Arkansas: Options for Tax Reform

Presentation to the Arkansas Tax Reform and Relief Task Force
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TOPICS OF DISCUSSION

- Tax Reform: General Overview
- Tax Reform: Suggested Reforms
  - Individual Income Tax Reforms
  - Corporate Income Tax Reforms
  - Tax Exemptions
  - Taxes on Capital
- Tax Reform: State Business Tax Climate Index
TAX REFORM
GENERAL OVERVIEW

- We’ve talked at length about the need for Arkansas to reform its tax code.
  - Emphasis should be placed on lowering the cost of capital, to encourage economic growth.

- Arkansas is falling behind by standing still. Just this year, Georgia, Iowa, Missouri, and Kentucky have passed comprehensive tax reforms.

- It’s also important to balance revenue availability with any reforms.
TAX REFORM
GENERAL OVERVIEW

As we’ve discussed over the last several months, Arkansas’s focus should be on several key areas:

- Lowering the individual income tax rate
- Lowering the corporate income tax rate
- Reforming the corporate income tax base
- Eliminating sales tax exemptions
- Repealing taxes on capital
I’ve been asked to outline a $200 million net tax cut to the task force.

I’ve developed my proposal based on the needed areas of reform and the current task force proposals being considered.

If starting from scratch, my proposals would have looked slightly different, largely due to sales tax exemption reform.
TAX REFORM
SUGGESTED REFORMS

- Individual Income Tax
  - Goal should be to lower the top marginal rate to at least 6 percent.
  - It would bring the state much closer in line to neighboring states.
Corporate Income Tax

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Corporate Income Tax

- Reforms to the corporate income tax base are needed as well.
- The task force should repeal Arkansas’s throwback rule, conform NOLs to the federal government, and move to single sales factor.
TAX REFORM
SUGGESTED REFORMS

• Tax Exemptions
  • The task force should repeal the following tax exemptions that are still open to consideration
    • Coin-operated car washes (sales tax)
    • Magazine exemption (sales tax)
    • Political contributions (income tax)
TAX REFORM
SUGGESTED REFORMS

- Taxes on Capital
  - Additionally, the task force should consider repealing two taxes on capital.
    - Repeal the franchise tax.
    - Repeal the inventory tax.
TAX REFORM
SUGGESTED REFORMS

• Total Revenue Impact
  • This package of reform would cost approximately $375 million, based on DF&A analysis of the individual proposals.
  • However, there will be interaction impacts, such as the move to single sales factor, repealing throwback rule, and lowering the corporate income tax.
  • The complete package should be estimated by DF&A.
  • Once, the full impact is understood, a few actions can be taken to minimize the revenue impact, namely using tax triggers and prioritizing reforms.
Tax Phaseins

- Revenues traditionally grow year-over-year as the economy grows.
- An important strategy to mitigate revenue impacts is to phase in the reforms over a series of years.
- Arkansas has done this in many cases, such as the 2017 individual income tax cuts, which don’t go into effect into 2019.
TAX REFORM
SUGGESTED REFORMS

• Tax Triggers
  • Second, tax triggers are a helpful way to manage revenue availability.
  • Tax triggers have been used extensively in more than a dozen states in recent years.
  • These examples have demonstrated what to do and what not to do.
**Tax Triggers**

- There are several key components to include when designing a properly constructed tax trigger.
  - Any tax cuts should be triggered based on revenue, not spending, growth.
  - Need to consider what measure of revenue. Tax collections, general revenues, etc.
  - Also, generally want to build in some natural growth, such as population growth plus inflation.
  - Triggers can also be combined with tax phaseouts.
    - They can help accelerate reforms.
Then, the key is determining what to implement first and what to do via phase-in and trigger.

Given the revenue target, I would prioritize the tax cuts as such.
- Individual income: Cut top rate to 6.5 percent
- Corporate income: Single sales factor, repeal throwback, and expand NOLs.
- Repeal aforementioned exemptions
- Repeal the franchise and inventory taxes.
- And then use tax triggers to lower the individual and corporate income tax rates to 5.9 percent.
State Business Tax Climate Index

We’ve run projected results based on the tax plan that I’ve outlined above through the State Business Tax Climate Index.

- Corporate and individual income tax rate cuts to 5.9 percent
- Repeal throwback rule, expand NOLs, move to single sales factor
- Overall score moves from 39th to 36th
  - Corporate from 39th to 26th
  - Individual from 30th to 29th
- If we add franchise and inventory tax repeal, even more dramatic movements.
  - Overall moves from 39th to 31st
  - Property moves from 22nd to 7th
Moving Arkansas to 31st would dramatically improve the state’s tax structure, particularly its corporate and property tax structure.
CONCLUSION

- Questions?

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