusion							
Tax Change as % of Income	-1.0%	-0.7%	-0.2%	—	-0.1%	-0.2%	-0.2%
Average Tax Change	-119	-189	-99	—	-74	-516	-2,754

State Tax Change (\$1000)	-199,000	% Taxpayers w/Cut	28%
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Summary



Summary



- Is it prudent to cut taxes at this time?
- If cutting...
 - Find the means to pay for tax cuts now rather than at some future date where the means may not be available
 - Avoid further erosion of corporate income tax
 - Target tax cuts to those with higher combined state & local taxes relative to income (refundable EITC, increase standard deduction)
 - If insistent on cutting taxes for top-income earners, moderate with elimination of costly loopholes (capital gains) and pair with refundable tax credits for low-income taxpayers

Questions?



Thank you for your time and attention!

Contact Info



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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

