



pfm

State of Arkansas Tax Relief and Reform Legislative Task Force

Arkansas Tax Issues Presentation

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Project Team Leaders

Randall Bauer, Project Manager

Randall Bauer joined PFM in 2005, where he has led numerous state and local government finance and revenue-related projects. These project clients have included the States of Delaware, Hawaii, Illinois, Kansas, New York, Oklahoma, Pennsylvania and Washington as well as the Cities of Baltimore, Cincinnati, Colorado Springs, St. Louis, and Washington DC. Prior to joining PFM, Mr. Bauer served for nearly 7 years as Budget Director for the State of Iowa and 11 years in senior tax and budget staff roles for the Iowa State Senate.

Deanna Yocco, Senior Analyst

Deanna Yocco joined PFM in 2015 and is based in PFM's Philadelphia office. She provides quantitative, analytical, and research support for governmental performance improvement projects. Ms. Yocco has served as the lead analyst for projects with the States of Hawaii, Illinois and Oklahoma. Prior to joining PFM, Ms. Yocco was a Budget Analyst for the Ohio Office of Budget and Management, where she was responsible for the preparation of the Governor's Monthly Financial Report, detailing the State's economic forecast, revenues, and preliminary monthly disbursements.



Project Team Leaders

John Cape, Subject Matter Expert

John F. Cape is a national expert on public policy, with over 35 years experience in the public sector. At PFM, he served as the Engagement Director for project clients that included the States of Colorado, Georgia, New Jersey, New Mexico, Oregon, Pennsylvania and Virginia. Prior to joining PFM, Mr. Cape was the Director of the Budget for New York State. Mr. Cape serves as a Senior Fellow of the Rockefeller Institute of Government and is a Fellow of the State Academy of Public Administrators.

Andrew Sidamon-Eristoff, Subject Matter Expert

Andrew Sidamon-Eristoff has over 30 years of experience in tax policy and administration. Among his experience is serving as New Jersey State Treasurer, Commissioner of the New York State Department of Taxation and Finance, Commissioner of the New York City Department of Finance and as a Senior Tax Advisor to the USAID Business Climate Reform Project. Mr. Sidamon-Eristoff also served as a Council Member on the New York City Council. He served on the Board of the Federation of Tax Administrators and is also certified in the use of the IMF Tax Administration's Diagnostic Assessment Tool.



Coverage Topics

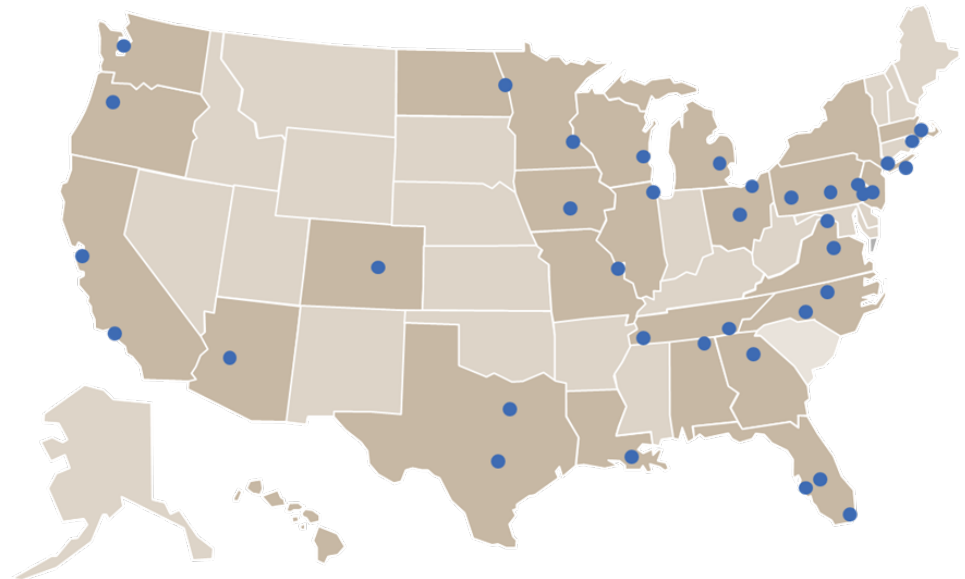
- PFM Overview and Project Team
- General Outline of a Direction/Roadmap Towards Reform and Relief Options
- How Does Arkansas Stack Up?
- Exemptions: How Do You Score Them?



PFM Overview

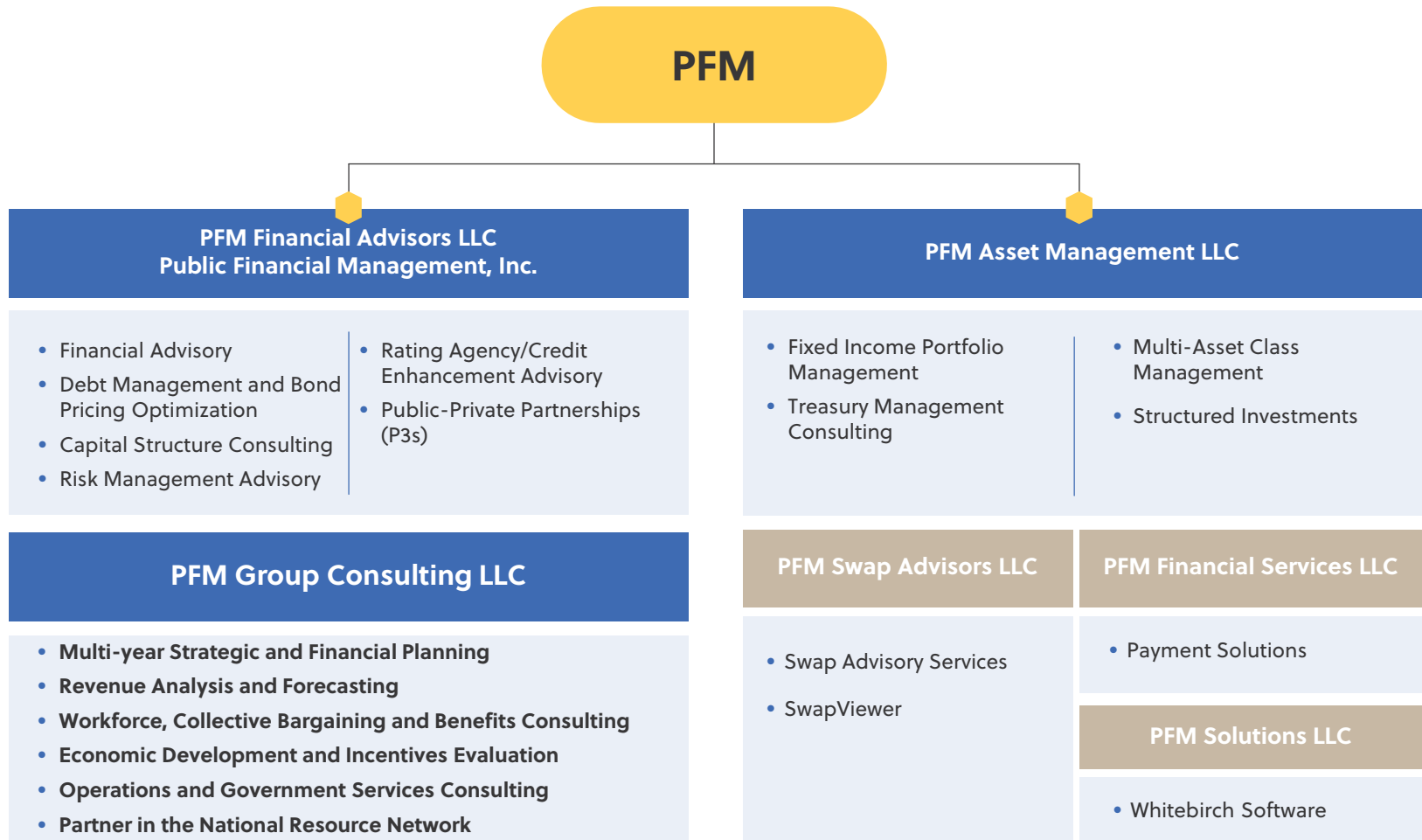
- PFM was founded in 1975 on the principle of providing **sound, independent financial advice to state and local governments.**
- The PFM Management and Budget Consulting practice is a dedicated team of experienced professionals focused on the unique challenges of the public sector, with services that include:
 - Fiscal, Policy and Program Support.
 - Tax and Revenue Analysis.
 - Economic Development and Incentives Evaluation.
 - State and Federal Revenue Maximization.
 - Program/Performance Improvement.
 - Workforce Consulting.

**PFM has over 600 professionals
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PFM Services for State and Local Governments





Relevant PFM Past/Current Projects

■ Tax and Revenue Structures:

- Delaware options for changes to the State/County finance relationship (current).
- Hawaii review of state revenue structure including sufficiency, equity and efficiency.
- Hawaii review of state revenue structure including ability to export revenue, collections processes and systems (current).
- Kansas options to increase the capture of non-tax revenue.
- Pennsylvania review of revenue estimating and administrative processes.
- Washington review of existing fee structure to determine sufficiency.
- Long Island Regional Planning Council study of alternatives to the property tax (current).
- Aurora review of tax sufficiency and revisions to City tax and revenue structure.
- Colorado Springs analyze existing revenue structure for long-term sufficiency.
- Pittsburgh recommendations for revisions to City tax structure and internal processes.
- Providence analysis of alternatives to existing tax and revenue structure.
- St. Louis recommendations for revisions to City tax and revenue structure.



Relevant PFM Past/Current Projects

■ **Economic Development and Incentives:**

- Oklahoma evaluation of incentives efficacy, financial and economic impact (current).
- Hawaii evaluation of incentives financial and economic impact.
- New York evaluation of financial incentives and economic impact from specific projects.
- Pennsylvania evaluation of financial incentives and economic impact from a specific project.
- Kansas City review of City tax incentives and economic and financial impact.
- St. Louis review of City tax incentives and economic and financial impact.

■ **Revenue Estimating:**

- Pennsylvania revenue estimating processes and peer benchmarking.
- New Orleans establishing processes after Hurricane Katrina.
- Pittsburgh vetting City revenue estimates.
- Portsmouth identifying areas of concern with current City revenue estimates.



Path Forward: Outline Towards Reform/Relief Options

- Menu of Alternatives to Study and Provide Written Reports
 - Analysis by tax type (income, sales, excise, property taxes)
 - Problem/solution analysis (competitiveness, tax burden, grow specific sectors)
 - Multiple unrelated areas of study (state 'x' reform, approaches to Nexus, simplification)
- Facilitated Task Force Discussion
 - Questions and discussion to lead to topics for written preliminary report
 - Presentations and discussion for topics for written preliminary report
 - Multiple meetings versus one or two remaining meeting
- Multiple-day Meeting Combination of these Approaches
 - In-depth benchmarking and case studies
 - Analysis (both dynamic and static) of tax alternatives
 - Combination of options based on parameters identified by the Task Force



How Does Arkansas Stack Up?

- Reviewed Past Task Force Presentations and Information
 - NCSL: high-level benchmarking on structure, rates, other state reform experience
 - DFA home-grown resources: listing of incentives and exemptions
 - Tax Foundation: 'Arkansas The Road Map to Tax Reform'
 - COST: Testimony on business taxes

- Additional Areas for Benchmarking and Analysis
 - Economic development incentives – types and evaluation methods
 - Key features of income tax (exemptions, deductions, credits, treatment capital gains and losses)
 - Measures of tax burden
 - Tax administration features
 - Other state tax reform



Advantage Arkansas Incentive

	Oklahoma	Arkansas	Kansas	Louisiana	Missouri
Program Name	Quality Jobs	Advantage Arkansas	PEAK	Quality Jobs	Missouri Works
Job Creation Requirement	None	None	10 or more new jobs in metropolitan areas 5 new jobs in other areas	5 New Jobs	10 or more new jobs 2 or more if located in rural area or other designated zone
New Payroll Requirement	\$2.5 Million	\$50,000 to \$125,000, depending on county	None	\$500,000 for businesses with 50+ employees \$250,000 for businesses with -50 employees	None
Wage Requirement	Wages paid to new jobs must be greater than or equal to the average County wage where the business is located	Average hourly wage of the company must be greater than or equal to the lowest county average hourly wage	Wages must be greater than or equal to the county median wage where the company is located	\$14.50 per hour for 5 percent rebate \$19.10 per hour for 6 percent rebate	90% of County Avg Wage*
Health Insurance Requirement	Employees must pay no more than 50% of the premium cost	None	Full-time employees must be offered health insurance and the company must pay at least 50 percent of premium	\$1.25 per hour in health care benefits for FT employees Must offer coverage for dependents of FT employees At least 50% of employees in new jobs must accept coverage	Full-time employees must be offered health insurance and the company must pay at least 50 percent of premium
Capital Investment	None	None	None	None	\$100,000 in rural area
Benefit Type	Cash Rebate	Income Tax Credit	Retention of State payroll withholding tax	Cash Rebate	Retention of State payroll withholding tax and tax credits
Benefit Amount	5 or 6 percent of Qualified Payroll	1 to 4 percent of new payroll, depending on county	Retention of 95 percent of State payroll withholding tax	5 or 6 percent of payroll	Retention of 100 percent of State payroll withholding tax and tax credit of 5 to 6 percent of new payroll
Benefit Period	Up to 10 Years	5 Years	5 to 7 Years	5 Years	5 or 6 Years
Program Cap	None	None	None	None	\$116 million



Re-established Well Production Incentives

State	Arkansas	Kansas	Louisiana		Oklahoma	Texas
Program Name	Inactive Wells and Fields Re-Establishment Tax Incentive	Inactive Well Exemption	Inactive Wells Re-Establishment Tax Incentive (Expired 2010)		Re-Established Production Rebate	Previously Inactive Wells Production Tax Exemption
Incentive Type	Tax Exemption	Tax Exemption	Tax Exemption		Tax Exemption	Tax Exemption
Incentive	Tax exemption on production for 10 years from date of re-establishment	Tax exemption on production for 10 years after date of receipt of such certification	- 2 year exemption for wells certified between July 31, 1994 and June 30, 2000 or between July 31, 2002 and December 31, 2004	- 5 year exemption for wells certified between January 1, 2005 and June 30, 2010	Tax exemption on production for 28 months from date of re-establishment	Tax exemption on production for 10 years from date of re-establishment
Inactivity Threshold	12 months	36 months	24 months		12 months	24 months
Effective Date	7/1/1995	7/1/1996	7/31/1994		7/1/1994	9/1/1997
Sunset Date	None	None	6/30/2010		6/30/2017	2/28/2010



Coal Production Incentives

State	Arkansas	Kentucky		Oklahoma		Virginia
Program Name	Coal Mining Income Tax Credit	Coal Incentive Tax Credit	Clean Coal Incentive Tax Credit	Coal Tax Credits		Coal Employment and Production Incentive Tax Credit
Credit	\$2 per ton of coal mined, produced or extracted; additional \$3 per ton mined in excess of 50,000 tons if sold to electric generation plant for less than \$40 per ton excluding freight charges	\$2 per incentive ton of coal used to generate electric power or used as feedstock for an alternative fuel facility	\$2 per ton of eligible coal not already claimed as a credit under the Coal Incentive Tax Credit	2 credits totaling \$5 per ton available to businesses purchasing OK-mined coal	\$5 per ton available to businesses primarily engaged in mining, producing or extracting coal; not valid for any month in which the average price of coal is \$68 or more per ton, excluding freight charges	\$3 per ton of VA coal used for electricity generation
Carry-Forward	5 years	10 years	Unknown	5 years	5 years	10 years
Transferable?	Yes	No	No	Yes (prior to December 31, 2013)	Yes (prior to December 31, 2013)	Yes
Effective Date	1/1/2003	7/14/2000	1/1/2005	1/1/1993	1/1/2001	1/1/2001
Sunset	None	None	Unknown	12/31/2021	12/31/2021	None



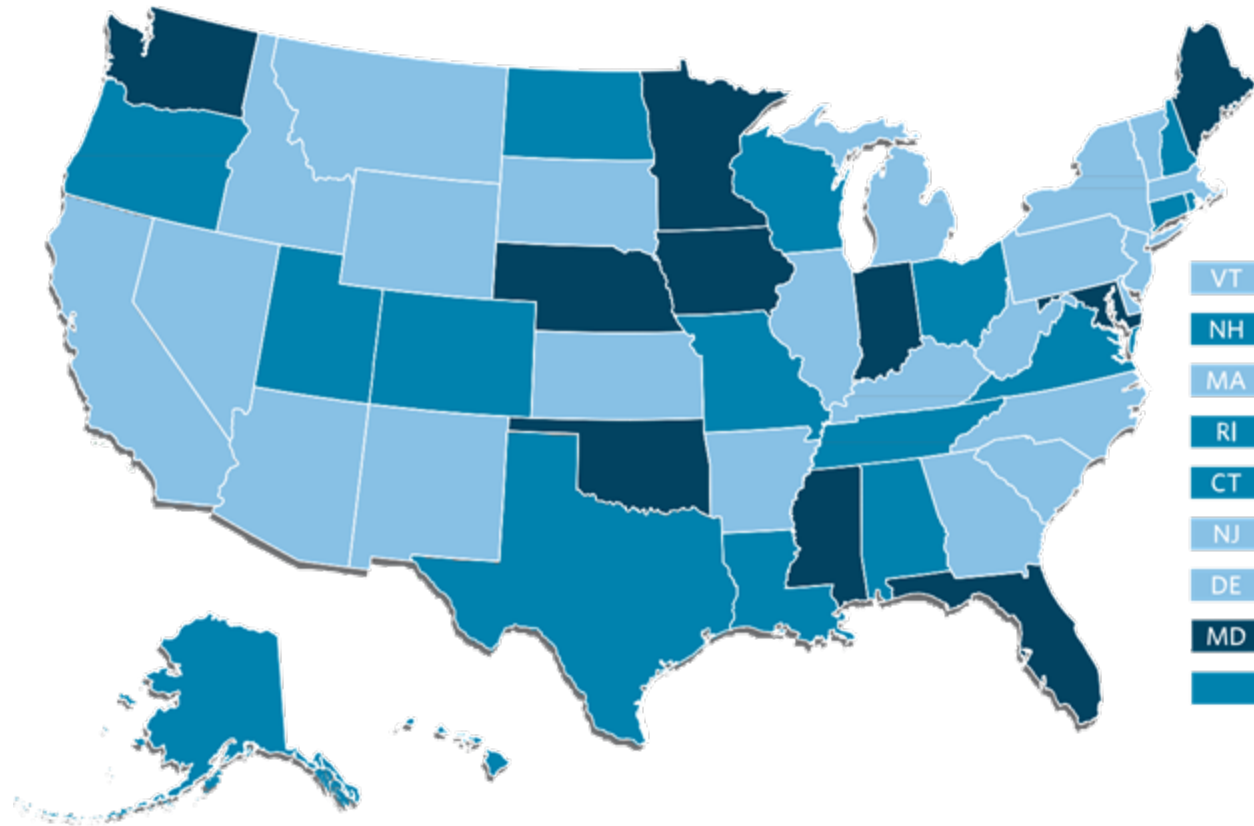
Pew National Assessment

- States evaluated on three criteria:
 - Planning
 - Measuring the impact
 - Informing policy choices
- “Leads to regular, high quality analyses”
- Ten Leading States
 - “Have taken meaningful steps to achieve all three criteria”
 - Well designed plans, experience in producing quality evaluations, and a process for informing policy choices
 - Florida, Indiana, Iowa, Maine, Maryland, Minnesota, Mississippi, Nebraska, Oklahoma and Washington





Pew National Assessment – All States Comparison



10 leading 18 making progress 23 trailing



Pew National Assessment: Arkansas

- “Arkansas is trailing other states because it has not adopted a plan for regular evaluation of tax incentives.”
- “The state used to regularly study tax incentive programs but shifted the focus of the process because policymakers found the evaluations too technical and abstract.”
- “To re-establish an evaluation process, Arkansas could build capacity in the legislative audit office or contract with outside experts.”
- Possibly look at the Oklahoma process – evaluations have specific criteria and focus on ‘real world’ concerns of policymakers – in 40 pages or less.





How Does Arkansas Stack Up? Tax Burden

- District of Columbia CFO Methodology
 - Compares family of 3 at varying income levels for DC and largest city in each state
 - Uses actual taxes paid and consumer expenditures
- Little Rock Rankings

Income	Rank (1 highest)	Tax % Income
\$25,000	12	13.2%
\$50,000	17	9.5%
\$75,000	22-24	9.3%
\$100,000	15	10.6%
\$150,000	16	10.7%



Property Tax Comparison Study (taxes paid in 2016)

- Lincoln Institute of Land Policy
 - Calculates the effective tax rate: tax bill as percent of property's market value
 - 73 large U.S. cities and a rural municipality in each state
 - Four different property types (homestead, commercial, industrial, apartments)
- Little Rock and Pocahontas Rankings (1 is highest)

City	Homestead	Commercial	Industrial	Apartments
Little Rock	37	37	28	30
Pocahontas	49	47	43*	45

* Denotes average of industrial properties with land and building value of \$100,000, \$1 million and \$25 million.



State Business Tax Climate Index 2017

- Council on State Taxation (COST) and Tax Foundation
 - Composite of ranks on corporate, individual, sales tax, unemployment insurance and property taxes
 - Rank of 1 is best, 50 is worst
- Arkansas Rankings

Overall Rank	Corporate Tax	Individual Income Tax	Sales Tax	Unemployment Insurance Tax	Property Tax
38	40	29	44	30	24



Administrative Issues

■ Simplification

- Moving to Federal AGI base for the income tax would reduce taxpayer compliance costs and facilitate broader federal conformity
- This could include, if desired, adoption of a state EITC based on the federal EITC to replace the current low-income tax exemption
- There might be compliance benefits arising from increased data sharing opportunities with the Feds
- Extensive list (and growing) of sales tax exemptions
- Sales tax holidays and tax amnesty are administratively burdensome

■ Low hanging fruit?

- Arkansas scores a B+ on the COST Scorecard on Tax Appeals and Procedural Requirements
- Establishing an independent tax dispute forum would lift Arkansas to an “A”
- An inexpensive way to position the state as more business friendly
- <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=94726>



Other States' Tax Reform

- Individual Income Tax
 - Reduction of brackets, simplification
 - Reduced reliance on the income tax
 - Tax fairness – EITC, increased standard deduction, other refundable credits
- Sales Tax
 - Reduced rate and broadened base – particularly consumer services
 - Simplify complicated administrative structures
 - Nexus and reporting issues related to e-commerce
 - Taxation of virtual purchases
- Corporate Tax
 - Simplification of administration
 - Changes in methods of apportionment
- Property Tax
 - Circuit breakers, credits, other relief
 - Limits on growth



Other States' Tax Reform: North Carolina

- NCSL Identified Key Tax Reform Features
 - Lowered personal and corporate income tax rates/broadened base
 - Personal income tax changed to flat tax, rate of 5.499% in 2017
 - Corporate tax rate lowered from 6.9% in 2013 to 3.0% in 2017 (with revenue trigger)
 - Repealed the Estate Tax

- Additional Changes in 2017 Session
 - Broad-based reductions with 1/1/2019 tax year effective date
 - Reduced personal income tax rate from 5.499% to 5.25%
 - Increase the personal income tax standard deduction from \$17,500 to \$20,000 for joint filers and surviving spouses, \$14,000 to \$15,000 for heads of households, and \$8,750 to \$10,000 single filers and married taxpayers filing separately
 - Reduced the corporate franchise tax for S-corporations
 - Changed child care tax credit to a deduction, based on income and filing status
 - Part of budget bill vetoed by Governor Cooper
 - Overrode by the North Carolina Legislature



Other States' Tax Reform: E-commerce

■ States Passing Economic Nexus Standards

- Wyoming, North Dakota, Indiana and Maine (March-April-May-June) \$100,000 sales or over 200 separate transactions
- Ohio (June) using in-state software, gross receipts of \$500,000 for sales into Ohio
- Rhode Island (August) in-state software nexus, over \$100,000 in sales
- Tennessee administrative action for remote sellers 'who regularly and systematically solicit business in the state'

■ States Passing Marketplace Sellers Standards

- Minnesota (June) marketplace providers with sales of over \$10,000 into state
- Washington (July) agents with sales of \$10,000, referrers sales of \$267,000 into state

■ Colorado-type Reporting Standards

- All effective 7/1/17
- Alabama notify customers and Department of Revenue
- Louisiana notification if sales of over \$50,000 into the state
- Rhode Island allows either/or of reporting or collection (see above)



Exemptions: How to Score Them?

- **Inventory and Benchmarking**
 - Regular, updated inventory is key (DFA 2012 document updated?)
 - Separate by type (category, industry, type)
 - Categorize and benchmark other states related to competition issues
- **Qualitative Rationales**
 - Efficient markets (for example, pyramiding through taxing inputs or business-to-business services)
 - 'Community resource' exemptions such as for non-profit organizations
- **Quantitative – an expectation of quantifiable economic activity**
 - Evaluate them as you would an economic incentive – shift share, specific location decisions
 - Direct economic incentives can be modeled if data is captured (and should be)
 - May be the opportunity to identify indirect and induced effects, but timing of additional economic impact can be problematic (it depends)
- **Exemption Budgets**
 - Some states have established budgets for exemptions that can vary from year to year



Questions and Discussion