

MINUTES
TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE
JUNE 21, 2018

The Tax Reform and Relief Legislative Task Force met Thursday, June 21, 2018, at 9:00 a.m., in Committee Room A-MAC, Little Rock, Arkansas.

Task Force Members Present: Senators Jim Hendren, Chair; Jonathan Dismang, Bart Hester, Missy Irvin, and David Wallace. Representatives Lane Jean, Chair; Jim Dotson, Kenneth B. Ferguson, Joe Jett, Bob Johnson, and Mathew Pitsch.

Other Legislators Present: Senators Trent Garner, Jason Rapert, and Bill Sample. Representatives Fred Allen, Scott Baltz, Charlie Collins, Trevor Drown, Jon Eubanks, Mickey Gates, Jimmy Gazaway, Justin Gonzales, Michael John Gray, Kim Hammer, Ken Henderson, Steve Hollowell, Donald Ragland, Marcus Richmond, Laurie Rushing, Johnny Rye, Matthew Shepherd, and James Sorvillo.

Senator Hendren called the meeting to order.

Excise Tax Presentation [Exhibit B]

Ms. Nicole Kaeding, Special Projects Director, Tax Foundation, Washington D.C., was recognized to present an overview of the state's excise taxes and rates. She said Arkansas' cigarette tax is the second highest compared to neighboring states. Ms. Kaeding is concerned raising the cigarette tax may lead individuals to purchase cigarettes from bordering states that have lower tax rates. Ms. Kaeding advised the task force in keeping taxes moderate if the state adopted the Arkansas Medicinal Marijuana Amendment, as not to exacerbate the black market. Ms. Kaeding recommended the task force consider raising the state's gas tax rather than imposing an excise tax to fund transportation and increase revenue.

Excise Tax Presentation [Exhibit C]

Ms. Lisa Christensen Gee, Senior Policy Analyst, Institute on Taxation and Economic Policy, Washington, D.C., was recognized to present information regarding Arkansas excise taxes. Ms. Gee cited excise taxes as an unsustainable revenue source that tends to be more regressive than general sales taxes, especially for low income families. She suggested that if the task force were to impose an excise tax on cigarettes and alcohol, there should be a switch from a flat per-value tax to a percentage-based tax. She said 57% of the U.S. population lives in states where the gas tax rate varies. Ms. Gee suggested the task force raise the gas tax rate and choose variable rate formulas that will increase sustainable revenues and help alleviate challenges posed by increased fuel prices and road construction costs. She also suggested the task force consider offsetting the gas tax increases with income tax credits such as the Earned Income Tax Credit (EITC).

Proposals for Excise and Miscellaneous Taxes to be Discussed and Considered at the June 26 and 27, 2018, Meetings

Staff compiled task force members' requests for more information for consideration for possible change regarding excise and miscellaneous tax, and Senator Hendren read the proposals to task force members.

Legal and Fiscal Analysis of Sales and Income Tax Proposals and Requests [Exhibit E]

Ms. Joi Leonard, Administrator, Legal Research and Drafting Section, Bureau of Legislative Research (BLR); Department of Finance and Administration (DFA) representatives Mr. Walter Anger, Commissioner of Revenue; Mr. Joel DiPippa, Senior Counsel; Dr. John Shelnutt, Administrator of the Office of Economic Analysis and Tax Research; and Mr. Paul Gehring, Assistant Commissioner of Revenue, were recognized to answer questions regarding the list of sales tax exemption proposals and requests. Ms. Leonard gave a brief overview of each proposal for consideration.

The following sales tax proposals were approved by the task force at the April 25 and 26, 2018, meetings as recommendations to be included in the final report:

- **Legislative Review Item:** (Motion by Sen. Hendren and Rep. Jett) Proposal to clearly define local sales tax levels including a cap on those levels.
- **Sales Tax Proposal #A: Local Sales Tax:** (Motion by Sen. Hendren) Proposal to clearly define local sales tax levels including a cap on those levels.
 - DFA expects there to be no fiscal impact at the State level because these are local revenues that are sent to the city and county.

The following items were approved by the task force for further study, development, and consideration regarding sales tax exemptions:

- **Sales Tax Proposal #8: Coin – Operated Car Washes:** (Motion by Sen. Hester) Proposal to repeal the sales tax exemption for services provided by coin-operated car washes where labor is performed solely by the customer or mechanical equipment.
 - DFA projects a revenue loss of \$1.8 million of which \$1.2 million would be general revenue.
- **Sales Tax Proposal #9: 4-Wheelers/ATVs:** (Motion by Sen. Hester) Proposal to repeal the sales tax exemption on sales of four-wheelers and all-terrain vehicles (ATVs) for farm use.
 - DFA projects shifting from an exemption to a rebate for agriculturally qualified four-wheelers and ATVs would not have an immediate impact on the state tax revenue.
- **Sales Tax Proposal #16: Exemption Under \$10k:** (Motion by Rep. Pitsch for Rep. Cavanaugh) Proposal to repeal any sales tax exemption less than ten thousand dollars (\$10,000).
 - DFA projects an estimated increase of \$41,000 per year in general revenue.
- **Sales Tax Proposal #17: Named Entities:** (Motion by Sen. Irvin) Proposal to refine how entities qualifying for tax exemptions are defined, in order to avoid constitutional implications of named entities.
 - Awaiting fiscal analysis from DFA
- **Sales Tax Proposal #41: Magazine/Publication Subscription Sales:** (Motion by Sen. Hendren) Proposal to repeal the sales tax exemption on the sale of any publication, other than newspapers, through regular subscription.
 - DFA projects a revenue increase of approximately \$1.5 million in general revenues based on FY2011.

The following income tax exemptions were approved by the task force at the May 23 and 24, 2018, meetings as recommendations to be included in the final report:

- **Legislative Review:** (Motion by Rep. Dotson) Proposal for regularly occurring legislative review process of all individual income tax and corporate tax deductions, exclusions, and credits.
 - Ms. Leonard said the fiscal analysis depends on the specifics of the proposal.
- **Income Tax Proposal #19: Repeal the Throwback Rule:** (Motion by Rep. Dotson) Repeal the throwback rule for multistate business income under Arkansas Code § 26-51-716.
 - DFA estimates revenue reduction of \$24.5 million for FY2018.
- **Income Tax Proposal #20: Single Sales Factor Apportionment:** (Motion by Rep. Dotson) Amend the apportionment formula for taxing multistate business income to use a single sales factor apportionment.
 - DFA estimates an increase of \$8.8 million in general revenue based on FY2016.

The following items were approved by the task force for further study, development, and consideration regarding sales tax exemptions:

- **Income Tax Proposal #1B: Net Operating Losses:** (Motion by Rep. Johnson) Proposal to incrementally increase the carry-forward period on net operating losses for all businesses to twenty (20) years.
 - DFA projects a revenue loss of \$159.5 million in FY2044 and every year thereafter.
- **Income Tax Proposal #5: Individual Income Tax Brackets:** (Motion by Sen. Hendren and Rep. Jean) Proposal to simplify the individual income tax brackets.
 - DFA provided two income tax bracket options (Handouts 1 & 2). Option A: does not raise any individual income tax rates but would have a revenue loss of \$195 million. Option B: would raise some rates but have a revenue loss of \$44 million.
 - Mr. Richard Wilson, Assistant Director, Bureau of Legislative Research, was recognized to explain the impact of both individual income tax bracket options.
- **Income Tax Proposal #10: Corporate Income Tax:** (Motion by Rep. Dotson) Proposal to simplify corporate income tax brackets and tables.
 - DFA estimates a revenue loss of \$6.5 million and a total phased-in fiscal impact loss of \$38.7 million, if the top marginal rate for corporate income is reduced to 5.9%.
- **Income Tax Proposal #12: Earned Income Tax Credit:** (Motion by Sen. Elliott) Proposal to create a refundable earned income tax credit in an amount equal to 15% of the federal EITC.
 - DFA estimates a revenue loss of \$116.5 million, with an average EITC of \$383 per filer. DFA cannot provide a fiscal impact on the proposed grant component without more information.
- **Income Tax Proposal #16: Standard Deduction:** (Motion by Rep. Dotson) Proposal to make the Arkansas standard deduction equal to 0.183% of the federal standard deduction under the Tax Cut & Jobs Act of 2017.
 - DFA indicates there is no revenue impact.
- **Income Tax Proposal #18: Tax Triggers:** (Motion by Rep. Jett) Proposal to create a tax trigger to reduce the top individual income tax rate to 6% based on the Revenue Stabilization Act.
 - DFA states the proposal would be revenue neutral because the rate reduction would be dependent on funding that was allocated from a new fund created within the RSA.
- **Income Tax Proposal #21: Capital Gains over \$10 Million:** (Motion by Sen. Hendren) Proposal to repeal the capital gains tax exemption for capital gains over \$10 million.
 - DFA estimates increase in general revenue of \$4.6 million.
- **Income Tax Proposal #29: Political Contributions:** (Motion by Rep. Dotson) Proposal to repeal the income tax credit for contributions made to an approved political action committee.
 - DFA is unable to provide a fiscal impact with respect to repealing part of the deduction for political contributions.
- **Income Tax Proposal #30: Pass-through Entity Tax:** (Motion by Rep. Jett) Proposal to create an optional tax for Arkansas businesses that operate as pass-through entities.
 - DFA estimates no tax revenue cost to the state regarding collections under this proposal. However, implementation of this proposal would require additional DFA staffing and programing at an approximate cost of \$500,000 per year with an additional cost for creation of a new tax type.

Prioritization of Tax Relief Proposals

Ms. Nicole Kaeding, Special Projects Director, Tax Foundation, Washington D.C., was recognized to make her presentation “Arkansas’ Options for Tax Reform” **[Exhibit F-1]**. She outlined a \$375 million a year tax reform package that included lowering the individual and corporate income tax rate from 6.9% to 6.5%, reforming the corporate income tax base by repealing the Arkansas’ throwback rule, extending net operating losses (NOLs) by adopting the federal unlimited carry-forward, and moving to a single sales factor. Ms. Kaeding also suggested the task force eliminate tax exemptions, repeal the corporate franchise and inventory tax, and set up phase-ins and tax triggers to further lower the individual and corporate income tax rates from 6.5% to 5.9%.

Ms. Lisa Christensen Gee, Senior Policy Analyst, Institute on Taxation and Economic Policy, Washington, D.C., was recognized and presented several tax credit scenarios in her presentation, “Arkansas Tax Cut Options” **[Exhibit F-2]**. Ms. Gee’s \$200 million tax cut plan included providing tax relief to low-income tax earners by enacting a refundable earned income tax credit (EITC) equal to 25% of the federal EITC or by doubling the standard deduction and enacting an EITC equal to 15% of the federal EITC. She suggested that, if the task force insisted on cutting the top individual income tax rate, the task force should exclude certain capital gains from state income taxes and pair with an EITC for low-income taxpayers.

Mr. Randy Zook, President and CEO, Arkansas State Chamber of Commerce; and Mr. Kurt Naumann, Director, Strategic Planning and Research, Arkansas Economic Development Commission, were recognized for brief comments. They agreed about the significant benefits legislation has made to businesses in the state by eliminating the sales tax on utilities, funding unemployment insurance, and exempting the capital gains tax. Mr. Zook and Mr. Naumann each provided suggestions on a \$200 million tax cut package (Attachments 1 & 2).

The meeting adjourned at 2:46 p.m.