# MINUTES
# TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE
# JULY 27, 2018

The Tax Reform and Relief Legislative Task Force met Wednesday, July 27, 2018, at 9:00 a.m., in Committee Room A-MAC, Little Rock, Arkansas.

**Task Force Members Present:** Senators Jim Hendren, Chair; Missy Irvin and Larry Teague. Representatives Frances Cavenaugh, Jim Dotson, Kenneth B. Ferguson, Bob Johnson, and Mathew Pitsch.

**Other Legislators Present:** Senators Jimmy Hickey and Trent Garner. Representatives Gary Deffenbaugh, Jana Della Rosa, Charlotte Douglas, Jimmy Gazaway, Justin Gonzales, Fredrick Love, Austin McCollum, Chris Richey, Johnny Rye, Matthew Shepherd, and James Sorvillo.

Senator Hendren called the meeting to order.

**Consideration to Approve the June 20, 21, and 26, 2018, Minutes [Exhibits C-1, C-2, C-3]**

Representative Ferguson made the motion to approve the minutes from the June 20, 21, and 26, 2018, meetings and, with a second by Representative Dotson, the minutes were adopted without objection.

**Presentations on Arkansas' Overall Tax Burden and Tax Triggers [Exhibits D-1, D-2]**

**Ms. Nicole Kaeding, Special Projects Director, Tax Foundation, Washington, D.C.,** was recognized to present an overview on the regressivity of Arkansas' current tax code as compared to other states and how to implement tax triggers without creating fiscal distress [Exhibit D-1]. Ms. Kaeding recommended the task force design a tax code that treats all businesses similarly, is simple for the state to administer and transparent for tax filers to understand, uses stable revenue streams and net operating losses (NOLs) to offset volatile revenue streams, and does not make effective change dates on internet sales tax collections retroactive. She suggested the task force focus on lowering the top marginal rate and then focus on moving to a single sales factor to reduce regressivity. Ms. Kaeding explained how other states use tax triggers and phase outs, and she suggested the task force consider several key factors when designing a properly constructed tax trigger such as revenue growth, tax collections, population growth, and inflation costs.

**Mr. Carl Davis, Research Director, Institute on Taxation and Economic Policy, Washington, D.C.,** was recognized to present information regarding the regressivity with the state's tax code [Exhibit D-2]. Mr. Davis said Arkansas has the 11th most regressive tax system above the national average. He said heavier reliance on sales and excise taxes is associated with more regressive tax systems and lead to higher taxes on moderate income families. He said most Arkansas taxpayers pay more in state and local consumption taxes than in income taxes. Mr. Davis suggested the task force avoid tax triggers but rather enact language that allows future lawmakers to evaluate fiscal situation and vote to implement or enact a multi-layered trigger that only takes automatic effect if the budget is in exceptionally good shape.

**Legal and Fiscal Impact of the *South Dakota v. Wayfair* Supreme Court Decision [Exhibit E]**

**Ms. Joi Leonard, Administrator, Legal Research and Drafting Section, Bureau of Legislative Research (BLR); Department of Finance and Administration (DFA) representatives 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.

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Ms. Leonard gave a brief overview of the U.S. Supreme Court's ruling regarding South Dakota v. Wayfair on sales tax collections by remote sellers. She stated that the Court noted that the validity of the physical presence rule under *Quill* and *Bella Hess* law was unworkable and could put local and interstate businesses at a tax disadvantage and that the power for states to regulate internet commerce still applies if the tax relates to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services the state provides.
Ms. Leonard said that the Court indicated that several elements of South Dakota's law mitigated the burden on interstate commerce. Under the Streamline Sales and Use Tax Agreement, Arkansas law already contains several of the provisions the U.S. Supreme Court focused on in analyzing the validity of South Dakota's law. She mentioned that if the task force is interested in pursuing legislation to require out-of-state sellers to collect and remit Arkansas sales and use taxes, one option would be to design a law similar to South Dakota's model, such SB140 of 2017. Ms. Leonard advised the task force to be mindful of effective dates regarding the state's food tax trigger and the 4.5% income tax rate trigger. She also noted some developments to watch, including potential action by Congress, any development in the Wayfair case on remand, and how other states will handle online sales tax collections.

Mr. Gehring presented a DFA estimate on the dollar amount of sales tax collections the state would receive each year from online purchases if the state were to enact a law similar to South Dakota's model. Estimated general revenue impact at 4.5% total $24,491,000; special revenue impact of 2% total $10,883,000; total state impact at 6.5% total $35,374,000; and local government impact at 1.5% total $8,162,000. Mr. Gehring said online retailers that have current sales tax registrations with DFA are not included in the estimates.

**<u>Presentation on the Marriage Penalty</u> [Exhibit F]**

**Mr. Paul Gehring, Assistant Commissioner of Revenue; Dr. John Shelnutt, Administrator of the Office of Economic Analysis and Tax Research; and Mr. Joel DiPippa, Senior Counsel, Office of Revenue Legal Counsel, DFA,** were recognized. Mr. Gehring presented an overview on the marriage penalty and marriage bonus. Mr. Gehring stated that under a progressive income tax system, marriage penalties and bonuses arise because the household rather than the individual is the unit of taxation.
He said marriage penalties and bonuses result from the combination of progressive tax rates and taxing married couples as single units. A married couple is not obligated to file a joint tax return, but their alternative of filing separate returns as a married couple generally results in greater tax liability at the Federal level. Couples in which one spouse earns all of the couple's income never incur a marriage penalty and almost always receive a marriage bonus because joint filing shifts the higher earner's income into a lower tax bracket. Mr. Gehring also explained that under the Tax Cuts and Jobs Act (TCJA), the final legislation retains the marriage penalty for the highest income earners while eliminating the penalty at lower income brackets. He said earlier proposals from the House and Senate sought to eliminate the marriage penalty for all federal taxpayers. The TCJA generally eliminates marriage penalties except for couples making over $600,000 per year. He said there are a few key differences between state and federal forms. Arkansas married couples have the option to file jointly or separately on state individual income tax returns. Taxpayers consider both options to determine which option is to their best financial advantage. Mr. Gehring said the filing status of an Arkansas resident does not have to be the same as the federal filing status. He said married taxpayers must each elect to use the standard deduction or both spouses must claim itemized deductions even if the spouses file separate returns or file separately on the same return.

The meeting adjourned at 1:59 p.m.