

WRITTEN TESTIMONY SUBMITTED TO:
THE ARKANSAS TAX REFORM AND RELIEF TASK FORCE

**ITEP Microsimulation Analysis of Gov. Hutchinson’s Income Tax Reform Plan Presented to the
Arkansas Tax Reform and Relief Legislative Task Force**

September 26, 2018

Thank you for the opportunity to submit these written comments on the most recent tax plan proposed on behalf of Gov. Asa Hutchinson to the Arkansas Tax Reform and Relief Legislative Tax Force on August 22, 2018. My name is Lisa Christensen Gee and I am a Senior State Tax Policy Analyst for the Institute on Taxation and Economic Policy (ITEP), a nonprofit research group. ITEP’s research focuses on federal and state tax policy issues with an emphasis on the goals of sustainability and fairness. ITEP has testified before the Task Force on multiple occasions regarding Arkansas’ tax system and proposed reforms. ITEP is submitting these written comments as we were unable to attend the Task Force meetings held this week in person.

My written comments present the results of ITEP’s microsimulation analysis of the proposals outlined below, detailing the impact these policy changes will have on state revenues and on taxpayers across the income spectrum. Further, it provides a comparative analysis of the governor’s plan to “Option A” recommended by the Task Force in its final report.

Proposals Analyzed

ITEP analyzed the governor’s income tax reduction proposal in two phases:

- Under both phases, the standard deduction was changed from \$2,200 for single taxpayers to \$6,800 and from \$4,400 for married taxpayers to \$13,600.
- Under both phases, the personal credit remained \$26.
- Under Phase I, the three income tax tables existent under current law were replaced with the following single table:

2-4-5.9/6.5 Table – Phase One		
\$0 to	\$8,000	2.00%
\$8,001 to	\$18,000	4.00%
\$18,001 to	\$65,000	5.90%
\$65,001+		6.50%

- Under Phase II, the following single income tax table was used:

2-4-5.9 Bracket – Phase Two		
\$0 to	\$8,000	2.00%
\$8,001 to	\$18,000	4.00%
\$18,001+		5.90%

When analyzing “Option A” from the Task Force’s Policy Recommendations report, ITEP substituted the three income tax tables existent under current law with with the following single table:

Option A Brackets		
\$0	\$4,299	0.0%
\$4,300	\$8,399	2.0%
\$8,400	\$12,599	3.0%
\$12,600	\$20,999	3.4%
\$21,000	\$35,099	5.0%
\$35,100	\$80,000	6.0%
\$80,000 and up		6.5%

Analyses compare proposed policy changes against enacted Arkansas law, which includes the “low income” tax cuts effective tax year 2019.

Revenue Impact of Gov.’s Proposal vs. Option A

In 2018 dollars, ITEP estimates the governor’s proposal will cost the state over \$200 million annually compared to current law—\$111 million in the first phase and an additional \$92 million in the second phase.

Cost of Proposal in 1000s

Gov Phase 1	(111,000)
Gov Phase 2	(92,000)
Gov Combined	(203,000)
Option A	(275,000)

The combined cost of the governor’s plan is \$72 million less than the Task Force’s proposed “Option A,” which ITEP estimates would cost the state \$275 million a year in 2018 dollars.

Comparative Impact of the Proposals on Taxpayers Across the Income Spectrum

Incidence Analysis, Option A

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$22,000	\$22,000 – \$36,000	\$36,000 – \$55,000	\$55,000 – \$93,000	\$93,000 – \$199,000	\$199,000 – \$436,000	\$436,000 – Or More
Average Income in Group	\$14,000	\$30,000	\$44,000	\$71,000	\$125,000	\$264,000	\$1,230,000

Option A Compared to TY19 Law							
Tax Change as % of Income	-0.0%	-0.2%	-0.2%	-0.2%	-0.3%	-0.4%	-0.3%
Average Tax Change	-0	-62	-98	-160	-359	-1,035	-4,252

Slate Tax Change (\$1000)
-275,000

% with Income Tax Cut	0%	38%	61%	74%	87%	93%	100%
Avg. Tax Cut for Those w/Cut	-1	-161	-161	-216	-412	-1,114	-4,264
Share of Tax Cut	0%	6%	10%	16%	27%	20%	22%

% Taxpayers w/Cut
51%

Share to bottom 80%	31%
Share to Top 20%	69%

The Task Force’s “Option A” proposal would give a tax cut to 51% of Arkansas residents, with 69% of the total tax dollars going to the top 20% of taxpayers (incomes >\$93,000).

Taxpayers in the bottom 20% would not receive a tax cut. On average, taxpayers making between \$22,000 and \$93,000 would receive a tax cut equal to 0.2% of their incomes, averaging between \$62 and \$160. Taxpayers in the top 20% (with incomes >\$93,000) would receive higher tax cuts, between 0.3% and 0.4% of their incomes, with the top 1% receiving on average a cut equal to \$4,252.

Incidence Analysis, Governor’s Proposal¹

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$22,000	\$22,000 – \$36,000	\$36,000 – \$55,000	\$55,000 – \$93,000	\$93,000 – \$199,000	\$199,000 – \$436,000	\$436,000 – Or More
Average Income in Group	\$14,000	\$30,000	\$44,000	\$71,000	\$125,000	\$264,000	\$1,230,000

Combined Impact							
Tax Change as % of Income	-0.04%	-0.2%	-0.1%	-0.02%	-0.04%	-0.3%	-0.7%
Average Tax Change	-5	-56	-52	-12	-44	-848	-8,128

Slate Tax Change (\$1000)
-203,000

% with Income Tax Cut	16%	52%	65%	54%	52%	83%	98%
Avg. Tax Cut for Those w/Cut	-33	-110	-100	-141	-319	-1,059	-8,269
Share of Tax Cut	1%	6%	7%	8%	13%	19%	46%

% Taxpayers w/Cut
49%

Share to bottom 80%	22%
Share to Top 20%	78%

% with Income Tax Increase	—	1%	9%	30%	41%	14%	1%
Avg. Tax Increase for Those w/Increase	—	+74	+147	+219	+292	+249	+211
Share of Tax Increase	—	1%	7%	37%	51%	4%	0%

% Taxpayers w/Increase
14%

Share from bottom 80%	44%
Share from Top 20%	56%

Once fully phased-in, 49% of Arkansans would receive a tax cut under the governor’s plan while 14% would experience a tax increase. The governor’s tax cut is even more heavily-weighted to the richest taxpayers than Option A with 78% of the total cut going to those with incomes over \$93,000 (compared to 69% under Option A).

¹ See break down of this analysis by phase of the governor’s proposed plan in the Appendix.

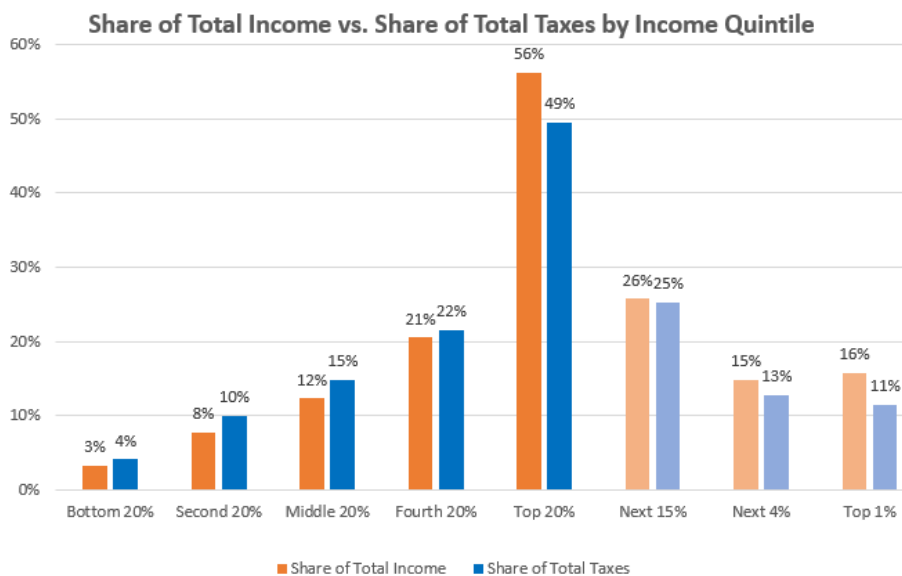
Average tax cuts as a share of income vary more significantly under the governor’s proposal. The lowest 40% (incomes less than \$36,000) fare similarly under the governor’s plan as they would under Option A. The middle 20% (incomes \$36,000-\$55,000) would get half the size of a tax cut under the governor’s proposal compared to Option A (\$52 vs. \$98). The 4th quintile (incomes \$55,000-\$93,000) barely gets a cut under the Gov’s proposal at all (\$12 vs. \$160 under Option A). The next 15% (incomes \$93,000-\$199,000) similarly lose out by preferencing the governor’s proposal over Option A, with an average tax cut of \$44 under the governor’s plan compared to \$359 under Option A. The next 4% (incomes \$199,000-\$436,000) similarly fare better under Option A with an average tax cut of \$1,035 compared to \$848 under the Gov’s proposal.

The biggest winners by far under the governor’s plan are the top 1% of taxpayers who would get twice the size of a tax cut under the Gov’s proposal compared to Option A—\$8,128 vs. \$4,252.

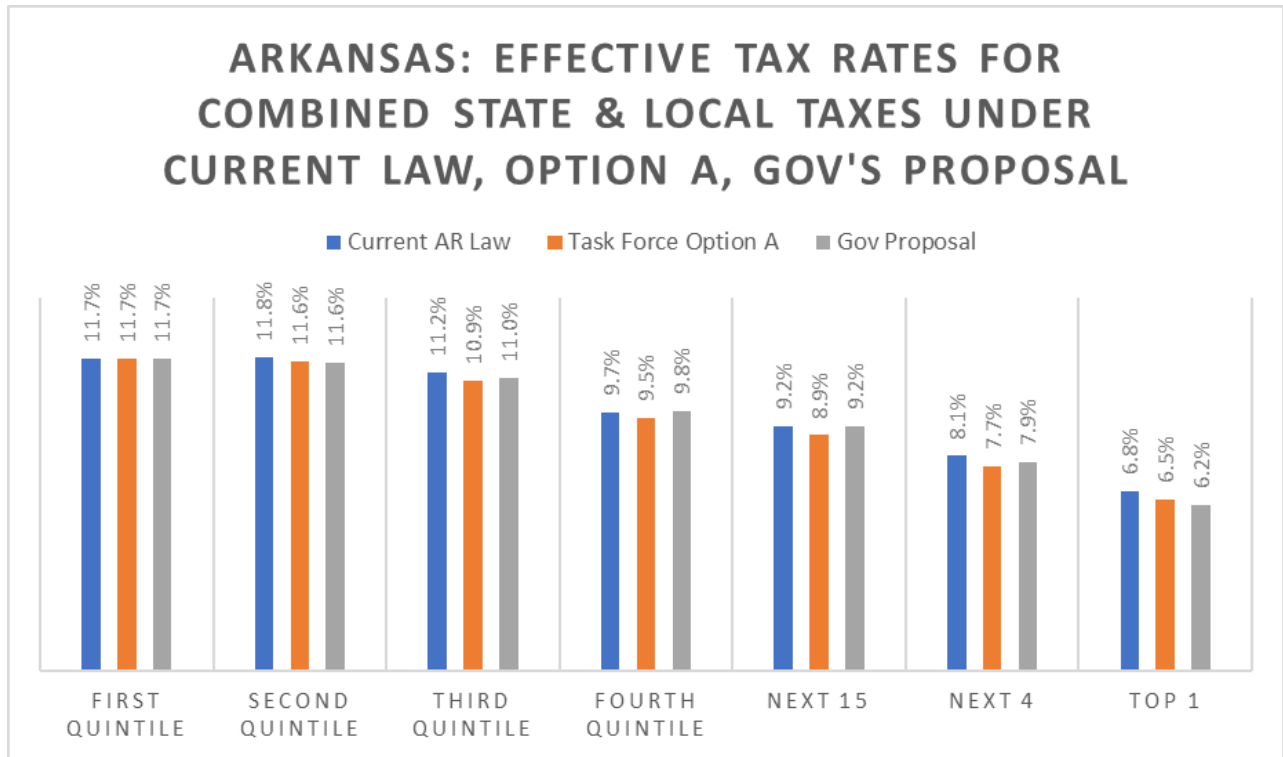
Observations

The incidence of Arkansas’ current tax law is regressive—requiring that lower- and middle-income families pay higher percentages of their incomes in state and local taxes than those with higher incomes.

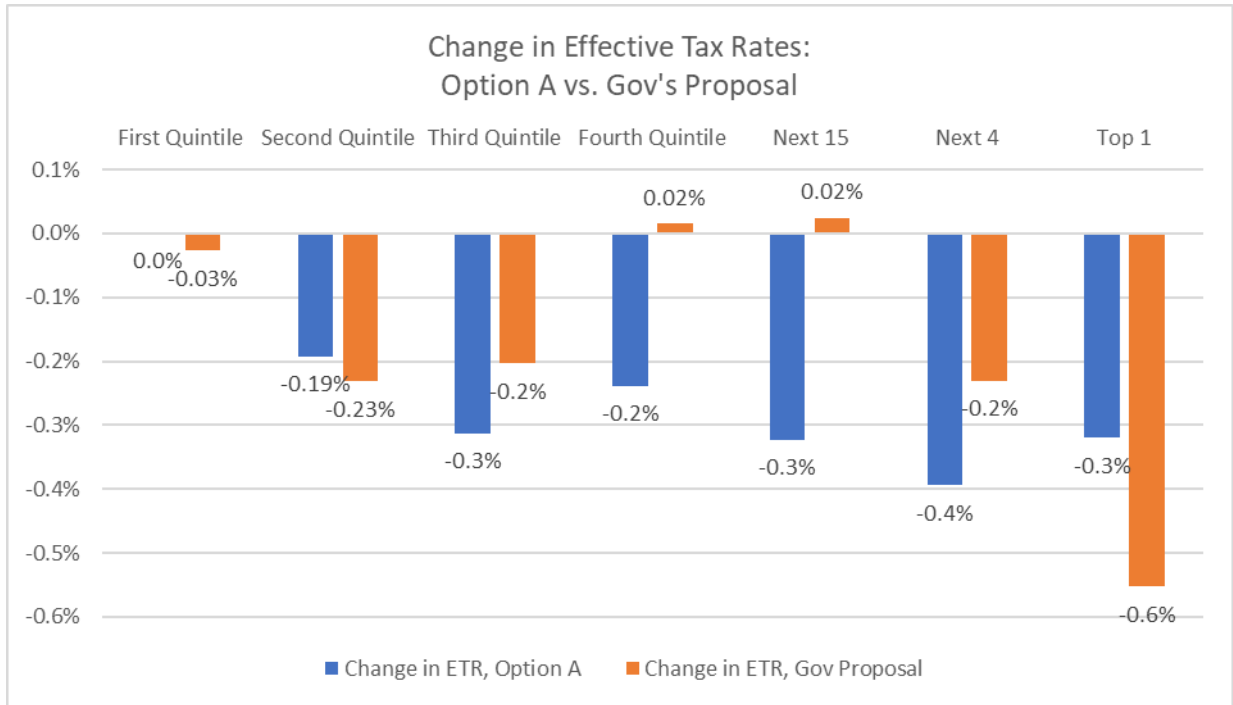
When considering the distribution of aggregate income and tax contributions by income group, the bottom 80% of taxpayers in the state—those with total incomes under \$93,000—all pay more in total taxes than their corresponding share of aggregate income, whereas the top 20% pays well below their share of total income.



The primary shortcoming of both the governor’s proposed tax cut and “Option A” recommended by the Task Force is that each further exacerbates this problem by making the incidence of Arkansas’ tax system even *more* regressive. If either were enacted, they would result in a net tax cuts for the average taxpayer in the top 80%, primarily benefitting the richest 20 percent, while affording no to little relief to those in the bottom 20% who already pay the highest share of their incomes in combined state and local taxes (and pay among the highest effective tax rates in the country).



In terms of tax fairness, the governor’s proposed reform is a worse offender, as it concentrates the tax cut on those taxpayers least in need of relief, whereas Option A does a better job of distributing the tax cut more evenly among all taxpayers in the top 60%.



Conclusion

ITEP continues to recommend to the Task Force that they could better fulfill their own legislative purposes and better serve the interests of all Arkansas taxpayers by prioritizing tax reforms that:

- Target any tax cuts to low- and middle-income taxpayers—those with the highest combined state & local taxes relative to income (via tax policies like a refundable EITC, increased standard deduction)
- If insistent on cutting taxes for top-income earners, moderate with elimination of costly loopholes (capital gains) and pair with refundable tax credits for low-income taxpayers

Thank you for your time and consideration of these remarks.

Respectfully submitted,

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Appendix

Gov. PIT Reform Proposal Compared to TY19 AR Law

All Arkansas Residents, 2018 Incomes

2018 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less than \$22,000	\$22,000 – \$36,000	\$36,000 – \$55,000	\$55,000 – \$93,000	\$93,000 – \$199,000	\$199,000 – \$436,000	\$436,000 – Or More
Average Income in Group	\$14,000	\$30,000	\$44,000	\$71,000	\$125,000	\$264,000	\$1,230,000

Phase I (Increase SD to \$4,400 for S/HOH and \$13,600 for M; condense rates/brackets w/top rate of 6.5%)							
Tax Change as % of Income	-0.04%	-0.2%	-0.1%	-0.01%	-0.005%	-0.2%	-0.3%
Average Tax Change	-5	-56	-52	-10	-6	-495	-3,522

State Tax Change (\$1000)
-111,000

% with Income Tax Cut	16%	52%	65%	54%	50%	78%	98%
Avg. Tax Cut for Those w/Cut	-33	-110	-100	-138	-259	-681	-3,585
Share of Tax Cut	1%	10%	11%	13%	17%	18%	31%
% with Income Tax Increase	—	1%	9%	30%	43%	19%	1%
Avg. Tax Increase for Those w/Increase	—	+74	+147	+221	+289	+202	+211
Share of Tax Increase	—	1%	7%	36%	52%	4%	0%

% Taxpayers w/Cut
48%

Share to bottom 80%	34%
Share to Top 20%	66%

% Taxpayers w/Increase
15%

Share from bottom 80%	44%
Share from Top 20%	56%

Additional Revenue Change from Phase II (further condense rates/brackets w/top rate of 5.9%)							
Tax Change as % of Income	—	—	—	-0.003%	-0.03%	-0.1%	-0.4%
Average Tax Change	—	—	—	-2	-39	-353	-4,606

State Tax Change (\$1000)
-92,000

% with Income Tax Cut	—	—	—	5%	31%	81%	98%
Avg. Tax Cut for Those w/Cut	—	—	—	-51	-124	-437	-4,684
Share of Tax Cut	—	—	—	1%	8%	21%	70%

% Taxpayers w/Cut
10%

Share to bottom 80%	1%
Share to Top 20%	99%

Combined Impact							
Tax Change as % of Income	-0.04%	-0.2%	-0.1%	-0.02%	-0.04%	-0.3%	-0.7%
Average Tax Change	-5	-56	-52	-12	-44	-848	-8,128

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Source: Institute on Taxation and Economic Policy, 9.17.2018

Task Force Option A vs. TY19 AR Law

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