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# State Tax Cut Roundup



## 2017 Legislative Session



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## State Tax Cut Roundup – 2017 Legislative Session

### Executive Summary – Tax Reform in the States

The 2017 legislative session ended with nine states enacting changes to their tax codes sufficient to qualify for *State Tax Cut Roundup*. Each state provided substantial tax relief for their citizens. Pro-growth tax reform was a key theme, as states took steps to both improve budget gaps and improve their economic competitiveness. *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index* illustrates how certain tax and fiscal policies lead states to prosper and others to fall behind. Fortunately, state legislators are heeding this message. The number of states enacting new tax relief legislation during the 2017 session totaled nine, which is equal to the number of states that qualified during the 2016 session.

The relatively low number states passing new tax relief this session is partly due to the continuation of phase-ins of previously enacted reforms, but also a product of prior successes. In aggregate, 30 states have qualified for inclusion in the five editions of this publication by enacting broad-based, pro-growth tax cuts. Phase-ins this year include a further reduction of Indiana’s corporate tax rate from 6.25 percent to 6.0 percent on July 1, 2017. This marks a continuation of reductions in the rate from a starting point of 8.5 percent in 2011 when the state adopted tax reform. New Mexico completed its corporate income tax rate reduction phase-in as of Jan. 1, 2018. The top rate is now 5.9 percent, a 0.30 percentage point decline from 2017 and a 1.7 percent reduction compared to 2013. North Carolina’s corporate income tax rate dropped from 4 percent to 3 percent for 2017, finishing off the long train of revenue-triggered reductions of the tax rate. In Tennessee, the state’s last vestige of an income tax, the Hall Tax, was reduced from 5 percent to 4 percent for the 2017 tax year. It is scheduled to drop by 1 percentage points every year until elimination. Mississippi began the phase-in of what may turn out to be the largest tax cut in state history (passed in 2016). In 2016, Rhode Island cut its unemployment insurance (UI) tax, resulting in a tax cut for employers of \$30 million for fiscal year 2017.<sup>i</sup> In December 2017, the state announced an additional \$10 million in tax relief for 2018 based off of the prior year’s UI reforms. Thanks to this prior legislation, the 2018 UI tax rates will drop by 0.1 percentage points, ranging from 0.89% to 9.49%.<sup>ii</sup>

Overall, the economic evidence strongly suggests states with lower tax burdens and more economic freedom regularly outperform their higher tax and more restrictive counterparts. Creating a tax and fiscal policy climate conducive to economic growth should be a top priority for every state. Hopefully, the example set by these reforms and their economic results over time will persuade other states to pursue pro-growth tax reform in the coming legislative session.

To be listed in *State Tax Cut Roundup*, a state must meet all the following criteria, which have remained consistent throughout each edition of this report:

- Substantially cut taxes at the state level
- Vote(s) occurred during the 2017 legislative session
- Tax cuts must result in a net decrease in taxes
- Tax cuts must apply broadly and neutrally, or otherwise move the state closer to the *ALEC Principles of Taxation*

## Best of the Best

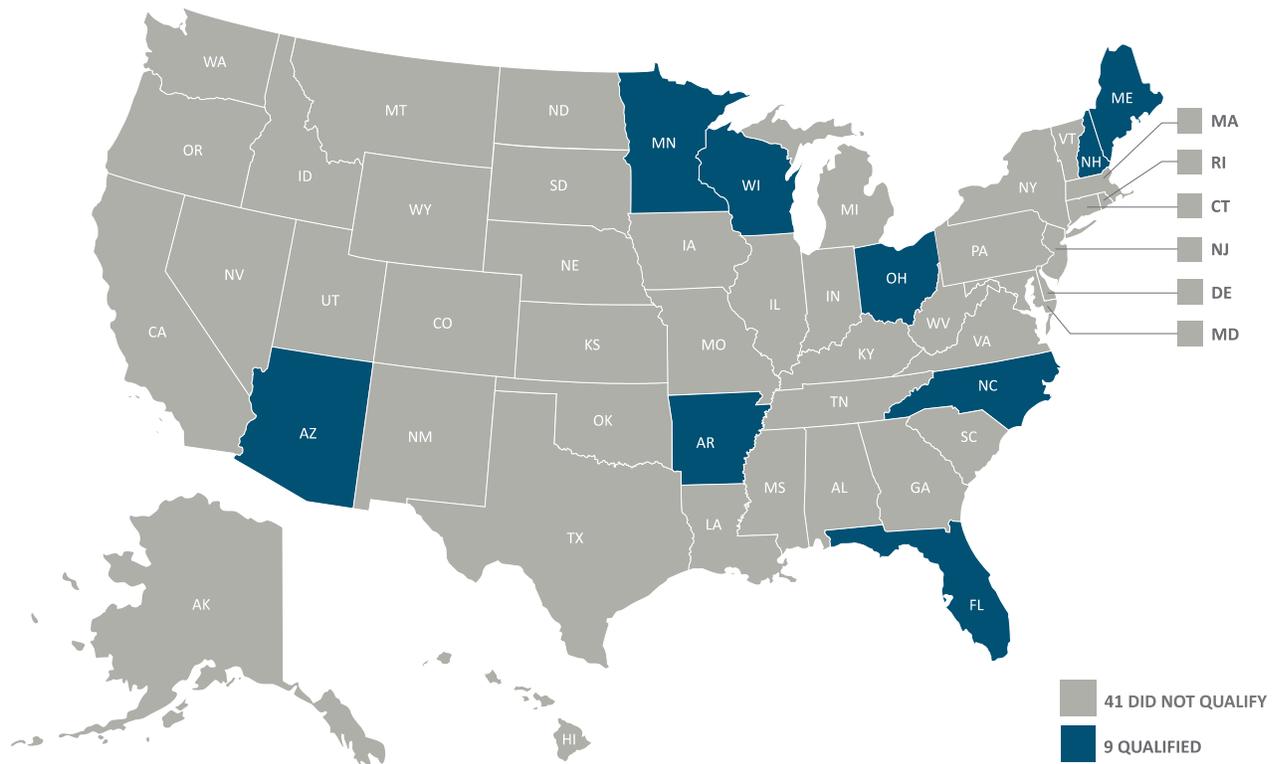
Maine, North Carolina, and Florida deserve special mention for enacting exemplary pro-growth tax reforms.

By far, Maine legislatively enacted the most significant new tax cut of 2017. A new tax bracket of 10 percent on high income earners went into effect on Jan. 1, 2017, following a ballot measure approval. The legislature—with Governor Paul LePage’s leadership—passed a budget on July 4, 2017, which eliminated the new tax bracket retroactive to the day it took effect. This repeal reduced the top individual income tax rate to 7.15 percent from 10.15 percent.

The Tar Heel State continued their tax cut bonanza following yet more positive revenue numbers and economic growth. The 2017 legislation will reduce the individual income tax rate from 5.499 percent to 5.25 percent, increase standard deductions, and lower the corporate income tax rate from 3 percent to 2.5 percent, effective in 2019. It gives meaningful relief to 99 percent of taxpayers. With a corporate rate already the lowest in the country among states that levy such a tax, this move enhances the pro-growth momentum the state experienced over the last five years.

Florida also jumped at the opportunity to continue cutting taxes. By lowering the Business Rents Tax, lawmakers are putting \$61 million back in the pockets of business every year, allowing them to invest more, create more jobs and expand economic well-being. In total, the Sunshine State is giving back nearly \$100 million to hardworking taxpayers.

**FIGURE 1 | STATES THAT QUALIFIED FOR STATE TAX CUT ROUNDUP DURING THE 2017 LEGISLATIVE SESSION**



## ALEC Principles of Taxation

The proper function of taxation is to raise money for core functions of government, not to direct the behavior of citizens or close budget gaps created by overspending. This is true regardless of whether government is big or small and this is true for lawmakers at all levels of government. Taxation will always impose some level of burden on an economy's performance, but that harm can be minimized if policymakers resist the temptation to use the tax code for social engineering, class warfare and other extraneous purposes. A principled tax system is an ideal way to advance a state's economic interests and promote prosperity for its residents. The fundamental principles presented here provide guidance for a neutral and effective tax system; one that raises needed revenue for core functions of government, while minimizing the burden on citizens.

### **Simplicity:**

The tax code should be easy for the average citizen to understand and it should minimize the cost of complying with tax laws. Tax complexity adds cost to the taxpayer, but does not increase public revenue. For governments, the tax system should be easy to administer and should help promote efficient, low-cost administration.

### **Transparency:**

Tax systems should be accountable to citizens. Taxes and tax policy should be visible and not hidden from taxpayers. Changes in tax policy should be highly publicized and open to public debate.

### **Economic Neutrality:**

The purpose of the tax system is to raise needed revenue for core functions of government, not control the lives of citizens or micromanage the economy. The tax system should exert minimal impact on the spending and decisions of individuals and businesses. An effective tax system should be broad-based, utilize a low overall tax rate with few loopholes and avoid multiple layers of taxation through tax pyramiding.

### **Equity and Fairness:**

The government should not use the tax system to pick winners and losers in society, or unfairly shift the tax burden onto one class of citizens. The tax system should not be used to punish success or to "soak the rich," engage in discriminatory or multiple taxation, nor should it be used to bestow special favors on any particular group of taxpayers.

### **Complimentary:**

The tax code should help maintain a healthy relationship between the state and local governments. The state should always be mindful of how its tax decisions affect local governments so they are not working against each other – with the taxpayer caught in the middle.

### **Reliability:**

A high-quality tax system should be stable, providing certainty in taxation and in revenue flows. It should provide certainty of financial planning for individuals and businesses.

## Pro-Growth:

A low tax burden can be a tool for a state's private sector economic development by retaining and attracting productive business activity. A high-quality revenue system will be responsive to competition from other states. Effective competitiveness is best achieved through economically neutral tax policies.

*The ALEC Principles of Taxation have been adopted by the ALEC Task Force on Tax and Fiscal Policy.*

## Tax Cuts by State

### Arizona

*2017 Rich States, Poor States Economic Outlook Rank: 8*

Arizona enacted two modest tax reduction measures in 2017. While minor cuts are preferable to harmful increases, any economic benefits to taxpayers are also likely to be small.

The personal exemption for state income tax filers will increase by \$50-\$150 in 2018 and another \$50-\$150 in 2019 (varying based on whether the taxpayer is single, head of household or married).<sup>iii</sup> For individual income earners, the exemption in 2018 will now shield the first \$2,150 in income from the state income tax. This yields maximum tax savings for an individual of approximately \$2.25 this year and \$4.50 in 2019.

This small tax reduction is built on the far more substantive tax reform agenda implemented over the past decade. Since 2013, Arizona has slashed the marginal corporate income tax from 6.97 percent to just 4.9 percent. In addition, the state's property tax burden as a share of personal income has declined from 0.31 percent to 0.267 percent.<sup>iv</sup> A continuation of these bold reforms can safeguard Arizona's economic competitiveness.

### Arkansas

*2017 Rich States, Poor States Economic Outlook Rank: 23*

Following a year without any relief for taxpayers, Governor Asa Hutchinson signed *Senate Bill 115* into law. The legislation lowered income tax rates for residents making less than \$21,000 per year, providing \$50 million in tax relief. Further, it reduced the lowest rate applicable to individuals in the middle tax bracket.

This relatively small reform does little to address the underlying issues and complexities of Arkansas individual income tax code. However, the bill does set the stage for substantial tax reform in 2019 by creating the "Arkansas Tax Reform and Relief Task Force," charged to examine the topic of tax reform in Arkansas in the upcoming fiscal years.<sup>v</sup> The task force will consist of 16 state legislators who will develop recommendations to modernize and simplify Arkansas' tax code, make Arkansas' tax laws competitive with other states, create jobs for Arkansans and "ensure fairness to all individuals and entities impacted by the tax laws of the State of Arkansas."

The complexity of the state's individual income tax exploded when the number of tax brackets expanded from one to three in 2016. The expansion to three rate schedules created tax cliffs whereby tax liability could grow by hundreds of dollars with just one additional dollar of marginal income.

Successful shepherding of substantial, broad-based tax relief by this newly created task force and lawmakers could yield economic dividends far surpassing the modest income tax relief enacted in 2017.

## Florida

*2017 Rich States, Poor States Economic Outlook Rank: 6*

Capping off Florida’s 2017 legislative session with a win for taxpayers, Governor Rick Scott signed *House Bill 7109*, which reduced by \$180 million the tax burden on Florida’s families and businesses. Pro-growth tax cuts continue to fuel economic expansion in one of the nation’s fastest growing states. By targeting tax cuts toward those which most hinder the economy—taxes on business capital, taxes on business to business transactions and taxes on productivity—Gov. Scott and lawmakers have kept their record of passing some form of tax cut every year – a record that will only continue to grow businesses and opportunity in the Sunshine State.<sup>vi</sup>

The tax cut package reduces the tax on business rents by 0.2 percent in 2018, equal to about \$61 million per year in relief. Florida is the only state with a tax on commercial leases, which is unfairly detrimental to small businesses. Unfortunately, the deal includes several base-narrowing sales tax holidays, which are one of the least efficient ways to return money to the taxpayer and has little to no impact on growth. All considered, however, the tax package continues Florida’s track record of substantial relief for their hardworking taxpayers.

With this most recent tax cut, Governor Scott has presided over the return of more than \$6.7 billion to hardworking taxpayers. It’s no wonder the Sunshine State continues to experience record domestic in-migration and has an economy set to breach the \$1 trillion mark.

## Maine

*2017 Rich States, Poor States Economic Outlook Rank: 42*

Despite a budget battle and government shutdown, Maine Governor Paul LePage secured the most significant legislative tax cut of 2017. A new tax bracket of 10.15 percent on those earning more than \$200,000 went into effect on Jan. 1, 2017, following the narrow approval of a ballot measure.<sup>vii</sup> The legislature—with the governor’s leadership—passed a budget on July 4<sup>th</sup>, 2017, which included elimination of the 3 percent income tax surcharge retroactive to the day it took effect. This repeal reduced the top individual income tax rate to 7.15 percent from 10.15 percent, amounting to a \$320 million tax cut. Having the second highest top marginal state income tax rate in the country would not have been sustainable for Maine, and the work of Gov. LePage and his allies has set Maine on the path to a brighter, more prosperous future.

## Minnesota

*2017 Rich States, Poor States Economic Outlook Rank: 45*

In 2017, after tumultuous political battles between Democratic Governor Mark Dayton and the Republican-controlled legislature, a \$650 million (over two years) tax relief omnibus bill was signed into law. While ALEC does not consider all portions of this omnibus bill to be fiscally responsible policy—such as provisions to help with privately-financed sports stadiums—it does contain some broad-based tax reductions.

Minnesota is one of the few states in the Midwest with split party control—that is, the legislative chambers and governorship are not controlled by the same party. In fact, except for 2013-2014, the state has not been controlled by one party since 1990. Because of this, Minnesota tends to swing back and forth regarding policy choices, and tax policy is no exception. For instance, the state legislated major tax increases in the 2013 session but partially reversed direction

the following year and qualified for our 2014 edition of *Tax Cut Roundup*. The political dynamics of the state make this tax reduction success even more notable.

Although not all of these provisions qualify as broad-based tax cuts, some of the following provisions of *House File 1* are worth mentioning: tax deductions for Social Security beneficiaries, contributions to 529 college savings plans, student loan interest and first-time homebuyers; increased tax credits for individuals with dependents, beginning farmers, research and development and low-income working families; a reduction of the tax on premium cigars; an increase in the estate tax exclusion; and a freeze on the state general levy applying to commercial-industrial property and seasonal-recreational property.<sup>viii</sup>

## **New Hampshire**

*2017 Rich States, Poor States Economic Outlook Rank: 18*

The Live Free or Die State continues to distinguish itself from high-tax states in the Northeast. Lawmakers doubled down on improving their business climate by reducing their business taxes. H.B. 517 scheduled reductions for both the Business Profit Tax (BPT) and the Business Enterprise Tax (BET) for calendar years 2019 and 2021. Over the three-year period, the BPT and BET will be lowered from 7.7 to 7.5 percent and from 0.6 to 0.5 percent, respectively. While the tax cut is not scored, H.B. 517 clearly diminishes the tax burden in a significant manner—an inducement for greater economic growth and opportunity. New Hampshire also repealed an electricity consumption tax, saving residents \$5.5 million dollars in annual utility costs.

New Hampshire lawmakers also repealed the commuter income tax in H.B. 104. Non-resident workers are an obvious beneficiary; but this also improves the ease of operating or starting a business in the state.

## **North Carolina**

*2017 Rich States, Poor States Economic Outlook Rank: 3*

In a spectacular end to the 2017 session, the North Carolina legislature enacted a new budget—in an override of Governor Roy Cooper’s veto—that once again prioritizes spending and cuts the state’s personal and corporate income tax rates. Keep in mind, these reductions are in addition to the long-term phase-ins from prior reforms. The 2017 legislation phases in several major tax relief objectives, most notably, lowering the state’s flat personal income tax rate further from 5.499 to 5.25 percent and the corporate tax rate from 3.0 to 2.5 percent, effective January 2019. Better yet, the franchise tax rate for S-Corporations also received a reduction.

With a corporate rate already the lowest in the country among states that levy such a tax, this move further enhances the pro-growth momentum the state has experienced over the last six to seven years.<sup>ix</sup> Annual growth in state spending has held well below the rate of population growth plus inflation, avoiding the spending excesses that torpedoed the much-discussed Kansas reforms. Repeated budget surpluses in the hundreds of millions of dollars illustrate the benefits of pro-growth tax relief paired with spending prioritization.

The past several years in North Carolina exemplify the strength of pro-growth tax reform. Called “the most significant tax reform of this decade,” desire for a more competitive economy has brought reforms to nearly every section of the state’s tax code. Since 2011, the sales tax, property tax, personal income tax and even the corporate income tax have all been reformed and reduced. Further, in 2013, lawmakers repealed the Death Tax.

North Carolina’s continued efforts regarding tax reform have spurred near-record growth since 2013. The phase-in of additional tax relief has further enhanced the state’s economic competitiveness. Strong domestic in-migration and non-farm payroll job growth put North Carolina ahead of every regional competitor and in the top-10 nationwide in overall economic performance, according to *Rich States, Poor States*.<sup>x</sup> Taking all cuts into account, lawmakers will have provided an estimated \$15 billion in tax relief for citizens of the Tar Heel State—an average of nearly \$1,500 for each resident.<sup>xi</sup>

## Ohio

*2017 Rich States, Poor States Economic Outlook Rank: 19*

The Ohio budget bill signed by Governor Kasich last year resulted in several tax reductions. While this publication will not commend all changes in the bill, such as targeted tax breaks or the temporary sales tax holiday, overall most Ohio taxpayers should experience a small net tax cut beginning in 2018.<sup>xii</sup>

Governor Kasich initially intended to both consolidate the number of personal income tax brackets and reduce the rates, in exchange for a broader sales tax base; but the state legislature disagreed with this approach. The number of brackets were successfully consolidated from nine to seven, resulting in no tax on the first \$10,650 of personal income. Additionally, the bill includes a deduction increase for college and disability savings.

## Wisconsin

*2017 Rich States, Poor States Economic Outlook Rank: 14*

The Badger State has been on a tax-cutting spree over the past several years, and has qualified for *Tax Cut Roundup* each year except 2016. Wisconsin struggled to pass a budget in 2017 and was nearly the last state to do so, but when all was said and done, Wisconsin taxpayers scored a major win.

During the 2017 session, Wisconsin eliminated two taxes entirely: the alternative minimum tax (AMT) and the state portion of the property tax, also known as the “forestry mill tax.” In total, while certain fees were increased, the changes will decrease net taxes by nearly \$150 million during the current budget cycle.<sup>xiii</sup> By the end of the current budget cycle in 2019, Wisconsin taxpayers will have received approximately \$8 billion in cumulative tax relief over Governor Scott Walker’s time in office.<sup>xiv</sup>

## Trends in State Tax Reform

Despite widespread budget weakness across states, an additional 9 states enacted broad-based tax relief during 2017 legislative sessions. Lawmakers faced uncertainty related to the proposed changes to federal tax policy (the Tax Cuts and Jobs Act was not signed into law until December 2017), weakening state revenues, and spending hikes. In addition, multiple states chose not to enact new tax cuts, but continued to experience the positive effects from the phasing in of previously enacted lower tax rates. Even with these tailwinds, 9 states enacted qualifying reductions of taxation on productivity and capital.

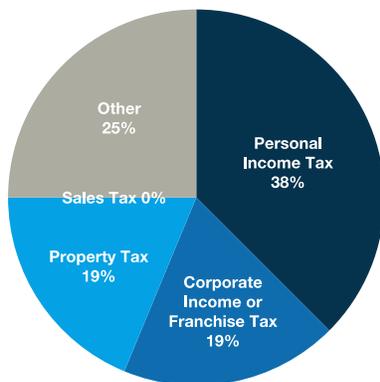
Taxes on productivity and capital, most notably corporate and personal income taxes, are among the most harmful to economic growth. Six of nine qualifying states chose to reduce or reform their personal income taxes. A continuation of this trend will boost those states’ economies. Further, three of the nine states elected to reduce or eliminate business

franchise or corporate income taxes, and four of the nine reduced or eliminated other miscellaneous taxes, including egregious business-to-business transaction taxes.

Nationally, 2017 continued efforts by lawmakers in both the 2015 and 2016 sessions to reduce tax burdens on productivity and capital, particularly by reforming corporate income taxes. The figure below details tax cuts by the type of tax reduced in the 2017 legislative sessions. Note the total exceeds the number of qualifying states (nine) due to the fact several of those states reduced more than one specific tax during the 2017 legislative sessions.

### Tax Cuts by Type

**FIGURE 2 | 2017 STATE TAX CUTS BY FORM OF TAXATION**

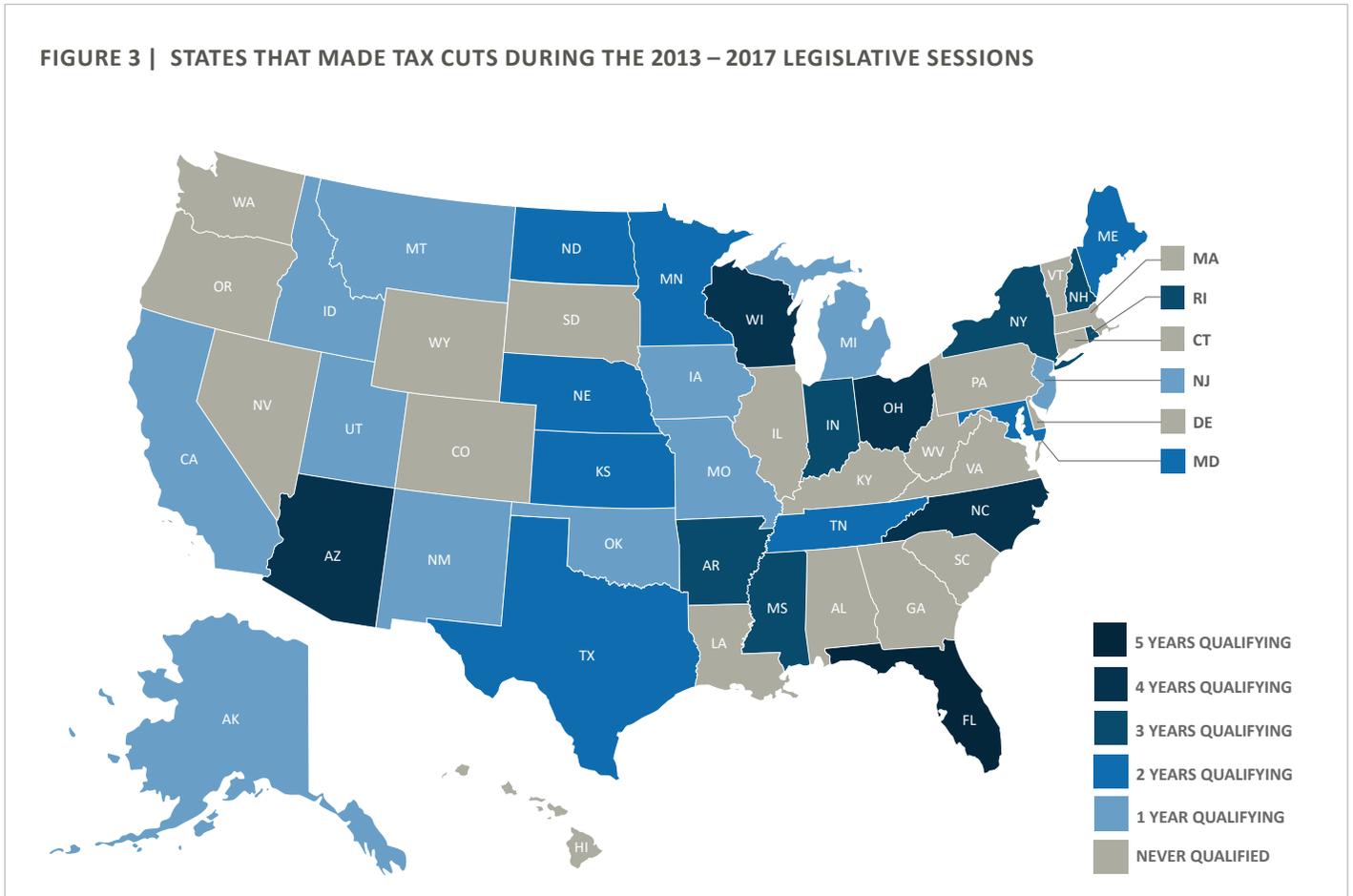


For many of the states in this year’s *State Tax Cut Roundup*, making the cut was almost “business as usual.” One of the nine qualified for its fifth year, four of the nine were qualifying for their fourth year, three for their third, and two for their second. North Carolina—which has maintained one of the best economic outlook rankings in *Rich States, Poor States* since beginning a series of major tax reforms in 2011—deserves special recognition. In the 2017 legislative session, the Tar Heel State provided substantial tax relief to its residents, enacting policy that continues to be the standard for state tax reform. The Sunshine State also achieved something incredible—Florida lawmakers successfully enacted significant pro-growth tax reform for

the fifth consecutive year, earning the honor of being the only state to make it into every edition of *State Tax Cut Roundup*. The map below details the cumulative number of times each state has qualified for this publication over the 2013-2017 legislative sessions.

**States Qualifying for State Tax Cut Roundup During the 2013-2017 Legislative Sessions**

**FIGURE 3 | STATES THAT MADE TAX CUTS DURING THE 2013 – 2017 LEGISLATIVE SESSIONS**



**Implications of State Taxes for Economic Growth**

State lawmakers possess the power to create a tax and fiscal policy environment conducive to economic growth. Individuals, businesses and even government revenues benefit from the increased savings and investment spurred by a growth in total economic output. Poorly designed tax policy creates a fundamental disconnect between work and reward, driving out the key ingredients to earned success. Although the core functions of government certainly require tax revenue, the tax system should strive to impose a minimal burden on the people and limit market distortions.

A large volume of academic literature finds taxes negatively affect economic growth,<sup>xv</sup> but some forms of taxation stunt economic growth more than others. Organization for Economic Development (OECD) scholars found taxes on income and capital are far more distortionary and harmful<sup>xvi</sup> to economic growth than consumption taxes such as sales and property taxes.<sup>xvii</sup> Comparing economic growth within the states, it is no surprise those relying primarily on income taxes substantially underperform their lower or no-income-tax counterparts.

**TABLE 1 | NINE ZERO EARNED INCOME TAX STATES VS. NINE HIGHEST EARNED INCOME TAX (PIT) RATE STATES**

State	1/1/17	2006-2016				In 2004-2014
	Top Marginal PIT Rate†	Population	Payroll Employment	Personal Income	Gross State Product‡	State & Local Tax Revenue§
Avg. of 9 Zero Earned Income Tax Rate States*	0.0%	11.9%	7.0%	44.2%	31.2%	55.7%
50-State Avg.*	5.6%	8.8%	5.6%	44.4%	41.2%	44.0%
Avg. of 9 Highest Earned Income Tax Rate States*	10.3%	5.6%	3.6%	38.6%	32.9%	53.1%

Similar to personal income taxes, individuals ultimately bear the burden of corporate income and other business taxes. Businesses collect and remit the taxes, but the taxes may be absorbed by consumers in the form of higher prices, by workers in the form of lower wages, or by shareholders in the form of lower realized earnings. Robust statistical analysis in a U.S. Treasury Department paper concluded labor bears a substantial portion of the corporate income tax burden in the long-run. Worse, they found this incidence shifting occurs even in the short run immediately following tax increases.<sup>xviii</sup> Further, research by Brown University economist David Weil notes a strong correlation between capital invested and worker wages. By taxing business income and capital, states reduce the free capital stock, reduce capital investment, hurt workers and fundamentally stunt economic growth.<sup>xix</sup>

Among taxes on capital, gross receipts taxes are especially egregious thanks to the taxes incurred at each layer of production until delivery to the end user, greatly increasing the final price of a given good or service (a process known as “tax pyramiding”). Tax pyramiding is especially harmful to industries with longer cycles like manufacturing and consumer retail.<sup>xx</sup>

Corporate income, franchise and gross receipts taxes all fall primarily on the backs of workers, consumers, capital investment or shareholders; a less robust economy is the unfortunate result. Even if the degree to which taxation affects economic growth is not always agreed upon, a majority of economists agree taxes negatively affect economic growth. The Tax Foundation surveyed peer-reviewed studies on the relationship between taxes and economic growth and found that of 26 peer-reviewed studies since 1983, 23 found a negative relationship between taxes and economic growth and the other three found no relationship at all.<sup>xxi</sup> Christina Romer, formerly head of President Obama’s Council of Economic Advisors, and her husband David Romer, have found similar results. Their study concluded every 1 percent increase in taxation lowers real GDP by 2 to 3 percent.<sup>xxii</sup> They also found corporate income taxes are the most damaging to economic growth, followed by personal income taxes and finally consumption taxes.

### Conclusion

While the academic and empirical results demonstrate lower taxes contribute to higher rates of economic growth, there are always some who remain unconvinced. Fortunately, economic reality factors into state tax policy. The 30 states qualifying for inclusion in this publication over the last five years have cut taxes, returning billions to hardworking taxpayers. Thanks to the powerful stories of success championed by these states and so many others, showing that broad-based, pro-growth tax relief is the best way to grow economies, increase entrepreneurship and improve lives, Congress followed suit and passed the most significant federal tax reform in 31 years.

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