EXHIBIT D1

Testimony of

Douglas L. Lindholm

President & Executive Director

Council On State Taxation

July 11, 2017

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Council On State Taxation

Arkansas Tax Reform and Relief Task Force

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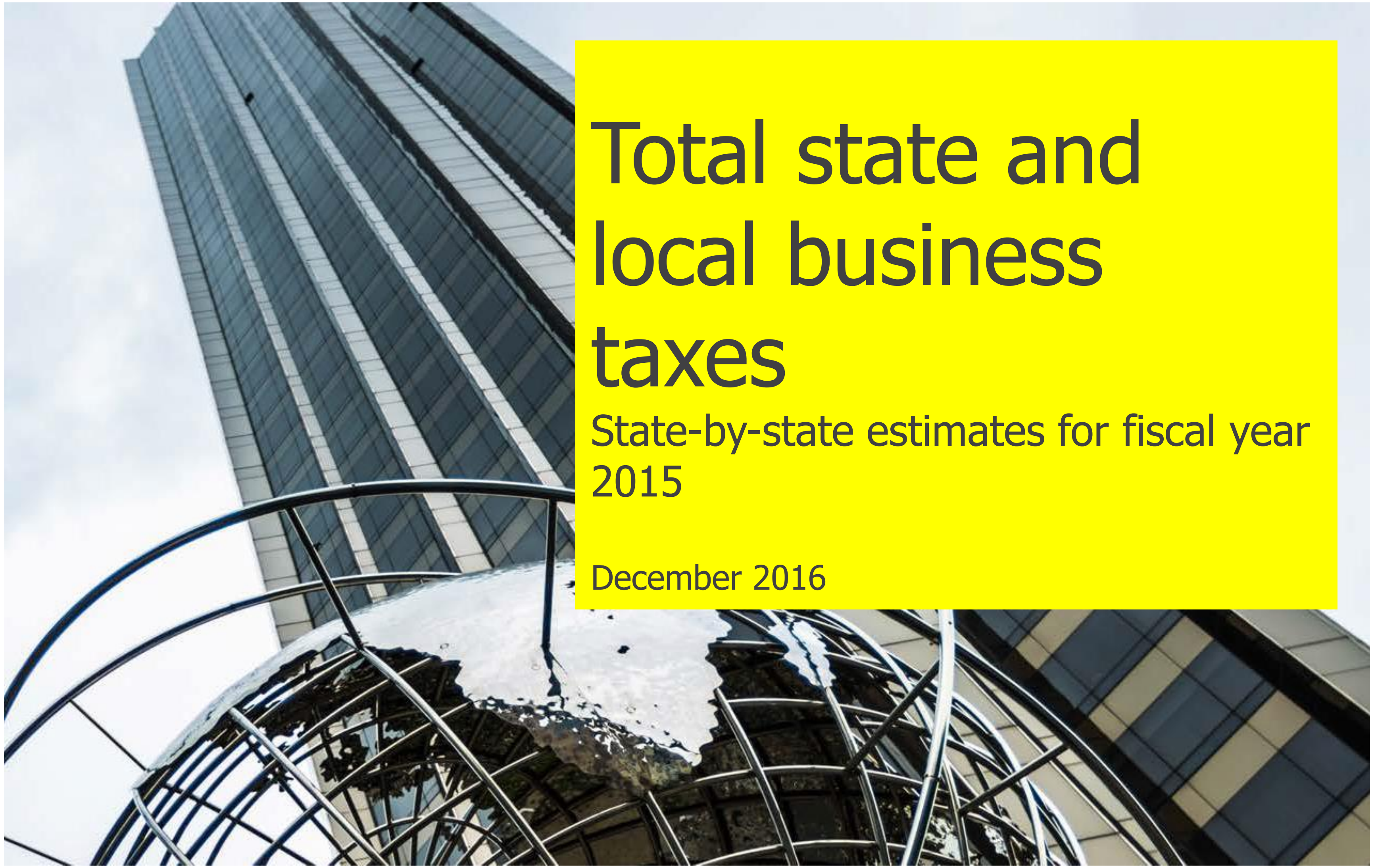
AGENDA

- Are Businesses Paying Their Fair Share of Arkansas Taxes?
- Taxes Paid by Business: Arkansas v. US Average
- Evaluating State Corporate Income Taxes
- Policy Choices to Reform Arkansas Business Taxes

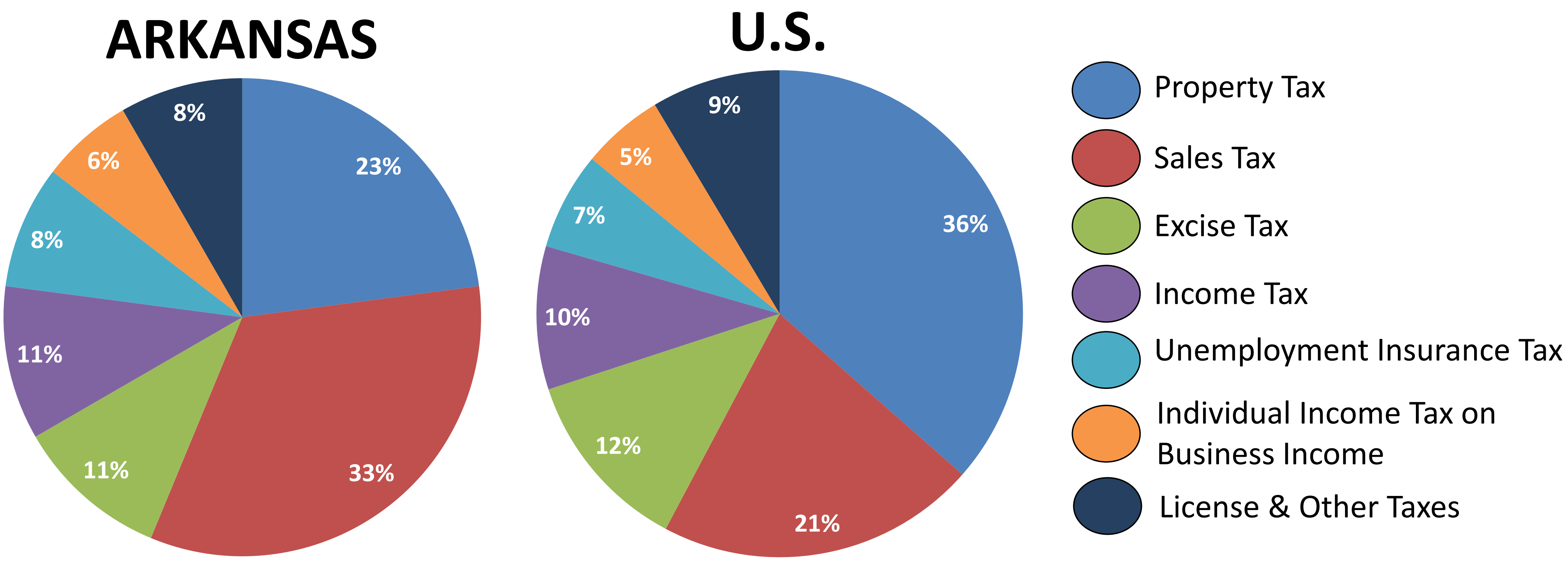
Are Businesses Paying Their Fair Share of Arkansas Taxes?

- What is a “fair share”?
- Legislators must look at all business taxes to address this question
- First, ask why tax business at all?
- All business taxes are reflected in three ways:
  - Higher prices for consumers
  - Lower wages for workers (labor)
  - Lower return on investment for owners
- Evaluate benefits directly received by business from government spending

COST Business Tax Burden Study



Taxes Paid by Business: Arkansas v. US Average



Source: Total State and Local Business Taxes: State-By-State Estimates for Fiscal Year 2015
COST, STRI and Ernst & Young, December 2016

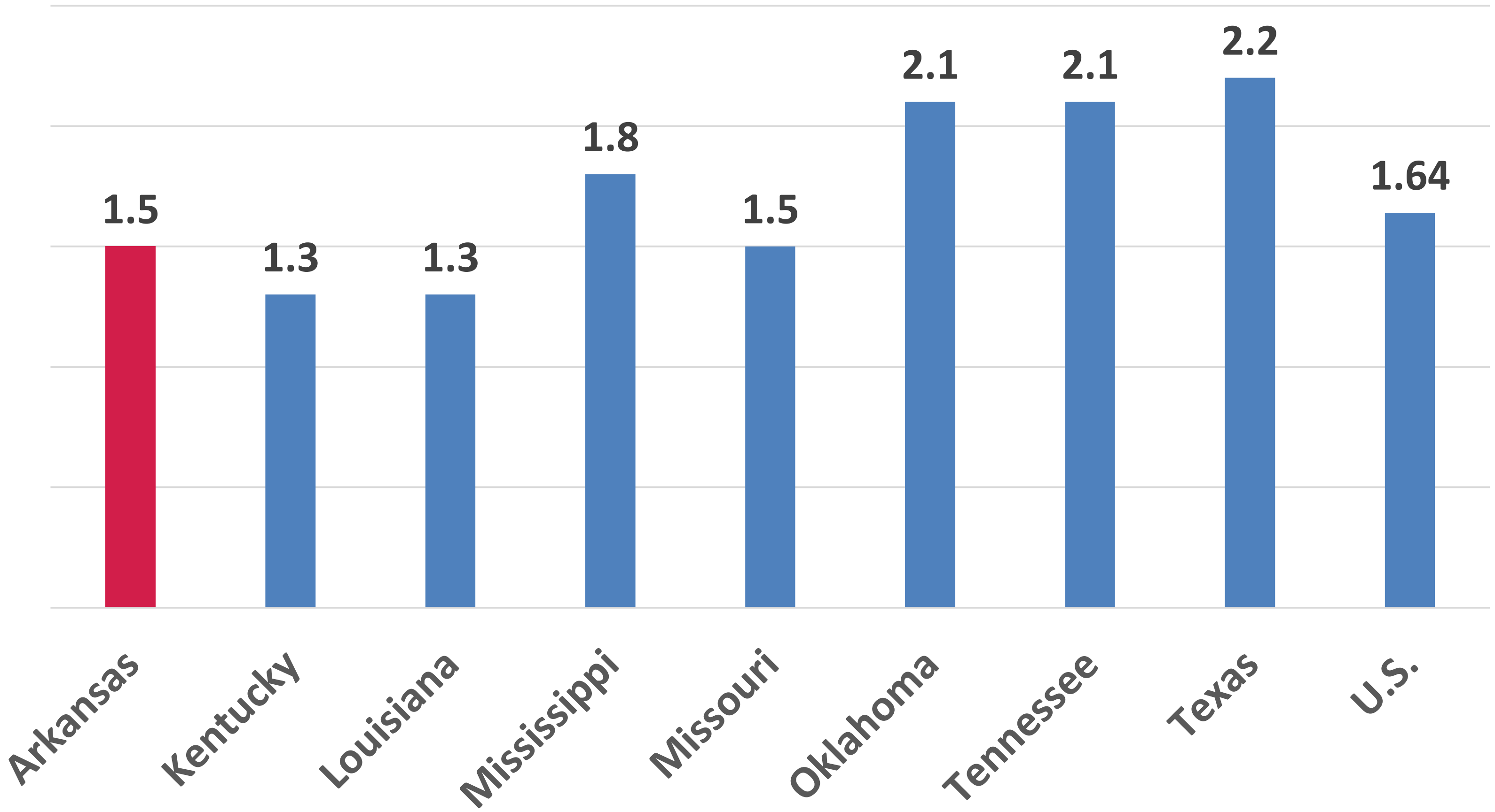
What do Businesses Pay?

- Businesses paid more than $707.5 Billion in U.S. state and local taxes in FY2015, an increase of 1.9% from FY2014.
- In FY 2015, Arkansas businesses paid $4.7 billion in state & local taxes to the State, an increase of 3.3% from FY 2014.
- Remarkably, the business share of SALT nationally has been within 1% of 45% since 2000

COST Study, *Total state and local business taxes: State-by-state estimates for fiscal year 2015*, December 2016

Tax Benefit Ratio

Arkansas v. Neighboring States and U.S.



Source: Total State and Local Business Taxes: State-By-State Estimates for Fiscal Year 2015
COST, STRI and Ernst & Young, December 2016

Evaluating State Corporate Income Taxes

- Be wary of the false dichotomy of taxing business v. individuals
- The corporate income tax is inherently unstable – by design
- The ephemeral concept of “income” makes the tax inherently complex
- Most businesses choose to be taxed under the personal income tax
- Efforts to “fix” the tax can have greater repercussions on economic development than the tax itself
- State corporate income tax revenues are not “declining,” they’re shifting to the personal income tax

Economic Role of the Corporate Income Tax

- Bill Fox, *et al*.: "…there is little [economic] justification for the state corporate income tax."
- Charles McClure: "It is hard to think of a good reason to tax corporate income….The case against state corporate income taxes is even stronger."
- OECD: "…corporate income taxes are the most harmful type of tax for economic growth."

From Institute for Taxation and Economic Policy:

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April 27, 2017

3 Percent and Dropping: State Corporate Tax Avoidance in the Fortune 500, 2008 to 2015

REPORT

Read Report as PDF (Includes Full Appendices)

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INTRODUCTION

The trend is clear: states are experiencing a rapid decline in state corporate income tax revenue. Despite rebounding and even booming bottom lines for many corporations, this downward trend has become increasingly apparent in recent years. 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. A number of factors are driving this decline, including: a race to the bottom by states providing significant "incentives" for specific companies to relocate or stay put; blatant manipulation of loopholes in state tax systems by corporate accountants; significant cuts in state corporate tax rates; and the

COST Rebuttal (at *www.cost.org*):

May 5, 2017

INSTITUTE ON TAXATION AND ECONOMIC POLICY REPORT MISLEADS POLICYMAKERS AND THE PUBLIC

On April 27, the Institute on Taxation and Economic Policy (ITEP) released a report (hereinafter "ITEP study") claiming that 240 of America's largest and most profitable corporations "…avoided a total of $126 billion in state corporate income taxes over the eight years [from 2008-2015]." *["3 Percent and Dropping: State Corporate Tax Avoidance in the Fortune 500, 2008 to 2015"]* The ITEP study repackages and rebrands a 2014 study ITEP released in conjunction with its sister organization, Citizens for Tax Justice *[see "90 Reasons We Need State Corporate Tax Reform: State Corporate Tax Avoidance in the Fortune 500, 2008 to 2012"* (available at www.ctj.org)*]*. These reports are deeply flawed in both their analysis and conclusions.

The latest ITEP study, like the earlier version, focuses exclusively on a decline in state and local corporate income taxes as driving the need for "tax reform," and decries corporate tax "avoidance" generally. In so doing, it distorts the true composition of business tax payments to state and local government, and misleads policymakers and the public regarding the overall picture of corporate contributions to state revenue systems. It is unfortunate that the report, purportedly a comprehensive research paper, is so overtly political in its scope and message. It is equally unfortunate that the authors decided to republish much of their material in the face of our criticism of the earlier version [see *"Updated Citizens for Tax Justice Report Misleads Policymakers and the Public"* (Council On State Taxation; March 31, 2014)].

1) What the Authors Deliberately Left Out:

As is the case with any study, **readers should ask themselves what the study excludes**. In the case of the ITEP study, the answer to this question is enlightening:

- The ITEP study looks at only state and local corporate income taxes. The study does not include franchise, net worth, capital stock, gross receipts, excise or other similar business taxes paid to state and local governments. Perhaps more importantly, the study also excludes all property taxes, sales taxes (paid by companies on their business purchases, not on consumer sales), and state payroll taxes paid by companies during those eight years.

Trend to Watch: Growth of Pass-Through Entities (PTEs) Taxed under the PIT

- In 1980, PTEs accounted for 20% of total US business income; In 2012, PTEs accounted for 64% of US business income (Tax Foundation Report)
- Income earned by C Corporations incurs a federal effective tax rate nearly 60% more than PTEs (NBER Study)
- Income earned by C Corporations incurs a state effective tax rate roughly 30% higher than PTEs (forthcoming COST/PwC Study)
- Growth of PTE's will have significant future impact:
  - Federal tax reform implications (corporate integration?)
  - Federal and state audits of partnerships as entities
  - Growth of PTE's accounts for much of the growth in income inequality over last three decades (NBER)

Policy Choices to Reform Arkansas Business Taxes

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Corporate Income Taxes:

- Avoid mandatory unitary combined reporting
- Repeal the "Throwback" rule for apportioning State corporate income taxes
- Conform the NOL carryover rule to the federal rule
- Review federal conformity to address lack of guidance in many areas

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Problems with Unitary Combined Reporting

- The concept of "Unitary" is a Constitutional Doctrine that relies on vague, uncertain, and overbroad definitions
- Unitary reporting encourages both taxpayers and tax administrators to "cherry-pick" members of the unitary group for revenue purposes
- Unitary reporting creates winners and losers depending entirely on out-of-state factors
- Unitary litigation is exceedingly complex and expensive
- Judicial decisions on unitary issues carry no precedential weight except as to the taxpayer involved
- Recent state studies (Maryland, Rhode Island and Indiana) have concluded that mandatory combined reporting is not an effective revenue raiser

Policy Choices to Reform Arkansas Business Taxes

COST Council On State Taxation

Corporate Franchise Taxes and Other Business Activity Taxes:

- Avoid “Alternative Base” Business Taxes
  - Several states considered an Ohio-style “CAT” this year – all rejected it
  - Gross receipts taxes violate numerous principles of sound tax policy

- Phase-Out the Arkansas Franchise Tax
  - Franchise taxes are levied on capital deployed in the state and are a disincentive to economic growth
  - Franchise taxes are being phased out nationwide by states

Gross Receipts Taxes as a Policy Choice

- Uneven Stealth Tax: Violates principles of economic competitiveness and transparency
- Unfair Tax: Imposes Significant Tax Burden on Start-Up, Low Margin and Unprofitable Enterprises
- Tax Pyramiding: Imposed at Every Level of Production
- Least Economically Neutral Tax

- "There is no sensible case for gross receipts taxation…. [Gross receipts taxes] do not belong in any program of tax reform."

COST/Tax Foundation: "Gross Receipts Taxes in State Government Finances: A Review of Their History and Performance," John Mikesell, Indiana University, Published January, 2007

Policy Choices to Reform Arkansas Business Taxes

Sales & Use Taxes

- Improve Sales Tax Design:
  - Avoid taxing business to business (B2B) transactions
  - Focus on taxing consumption-based goods and services
- Improve Sales Tax Administration:
  - Continue participation in the Streamlined Sales & Use Tax Agreement (SSUTA)
  - Provide reasonable vendor compensation for taxpayer collection responsibilities
  - Review COST Sales Tax Scorecard (late summer release)

"What's Wrong With Taxing Business Services?"

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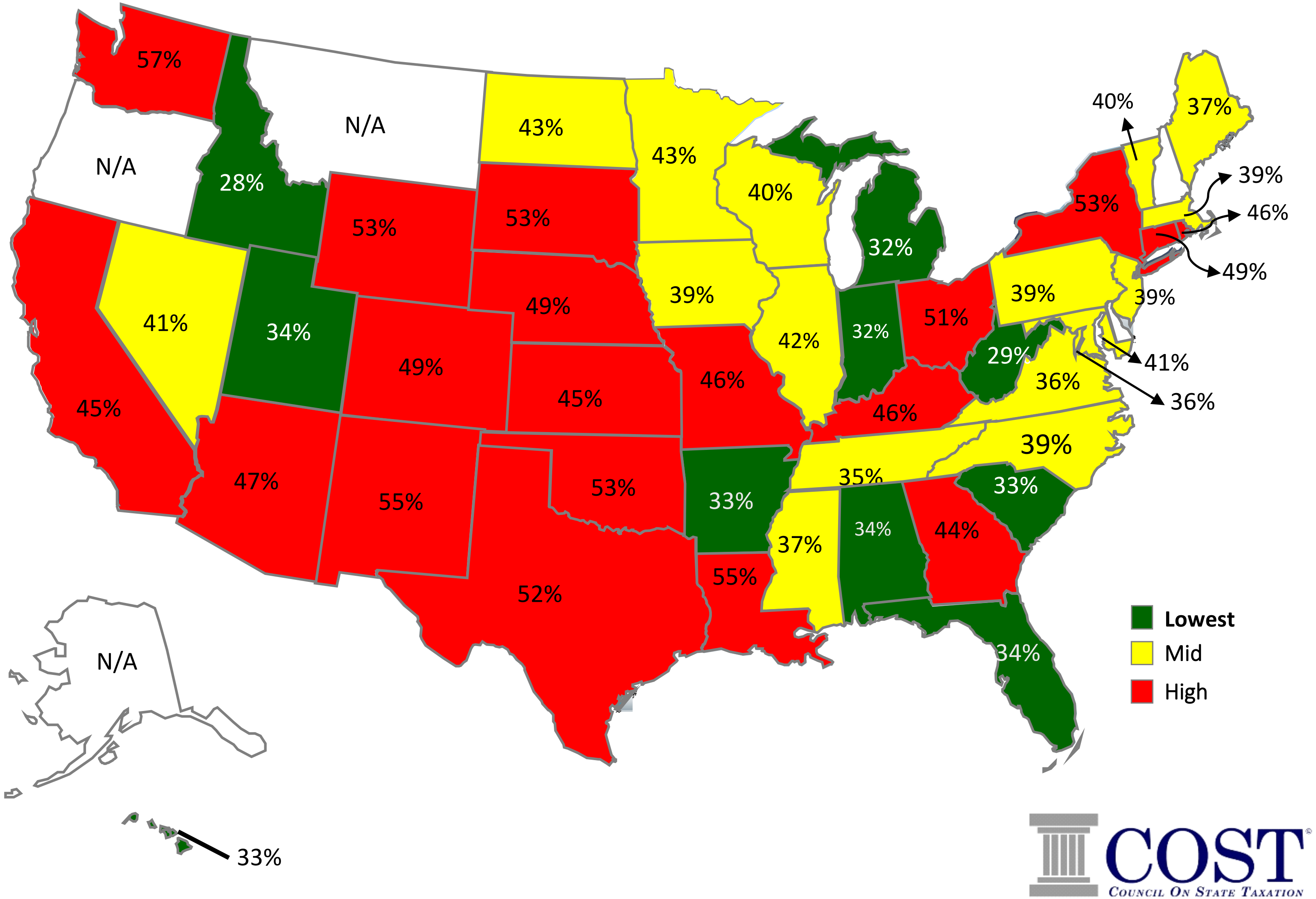
- **COST Study on Problems with Taxing Business Services: April 4, 2013**
  - "Pyramiding" of the tax leads to arbitrary and hidden differences in effective sales tax rates on different goods and services that distort consumer choices;
  - Lack of transparency in sales tax base creates higher "hidden" effective tax rates making it difficult to determine who bears the burden of the tax;
  - Taxes on intermediate purchasers put companies at a competitive disadvantage and encourages them to relocate;
  - Encourages companies to self-provide business services, reducing efficiency and competition;
  - Detrimental impacts on a state's business tax competitiveness; and
  - Extremely difficult compliance, sourcing, and definitional burdens for taxpayers and tax administrators alike.

State and Local Sales Taxes Imposed on Business Input Purchases, 2011



COST Sales Tax on Business Inputs Study, Published 2013

Policy Choices to Reform Arkansas Business Taxes

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General State Tax Administration

- Improve State Tax Appeals and Procedural Requirements:
    - Ensure adequate expertise at appeals level
    - Eliminate pay-to-play through final resolution
    - Modify corporate return due date and extensions
    - Alleviate compliance burden on reporting of federal changes
    - Avoid retroactive taxation

Policy Choices to Reform Arkansas Business Taxes

Make the Property Tax More Competitive:

- Eliminate the property tax on manufacturing inventories
- Simplify the process for property tax abatements for new manufacturing plants, machinery & equipment, and major expansion projects
- Property tax rates and abatements should apply equally to residential and commercial/industrial properties.
- Exclude intangible property

Policy Choices to Reform Arkansas Business Taxes

Improve Property Tax Administration (See COST Property Tax Scorecard)

- Provide a *de minimis* exclusion
- Provide consistent report due dates across property types and taxing jurisdictions
- Exclude intangible property
- Provide at least 60 days to appeal
- Allow taxpayer to defer payment on disputed tax rather than prepay for centrally assessed property (although taxpayer may defer payment on locally assessed property)
- Provide property tax forms, including exemption forms, on a centralized website
- Provide a detailed explanation of the State’s property tax system online
- Make valuation of property data available via website
- Provide property taxpayers with valuation notices, including appeals process information

Arkansas Tax Reform and Relief Task Force

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QUESTIONS?

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