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State Tax Reform

*Presentation to the West Virginia Legislature
Joint Select Committee on Tax Reform
May 18, 2015*

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Fiscal Affairs Program
National Conference of State Legislatures



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National Conference of State Legislatures

NCSL is committed to the success of all legislators and staff

Our mission is to:

- Ensure state legislatures a strong, cohesive voice in the federal system
- Improve the quality and effectiveness of state legislatures
- Promote policy innovation and communication among state legislatures



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Overview

- Discuss tax trends
- Discuss tax changes in other states
- Discuss outcomes



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NCSL Fiscal Surveys

- State Budget Update
 - Current snapshot-2 or 3 x per year
- State Budget Actions
 - Shows spending in major categories
- State Tax Actions
 - Shows tax activity in calendar year



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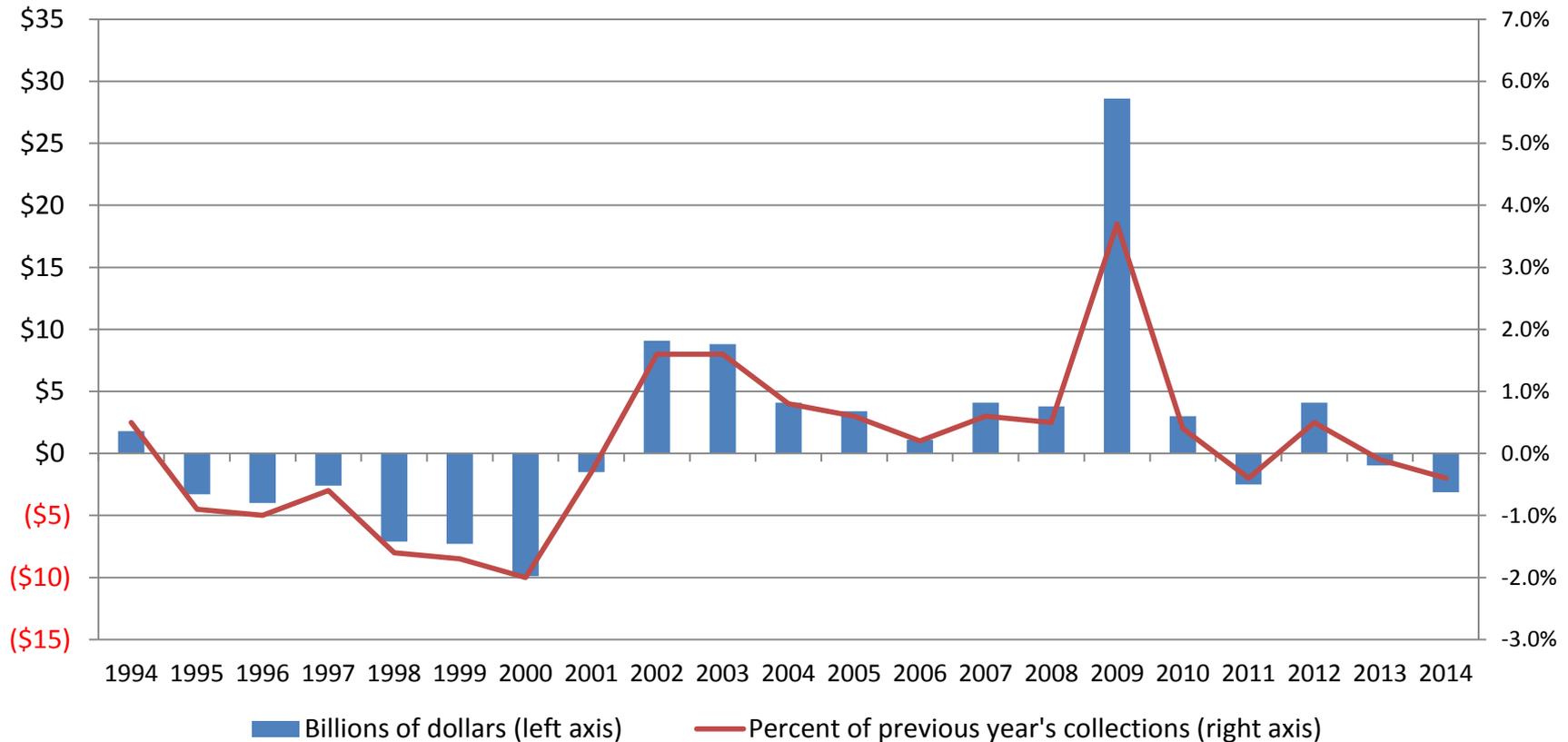


State Tax Categories

- Individual Income Taxes
- Corporate Income Taxes
- General Sales and Use Taxes
- Cigarette and Tobacco Taxes
- Alcoholic Beverage Taxes
- Motor Fuel Taxes
- Health Care Provider Taxes
- Miscellaneous
 - Gaming taxes
 - Vehicle license taxes
 - Estate taxes
 - Severance taxes
 - Real estate transfer taxes
- State Actions that affect Property Taxes
- Fees/Accelerations/Other non-tax revenue measures



State Tax Changes, 1994-2014





A Tax Cut is Not Always A Tax Cut

Depends on measurement method:

Baseline

-based on current law

Taxpayer liability

-based on effect of changes on taxpayer

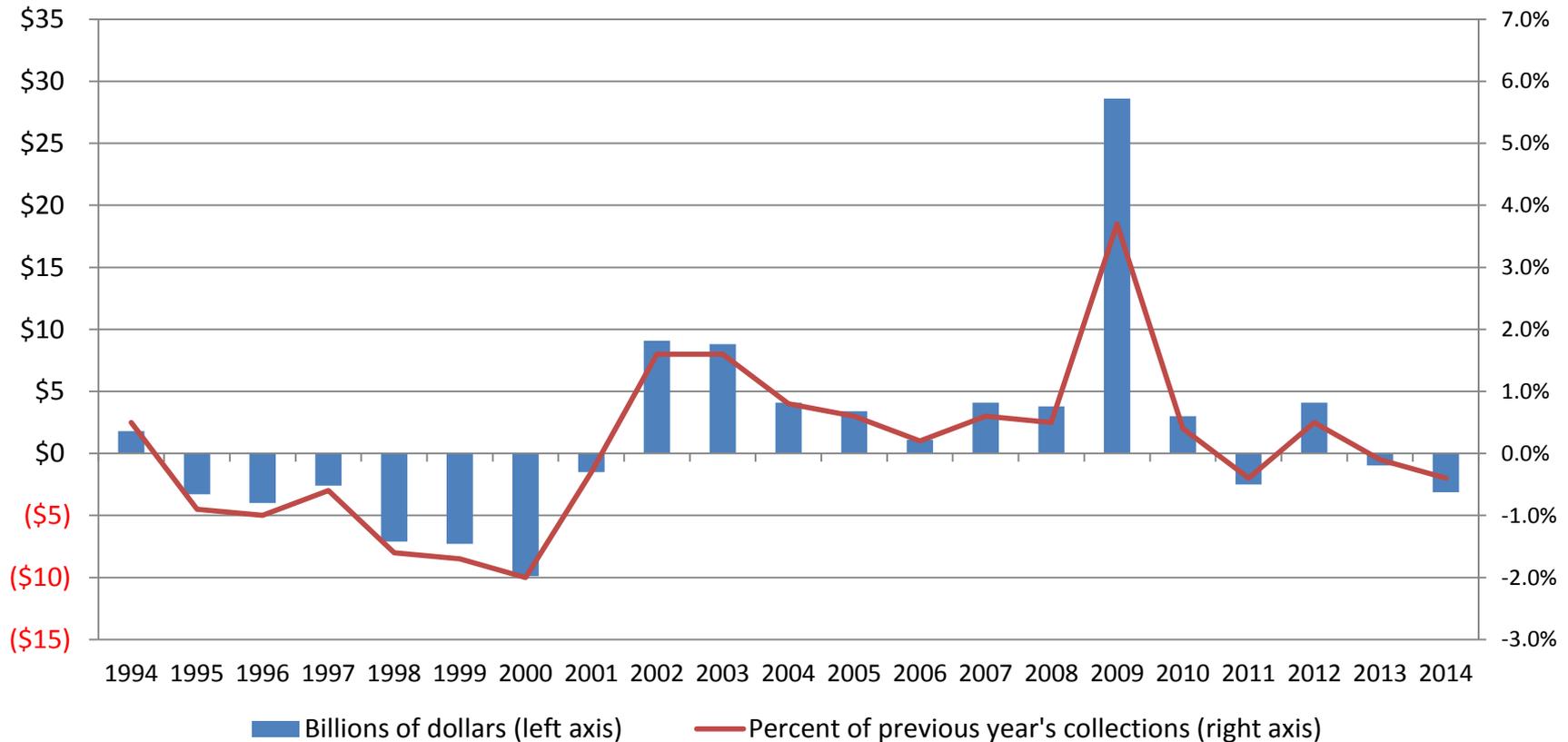


An Example

- **Legislation 2013**
 - Temporary sales tax increase 5% to 6%
 - New lower permanent rate of 4.5%
- **Action 2014**
 - Lower rate to 4.75%
- **Tax increase or tax cut?**



State Tax Changes, 1994-2014





Tax Trends During Downturn

Temporary Taxes

Targeting High-Income Earners

Broadening Tax Base

Tax Trends Since 2012



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Tax Actions in Specific States





Kansas

- **2012: Restructured the personal income tax**
- **2013: Cut the personal income tax again**
- **2013: Broadened the base**
- **2013: Reduced the sales tax (maybe)**

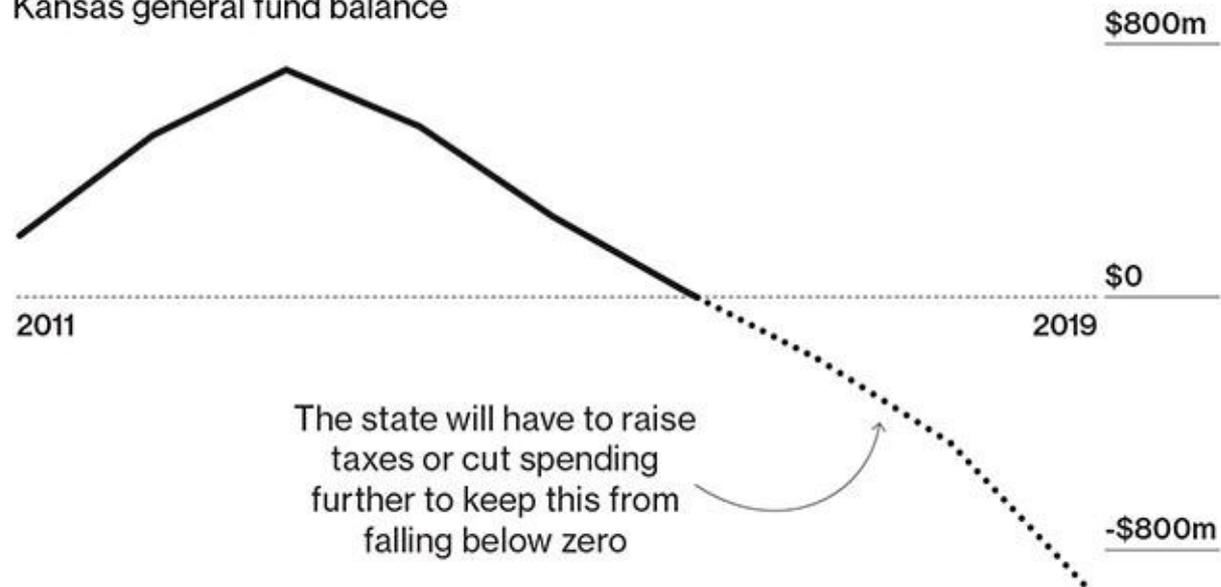
"Our new pro-growth tax policy will be like a shot of adrenaline into the heart of the Kansas economy. It will pave the way to the creation of tens of thousands of new jobs, bring tens of thousands of people to Kansas, and help make our state the best place in America to start and grow a small business."

-Gov. Sam Brownback



Tax Cuts Have a Price

Kansas general fund balance



DATA: KANSAS LEGISLATIVE RESEARCH DEPARTMENT



Kansas After Reform

- Large budget gaps
- Credit rating downgraded
- Lessons learned:
 - Need better communication
 - Too much, too fast





North Carolina

- **Approved a personal and corporate income tax reform measure by lowering rates and broadening the base**
- **PIT rate changes to a flat rate of 5.75%**
- **CIT rate reduced to 5%, lower if trigger met**
- **Repealed the estate tax**





North Carolina Since Tax Reform

Expected to end the current fiscal year with a \$400 million surplus

“Far from starving state government, tax cuts and tax reform have spurred economic growth and job creation.”

Senate President Pro Tempore Phil Berger

“Taxpayers making under (\$67,000), which is around 80% of taxpayers in North Carolina, will, on average see their taxes increase under the plan.”

Cedric Johnson, public policy analyst for the N.C. Justice Center



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“It looks like for the state as a whole, we’re moving into a higher gear and I think more people and more businesses in 2015 will become optimistic about the economy.”

**North Carolina Economist Mike Walden (North
Carolina Public Radio, Jan. 5, 2015)**



Tax Triggers

- **Implement tax cuts when revenue meets established threshold**
- **Triggers have been used by many states**
 - **Oklahoma**
 - 2014-cut PIT in two phases, contingent on revenue triggers
 - **Missouri**
 - 2014-phased-in PIT rate cut beginning in 2017 contingent on trigger being met



Indiana

- **2011**—Enacted CIT rate reduction
- **2012**—Restructured PIT
- **2013:**
 - More CIT cuts
 - Reduced personal income taxes
 - Repealed inheritance tax
- **2014**—Local option exemption for some business personal property
- **2015**—Made the personal property exemption statewide





Indiana Since Tax Reform

- **Fiscally sound**
- **Budget balance forward**
- **Corporate income tax collections strong**
- **Lessons Learned:**
 - Phase in cuts
 - Didn't cut big revenue stream too much



“We found ourselves as an outlier with our corporate tax rate. Since the rate was lowered, 53 companies have moved from Illinois to Indiana, many of them were driven by tax issues. Corporate tax revenues are the real shining light in this whole thing; they have consistently exceeded projections. For the month of April, corporate tax revenues outperformed projections by 13%”

- Sen. Brant Hershman (Chair, Tax & Fiscal Policy)



Ohio Tax Reform 2005

- **Enacted new Commercial Activity Tax (CAT)**
 - Broad based, low-rate business gross receipts tax of 0.26%
- **Phased out corporate franchise tax -over 5 years**
- **Eliminate tax on tangible personal property**
- **Reduced the state sales tax rate from 6% to 5.5%**
- **Raised the cigarette tax**
- **Cut personal income tax rates by 21% over 5 years**



Ohio 2013

- **Phase-in personal income tax cuts over three years**
- **Reduced taxes on small business**
- **Created new EITC**
- **Imposed an income limit on the \$20 personal exemption credit**

- **Increased the state sales tax rate**
- **Means test homestead exemption**



Ohio Since Tax Reform

Still considered a high tax state

Considering more reform measures



“Revenue looks solid and spending is below estimate.”

Ohio Legislative Service Commission
(NCSL State Budget Update Survey, Dec. 2014)



New York

- **High tax state trying to improve business climate**
 - **2012- Restructured PIT**
 - **2013 – Tax breaks for manufacturers**
 - **2014 – Reformed business taxes**

Current outlook: Optimistic

“I wouldn’t call our personal income tax changes reform. It was a restructure—more like Robin-Hooding. We lowered rates on lower and middle income taxpayers, but kept the higher bracket in place.

But we did significantly reform our business taxes.”

– New York Senate Fiscal Analyst



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“Current fiscal outlook is optimistic. Revenue is expected to grow at a steady rate, budget is balanced with spending growth capped at 2 percent. Bank settlement funds have been used to address economic development and infrastructure needs that would otherwise have been bonded.”

(New York Senate Finance Committee,
NCSL State Budget Update survey, April 2015)



Michigan Past Reform

- **1975 - Adopted the Single Business Tax (VAT Tax)**
- **1994 - School Finance Reform**
 - Reduced school property taxes by 33%
 - Raised sales tax from 4% to 6%
 - Shifted school funding to state and approved statewide property tax
- **2007-Tax Reform - Replaced the Single Business Tax**
 - SBT was tax on amount of value a business adds to its output
 - Most of the burden of the tax carried by very few
 - Adopted the Michigan Business Tax - 0.8% gross receipts and 4.95% income tax



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Michigan 2011

- **Replaced the Michigan Business Tax**
 - Eliminated MBT, replaced with 6% flat corporate income tax
 - Eliminated all credits and deductions, except small business credit
 - Raised personal income taxes, cut rate and broadened base



“The changes we've put in place make Michigan a more attractive place for businesses today and in the future.

A major part of that effort was replacing the Michigan Business Tax—the dumbest tax in the United States—with a simpler, fairer Corporate Income Tax.”

Governor Rick Snyder, Michigan
(in a speech on July 1, 2013)



“We wanted to make sure we put a date certain on (ending the MBT) while keeping our promises so that there isn’t a separate set of tax code for a handful of companies.”

Representative Jeff Farrington, Chair, House Tax Policy Committee

“The people of Michigan were essentially told the MBT program is gone. Setting a date certain is certainly one way to kind of drive a stake through this beast and make sure it doesn’t live on in perpetuity.”

Michigan Representative Jim Townsend



Michigan Continued

- **2014– Phase-out personal property tax**
 - Voter’s approved measure
- **2015-Transportation funding reform**
 - Voters reject measure
- **Current Outlook:**
 - Revenues on target, but tracking complicated



States See Uneven Post-Recession Recovery

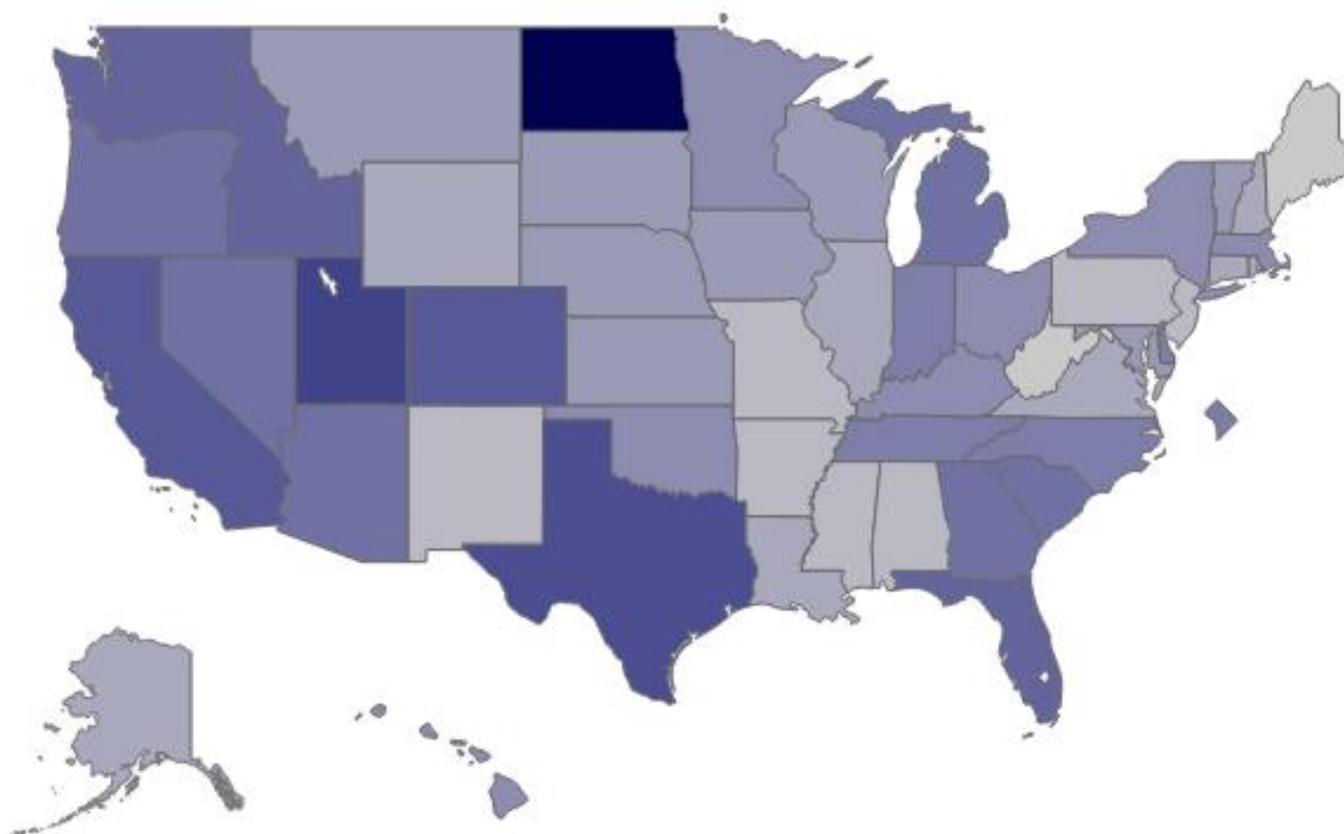
Hover over a state
for more information

Percent Change in Employment

2.16%



28.86%



Stateline data visualization by Jake Grovum Source: Stateline analysis of Bureau of Labor Statistics CES total nonfarm employment data. Change in employment compares state's lowest employment since January 2008 with March 2015 employment.



Rhode Island

- 2006—implemented an alternative flat tax
- 2010—simplified personal income taxes
- 2014—business tax reduction
 - Lowered the corporate income tax rate
 - Single Sales Factor
 - Combined Reporting
 - Eliminated the Franchise Tax



“We would like to remove any impediments to those companies who are here and we would like those companies to grow organically. The current tax structure is almost like a disincentive to add jobs.”

– Sen. Daniel DaPonte, SB 2988 sponsor



Arizona

- **Business Tax Cuts**
- **Delayed Implementation**
 - Enacted cuts in 2011
 - Implemented them in 2014





District of Columbia

- **Reduced marginal tax rates on income between \$40,000 and \$60,000**
- **Raised the standard deductions**
- **Raised the marginal tax rate on incomes above \$350,000**
- **Broadened the income tax base by eliminating certain credits**
- **Reduced the business income tax rate**
- **Switching to a single weighted sales apportionment factor**
- **Broadened the sales tax base**

"I really am enamored with freeing up some of the burdens on business investment, for us to diversify our economy outside the federal government. I really am worried about the retrenchment of the federal government."

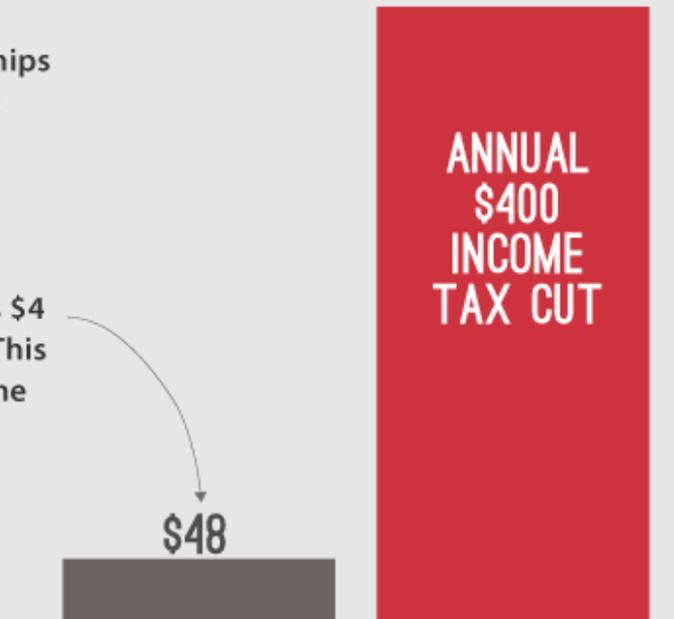
- Anthony Williams; Former DC Mayor and DC Tax Revision
Commission Chair



DC TAX REFORM SAVES MIDDLE CLASS RESIDENTS **\$400 PER YEAR**

How does expanding DC's sales tax to gym memberships compare to the income tax cuts that everyone will receive?

The sales tax on a \$70 per month gym membership is \$4 per month (\$48 per year). This is greatly outweighed by the income tax cuts.

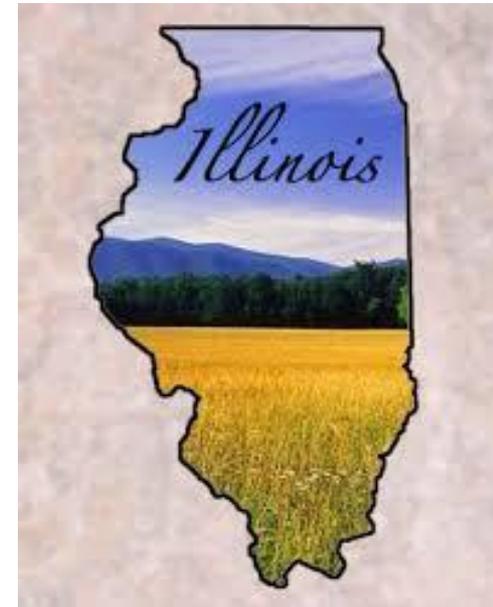


Note: Income tax cut is average cut for incomes between \$50,000-\$75,000
Source: Wes Rivers, Sales Tax on Services Helps Provide Tax Reductions for Most DC Residents, DC Fiscal Policy Institute



Illinois

- **2011-Lawmakers Approve Temporary Tax Increases**
 - PIT raised 3 percent to 5 percent
 - CIT raised 4.8 percent to 7 percent
- **Budget problems not fixed**
- **2014- Increases were not extended**
 - CIT dropped from 7 percent to 5.25 percent
 - PIT dropped to 3.75 percent





Illinois Now



- Facing budget shortfall of \$6 billion for FY2016
- Unpaid bills increased between 2011 and 2013, from \$8.5 billion to \$9 billion, respectively
- Interest payments more than doubled
- Pension debt grew by \$17 billion

“The 67 percent income tax increase resulted in taxpayers paying an additional \$34.1 billion in taxes over the four years in which it was in effect. It did little to pay down overdue bills.”

– Governor Rauner (2/15)



“The budgetary pressure seems unrelenting. Despite fixing the current year budget gap by tapping one-time funding, as well as cutting most agencies, the FY 2016 hole is several times as large.

Legislators and the governor will have to negotiate through financial landmines over the remaining weeks of spring session to avoid carrying the budget hole into the new fiscal year.”



What's on the Horizon?

- **Sales tax expansion**
- **Business tax cuts**
- **Credits and exemptions under more scrutiny**
- **Changes in transportation funding**
- **Revenue forecasting volatility**
- **Next economic downturn?**



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Questions?

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