

# STATE TAX CUT ROUNDUP



## 2019 LEGISLATIVE SESSION

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2019 Legislative Session

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## EXECUTIVE SUMMARY – TAX REFORM IN THE STATES

The 2019 state legislative sessions ended with 6 states enacting substantial net tax relief for their citizens: Arizona, Florida, North Carolina, Tennessee, Virginia and West Virginia. Arizona and Virginia began their legislative sessions with unanswered questions on federal tax conformity following passage of the federal Tax Cuts and Jobs Act of 2017. Arizona substantially cut personal income taxes by reducing the number of tax brackets from five to four and cut tax rates for nearly every bracket. Virginia increased their standard deduction and decoupled from a handful of federal tax changes that raised the net tax burden. While the Old Dominion did not reduce nominal tax rates like many states conforming to federal tax changes, Virginia legislators returned all \$420 million in unlegislated effective tax increases on individuals caused by delayed tax conformity back to taxpayers as a one-time refund. In an act unrelated to federal tax conformity, North Carolina also reduced effective personal income tax rates by increasing the state standard deduction for both single and joint filers.

The other three states – Tennessee, West Virginia and Florida – qualified for this year’s report by substantially cutting business taxes. Tennessee made its business tax code more neutral by removing the discriminatory amusement tax on fitness center memberships and professional licenses. West Virginia reduced the severance tax rate on coal used to generate electricity, both improving the business environment for one of West Virginia’s key industries, as well as lowering electricity prices for ratepayers who receive power from coal. Florida marks its seventh consecutive appearance in *State Tax Cut Roundup* by making additional tax cuts to its notorious business rent tax. Reducing and eventually repealing the business rent tax will go a long way in setting up Florida small businesses and startups for success by lowering the fixed costs of running a business.

The 2019 legislative sessions were remarkable in that so few states qualified for *State Tax Cut Roundup*. In fact, this edition of *State Tax Cut Roundup* has the fewest qualifying states of any edition since ALEC began publishing *State Tax Cut Roundup* in 2013. Many states passed large tax cut bills, but the tax cuts were more than offset by tax increases. Expanding the sales tax to include remote retail sales in the wake of the *Wayfair* decision from the U.S. Supreme Court. Additionally, increasing the motor fuel tax rate was common this year. While cuts to the personal income tax, corporate income tax or sales tax are certainly good policies, many states ended their legislative sessions with tax increases that exceeded the amount of taxes cut.

Overall, the economic evidence strongly suggests states with lower tax burdens and more economic freedom regularly outperform their higher taxing, more restrictive counterparts.<sup>1</sup> 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 subsequent legislative sessions.

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

- Substantially cut taxes at the state level
- Vote(s) occurred during the 2019 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

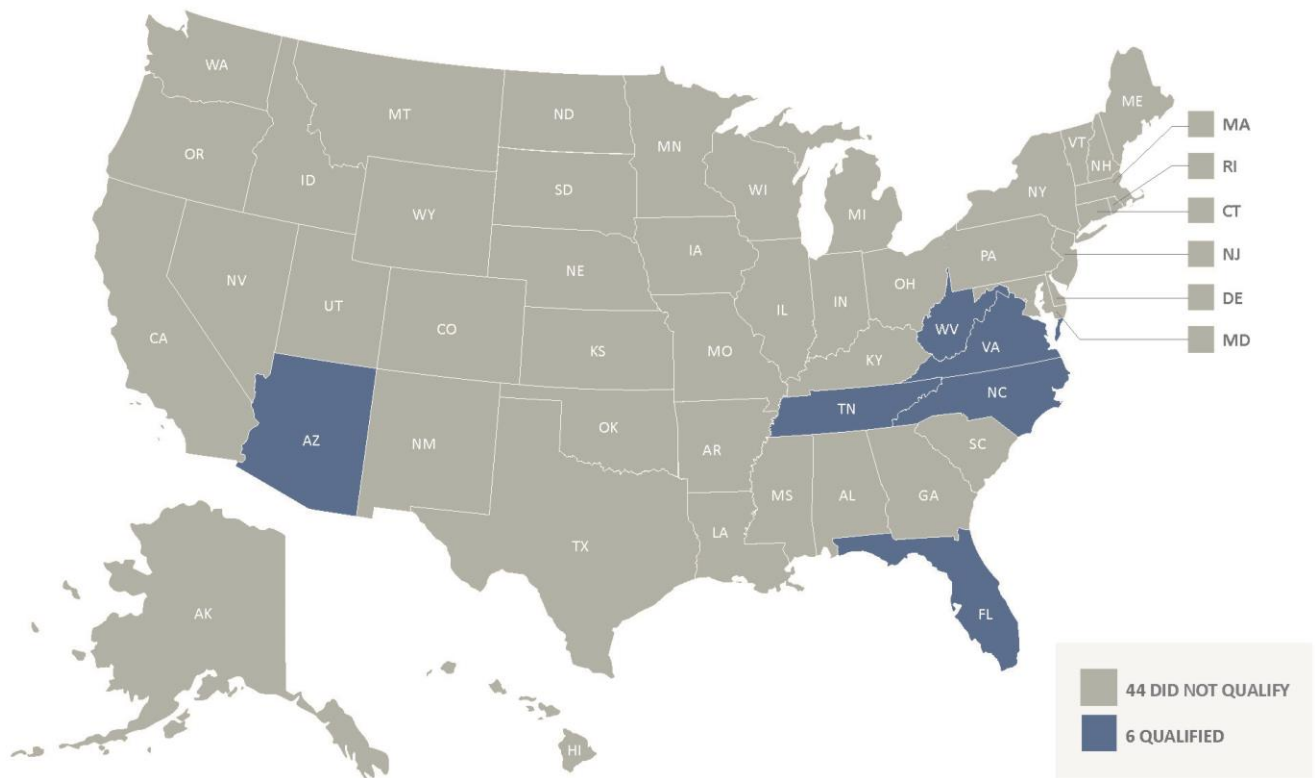
Arizona and Virginia deserve special mention for enacting exemplary pro-growth tax reforms. While both states were initially slow movers on the issue of federal tax conformity, their conformity legislation successfully clarified their respective state tax codes following the landmark federal Tax Cuts and Jobs Act reforms and also returned effective state-level revenue increases back to taxpayers through significant personal income tax reforms.

If Arizona had conformed to the federal tax changes without any corresponding tax cuts, Arizona taxpayers would have faced an annual effective tax increase exceeding \$236 million. While many states decided to pocket this additional revenue to fund increased government spending, Arizona decided it would be put to better use back in taxpayers' pockets. By increasing the state standard deduction to \$12,200 and \$24,400 for single and joint filers, respectively, removing the second-lowest personal income tax bracket, reducing rates for nearly every remaining personal income tax bracket, and creating a new dependent exemption, Arizona saved income earners an expected \$680 million in Fiscal Year (FY) 2020 tax liability compared to the federal tax conformity baseline if Arizona conformed without cutting taxes. Including revenue generating provisions inherent to federal tax conformity, such as effectively eliminating the personal and dependent exemptions, Arizona taxpayers can expect an estimated net \$52 million in tax savings for FY 2020 compared to FY 2019.

Virginia also used the opportunity of federal tax conformity to deliver a net tax cut, although without the added benefit of nominal rate reductions. Still, by increasing the state standard deduction by 50% to \$4,500 and \$9,000 for single and joint filers, respectively, allowing property owners to deduct their property taxes from state income tax liability, and allowing an additional business interest deductions, Virginia taxpayers can expect to save an estimated \$331 million in FY 2020 tax liability compared to pre-conformity revenue estimates. This reduction in tax liability represents the first time Virginia has qualified for *State Tax Cut Roundup* since ALEC began publishing the report in 2013.

Like Arizona, Virginia also delayed deciding federal tax conformity questions until the 2019 legislative session. In the meantime, many conformity provisions took effect and led to an unlegislated effective state-level tax increase on Virginia taxpayers. As a part of their conformity legislation, Virginia legislators returned revenue from the FY 2019 effective tax increase back to taxpayers as a one-time refund. In all, \$420 million in excess revenue collection was returned to taxpayers. Also like Arizona, Virginia conformed to many revenue generating provisions inherent to federal tax conformity. Despite conforming to these provisions and extending the sales tax to include marketplace facilitators and remote sellers, the Virginia General Assembly saved taxpayers an estimated \$51.6 million in FY 2020 tax liability.

FIGURE 1 | STATES THAT QUALIFIED FOR STATE TAX CUT ROUNDUP DURING THE 2019 LEGISLATIVE SESSION



## TRENDS IN STATE TAX REFORM

The Tax Cuts and Jobs Act of 2017 continued to pay dividends for taxpayers, as the five states yet to conform to federal tax changes passed their own tax conformity legislation. As discussed above, two of these states decided to use the opportunity to deliver a net tax cut: Arizona and Virginia. In terms of tax cuts, many states decided to capitalize on previously enacted legislation. Both Indiana and North Dakota shepherded phase-ins of business and corporate income tax cuts passed during their respective 2014 and 2015 legislative sessions. However, *State Tax Cut Roundup* focuses on legislated tax changes during the 2019 legislative session. Since Indiana and North Dakota's tax cuts were unlegislated phase-ins, they do not qualify for *State Tax Cut Roundup 2019*. In the "Other Significant Tax Reforms" section below, an explanation of Indiana and North Dakota's tax cuts is included.

*State Tax Cut Roundup 2019* has the fewest featured states of any *State Tax Cut Roundup* edition due to several factors. First, many states passed large tax cuts in 2018, taking advantage of the opportunity to cut taxes offered by the federal tax conformity issue. Since only five states had yet to decide on conformity legislation as of January 2019, a similar opportunity for tax cuts did not exist for many states in 2019. Second, as mentioned above, many states already passed large tax cuts in 2018 relying on little more than a fiscal estimate to ensure the budget was balanced. Consequently, it is likely legislators felt the need to wait until actual revenue figures arrived to cut additional taxes. Third, five states (Alabama, Arkansas, Illinois, Ohio and South Carolina) passed gasoline tax increases during their 2019 legislative sessions that outweighed many tax cuts passed during the same session.<sup>ii</sup> Since all legislation passed during the 2019 legislative session must amount to a net tax cut to qualify for *State Tax Cut Roundup*, these states did not qualify. Finally, many states were still determining their remote sales tax policy following the landmark *South Dakota v. Wayfair* Supreme Court decision. Many states that passed tax cuts also extended their sales tax bases to include marketplace facilitators and remote sellers, which effectively created revenue increases that outweighed tax cuts made during the same session. The six states that *did* qualify for *State Tax Cut Roundup 2019* all made significant tax cuts deserving of coverage in this year's report.

## TAX CUTS BY STATE

### Arizona

*2019 Rich States, Poor States Economic Outlook Rank: 10*

Arizona began the 2019 legislative session as one of five states (Arizona, California, Massachusetts, Minnesota and Virginia) that had yet to conform to federal tax changes following the federal Tax Cuts and Jobs Act of 2017.<sup>iii</sup> Conforming to the federal tax code without any corresponding tax cuts would have resulted in Arizona collecting an additional \$236 million in taxes annually.<sup>iv</sup> Rather than conforming first and cutting taxes later, Arizona opted to delay deciding on federal tax conformity until the 2019 legislative session.<sup>v</sup>

Arizona went one step further than merely making federal tax conformity revenue neutral. During the 2019 legislative session, Arizona used federal tax conformity as an opportunity to deliver a net tax cut to income earners. First, Arizona matched federal policy by raising the standard deduction to \$12,200 and \$24,400 for individual and joint tax filers, respectively. Second, Arizona eliminated the second lowest of its five total tax brackets, allowing more income to fall into the bracket with the lowest rate. Third, Arizona lowered personal income tax rates for three of the four remaining tax brackets. Finally, Arizona also established a tax credit of \$100 for every dependent under 17 years of age and \$25 for every dependent older than 17. Altogether, Arizona's tax cuts removed an estimated \$680 million in FY 2020 personal income tax liability. Factoring in the base-broadening provisions inherent to federal tax conformity and post-*Wayfair* sales tax increases, Arizona's conformity legislation is expected to cut \$52 million on net from income earners' FY 2020 tax liability.<sup>vi</sup>

This is the Grand Canyon State's fifth appearance in *State Tax Cut Roundup*. Only Florida and North Carolina have been featured more often. This demonstrates Arizona's commitment to pro-growth tax reforms in recent years.<sup>vii</sup> A competitive tax code has made Arizona one of the fastest growing states in the country at the expense of neighboring high-tax California and New Mexico. According to *How Money Walks*, Arizona has gained nearly \$12 billion in annual adjusted gross income (AGI) from California and over \$850 million in AGI from New Mexico since 1992.<sup>viii</sup> As California and New Mexico continue to pass net tax increases while Arizona makes its tax code more competitive, Arizona can expect to see additional economic growth and an increasingly vibrant state economy at the expense of its high-tax neighbors.

### Florida

*2019 Rich States, Poor States Economic Outlook Rank: 8*

Making its seventh annual appearance in *State Tax Cut Roundup*, Florida qualified for the 2019 report with another legislated tax cut to the business rent tax.<sup>ix</sup> Specifically, Florida reduced the business rent tax from 5.7% to 5.5%. This singular cut is expected to save Florida job creators over \$27 million in reduced tax liability annually.<sup>x</sup>

Florida is currently the only state that levies a tax on commercial real estate leases.<sup>xi</sup> A tax on commercial leases is one of the most economically damaging taxes a state can possibly enact, because it directly reduces business profitability by increasing the cost of leased facilities and storefronts. Naturally, these costs are often passed on to consumers in the form of higher prices. But thanks to its 2019 tax cut, the Sunshine State can expect to see increased business profitability and lower prices for consumers. This change ultimately results in improved economic competitiveness for Florida, a crucial metric for any state in the already economically competitive Southeast.

## North Carolina

*2019 Rich States, Poor States Economic Outlook Rank: 6*

Another year of pro-growth tax reform makes *State Tax Cut Roundup 2019* the fifth consecutive appearance for North Carolina. Few states have been as devoted to personal income tax reform as North Carolina. Since 2008, consistent personal income tax reforms have reduced North Carolina's top marginal personal income tax rate from 8% to the current rate of 5.25%.<sup>xii</sup> In each of its five previous appearances in *State Tax Cut Roundup*, North Carolina legislators voted to cut personal income tax rates.<sup>xiii</sup> North Carolina's commitment to pro-growth tax reform has dealt dividends to the state economy in increased economic competitiveness. In 2008, when North Carolina tax rates reached their peak, the Old North State ranked 21st in state economic competitiveness.<sup>xiv</sup> By 2016, North Carolina had rocketed from 21st to second in state economic competitiveness thanks to personal and corporate income tax reforms.<sup>xv</sup> North Carolina's economic outlook currently ranks sixth, due to other states adopting the pro-growth tax policy model and becoming top competitors.<sup>xvi</sup>

During the 2019 legislative session, North Carolina legislators continued their commitment to personal income tax reform by increasing the standard deduction from \$15,000 to \$16,125 for single filers and \$20,000 to \$21,500 for joint filers. This reform alone will save North Carolina income earners nearly \$180 million in estimated FY 2020 tax liability.<sup>xvii</sup> Including other tax changes, such as expanding the state sales tax to cover remote sales, the North Carolina 2019 tax reform results in an estimated net tax cut of nearly \$25 million from FY 2020 tax burden.<sup>xviii</sup>

North Carolina policymakers are already realizing the benefits of a competitive state tax policy. Pro-growth tax reform and a competitive state tax code have been accompanied by state cumulative gross domestic growth (GDP) growth of over 36%, nearly 500,000 new residents, and nearly 7% growth in employment since 2008.<sup>xix</sup> Tax reform is clearly positioning North Carolina's economy as one of the most vibrant state economies in the country.

## Tennessee

*2019 Rich States, Poor States Economic Outlook Rank: 7*

Tennessee is one of only three states in the South that does not levy a personal income tax on wage and salary income; however, the state's effective personal income tax rate is not 0%.<sup>xx</sup> Tennessee still levies the "Hall Tax" on stock and dividend income. Thanks to efforts from state legislators in 2016, the Hall Tax rate reached a new low of 1% in January 2020 will be fully phased out in January 2021.<sup>xxi</sup>

With Tennessee's effective personal income tax poised to reach 0%, state lawmakers have turned their attention to reducing business taxes. In two measures to cut business taxes in 2019, Tennessee began scaling back the amusement tax paid on gym, health club, and fitness studio memberships and exempted many professions from the professional privilege tax.

Tennessee's application of the amusement tax to gym memberships was rife with poor tax policy. First, the Tennessee Department of Revenue was issuing many administrative rules detailing which gyms were and were not obligated to collect the tax. The Tennessee Department of Revenue's rulemaking created a tax code where many small, specialized gym memberships were being taxed, while many national chain gym memberships were not, resulting in a discriminatory tax on small business.<sup>xxii</sup> Second, Tennessee gave localities the authority to levy their own amusement tax rate on gym memberships, creating harmful tax pyramiding that raised the cost of a gym membership by 9.5% on average.<sup>xxiii</sup> In total, removing gym and health club memberships from the amusements tax is estimated to save Tennessee fitness customers \$9,046,600 in FY 2020 state and local tax burden. The Tennessean fitness industry also stands to gain from lower tax compliance costs and being on an equal playing field with other recreation industries.<sup>xxiv</sup>

As of 2019, Tennessee was one of six states that collected a “professional privilege tax” levied on certain occupations as the price of doing business in the state. Nationwide, the trend has been toward eliminating professional privilege taxes, with Texas repealing its version of the tax most recently in 2015.<sup>xxv</sup> While not a full repeal, Tennessee exempted many professions from having to pay the tax, such as veterinarians, speech pathologists and accountants. The professional privilege tax still applies to attorneys, lobbyists, and certain agents and physicians.

Tennessee also repealed the provision that would automatically revoke a professional’s license if he or she failed to pay the appropriate privilege tax.<sup>xxvi</sup> Despite retaining the privilege tax for select professions, the partial repeal of the tax is estimated to save Tennessean professionals over \$22 million in FY 2020.<sup>xxvii</sup> As for the professions still required to pay the tax, Senator Brian Kelsey (the sponsor of Senate Bill 398 partially repealing the professional privilege tax) stated that he expects to continue efforts to fully repeal the tax during the 2020 legislative session.<sup>xxviii</sup>

## Virginia

*2019 Rich States, Poor States Economic Outlook Rank: 14*

Marking its first appearance in seven editions of *State Tax Cut Roundup*, Virginia legislators passed one of the largest personal income tax cuts of any state in 2019 during its federal tax conformity process. Like many states, Virginia’s Department of Taxation forecast the state would see an effective state level tax increase exceeding \$500 million annually from conforming to federal tax changes. In fact, this forecasted tax increase was expected to approach \$1 billion annually if the Virginia General Assembly conformed to federal tax changes without passing corresponding tax cuts.<sup>xxix</sup>

During the 2019 legislative session, Virginia conformed to the federal tax changes while also delivering a net tax cut to income earners. First, Virginia increased the state standard deduction from \$3,000 to \$4,500 and \$6,000 to \$9,000 for single and joint filers, respectively. Virginia also allowed taxpayers to deduct up to 20% of business interest payments from personal and corporate income taxes – a tax expenditure technically disallowed at the federal level under the Tax Cuts and Jobs Act. Finally, property owners may now deduct any state and local property taxes from their state personal income tax liability to compensate taxpayers for the \$10,000 limit on the federal state and local tax (SALT) deduction. Altogether, the tax cut provisions passed by the Virginia General Assembly are expected to save taxpayers over \$331 million in FY 2020.<sup>xxx</sup>

Since the Tax Cuts and Jobs Act took effect in January 2018, but the Virginia tax reforms were not passed until the 2019 legislative session, many of the provisions leading to an effective state-level tax increase already took effect. Rather than pocketing this FY 2019 effective tax increase, Virginia returned the windfall revenue back to taxpayers as a one-time refund of \$110 and \$220 for single and joint filers, respectively. This refund alone amounted to \$420 million in excess tax revenue returned to Virginian families and job creators. Finally, to ensure conformity would not result in a net tax increase year-over-year, the Virginia conformity legislation creates a “Taxpayer Relief Fund” where all estimated excess revenue from federal tax conformity in future fiscal years will be deposited to fund future tax cuts.<sup>xxxi</sup>

Unfortunately, a new progressive majority in the Virginia General Assembly found the political capital necessary to repeal the Taxpayer Relief Fund in the revised 2018-2020 biennium budget.<sup>xxxii</sup> Rather than funding future tax rate decreases or additional tax refunds, every cent of effective tax increases remaining from federal tax conformity will instead go to the general fund.

Federal tax conformity also contains some revenue generating provisions, such as repealing the personal exemption and, in Virginia’s case, decoupling from the Pease limitation repeal. Consequently, Virginia taxpayers over a certain income will still have a cap on the number of itemized deductions available, while taxpayers in other states no longer have the same constraint. In terms of other tax increases, Virginia also began collecting sales tax on online sales made through



marketplace facilitators and sales made by out-of-state retailers. Despite these tax increases, the Virginia 2019 tax legislation is estimated to deliver a FY 2020 net tax cut of \$51.6 million.<sup>xxxiii</sup>

## West Virginia

*2019 Rich States, Poor States Economic Outlook Rank: 35*

After its first appearance in the 2018 edition of *State Tax Cut Roundup*, West Virginia followed up with another year of net tax cuts for individuals and businesses. On the individual side, West Virginia passed legislation exempting social security income from state income taxes for senior citizens earning less than \$50,000 for single filers and \$100,000 for joint filers in annual adjusted gross income. Beginning January 2020, 25% of social security income is exempt from state income taxes. This percentage increases annually until social security income is fully exempt beginning in January 2022. Upon full enactment, the exemption of social security income from state income taxes is expected to save senior citizens over \$25 million in reduced tax burden annually.<sup>xxxiv</sup>

West Virginia also helped its business community by reducing the severance tax rate on “steam coal” or “thermal coal” extraction. Also known as “bituminous coal,” steam coal is used primarily in electricity generation.<sup>xxxv</sup> Reducing the severance tax rate from 5% to 3% on the gross value of steam coal is expected to save West Virginia coal extraction companies \$58.1 million in FY 2020.<sup>xxxvi</sup> Of course, since steam coal is used to generate electricity, these savings will also impact electricity utilities who purchase West Virginia coal to generate electricity. In turn, these savings will be passed on to ratepayers as the cost to generate electricity drops, especially since over 90% of West Virginia electricity is generated from coal.<sup>xxxvii</sup> Cutting the severance tax rate on coal is a prime example of how cutting business taxes can generate the most good for a state economy. Cutting business taxes improves business profitability leading to employment growth, capital gains and lower prices for consumers.

## HONORABLE MENTIONS: OTHER NOTABLE EXAMPLES OF 2019 STATE TAX REFORM

While the following states did not legislate a net tax cut during the 2019 legislative session, each state phased in cuts to create a net reduction in estimated FY 2020 tax burden for businesses. Even though the states did not qualify for *State Tax Cut Roundup: 2019* according to the report methodology, their phased-in tax cuts deserve recognition.

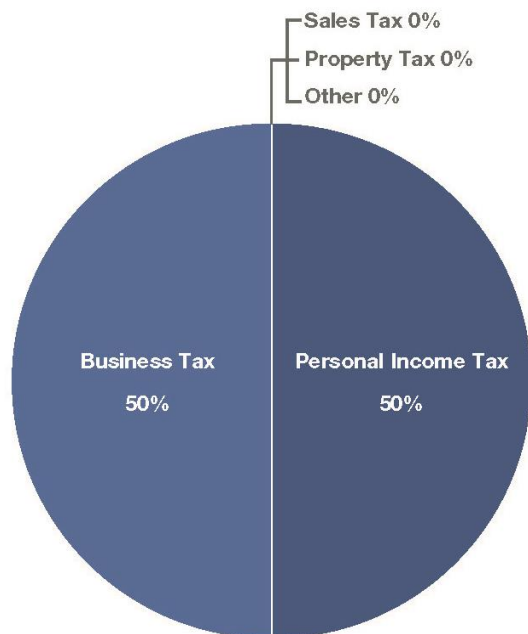
First, the Indiana corporate income tax cuts, originally made in 2011 and accelerated in 2014, marked their ninth year of consecutive rate cuts. Originally set at 8.5% in 2011, the corporate income tax rate was cut to 6.5% by FY 2016 through annual phased-in rate cuts.<sup>xxxviii</sup> In 2014, then-Governor Mike Pence made additional tax cuts a focus of his administration and helped pass another corporate income tax cut, reducing the rate to 4.9% by FY 2022 over eight years of phased-in rate cuts.<sup>xxxix</sup> The 2014 tax cuts also reduced the Financial Institution Tax (FIT). Starting in 2018, the FIT will be reduced from 6.5% to 4.9% by 2023. Starting July 1, 2019, the Indiana corporate income tax rate lowered from 5.75% to its new low of 5.5%, and the FIT tax rate was reduced from 6.25% to 6% as of January 1, 2020. The FY 2020 tax rate cuts represent an estimated \$83.2 million in FY 2020 tax savings for Indiana banks, companies and small businesses, giving Indiana one of the lowest corporate income tax rates in the Midwest.<sup>xl</sup>

New Hampshire also phased-in business tax cuts. While the state does not collect personal income tax, New Hampshire does levy a business profits tax (BPT) on corporations with annual income over \$50,000 and a business enterprise tax (BET) on total compensation, dividend and interest payments from corporations with annual gross receipts over \$150,000.<sup>xli</sup> In 2017, New Hampshire passed rate cuts to both the BPT and BET to take effect December 31, 2019. The first phase of rate cuts reduces the BPT from 7.9% to 7.7% and the BET from 0.675% to 0.6%.<sup>xlii</sup> These two rate cuts are expected to save New Hampshire businesses nearly \$38 million in FY 2020. Given certain revenue triggers, these rates are set to reduce again on

December 31, 2021 to 7.5% and 0.5%, respectively.<sup>xliii</sup> Once fully implemented, these tax cuts will signal to businesses New Hampshire's standing as the only state in the Northeast with a pro-growth tax policy. In the meantime, New Hampshire is the only state in the Northeast with future tax cuts for businesses on the horizon.

## TAX CUTS BY TYPE

FIGURE 2 | 2019 STATE TAX CUTS BY TYPE

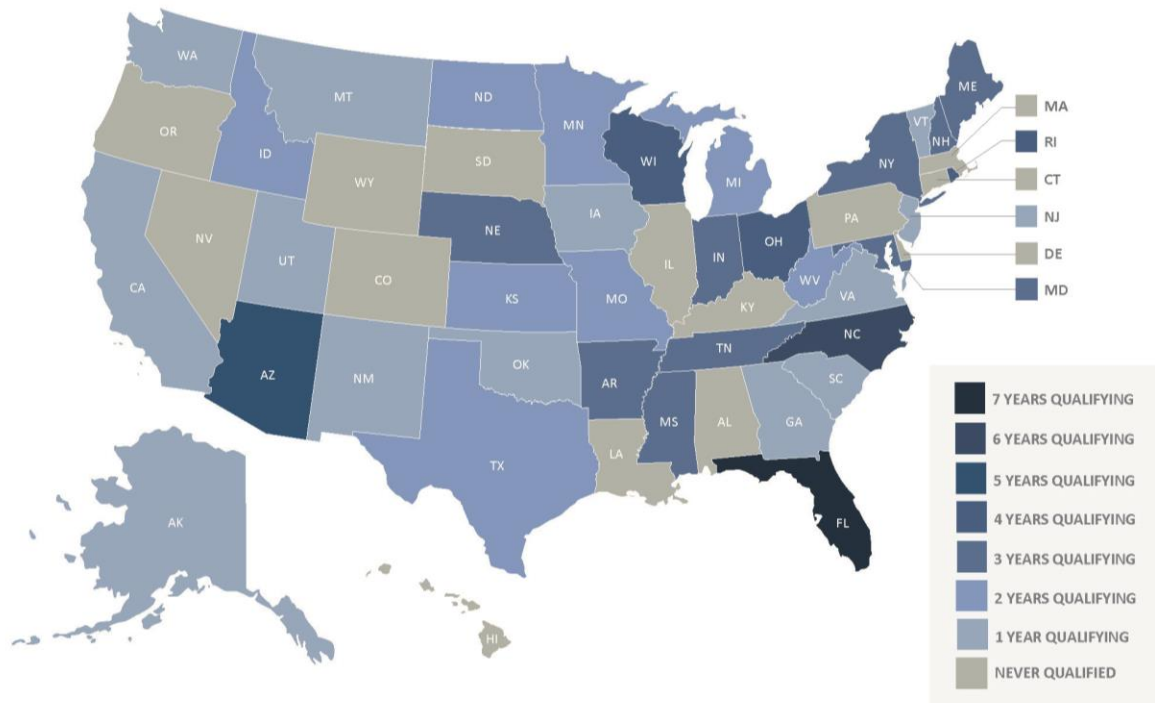


Of the 6 states that qualified this year, every state cut personal income tax or business tax burdens, as displayed in Figure 2. For states looking to improve their economic competitiveness, these are the tax reforms they should be aiming for. A large volume of academic literature (23 out of 26 peer-reviewed studies since 1986) demonstrates that all taxes harm economic growth. Of the studies that differentiate between various forms of taxation, personal and corporate income taxes are the most harmful to long-term economic growth.<sup>xliiv</sup> In fact, Organization for Economic Cooperation and Development (OECD) scholars found a 1% decrease in income tax burden led to an expected 0.25% to 1% increase in gross domestic product (GDP) per capita between 1971 and 2004.<sup>xliv</sup>

Figure 2 details tax cuts by the type of tax reduced in the 2019 legislative sessions. Note the total exceeds the number of qualifying states (six) due to Tennessee and West Virginia reducing more than one specific tax.

The figure below details the frequency of appearances in *State Tax Cut Roundup* by state since 2013. Recording how many times a state cut taxes since 2013 gives information on which states keep tax reform on their legislative agendas over many years versus which state tax reforms are only temporary policy whims. Including tax reforms made during 2019 legislative sessions, Florida is the state most devoted to commonsense tax reform, with seven consecutive appearances in *State Tax Cut Roundup*. Arizona and North Carolina are not far behind with five and six *State Tax Cut Roundup* appearances, respectively.

FIGURE 3 | STATES QUALIFYING FOR STATE TAX CUT ROUNDUP DURING THE 2013-2019 LEGISLATIVE SESSIONS



### IMPLICATIONS OF STATE TAXES FOR ECONOMIC GROWTH

Every year, state policymakers make critical decisions regarding how they will fund their states’ obligations to the public. Education, transportation and health care are multibillion-dollar responsibilities, and how policymakers decide to fund these responsibilities can have significant consequences for long-term growth. Not all taxes have the same effect on the economy, and it should be the goal of policymakers to balance the budget with minimal impact on the state economy. Looking first at spending to make sure dollars are being used efficiently, appropriators should then look to which revenue sources have the lowest impact on state economic growth. By picking a revenue source with little impact on state long-term growth, policymakers ensure the tax base is stable and revenue is predictable for each fiscal year. If the revenue source has an outsized impact on state economic growth, the state tax base erodes due to economic decisions made by taxpayers to save money on taxes, and the state may become trapped in a negative feedback loop of raising tax rates to feed state spending.

Organization for Economic Co-Operation and Development (OECD) scholars found taxes on income and capital are far more distortionary and harmful to economic growth than consumption taxes such as retail sales, and property taxes.<sup>xlvi,xlvii</sup> Looking at the previous section, states’ commitments to cutting personal income and business taxes are a harbinger that states are following economic research. States moving their tax codes toward a reliance on consumption and property taxes rather than income and investment taxes will make their tax codes more stable in the long term.

Overreliance on income and investment tax revenue also has a distinctly negative effect on the state economy. Looking at the table below, the nine states with the highest top income tax rates see personal income growth, employment growth, and population growth well below the performance of states without a personal income tax. The nine states without an income tax saw 83% higher population growth, 36% higher employment growth and 3% higher personal income growth than the states with the highest income tax rates. The outstanding economic performance of states that avoid income taxes indicates how taxing income and investment discourages economic growth.

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

State	As of 1/1/2019 Top Marginal PIT Rate	10-Year Growth				
		Population	Payroll Employment	2008 – 2018		2006 – 2016
				Personal Income	Gross State Product	State & Local Tax Revenue
Average of 9 Zero-Earned Income Tax Rate States	0.0%	10.8%	7.9%	41.9%	31.6%	25.5%
50-State Average	5.6%	7.0%	5.7%	38.3%	34.8%	31.5%
Average of 9 Highest-Earned PIT Rate States	10.5%	5.9%	5.8%	40.7%	39.6%	39.9%

Source: Laffer Associates

The table above provides clear data on the economic damage caused by taxes on income and capital. But understanding how these taxes discourage growth is also important. Basic economics dictates that income taxes discourage work, savings and investment by taxing the next dollar earned. A high income earner in California, where the top marginal tax bracket is 13.3%, could see only 49 cents on each dollar earned once federal tax rates are also applied.<sup>xlviii,xlix</sup> Of course, this analysis does not include state sales tax burden on purchases made with that income, property taxes paid on both personal and real property, or the limited state and local tax deductions from federal tax liability. Once every tax levy is factored in, California and the federal government tax most of every next dollar earned under the top marginal income tax bracket. Taxpayers in high-tax states are then faced with the very real choice of whether it is worth working for that additional dollar.

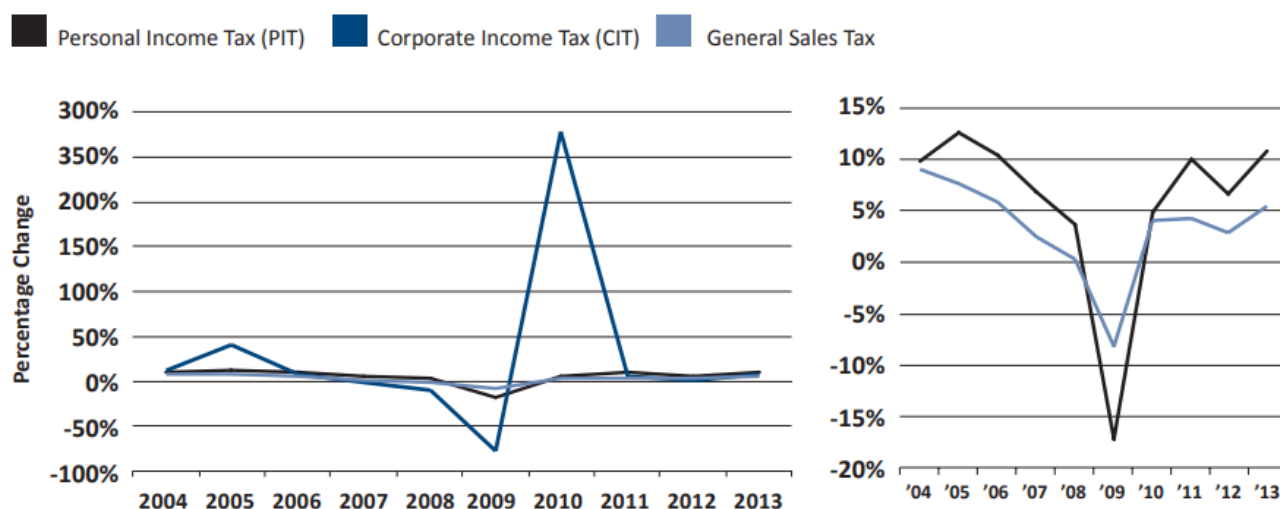
State taxpayers have the option simply to move to another state to save money on taxes. Continuing the example above, California lost over \$40 billion in annual adjusted gross income (AGI) since 1992 to Nevada, Texas and Arizona.<sup>i</sup> Nevada and Texas do not levy a personal income tax, and Arizona’s top marginal rate is 4.54% (far lower than California’s 13.3%).<sup>ii</sup> New York and New Jersey have the second and third highest top marginal personal income tax rates at 12.7% and 11.75%, respectively, and have lost a combined \$55 billion since 1992 to Florida, a no-income-tax state.<sup>iii,iiii</sup> The difference in population growth in the table above is telling, but it includes decisions that can have little to do with tax rates, such as net births and immigration from foreign countries. AGI and net domestic migration from high-tax to low-tax states are more telling, since they represent conscious decisions of income-earners to move where they can maximize their take-home pay.

Taxing corporate income has many of the same drawbacks as taxing personal income but in a more acute sense. Corporations must maximize revenue while minimizing cost to fulfill their responsibilities to shareholders and investors. Corporate income taxes only increase the cost of doing business in a state. If corporate income taxes and other business taxes threaten the fiduciary responsibility of a company to its shareholders, it is expected the company will relocate to states with a lower cost of doing business. Financier Carl Icahn did just that when he relocated his residence and company headquarters from New York to Florida. Florida levies no personal income tax and the corporate income tax is just 5.5% compared to New York with top marginal personal and corporate income tax rates of 12.7% and 17.23%, respectively.<sup>liv</sup>

With a personal wealth of \$20.4 billion and Icahn Enterprises' valuation of \$13.6 billion, Icahn's relocation will blow a hole in New York's budget.<sup>lv</sup>

Companies frequently change behavior due to economic incentives offered by tax policy, such as relocating certain operations to lower taxed locales to reduce overall tax burden.<sup>lvi</sup> Unlike individuals who must always earn income, businesses drop off tax rolls completely when they close shop. Pew Charitable Trusts found that state revenue forecasts are increasingly inaccurate due to the high volatility of revenue generated from corporate income, capital gains and non-withheld personal income taxes, such as dividend or self-employment income.<sup>lvii</sup> Increasingly inaccurate revenue forecasts suggest that states are more likely to experience a revenue shortfall, triggering mid-fiscal year budget adjustments that are costly in terms of both dollars and man-hours. States can avoid revenue shortfalls by decreasing reliance on volatile sources of revenue.<sup>lviii</sup>

FIGURE 4 | COMPARATIVE TAX VOLATILITY, 2004-2013



Source: Center for State Fiscal Reform, American Legislative Exchange Council

A closer look at PIT Percentage Change and General Sales Tax Percentage Change

Beyond the policy benefits of a lowered corporate income tax, states can also see economic benefits from corporate income tax cuts. As discussed above, companies are remarkably responsive to economic conditions and corporate income tax cuts. Economists Jonathan Gruber and Joshua Rauh estimated corporate income tax elasticity at 0.2, meaning for a 10% reduction in corporate income tax rates, corporate income tax revenue only falls by 2%, indicating that corporations behave highly elastically around tax policy.<sup>lix</sup> In fact, a 10% tax cut resulting in only 2% in lost revenue implies that 80% of the corporate income tax cut pays for itself. Dwenger and Steiner in their own research paper analyzing Gruber and Rauh's work also found corporations behave elastically around tax rates (at a rate of 0.6), and found the cause of such elasticity is a drop in corporate tax avoidance and a larger corporate income tax base.<sup>lx, lxi</sup> For states, corporate income tax cuts mean corporations are less likely to relocate or shift economic activities to other states and the corporate income tax becomes less volatile due to a broader tax base.

Given the twofold benefit to states that cut corporate income taxes, it makes sense that half of all net tax cuts made during the 2019 legislative session were to business taxes. States are seeing firsthand the policy problem of high corporate income taxes: increased revenue volatility and decreased business activity. Of course, just as corporate income taxes cause businesses to shift behavior away from high-tax states, personal income taxes can cause residents and pass-through corporations that pay personal income tax rates to relocate in order to save money on taxes, too.

## CONCLUSION

Although only six states qualified for this year's *State Tax Cut Roundup* report, each state reduced its reliance on revenue streams proven to have the most negative impact on long term growth. Despite other states passing tax cut bills, they did not qualify for this report because they passed tax increases elsewhere, resulting in a greater tax burden on net. For states looking to make real steps forward in economic competitiveness, each future edition of *State Tax Cut Roundup* will continue to offer a window into which states are moving toward a more competitive economy and provide a manual for how they can bring long term prosperity back home.

## APPENDIX: 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.

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