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# State Tax Cut Roundup



2015 Legislative Session

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## I: Executive Summary—Tax Reform in the States

The 2015 legislative session featured a notable number of states achieving tax relief and tax reform for their citizens. Pro-growth tax reform was a key theme throughout the 2015 legislative session, as many states took steps to improve their economic competitiveness. In this past legislative session, 17 states substantially reduced their tax burdens. The 8th edition of *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index* is a great guide to which tax and fiscal policies lead states to prosper and others to fall behind. Overall, the economic evidence strongly suggests that states with lower tax burdens and more economic freedom regularly outperform their higher tax and more restrictive counterparts.

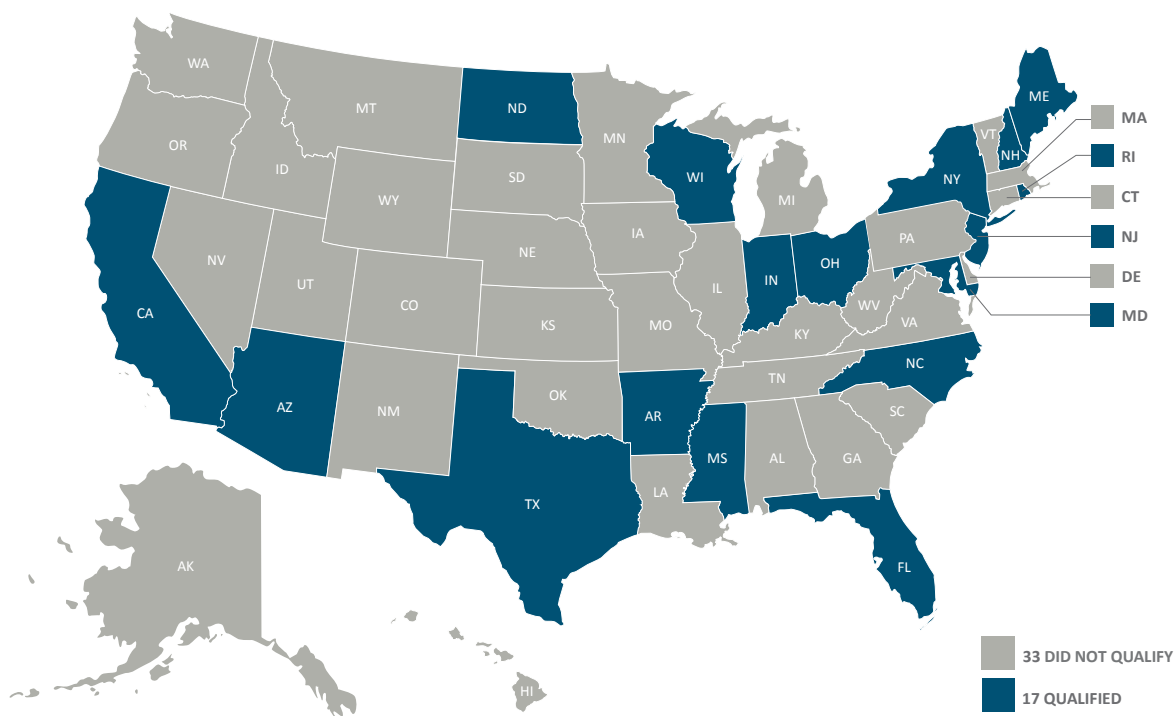
Key highlights of tax reform developments occurring in 2015:

- Four states—Florida, Indiana, Ohio and Wisconsin—have qualified for all three editions of the *State Tax Cut Roundup*. Nine of the 17 states have qualified once previously, while 21 states have yet to qualify.
- 10 states cut their personal income tax burdens, eight states reduced corporate income tax or business franchise tax burdens, six states reduced their property tax burdens, four states cut excessively high fees or tolls, three states cut their sales tax burdens, three states cut discriminatory taxes and one state reduced the burden of the death tax.
- 10 states that did not cut taxes in 2015 saw taxes reduced based on previously passed law, as scheduled tax reductions phased-in, revenue triggers were met or temporary tax increases were allowed to expire. Five additional states featured both tax reductions in 2015 and also tax decreases taking place as a result of previously passed laws.
- 13 tax cutting states featured Republican governors and four had Democrat governors. Of the tax cutting states, 11 featured a legislature with unified Republican control, four with unified control of the legislature by Democrats and two with a “split” legislature. 10 tax cutting states featured unified control of both houses of the legislature and governor’s office by Republicans and two by Democrats.
- 13 of the tax cutting states featured a call by the state’s governor for tax reform during the state’s 2015 state of the state address.<sup>1</sup>
- 10 of the states cutting taxes in 2015 featured overall state and local tax burden rankings in the top 20 of highest tax burden states. Only two states that cut taxes were among the 10 lowest taxing states.
- Considering the *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index* economic outlook rankings, four of the states cutting taxes in 2015 ranked among the top 10 most competitive for economic outlook, four ranked between 11th and 20th, three ranked between 21st and 30th, two ranked between 31st and 40th, and four ranked among the 10 least competitive states.<sup>2</sup>

To be listed in the *State Tax Cut Roundup*, a state must meet all of the following criteria:

- Substantially cut taxes at the state level
- Vote(s) and/or policy change occurred during the 2015 legislative session
- Tax cuts must result in a net decrease in taxes over the legislative session
- Tax cuts must apply broadly and neutrally, or otherwise move the state closer to the ALEC *Principles of Taxation*

Figure 1: States That Qualified for State Tax Cut Roundup During the 2015 Legislative Session



## II: 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.

## III: Tax Cuts in 2015 by State

**Arizona**

*2015 Rich States, Poor States Economic Outlook Rank: 5*

Following a 2014 legislative session that saw several good tax policy changes and a *Rich States, Poor States* economic outlook ranking of 7, Arizona kept up its tax-cutting momentum during the 2015 legislative session.

Arizona is gradually reducing the insurance premium tax rate from 2 percent to 1.7 percent over the course of 10 years and those phase-ins continued during the 2015 legislative session.<sup>3</sup> Insurers in Arizona do not pay normal corporate income taxes and are instead subjected to the insurance premium taxes, which is based on revenue rather than income.<sup>4</sup> Because of how the insurance premium tax is calculated, Arizona insurers often suffer higher effective tax rates than other corporations operating within the state. Reducing their tax burden will serve to make Arizona’s economy even more competitive for years to come and

reduces the price of insurance for the state's citizens. This particular measure will save Arizona taxpayers \$1.3 million in 2016 but will gradually rise as the cuts continue to phase-in.<sup>5</sup>

State legislators provided additional relief to Arizonans by permanently fixing each income tax bracket to the Metropolitan Phoenix Consumer Price Index, essentially adjusting the brackets for inflation, which will return \$15.4 million to the taxpayers in 2017 and \$24.7 million in 2018.<sup>6</sup>

## Arkansas

*2015 Rich States, Poor States Economic Outlook Rank: 22*

Arkansas Governor Asa Hutchinson, fresh off a November 2014 election win, set out early in the 2015 legislative session to lead an effort to reduce the burden of the state's personal income tax. Arkansas passed personal income tax reform that reduced the tax burden on middle-class taxpayers, reducing the rate from 7 percent to 6 percent on income between \$36,000 and \$75,000 and from 6 to 5 percent on income between \$21,000 and \$35,000.<sup>7</sup> The cut is expected to put more money in the pockets of the 600,000 Arkansas taxpayers in 2016.<sup>8</sup> Additionally, the state increased the exclusion for net capital gains from 30 percent to 50 percent and created an exemption for net capital gains in excess of \$10 million.<sup>9</sup>

## California

*2015 Rich States, Poor States Economic Outlook Rank: 44*

The California State Legislature managed to participate in this year's wave of tax reductions. The state installed a new Earned Income Tax Credit (EITC) equal to 85 percent of the federal credit, which will return \$380 million to California taxpayers in 2016.<sup>10</sup> Though the move does reduce California's personal income tax burden, it does little to address the harm to economic growth caused by the state's destructive income tax code. California continues to hold the dubious distinction of having the nation's highest personal income tax rate and most progressive income tax code.<sup>11</sup>

## Florida

*2015 Rich States, Poor States Economic Outlook Rank: 15*

Florida's 2015 tax cuts qualified the state for the *State Tax Cut Roundup* for the third consecutive year. The big ticket item of the session was the reduction of the state's Communication Services Tax from 6.65 percent to 4.92 percent, cutting \$266 million in taxes for Florida residents.<sup>12</sup> This measure was overdue, as Florida had the fourth highest state wireless taxes before the reform, reaching a full 22.38 percent effective rate when combined with federal taxes.<sup>13</sup>

Additionally, Florida reduced sales taxes on business-to-business transactions for agricultural products.<sup>14</sup> As the Council on State Taxation and others have pointed out, business-to-business transactions should never be included in the sales tax base. Doing so causes "tax pyramiding" where the effective rate of taxation compounds as taxes are levied on each step of the chain of production.<sup>15</sup> As such, reducing or eliminating these sales taxes levied on business-to-business transactions is always sound tax policy.

Florida policymakers also chipped away at the corporate income tax burden by expanding the research and development tax credit.

## Indiana

*2015 Rich States, Poor States Economic Outlook Rank: 3*

Indiana makes the *State Tax Cut Roundup* for the third straight year following strong tax reform. The state continued to see tax cuts phase-in during 2015 from past tax reform, including a corporate income tax rate decrease from 8.5 percent to 7 percent, a personal income tax rate cut from 3.4 percent to 3.3 percent and a reduction in the tax rate of the financial institutions tax from 8 to 7.5 percent. Moreover, the same past reform bills responsible for these cuts provide for additional, scheduled cuts in future years.

These and other tax reforms, in addition to the passage of right-to-work, have pushed Indiana's *Rich States, Poor States* economic outlook ranking from 24 in 2012 to 14 in 2013, and third in 2014 and 2015. Building on these recent pro-growth reforms, Indiana set out to broaden tax bases, lower rates and otherwise improve the structure of their tax code during the 2015 legislative session. Though Indiana aimed for near revenue neutrality, the state qualifies as cutting taxes under this study's methodology, both due to careful examination of revenue scores, as well as the soundness of the state's reforms.<sup>16</sup>

Indiana continued chipping away at the impact of its business personal property tax in 2015 by passing an exemption of \$20,000 of total business personal property in a county. In addition to reducing taxes state-wide by roughly \$8.5 million, the measure has the more notable effect of allowing a full 50 percent of Indiana businesses to avoid both filing and paying the tax, lowering both taxes and compliance costs. Additionally, the state took on two other structural issues by repealing the state's "throwback rule" and working to chip away at the state's "double-direct sales tax exemption." Both matters are rather technical from a tax compliance standpoint but provide a disincentive to state economic growth.

## Maine

*2015 Rich States, Poor States Economic Outlook Rank: 42*

A series of cuts in the 2015 session underscored Governor Paul LePage and the Maine Legislature's commitment to phasing down or perhaps eventually ending the state's income tax, once and for all. Raising the estate tax exclusion to \$5.45 million, which was passed in the last session and will incentivize individuals to reside and retire in Maine.<sup>17</sup> The most dramatic reform, both politically and economically, was the reduction of Maine's top marginal personal income tax rate from 7.95 percent to 7.14 percent by 2020.<sup>18</sup> Maine's outlook will improve if the state continues to implement broad-based tax and spending reforms.

## Maryland

*2015 Rich States, Poor States Economic Outlook Rank: 33*

Newly elected Maryland Governor Larry Hogan was stymied in many of his proposed tax reform efforts by majorities in both the state House and Senate. Left without legislative support, Governor Hogan turned to executive action. According to the Tax Foundation, Maryland had the 7th highest state and local tax burden

in the nation, taking in 10.9 percent of all state income.<sup>19</sup> So, Governor Hogan turned to a revenue measure he had unilateral control of and could reduce without votes from the legislature: tolls. Maryland cut many of its chronically high toll rates in 2015, which most notably featured an increase for the E-ZPass Maryland discount from 10 percent to 37.5 percent at the Bay Bridge and a toll reduction from \$5.40 to \$2.50.<sup>20</sup> The toll reductions took effect on July 1, 2015 and are projected to save Maryland citizens \$270 million over the next five years.<sup>21</sup>

## Mississippi

*2015 Rich States, Poor States Economic Outlook Rank: 20*

Mississippi aimed high at improving their state tax code during the 2015 legislative session. Policymakers attempted to pass a long-term plan to completely phase-out their personal income tax, in addition to considering legislation eliminating Mississippi's franchise tax on investments in business property and capital, creating self-employment deductions, creating a state earned income tax credit and exempting or reducing the personal income tax on taxpayers' first \$5,000 to \$10,000 of income.<sup>22</sup> Though these measures fell short due to opposition, Mississippi was able to pass two substantive tax cuts during the 2015 legislative session.<sup>23</sup>

Mississippi lowered their alcoholic beverage license tax by eliminating the state portion, while retaining the local portion.<sup>24</sup> Additionally, the state repealed its state motor vehicle inspection law and the related fee, which is expected to save drivers between \$2 million and \$3 million during the average year.<sup>25</sup> Though both tax cuts fall short of the state's bold 2015 tax reform goals, Mississippi policymakers will reportedly be taking another shot at tax reform during the 2016 legislative session.<sup>26</sup>

## New Hampshire

*2015 Rich States, Poor States Economic Outlook Rank: 29*

While the Live Free or Die State does not levy a tax on sales or personal wage income, the state's high business tax rates have caused New Hampshire to rank only 29th in economic outlook. During the 2015 legislative session, New Hampshire lawmakers reformed the state's business taxes as part of the state budget. Furthermore, lawmakers also provided New Hampshire homeowners with property tax relief during the session.

Seeking to improve New Hampshire's economic competitiveness, lawmakers passed a budget early in the 2015 session that would have provided much needed tax relief for employers through cuts to the state's Business Profits Tax (BPT) and Business Enterprise Tax (BET). Despite both taxes placing a heavy burden on employers, New Hampshire Governor Maggie Hassan vetoed the initial tax relief.

After months of debate over the budget, Governor Hassan and state legislators finalized a budget that would reduce both the BET and BPT over several years.<sup>27</sup> As part of the budget, starting in 2016, the BPT was reduced from 8.5 percent to 8.2 percent and the BET was reduced from 0.75 percent to 0.72 percent. In 2018, the BPT will be reduced from 8.2 percent to 7.9 percent and the BET will be reduced from 0.72

percent to 0.675 percent, but only if the general and education trust funds meet certain levels.<sup>28</sup> While the final budget is a watered-down version of the original tax relief provisions, it is still encouraging to see New Hampshire move toward tax reform. Additionally, lawmakers also included a provision in the budget that increases the research and development credit from \$2 million per year to \$7 million per year, starting on July 1, 2017.

Additionally, New Hampshire residents can look forward to modest property tax relief this year. Effective January 1, 2016, the homestead exemption amount increased from \$100,000 to \$120,000 for an individual and from \$200,000 to \$240,000 for couples filing jointly.<sup>29</sup>

### **New Jersey**

*2015 Rich States, Poor States Economic Outlook Rank: 46*

In 2010, under fiscal duress caused by the fiscal squeeze of excessive pension debt coupled with the effects of the economic recession, New Jersey reduced the size of its Earned Income Tax Credit (EITC). That cut was more than restored in 2015, when the state raised its EITC by 50 percent – from 20 percent to 30 percent of the federal tax credit for low-income workers. The move is expected to reduce revenues by \$122 million in 2016, while providing relief to roughly 500,000 Garden State residents.<sup>30</sup>

### **New York**

*2015 Rich States, Poor States Economic Outlook Rank: 50*

New York's poor tax climate has produced a dismal economic outlook ranking of 49 or 50 in all eight editions of *Rich States, Poor States*. However, New York leaders again took small steps toward a pro-growth economy during the 2015 legislative session, by providing property tax relief and repealing 57 fees.

New York lawmakers passed a bill that extends the property tax levy cap until June 15, 2020.<sup>31</sup> According to the Empire Center for Public Policy, the law is designed to limit "the annual growth of property taxes levied by local governments and school districts to 2 percent or the rate of inflation, whichever is less."<sup>32</sup> If local governments want to go above the spending limit, then they must obtain approval of more than 50 percent of the members of the governing body. School districts must also obtain a majority vote from voters in their community.<sup>33</sup> The property tax levy cap was set to expire in 2016, but New York lawmakers extended the sunset date to June 15, 2020.<sup>34</sup>

The bill also includes a property tax credit rebate, which is not the most effective way to decrease property taxes for all New Yorkers, according to the Empire Center for Public Policy.<sup>35</sup> Given that the property tax rebate credit only applies to individuals that meet a certain criteria and is a rebate check and not a reduction to rates or improvement to the tax code's structure, many in the state have criticized the measure as a gimmick, despite it putting some money back into taxpayers' pockets.<sup>36</sup>

Finally, New York leaders repealed 57 nuisance fees as part of the 2015-2016 budget. These burdensome fees provided plenty of red tape and fiscal headaches for taxpayers and businesses across the state.

Elimination of these 57 fees is projected to save taxpayers \$3 million.<sup>37</sup> Extending the property tax cap and eliminating 57 fees will help the Empire State to be more competitive for jobs and investments.

### North Carolina

*2015 Rich States, Poor States Economic Outlook Rank: 4*

The 2013 legislative session featured North Carolina passing some of the most significant tax reform of any state in recent decades.<sup>38</sup> After letting those multi-year tax cuts continue to phase-in during the 2014 legislative session, the state passed additional tax cuts in 2015 on top of the additional scheduled phase-ins from the 2013 reform package.

In 2015, previously passed cuts phased down the personal income tax rate from 5.8 percent to 5.75 percent, and the corporate income tax rate from 6 percent to 5 percent. Despite this, the legislature did not rest and pushed for more. Most notable from this second round of tax reform is the decrease of the personal income tax rate from 5.75 percent to 5.499 percent in 2017 and the repeal of the state's bank privilege tax.<sup>39</sup> Additionally, the state increased or reinstated numerous personal income tax credits and deductions that were reduced or eliminated as part of the 2013 reform package.<sup>40</sup>

Without question, the 2015 legislative session was another year of strong reform for North Carolina taxpayers. Not only did the personal income tax and corporate income tax rates drop as a result of continued phase-ins from the 2013 reform package, state policymakers reduced the personal income tax further and made other notable reforms. North Carolina had a *Rich States, Poor States* economic outlook ranking of 22 as of 2013. Due to the 2013 reforms, the state jumped to 6 in 2014 and 4 in 2015. The combination of continued phase-ins, hitting revenue triggers and additional reform is likely to continue bolstering North Carolina's competitiveness in years to come.

### North Dakota

*2015 Rich States, Poor States Economic Outlook Rank: 2*

North Dakota passed significant tax cuts and other tax reforms for the 2015-2017 biennium budget. The citizens of North Dakota will enjoy an estimated \$397 million in tax relief.<sup>41</sup> This includes \$250 million in property tax reductions by renewing the state paid tax credit program for the next two years. This means all North Dakota property owners will again see a 12 percent reduction in their property taxes. Finally, eligibility for the Homestead Tax Credit program was increased for the second year of the coming biennium. This is estimated to save North Dakotans about \$21 million.

Beyond property tax cuts, the state passed \$123 million in individual and corporate income tax relief, including cutting personal income tax rates by 10 percent and corporate income tax rates by 5 percent across all tax brackets. The oil extraction tax was reduced from 6.5 percent to 5 percent and various exemptions were removed. While the fiscal impact of this last tax cut is unknown, it is generally considered good policy to lower rates and broaden the base.

Finally, the state also enacted some positive structural tax reforms. The Governor's Task Force for Property Tax Reform reviewed the state's property tax system beginning in December 2013. The legislature adopted the Task Force's recommendations in 2015, resulting in the consolidation of tax levies and the repeal of 40 others. Also, votes will now be required to continue existing mill levies, ensuring that voters support these taxes. The reforms also include limits on mill levies and grant greater flexibility for political subdivisions to develop their operating budgets.

## Ohio

### *2015 Rich States, Poor States Economic Outlook Rank: 23*

Ohio enacted significant tax cuts in their 2016-2017 biennium budget, qualifying the state for the *State Tax Cut Roundup* for the third consecutive year. The citizens of Ohio will see nearly \$1.9 billion in net tax cuts over the next two years, including a 6.3 percent state income tax cut across all brackets which is retroactive back to January 1, 2015. The budget also maintains the existing 75 percent tax deduction on the first \$250,000 of business income for sole proprietorships and pass-through entities.<sup>42</sup> The rate had been temporarily raised for tax year 2014 from 50 percent to 75 percent for one year and scheduled to reset back to 50 percent in 2015.<sup>43</sup> However, 2015 legislative action maintained the 75 percent rate for 2015 and increased that to 100 percent on the first \$250,000 of income for 2016 and forward.<sup>44</sup>

Additionally, before 2015, business income above \$250,000 was subject to the standard personal income tax rates. However, for 2015 income above \$250,000, business owners and their investors will pay a graduated tax rate that mirrors the personal income tax brackets only up to \$41,700.<sup>45</sup> Beyond that income level, the tax will now top out at 3 percent, as opposed to continuing on a graduated path to the 4.997 percent top marginal personal income tax rate.<sup>46</sup> In 2016 and beyond, this will change to a flat rate of 3 percent on all business income above \$250,000.<sup>47</sup> These changes mean that many small businesses in Ohio will see significant tax reductions.<sup>48</sup>

Another noteworthy aspect of the Governor's budget is that it mandates a tax policy commission to recommend how to move Ohio's personal income tax to a 3.5 or 3.75 percent flat rate by 2018. This would be yet another sound tax reform if it were to be enacted.

While there are many positive tax reforms in Ohio's budget, not everything was pro-growth. The Governor originally proposed increasing several taxes, including the sales tax, severance tax, commercial activities tax and cigarette tax and using some of that revenue to offset a 23 percent cut to the state's income tax.<sup>49</sup> With the legislature only approving a 6.3 percent cut to the income tax, it is fortunate that they also rejected most of these tax increases. However, a 35 cent per pack tax increase on cigarettes was enacted as part of the budget.

## Rhode Island

*2015 Rich States, Poor States Economic Outlook Rank: 39*

Rejecting the Northeastern tendencies to consistently raise taxes, Rhode Island extended a sales tax exemption on energy products and services to businesses.<sup>50</sup> Previously, the exemption only applied to individuals. As noted above regarding Florida's 2015 tax reforms, a study by the Council on State Taxation on taxing business services or business-to-business transactions, these business inputs should never be taxed, as doing so causes tax pyramiding.<sup>51</sup> Tax pyramiding causes the effective rate of taxation of a final product to compound as taxes are levied on both the value of a product as well as the embedded tax cost in the product. This effect increases as the product makes its way through the value chain of production, much like the effect of compounding interest. As such, reducing or eliminating these sales taxes levied on business-to-business transactions is always sound tax policy. The cut will save Rhode Island taxpayers \$24.4 million in the 2016 fiscal year. Rhode Island taxpayers will also enjoy an expanded Earned Income Tax Credit in 2016 and a reduction in the corporate minimum tax.<sup>52</sup> State lawmakers also repealed a surcharge on medical imaging services such as CT scans and MRIs. The surcharge was equal to 2 percent of a patient's total bill.<sup>53</sup>

## Texas

*2015 Rich States, Poor States Economic Outlook Rank: 11*

The Texas Legislature only meets every other year, and as such, pushed hard for tax reform during the 2015 session of the legislature and managed to pass a significant package of tax reforms. Annual professional fees, which in this case more closely resemble a tax, were eliminated for more than 600,000 Texas workers, saving the taxpayers more than \$125 million.<sup>54</sup> The crown jewel of the session, however, was when the legislature sent a massive \$3.8 billion package of tax cuts to Governor Greg Abbott.<sup>55</sup> The package included a reduction to the business franchise tax or "Margins Tax," as well as an increase in the homestead exemption.<sup>56</sup>

Furthermore, Texas legislators reduced or eliminated onerous taxes that were misleadingly labeled fees. Fees on the delivery of some petroleum products, the diesel surcharge on the lease or sale of certain machinery, and the elimination of many \$200 professional licensing fees. These served mostly to raise general revenue and created a barrier to entry in these professions, thus their repeal was important as a tax cut and toward embracing a free and open economic environment. By the reduction or elimination of these taxes, Texas taxpayers will save a total of \$306.5 million in the 2016-2017 biennium fiscal window.<sup>57</sup>

## Wisconsin

*2015 Rich States, Poor States Economic Outlook Rank: 13*

Wisconsin continued cutting property taxes, as the state has for the past several years. This time the biennium budget increased the School Levy Tax Credit by \$211 million. This amount will come from state coffers and will be transferred from the state to municipalities, who are then required to lower property taxes. Similarly, the budget provides an additional \$108 million to school districts, which are also required to use the money to reduce property taxes.<sup>58</sup> This money will result in a small tax cut for the average

Wisconsin property owner of about \$5 a year.<sup>59</sup> However, it should also be noted that this makes the sixth straight year the citizens of Wisconsin have seen their property taxes frozen or reduced.<sup>60</sup>

The budget also contained some other tax reforms that will result in tax relief. The legislature increased the standard deduction for married filers starting in fiscal year 2017, reducing the “marriage penalty,” that results from single filers being able to claim a larger combined deduction than those filing jointly. The state also aligned Wisconsin’s Alternative Minimum Tax (AMT) to the federal AMT by adopting federal AMT exemption amounts and indexing provisions starting in fiscal year 2017.

## IV: Other Notable Tax Reductions in 2015

Separate from whether a state actively cut taxes both substantially and in a sound format during the 2015 legislative session, thus qualifying the state for the *State Tax Cut Roundup*, taxpayers in many states saw more money in their pockets or a friendlier tax code in 2015 by other means. Many taxpayers saw tax reductions in 2015 due to previously passed legislation phasing in prescribed tax rate reductions or achieving “revenue triggers” that, if met, unlocked tax cuts passed in previous legislative sessions but that were structured to not immediately take effect. Other states saw tax reductions due to past temporary tax increases—often passed due to an economic downturn or budget shortfall—which were finally allowed to expire.

These states do not qualify under the methodology of the *State Tax Cut Roundup* as tax cutting states for the 2015 session, but still merit recognition for their broader tax reform efforts and past tax reform efforts coming to fruition and entering the tax code in 2015. The narratives that follow detail the most notable and substantial of these developments. These states should not be counted among the 17 states that substantively cut taxes in 2015. Rather, these states give a greater context of the broader picture of state tax policy in 2015 from the perspective of sound, pro-growth tax principles.

### Phase-Out of Temporary Tax Increases

Two states—Hawaii and Illinois—maintained their scheduled phase-outs of temporary tax increases. Both states passed these temporary tax hikes in the wake of the recent recession – instead of adjusting spending to meet revenues as state taxpayers were forced to do. These so-called temporary tax hikes are often later added permanently to the state tax code, due to the failure of state policymakers to right the state’s fiscal ship. Thus, although Hawaii and Illinois are seemingly just keeping their basic promise to taxpayers, such promise-keeping can be uncommon and as such, both states deserve credit for keeping their commitments to taxpayers.

Hawaii allowed temporary personal income tax rate increases adopted in 2009 to expire at the end of 2015. The temporary tax hike expanded the state’s flat rate into three separate tiers with progressively escalating brackets. The former rates of 9 percent, 10 percent and 11 percent will decrease to a top marginal rate of

8.25 percent. This measure was projected to save taxpayers \$50 million in 2016, thus providing a substantial boost to the pocketbooks of the state's taxpayers.

In 2011, Illinois passed a temporary increase to the personal income tax and corporate income tax rates, due to depressed tax revenues, deep pension debt, massive debt service expense generated by the state's municipal bond debt, an \$8.5 billion backlog of unpaid bills and a fiscally irresponsible desire to not adjust state spending to match revenues during the recession. The constitutionally protected flat rate of the personal income tax increased from 3 to 5 percent and the corporate income tax rate also increased from 4.8 to 7 percent. In 2014, an effort to make the tax increases permanent, as well as repealing the constitutionally protected flat rate structure of the personal income tax, gained substantial momentum but ultimately fell short in the General Assembly.

After the November 2014 election of Governor Bruce Rauner, a firm line was drawn by the executive branch that the tax hikes would be allowed to begin phasing out in 2015 as scheduled by law, with the second and final phase-out coming in 2025. The temporary tax hike collected a stunning \$31.6 billion over five years, yet the state's backlog of bills still stands at \$7 billion, interest payments on debt are 3.5 times higher than in 2011 when the tax hike was passed, the state has seen five credit downgrades in the last 5 years, pension debt remains among the highest of any state and employment continues to substantially lag the rest of the country.<sup>61</sup> These facts continue to stand as major problems for the state but at least Illinois taxpayers saw a substantially smaller tax bill and greater prospects for economic growth in 2015.

### **Phase-In of Previously-Passed Tax Cuts**

10 states—New York, Maryland, West Virginia, North Carolina, Indiana, Pennsylvania, Michigan, New Mexico, Mississippi and Kansas—continued substantial scheduled phase-ins of tax relief passed during previous legislative sessions, meaning that taxpayers will face a smaller tax burden, separate from any new actions taken by the legislature during the 2015 session. It would be deeply remiss to ignore these tax changes, even though they do not officially qualify as 2015 cuts for the purpose of this study, as they are the result of past tax cuts that the respective legislatures had the foresight to firmly schedule for future years, rather than plan on follow-up legislative action in subsequent fiscal years. Taxpayers in these states enjoyed real, meaningful reductions in their tax bills and in the economic disincentives they face as a result of the tax code.

New York is in the second year of a five-year process to gradually increase the state's death tax exemption. Between 2015 and 2016, the threshold increases from \$2,062,500 to \$3,125,000.<sup>62</sup> The exemption will increase to \$4,187,500 for 2016-2017, \$5,250,000 for 2017-2019 and will match the federal exemption as of 2019.<sup>63</sup> This is good news, for those attempting to engage in end of life planning along with those set to inherit the family nest egg, but also for the state's economy as a whole. As previous ALEC research has shown, "the death tax is a bad tax, associated with huge costs and bad incentives, taking in almost no revenue, and without rational justification."<sup>64</sup>

Maryland also continued its phasing-in of an increase to the exemption to its state death tax, increasing from \$1 million to \$1.5 million in 2015.<sup>65</sup> Like New York, Maryland's death tax is scheduled to match the federal exemption in 2019, which is projected to be \$5.9 million that year, but will increase to \$2 million in 2016, \$3 million in 2017 and \$4 million in 2018.<sup>66</sup>

As of January 1, 2015, West Virginia's business franchise tax has been eliminated, down from 0.1 percent. Their business franchise tax was levied as a percentage of a business's overall net worth in a given tax year, which introduced substantial economic distortion, bad incentives and harm to growth, even compared to the extremely damaging corporate profits tax. Most problematic, businesses under some franchise tax regimes can face substantial tax bills even in years when the firm is severely in the red.

Indiana, meanwhile, continued its phase-in of three different tax cuts: the personal income tax, the corporate income tax and the financial institutions tax. The personal income tax rate dropped to 3.3 percent in 2015 and will continue to drop until it reaches 3.23 percent in 2017, the final year of phase-in under current law. In 2015, the corporate rate will similarly drop from 8.5 percent to 7 percent and is reduced every year until it hits 4.9 percent in 2022. As for the financial institutions tax, the rate went from 8 percent in 2014 to 7.5 percent in 2015, ultimately dropping to 4.9 percent in 2023. These policy reforms, along with the adoption of right-to-work, are major reasons why Indiana has skyrocketed up the *Rich States, Poor States* economic outlook rankings, jumping from 24 in 2012 all the way to 3 as of 2014 and 2015.<sup>67</sup>

Similar to Indiana, North Carolina has skyrocketed up the *Rich States, Poor States* economic outlook rankings, thanks to major tax reform that continued to phase-in during 2015.<sup>68</sup> North Carolina ranked 22 in 2013, the year the state's major tax reform package passed, which has subsequently lifted the state to 4 as of 2015. North Carolina's personal income tax rate recently fell from 5.8 percent down to 5.75 percent.<sup>69</sup> While that was the end of scheduled phase-in of the personal income tax reduction, the legislature took the affirmative pro-growth step to pass another cut to the tax, dropping the rate down to 5.499 percent in 2017, helping the state to qualify for the *State Tax Cut Roundup*.<sup>70</sup> Additionally, North Carolina's corporate income tax rate was also cut, due to phase-ins from the 2013 reform, dropping the rate from 6 percent to 5 percent in 2015.<sup>71</sup>

Despite a major 2015 budget battle in Pennsylvania featuring Governor Tom Wolf pushing for tax increases and strong resistance from the state legislature, common ground was at least found on the state's Capital Stock and Franchise Tax.<sup>72</sup> The phase-out of the tax began some 17 years ago under Governor Tom Ridge, but has been delayed numerous times, despite the major economic harm caused by such a tax that penalizes the expansion of business capital.<sup>73</sup> Pennsylvania policymakers united in 2015 to ensure after 171 years, the tax would finally meet its demise, dropping from a rate of 0.67 mills to 0.45 mills in 2015 while collecting some \$242 million and expiring completely on December 31.<sup>74</sup>

Michigan continued to phase-out its damaging business personal property tax in 2015, thanks to nearly 70 percent of voters calling for its end during the August 5, 2014 election.<sup>75</sup> Taxes of this sort are levied against business capital and as such, disincentivize business expansion, thereby distorting competitive markets and substantially harming economic growth. The tax collected \$1.286 billion before the beginning of the phase-out which will terminate the tax after 2023.<sup>76</sup>

New Mexico's scheduled reduction of its corporate income tax continued during 2015, with its maximum rate declining from 7.3 to 6.9 percent.<sup>77</sup> The reform was passed in 2013 when the top tax rate was 7.6 percent, with rate reduction phase-outs beginning in 2014 and continuing each year until 2018 when that top rate falls to 5.9 percent.<sup>78</sup> Without question, New Mexico's 2013 reforms improve economic competitiveness and each year's phase-ins provide a further enhancement to economic growth.

A four-year corporate income tax reduction phase-in, which started in 2014, is underway in Mississippi. It comes in the form of a corporate tax credit offered against inventory taxes paid, designed to defray ad valorem taxes and will provide \$21 million in tax relief for 2016.<sup>79</sup> The credit will continue to phase-in during 2017 but on a much larger scale and will save Mississippi businesses a projected \$126 million during the year.<sup>80</sup>

In 2012, the Kansas Legislature passed, and Governor Sam Brownback signed into law, a historic series of tax cuts. Most notably, the 2012 package of tax reforms phased in a reduction of their personal income tax and created a major exemption for non-wage pass-through business income. Facing mounting political pressure and a budget shortfall, the legislature and Governor Brownback opted to decelerate the income tax phase-down in future years as a supposed deficit-reduction measure.<sup>81</sup> Kansas taxpayers did ultimately see a lower income tax burden in 2015, with the rate dropping from 4.8 percent to 4.6 percent.

### Revenue Triggers Hit

While some states pass tax cuts that phase in on a firm annual schedule, other states predicate future tax reductions on hitting a specific revenue figure, largely to build a factor of caution into future tax cuts. In 2015, four states saw revenue growth that was sufficiently high to unlock tax cuts that would otherwise lay dormant in state law. The taxpayers of Oklahoma, North Carolina, Massachusetts and Oregon enjoyed reduced burdens due to the strength of their 2015 revenues. Colorado would have similarly been a beneficiary of such a trigger, but voters decided to allow the state to spend the extra revenue.

Oklahoma saw its top marginal personal income tax shrink from 5.25 percent to 5 percent in 2015 thanks to the state meeting a revenue trigger enacted in 2014.<sup>82</sup> This measure was originally chronicled in the 2013 edition of *State Tax Cut Roundup* as the 18th tax cut that year, only to later be invalidated by state courts, dropping the tax cut count to 17. The legislature came back in 2014 and again passed the legislation, this time firmly qualifying the state for the 2014 edition of the *State Tax Cut Roundup* and now coming to fruition in 2015 as the state achieved the revenue targets necessary to trigger a reduction to the personal income tax burden.

North Carolina's strong revenue figures during 2015 hit the threshold necessary to trigger a corporate income tax reduction to be implemented in 2016, dropping the corporate rate from 5 percent to 4 percent. This triggered tax cut came on top of scheduled phase-ins during 2015 that reduced the personal income tax and corporate income tax, as well as additional tax cuts that were implemented during the session.

Between 2014 and 2015, Massachusetts reached a revenue collection threshold, triggering an automatic cut in the state's flat personal income tax rate from 5.15 to 5.1 percent. The original legislation that caused the reduction was passed in 2000. Thus, taxpayers will realize a modest income tax savings, which will be appreciated in the state with the 12th highest overall tax burden as a percentage of state income, according to the Tax Foundation.

For the first time since 2007, Oregon has triggered its "kicker," a mechanism built into the tax code that offers taxpayers tax relief when the state collects receipts more than 2 percent above projections for a biennium. Originally the funds were to be distributed through a refund check, but the provision was modified and instead, taxpayers will claim a credit of 5.6 percent on their 2015 state income tax returns. The median tax relief is projected to be \$124 per person, with \$402 million to be paid back in total.<sup>83</sup>

Colorado would have sent its taxpayers a similar refund had voters not opted to allow the state to keep surplus revenue. Under the Taxpayers' Bill of Rights (TABOR), Colorado taxpayers are entitled to a tax refund if the state collects revenue above an amount calculated by factoring together the previous fiscal year's expenditures, population growth and inflation. In part due to the state's recent legalization and taxation of recreational marijuana, the state enjoyed a tax windfall as cannabis left the underground economy and was normalized into contemporary tax treatment relative to other "sin" products hit with a discriminatory excise tax. Given this, Coloradans were entitled to receive a refund, but in a statewide referendum vote, 69 percent of voters opted to allow the state to keep \$66 million in revenue generated by marijuana sales taxes.<sup>84</sup>

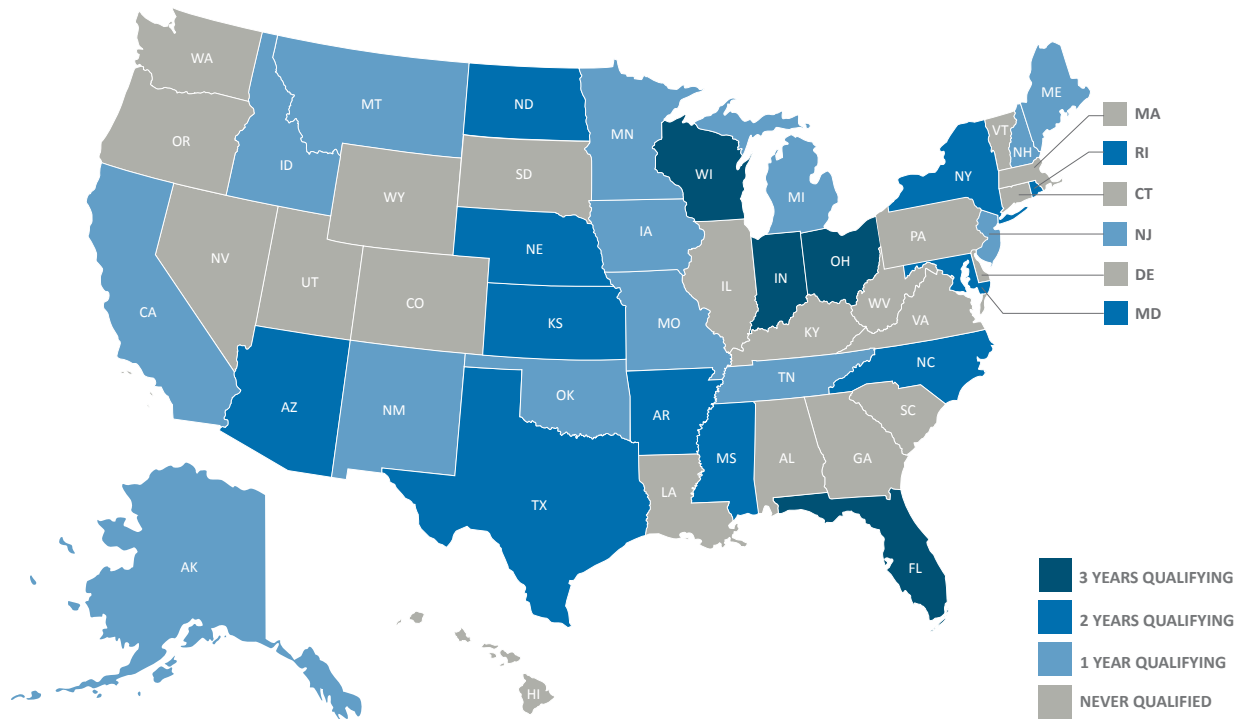
## V: Trends in State Tax Reform

The mark of 17 states cutting taxes during the 2015 legislative session matches the high water mark of 17 states cutting taxes in 2013. Coming off a recent election, many states focused on making substantive reforms to their tax climates, aimed at reducing the burden of government on taxpayers and in many cases, improving the state's capacity for economic growth through a more sound tax structure.

Of the 17 tax cutting states, four of those have also qualified for the 2014 and 2013 editions of *State Tax Cut Roundup*: Florida, Indiana, Ohio and Wisconsin. It is worth noting that North Carolina likely deserves consideration alongside those four states given that though the Tar Heel State did not cut taxes in 2014, it had major tax reduction phase-in that year from their massive 2013 tax reduction package, thus passing

very substantive 2014 tax cuts in 2013. Additionally, nine states cut taxes one year in addition to 2015. Those nine states, along with the two states that have cut taxes in 2014 and 2013 but not 2015, as well as the 21 states that have not cut taxes notably in any of the three years of *State Tax Cut Roundup* are detailed in Figure 2.

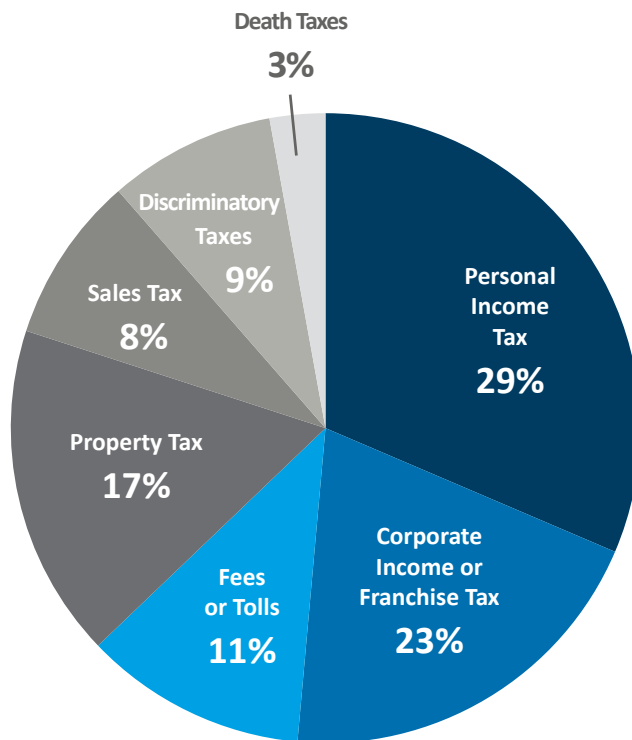
Figure 2: States That Qualified for State Tax Cut Roundup During the 2013-2015 Legislative Sessions



Regionally, 2015 tax cuts were most prominent in the Southern Census Bureau Region with six states offering tax relief and least prominent in the Western Region with only two tax cutting states. The Midwest Region featured four tax cutting states while the Northeast Region featured five.

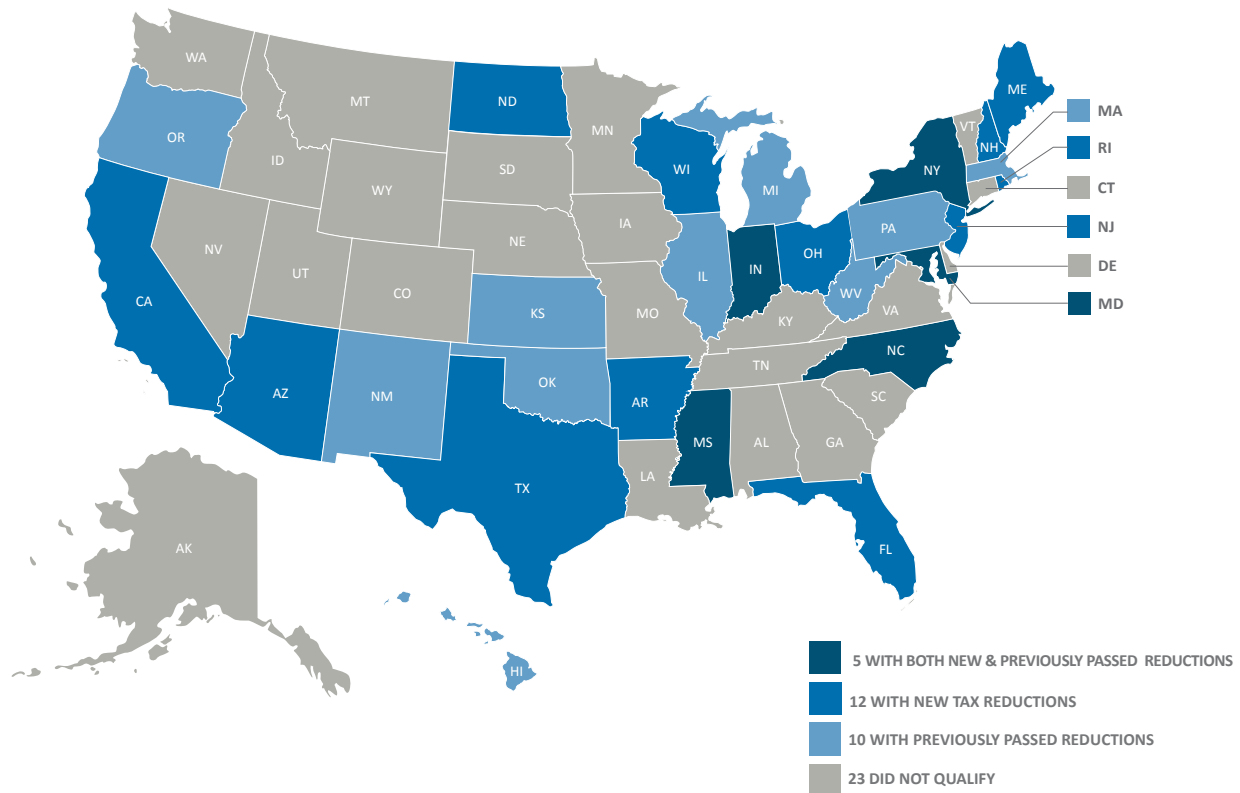
Of the 17 tax cutting states, the most popular area to cut by far was the personal income tax with 10 states making cuts, followed by eight states reducing their corporate income tax or business franchise tax and six states reducing their property tax burden. Figure 3 below details tax cuts by the type of tax reduced in the 2015 legislative session. Note that the total is greater than 17, due to the fact that 12 of those states reduced more than one specific tax during the 2015 legislative session.

Figure 3: 2015 Tax Cuts by Form of Taxation



In addition to the 17 states cutting their tax burdens in 2015, 10 additional states saw more money go into the pockets of taxpayers through tax reductions coming from previously passed legislation, achieving revenue triggers established in state law that unlocked tax relief when met, or allowing temporary tax increases to phase out. Moreover, five other states had significant tax reductions phase in from previous tax reform in addition to passing tax cuts in the 2015 legislative session and thus qualifying among the 17 2015 tax cutting states. These phase-ins, revenue trigger reductions and expiration of temporary tax increases are detailed in Figure 4.

Figure 4: States with Net Decreased Tax Burdens in 2015



Of the 17 states that qualified for *State Tax Cut Roundup*, 10 offered personal income tax relief. This is in addition to the six states where the personal income tax burden was reduced in 2015 due to phase-ins, revenue triggers and temporary income tax hikes ending. This development is good news for those concerned about state economic competitiveness as the personal income tax is one of the most damaging taxes a state can levy. Five of the 2015 tax cutting states actually reduced marginal personal income tax rates, while the other five either enhance credits or deductions, or made changes to the base or structure of their personal income tax.

Of the states that reduced their personal income tax burdens in 2015, they tended to have an above average level of personal income taxation as a percentage of their gross state product and an above average reliance on personal income taxation as a percent of the their total state tax revenue. Six of the 10 states cutting their personal income tax ranked among the top 20 states with the highest personal income tax burden. Conversely, three of the 10 states cutting their personal income tax in 2015 ranked in the bottom 20 for personal income tax burden. Figure 5 below details the states experiencing tax relief for their personal income tax burden, either through 2015 policy action or separately as a result of past legislation

taking affect, alongside the state's personal income taxation as a percentage of gross state product and total tax revenue.

Figure 5: 2015 Personal Income Tax (PIT) Changes, PIT as a Percentage of Gross State Product and Total Tax Revenue

State	2015 Tax Reductions	Other 2015 Tax Reductions	State Personal Income Taxation as a Percent of Gross State Product	Rank	State Personal Income Taxation as a Percent of Total State Tax Revenue	Rank
Alabama	.	.	1.77%	15	34.56%	25
Alaska	.	.	0.00%	1	0.00%	1
Arizona	YES	.	1.32%	11	25.22%	14
Arkansas	YES	.	2.41%	34	30.86%	18
California	YES	.	3.25%	49	50.16%	46
Colorado	.	.	2.07%	24	49.16%	44
Connecticut	.	.	3.38%	50	48.25%	42
Delaware	.	.	2.02%	22	33.78%	23
Florida	.	.	0.00%	2	0.00%	2
Georgia	.	.	2.06%	23	49.30%	45
Hawaii	.	YES	2.48%	38	28.49%	15
Idaho	.	.	2.30%	32	36.11%	27
Illinois	.	YES	2.46%	37	42.70%	37
Indiana	.	YES	1.73%	14	29.39%	16
Iowa	.	.	2.26%	29	41.04%	33
Kansas	.	YES	2.27%	30	38.80%	30
Kentucky	.	.	2.19%	28	34.42%	24
Louisiana	.	.	1.29%	10	29.71%	17
Maine	YES	.	3.01%	44	39.43%	31
Maryland	.	.	2.41%	35	42.46%	35
Massachusetts	.	YES	3.10%	45	53.87%	47
Michigan	.	.	1.98%	21	32.59%	20
Minnesota	.	.	3.15%	46	42.56%	36
Mississippi	.	.	1.84%	17	23.71%	12
Missouri	.	.	2.09%	25	48.30%	43
Montana	.	.	2.70%	41	39.53%	32
Nebraska	.	.	2.13%	26	44.54%	39
Nevada	.	.	0.00%	3	0.00%	3
New Hampshire	.	.	0.15%	9	4.21%	9
New Jersey	YES	.	2.41%	33	41.64%	34
New Mexico	.	.	1.50%	13	23.86%	13
New York	.	.	3.22%	48	54.61%	48
North Carolina	YES	YES	2.55%	39	46.57%	41
North Dakota	YES	.	1.41%	12	12.11%	10
Ohio	YES	.	1.89%	19	35.87%	26
Oklahoma	.	YES	1.85%	18	32.80%	21
Oregon	.	.	3.18%	47	68.34%	50
Pennsylvania	.	.	1.80%	16	31.73%	19
Rhode Island	YES	.	2.18%	27	37.04%	28
South Carolina	.	.	1.97%	20	38.50%	29
South Dakota	.	.	0.00%	4	0.00%	4
Tennessee	.	.	0.10%	8	2.13%	8
Texas	.	.	0.00%	5	0.00%	5
Utah	.	.	2.29%	31	45.09%	40
Vermont	.	.	2.46%	36	23.03%	11
Virginia	.	.	2.55%	40	56.81%	49
Washington	.	.	0.00%	6	0.00%	6
West Virginia	.	.	2.77%	43	33.39%	22
Wisconsin	YES	.	2.72%	42	43.77%	38
Wyoming	.	.	0.00%	7	0.00%	7

Also particularly notable for pro-growth fiscal impact, 11 states substantively reduced the burden of taxation levied against businesses. In particular, and noting some of the 11 states fit into multiple categories, eight states reduced their burden of corporate income taxation or their business franchise tax, three states reduced their sales tax levied against business-to-business transactions, one repealed a discriminatory tax against the healthcare industry, one reduced their severance tax on energy extraction and one reduced their tax levied on business personal property. Additionally, legislation passed before 2015 became current policy, and reduced the burden of taxation on business in six additional states. Three states passed both cuts in 2015 and had past cuts enter law through phase-ins, revenue triggers or temporary tax hike expirations.

While it is true that, in a 13 to four split, states with Republican governors led the way in providing their state's citizens with tax relief in 2015, there were multiple examples of government with power split between the two parties reducing the tax burdens of their citizens. In fact, of the 17 states that cut taxes, only 10 were held unilaterally by the Republican party at the gubernatorial and in both legislative houses.

Tax and fiscal issues permeated many governors' state of the state addresses in 2015, as detailed by ALEC research.<sup>85</sup> Of the 17 states that eventually cut taxes, only four had governors that did not make significant tax reform proposals: California, North Carolina, New Hampshire and New Jersey. The other 13 states featured state of the state addresses by governors calling for tax reform during the 2015 legislative session. Among that group, 10 of the governors called for tax cuts with no increases, while three called for a mix of revenue cutting and revenue raising measures.

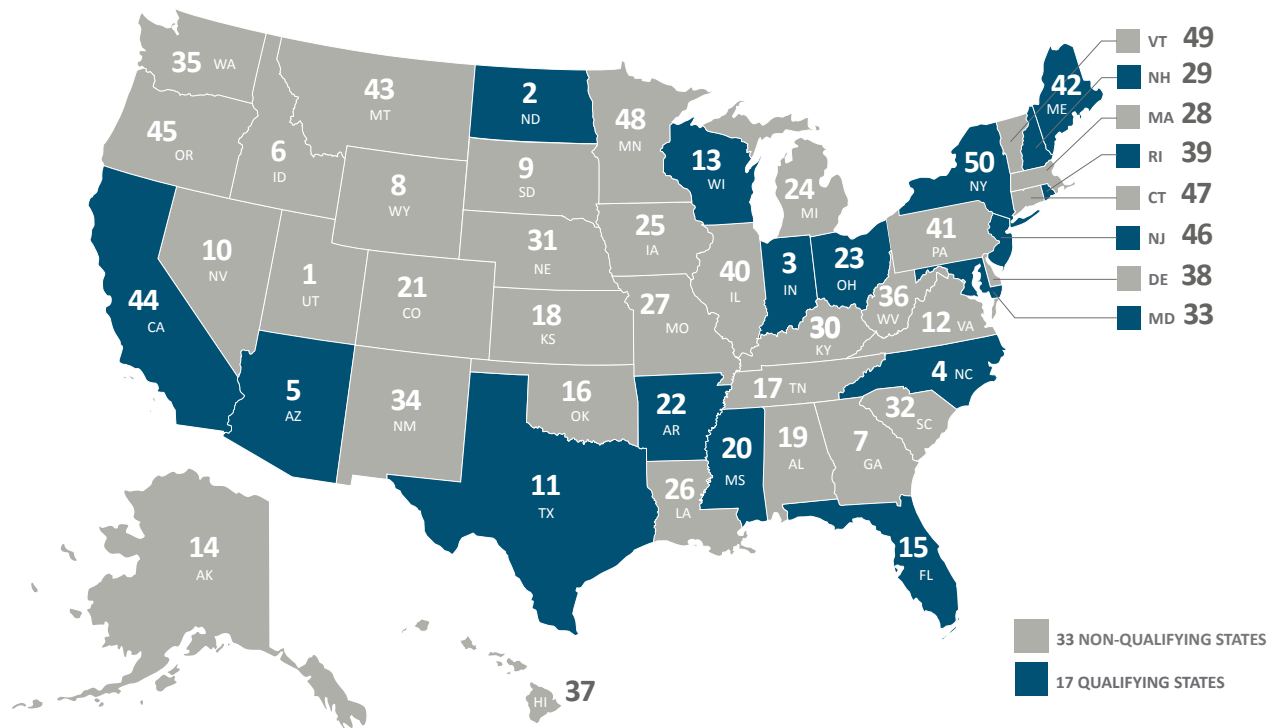
Regarding the personal income tax, which is arguably the most damaging to an economy, four governors proposed reductions to the tax in their state of the state address and saw those plans subsequently come to fruition as personal income tax reductions in 2015. In six other states, the legislatures took the initiative to reduce personal income tax burdens on their citizens, even though a personal income tax cut was not proposed during the governors' state of the state address. Finally, though governors in Idaho, Mississippi, South Carolina and Michigan proposed reductions to the personal income tax code in 2015, these four states failed to cut the tax.

Turning to total state and local tax burden as a percentage of state income, calculated by the Tax Foundation and available for 2012, six of the 17 states cutting taxes in 2015 were among the top 10 highest taxing.<sup>86</sup> Another four of the 17 tax cutting states were just one tier below, ranking between 11 and 20 in total state and local tax burden. There was only one state among third tier, four states among the fourth tier and only two states cutting taxes in 2015 among the 10 states with the lowest tax burden.

Considering state economic competitiveness more broadly, all 17 states were compared to both their economic outlook from the 2015 edition of the *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index*. The results of that comparison can be seen in Figure 6. With respect to economic outlook rankings, the 17 tax cutting states were fairly equally assorted among the ranks, with a slight bias

towards the most economically competitive states achieving tax reform and relief in 2015. Four of the states cutting taxes in 2015 ranked in the top 10 for economic outlook, four ranked between 11 and 20, three ranked between 21 and 30, two ranked between 31 and 40, and four ranked among the bottom.<sup>87</sup>

Figure 6: Comparing 17 Qualifying States to *Rich States*, *Poor States*: ALEC-Laffer State Economic Competitiveness Index Economic Outlook Rankings



## VI: The Impact of Taxes on Economic Growth

Creating a tax and fiscal policy climate that is conducive to economic growth ensures that the economic pie is growing for everyone. Individuals, businesses and even government revenues benefit when people are free to save and invest more of their money. Taxes fundamentally create a barrier between work and reward, and while tax revenue is needed to fund the core functions of government, the tax system should burden individuals and businesses as little as possible.

Not all taxes are equally damaging to the economy. According to the Organisation for Economic Cooperation and Development (OECD),<sup>88</sup> taxes on capital and income are the most economically damaging, while taxes on consumption and property are less economically damaging. The economic history of tax

systems in the states is a helpful guide for states striving to achieve a higher level of economic growth. States that rely primarily on income taxes routinely underperform their counterparts that choose not to levy taxes on personal income.

Figure 7: The Nine States with the Lowest and Highest Marginal Personal Income Tax (PIT) Rates (10-Year Economic Performance)

	1/1/15	2004-2014	2005-2014	2004-2014	2004-2014	2004-2014	2002-2012
State	Top Marginal PIT Rate**	Population	Net Domestic Migration†	Non-Farm Payroll Employment	Personal Income	Gross State Product	State & Local Tax Revenue‡
Alaska	0.0%	11.7%	-2.9%	11.2%	65.5%	60.7%	318.8%
Florida	0.0%	14.2%	4.4%	4.6%	43.1%	31.8%	44.0%
Nevada	0.0%	21.0%	7.0%	5.4%	35.9%	27.7%	65.1%
South Dakota	0.0%	10.7%	2.8%	10.3%	57.4%	49.0%	57.2%
Texas	0.0%	20.4%	5.4%	21.7%	75.9%	78.6%	65.7%
Washington	0.0%	14.3%	4.3%	12.3%	54.5%	57.2%	50.8%
Wyoming	0.0%	14.7%	4.9%	14.6%	76.4%	86.4%	111.5%
New Hampshire^	0.0%	2.8%	-0.3%	3.3%	43.0%	34.6%	46.5%
Tennessee^	0.0%	10.8%	4.5%	4.0%	45.6%	36.3%	54.0%
Average of 9 No Income Tax States*	0.0%	13.4%	3.3%	9.7%	55.3%	51.4%	90.4%
<b>50-State Average*</b>	<b>5.6%</b>	<b>8.8%</b>	<b>0.7%</b>	<b>6.1%</b>	<b>48.4%</b>	<b>43.6%</b>	<b>63.0%</b>
Average of 9 Highest Income Tax States*	10.4%	6.8%	-2.1%	4.7%	44.3%	40.1%	58.4%
Kentucky	8.2%	6.4%	1.3%	3.9%	42.7%	38.7%	39.4%
Maryland	9.0%	7.7%	-2.5%	4.0%	42.1%	40.9%	52.0%
Vermont	9.0%	1.1%	-1.5%	2.3%	41.8%	31.4%	63.6%
Minnesota	9.9%	7.3%	-1.3%	4.9%	41.7%	36.4%	52.3%
New Jersey	10.0%	3.5%	-6.0%	-0.9%	36.5%	29.5%	55.5%
Oregon	10.6%	11.2%	5.1%	7.2%	46.7%	51.3%	64.3%
Hawaii	11.0%	11.5%	-2.6%	7.2%	52.9%	45.2%	74.8%
New York	12.7%	3.0%	-7.5%	7.4%	47.3%	47.2%	70.7%
California	13.3%	9.1%	-3.4%	6.3%	47.1%	40.6%	52.5%

\* Equal-weighted averages.

\*\* Top marginal PIT rate is the top marginal tax rate on personal earned income imposed as of 1/1/2015 using the tax rate of each state's largest city as a proxy for the local tax. The deductibility of federal taxes from state tax liability is included where applicable.

† Net domestic migration is calculated as the ten-year (2005-2014) sum of net domestic in-migrants divided by the mid-year (2010) population.

‡ 2002-2012 due to Census Bureau data release lag.

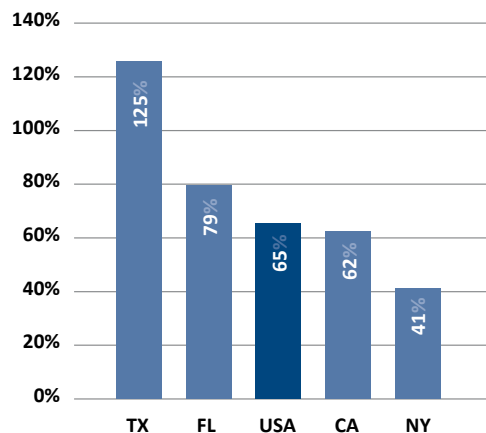
^ Tennessee and New Hampshire tax interest and dividend income but not ordinary wage income.

Source: Laffer Associates, U.S. Census Bureau, Bureau of Labor Statistics and Bureau of Economic Analysis

As shown in Figure 7, the nine states that do not levy a personal income tax experienced a cumulative job growth rate of 9.7 percent from 2004 to 2014 while the nine states with the highest personal income tax rates experienced less than half of that at just 4.7 percent over the same time period. The no income tax states also experienced much better rates of net domestic migration, personal income growth, population growth, gross state product growth and even higher tax revenue growth than their high tax counterparts.<sup>89</sup>

Another example of this disparity is the shocking divide in personal income growth among the four largest U.S. states. By population, California, Texas, New York and Florida are the four largest states and account for about one-third of the entire United States population. Both Texas and Florida choose not to tax personal income whatsoever, while California and New York have the two highest personal income taxes in the nation at 13.3 percent and 12.7 percent respectively. The results of this natural experiment are clear, and displayed in Figure 8 below. Both Texas and Florida have experienced much higher rates of personal income growth from 1990 to 2014.<sup>90</sup>

Figure 8: Comparing Growth in Real Personal Income (1990-2014)



Source: Federal Reserve Bank of St. Louis, Federal Reserve Economic Data (FRED), and Bureau of Economic Analysis

The statement “taxes negatively affect economic growth” is almost universally agreed upon by mainstream economists, even if the degree to which this is true enjoys less consensus. A Tax Foundation survey of peer-reviewed studies on the relationship between taxes and economic growth found that of 26 peer-reviewed studies since 1983, 23 found a negative relationship between taxes and economic growth. It is also worth noting that the three studies that did not find a negative relationship between taxes and economic growth found no measureable positive relationship.<sup>91</sup>

Christina Romer, formerly head of President Obama’s Council of Economic Advisors, and her husband David Romer, have found similar results. Their study found that every 1 percent increase in taxation lowers real

GDP by 2 to 3 percent. They also found that corporate income taxes were the most damaging to economic growth, followed by personal income taxes and finally consumption taxes.<sup>92</sup>

While the academic and empirical results show that lower taxes contribute to higher rates of economic growth, there are always some that will not be convinced. Fortunately, economic reality factors into state tax policy and has led to 17 states cutting taxes in 2015 and is likely to lead to more tax reductions in the future.

## VII: Conclusion

As the federal government remains largely in gridlock and unlikely to tackle reforming the United States' uncompetitive federal tax system, 2015 saw states push for substantial reform. 2015 tied the high-water mark of states qualifying for the *State Tax Cut Roundup* in addition to many states phasing in previously passed reforms. In 17 states, taxpayers saw more money in their pockets and in most of those states enjoyed significant improvement to their state's economic competitiveness.

From the perspective of economic competitiveness, perhaps most significant were the cuts to personal income taxes and business taxes, which dominated the tax cutting agenda of 2015. 10 states reduced their personal income tax burden and another eight states reduced their tax burden on business. Economic research and theory show these taxes inflict the greatest harm to growth and as such, their reduction helps to unlock economic competitiveness and a path toward a more prosperous future.

The push for more competitive tax systems continues to be one of the major storylines in state policy, both among states with uncompetitive tax codes and also among many traditionally pro-growth states. Analysis shows the push transcends party, geography and current policy climate. Policymakers across the country feel the push by constituents to grow jobs and incomes, and are looking to the "laboratories of democracy" for their solutions. The momentum for pro-growth tax reform continued to resonate across the country in 2015.

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